Northbridge Industrial Services

Proving the doubters wrong

30 September 2020

Northbridge's results for the six months to June were very encouraging, with revenues falling just 4.5% and adj. PBT maintained at break-even. While the pandemic reduced higher margin hire revenues, the performance of the Group's North American operations represented particularly good news. Recovery commenced from August within hire and the strong manufacturing order book translated to revenues from Q2. We anticipate normal trading levels resuming from FY21.

We have re-introduced estimates for FY20, but current uncertainty surrounding a potential second wave of COVID-19 delays new estimates for FY21 at this stage. The shares continue to trade at a significant discount to NAV and its peer group on a trailing EV/EBITDA basis.

The six months to June represented a 'game of two halves' - the first delivering strong recovery in hire revenues at Tasman, with the second disrupted by the pandemic. The issue in Q2 was a stalling of projects as travel restrictions and the quarantining of teams were put in place, with a difficulty in delivering services to some client locations.

Despite hire service revenues adversely affected during Q2, particularly at the higher margin Crestchic, the manufacturing arm of the loadbank/transformer supplier performed very strongly due to **record order books**.

Another bright spot was the performance of the North American arm of Crestchic, which has delivered a **CAGR in revenues of 111%** between 2016 and 2020. The region has rapidly grown to represent the second largest geographical area for the Group. With a market share of less than 2% of the loadbank market, we anticipate further strong growth from the region over the medium-to-long term.

Notwithstanding the reduction in revenues, management continued to **focus on costs**, with the adj. PBT maintained at break-even. We anticipate improvement during H2, reflecting the recovery in hire service markets from August, coupled with a strong performance at Crestchic manufacturing. The resumption of the higher margin hire sales should result in sequential growth in the gross margin.

The balance sheet remains strong, with management extending the facilities for the RCF and the loan notes by 12-months to June 2022. We anticipate net debt reducing to £5.4m by the year-end, **representing gearing of only 18% and a net debt/EBITDA ratio of just 0.9x.**

Valuation

The shares are well underpinned by the NAV per share of 109p, itself backed by a combination of freehold property and the hire fleet. On EV/EBITDA multiples we see Northbridge trading at a 40% discount to its peer group.

With the shares trading only modestly above 12-month lows, we believe they are yet to fairly reflect the recovery underway.

Company Data

EPIC	NBI
Price (last close)	83p
52 weeks Hi/Lo	162p/62p
Market cap	£23.3m
NAV/share (p)	109p
Net debt (Jun '20)	£6.3m

Share Price, p

Source: ADVFN

Description

Northbridge Industrial Services ("Northbridge") is a holding company focused on two divisions.

Crestchic Loadbanks, the larger division, 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.

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Interim results

2020 Interim Results

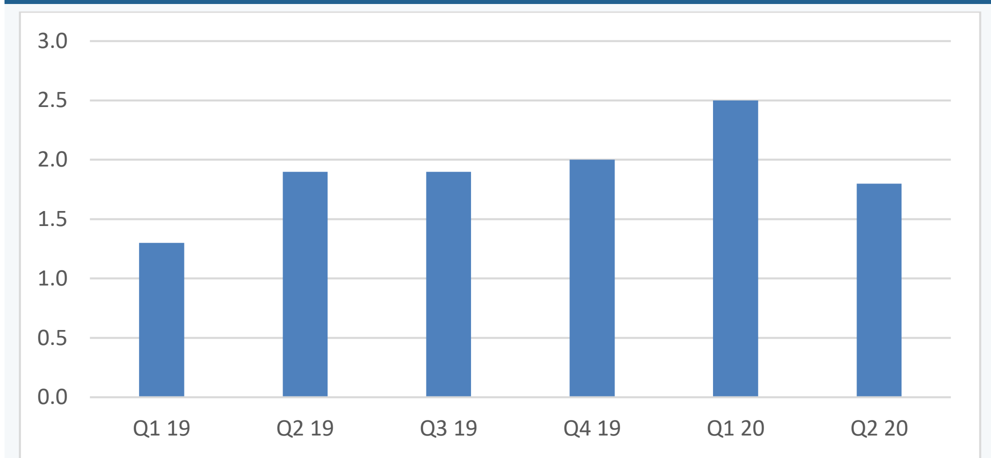
£m	H1 19A	H2 19A	FY 19A	H1 20A	Change
Crestchic hire	7.2	7.1	14.3	5.0	*-30.6%*
Crestchic sales	5.9	5.2	11.1	6.0	*1.7%*
Crestchic revenues	**13.1**	**12.3**	**25.4**	**11.0**	***-16.0%***
Tasman hire	3.2	3.9	7.1	4.3	*34.4%*
Tasman sales	0.5	0.5	1.0	0.7	*40.0%*
Tasman revenues	**3.7**	**4.4**	**8.1**	**5.0**	***35.1%***
Group revenues	**16.8**	**16.7**	**33.5**	**16.0**	***-4.5%***
Cost of sales	-9.3	-8.5	-17.8	-9.1	*-1.6%*
Gross profit	**7.5**	**8.2**	**15.7**	**6.9**	***-8.1%***
GP%	*44.7%*	*48.9%*	*46.9%*	*43.0%*	*-3.8%*
Operating costs	-6.7	-6.9	-13.6	-6.4	*-4.7%*
Other operating income	0.0	0.0	0.0	0.2	
EBITDA	**3.4**	**4.6**	**8.0**	**3.2**	***-6.3%***
Adj. EBIT	**0.8**	**1.3**	**2.1**	**0.7**	***-11.9%***
EBIT, %	*4.5%*	*7.6%*	*6.2%*	*4.1%*	*-7.7%*
Finance costs	-0.4	-0.5	-0.9	-0.3	*-9.5%*
Loss from JV	-0.3	-0.5	-0.8	-0.3	*-18.9%*
Adj. PBT	**0.0**	**0.3**	**0.4**	**0.0**	***59.1%***
Exceptional impairment costs	0.0	-0.1	-0.1	-7.8	
Reported PBT	0.0	0.2	0.2	-7.8	
Taxation	-0.1	-0.4	-0.6	0.0	
Tax, %	6.5	2.7	2.6	0.0	
PAT	-0.1	-0.3	-0.3	-7.8	
Adj. EPS (p)	**-0.4**	**-0.4**	**-0.8**	**0.1**	***-125.4%***
DPS (p)	0.0	0.0	0.0	0.0	

Source: Company, Equity Development

We think the results for the six months to June are highly impressive, with revenues only declining modestly and profits broadly unchanged y-o-y, despite the impact of the pandemic. The period was split into a pre-pandemic Q1, and a second quarter affected by COVID-19 related disruptions to the business.

Q1 saw an almost doubling of revenues from Tasman's hire operations, which witnessed a continuation of the strong demand experienced in H2 2019 as the recovery in the Group's markets continued. Tasman's Q1 hire revenues represented the highest quarterly level since 2015. Q2 saw several contracts deferred until Q4 2020 or into 2021, reflecting the decline in the oil and natural gas prices.

Q1 delivered strongest Tasman hire revenues since 2015 (£m)



Source: Company

No large projects were booked at Crestchic in either Q1 or Q2, unlike in H1 2019, which benefitted from sizeable contracts in Iraq and Abu Dhabi. Such rental agreements can be lumpy by nature. Revenues from the combined hire services declined by a cumulative 29% y-o-y in Q2, with Crestchic more severely affected, falling 40%.

By contrast, top-line growth in product sales improved by almost a quarter to £4.2m during the second quarter, with the most significant gains derived from the shipment of loadbanks from Crestchic's factory in Burton-on-Trent, reflecting the invoicing of record order books.

During Q1, the facility was busy with work-in-progress as typically there is a 12 to a 26-week lag between order intake and revenue booked. It is hardly surprising then that the record order book only began to convert into billings from Q2 onwards. The UK lockdown disrupted working practices, as vulnerable employees stayed at home and social distancing was implemented throughout the site, which in turn this reduced both productivity and output.

Revenues - quarterly progression

£m	Q1 '20	Q2 '20	H1 '20	Q1 '19	Q2 '19	H1 '19	Q1 '20 v Q1 '19	Q2 '20 v Q2 '19	H1 '20 v H1 '19
Crestchic hire	2.6	2.4	5.0	3.2	4.0	7.2	-18.8%	-40.0%	-30.6%
Crestchic sales	2.1	3.9	6.0	2.7	3.2	5.9	-22.2%	21.9%	1.7%
Tasman hire	2.5	1.8	4.3	1.3	1.9	3.2	92.3%	-5.3%	34.4%
Tasman sales	0.4	0.3	0.7	0.3	0.2	0.5	33.3%	50.0%	40.0%

Source: Company, Equity Development

Diverse performance

The less cyclical areas and regions tended to perform better and included:

- Power reliability
- Renewable energy
- Data centres
- UK
- Europe and North America

The areas/regions which performed less well during the pandemic were:

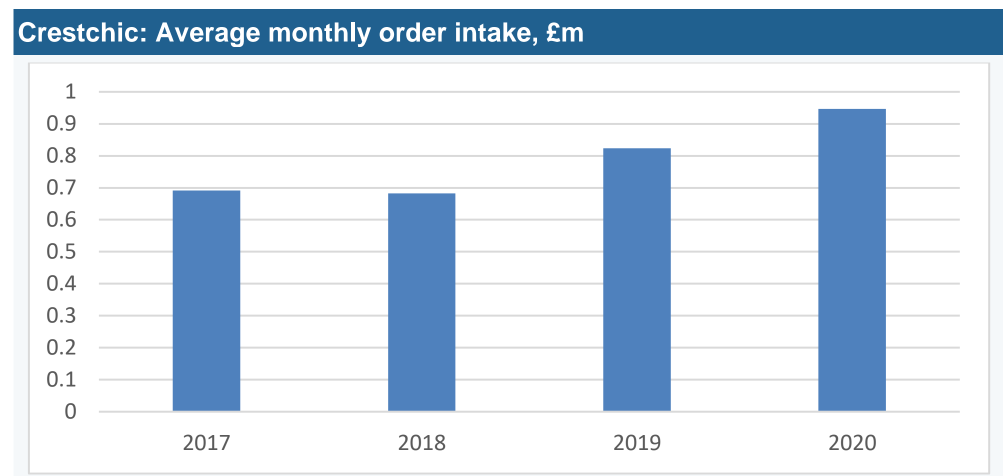
- Natural resources (mining and oil & gas)
- Shipbuilding
- Large energy projects (requiring movement of staff)
- Asia
- Middle East
- New Zealand

Key issues were the restrictions placed on the movement of international skilled workers central to such projects and the requirement to quarantine such employees with COVID-19.

Crestchic manufacturing gaining momentum

The average monthly order book at Crestchic for manufactured loadbanks and transformers increased by a CAGR of 11% between 2017 and 2020, to £0.95m pcm.

Crestchic: Average monthly order intake, £m



Source: Company

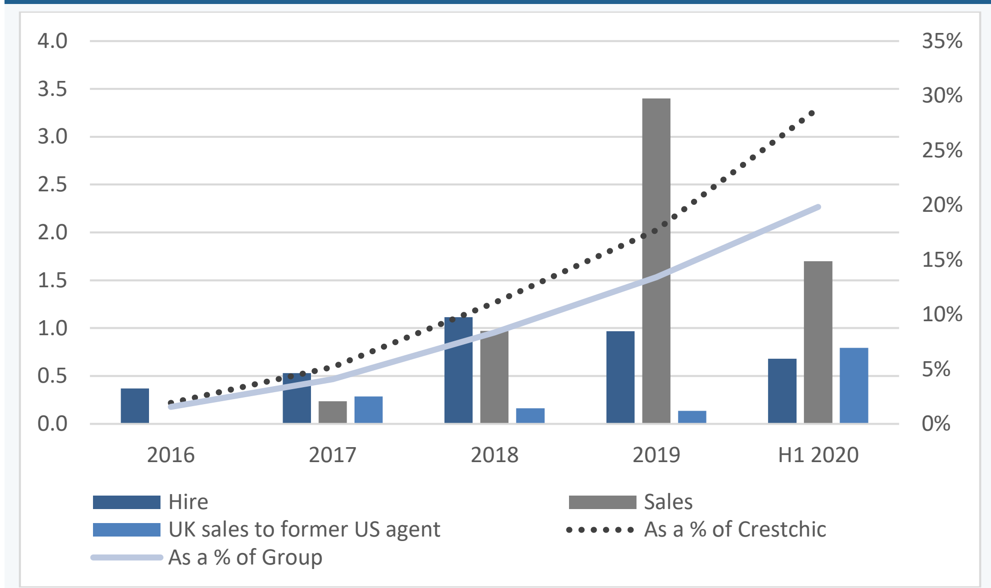
Growth in North America has been stunning

The growth in revenues to North America has been nothing short of stunning, rising by a CAGR of 130.0% between 2016 and the end of 2019. North American revenues accounted for just 1.9% of Crestchic's turnover in 2016 and 1.6% of Group sales. By the end of H1 2020, those percentages grew to 28.9% and 19.8%, respectively and highlighting a continuation of the strong growth levels.

Excluding the UK, North America represents the most significant revenue generator for the Group. Not bad for a business that was only established in 2016!

Also, a growing proportion of the increased order intake within Crestchic relates to the North American market, whether to third parties (via Crestchic USA) or from the UK to the division's former US agent. Combined, the US orders to be despatched from H2 2020 onwards amount to £4.7m. The Group's market share of their portion of the US loadbank market represents between 1% to 2%, **signifying a significant opportunity** available to Crestchic.

Crestchic: Strong growth trend in revenues from N. America (£m)



Source: Company and ED, including 2020 estimate

Cost base firmly managed

Overall costs declined 2.9% y-o-y to £15.6m (H1 2019A: £16.0m). Cost of sales fell 1.6% to £9.1m while operating expenses declined 4.7% to £6.4m.

One should bear in mind that in 2019 costs increased, reflecting the opening of new depots in Singapore (Tasman) and Pennsylvania (Crestchic), with the latter introduced in H2. Also, staff at Tasman received their first pay increase in several years and the hire fleet was added to (£2.2m of capex during 2019).

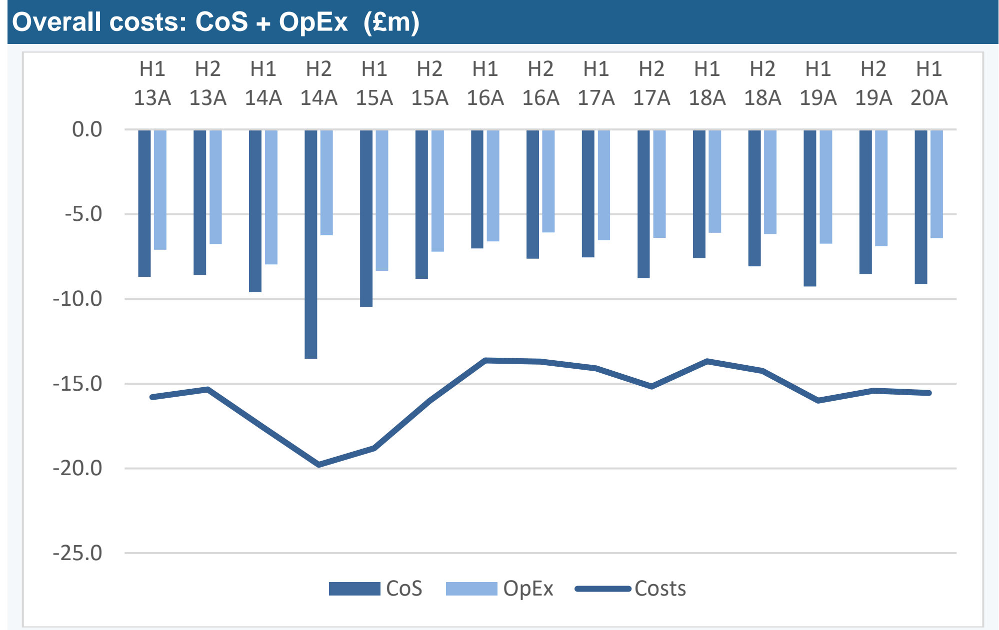
On this basis, the reduction in costs was a notable achievement and highlights that controlling expenses was a key area of management focus during the onset of COVID-19 lockdowns.

The actions to reduce the cost base in H1 includes:

- Negotiate existing fixed costs
- Restrict capex
- Utilise government support mechanisms
- Travel
- Exhibition costs and,
- The voluntary acceptance of a temporary 20% pay reduction to the salaries of senior employees

In the event, the voluntary salary and government support (£0.2m) reduced costs by more than £0.5m, albeit temporarily. Further government support of £0.1m is anticipated during Q3.

Overall costs: CoS + OpEx (£m)



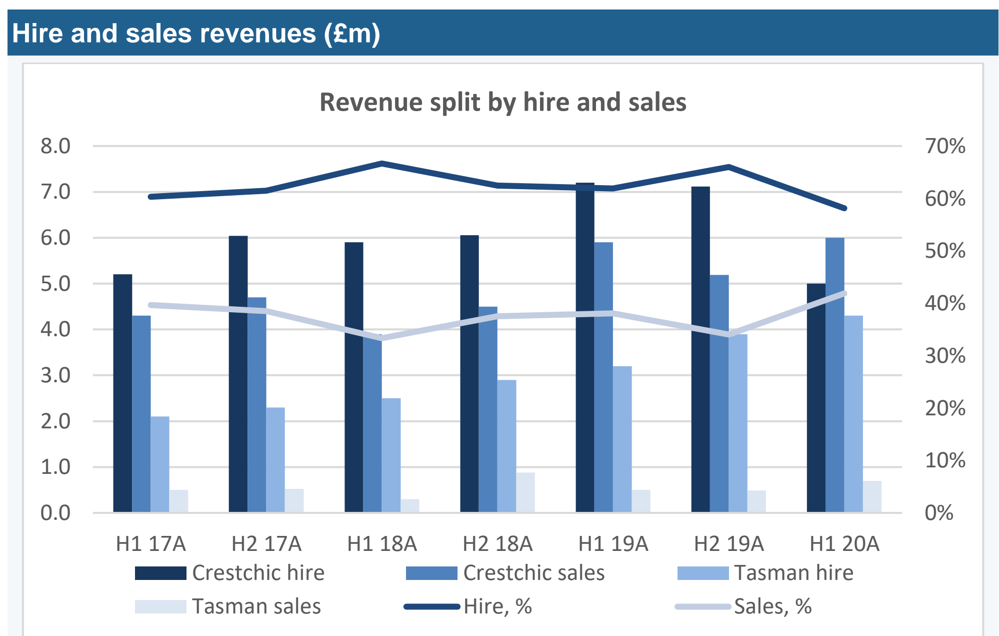
Source: Company, Equity Development

The level of hire revenues correlates directly to gross margin

The most significant impact on profitability during H1 was the reduction in rental sales, from £10.4m in H1 '19A to £9.3m in H1 '20A. We have highlighted the reasons for this, but significantly, the gross margins tend to be markedly higher than for product sales.

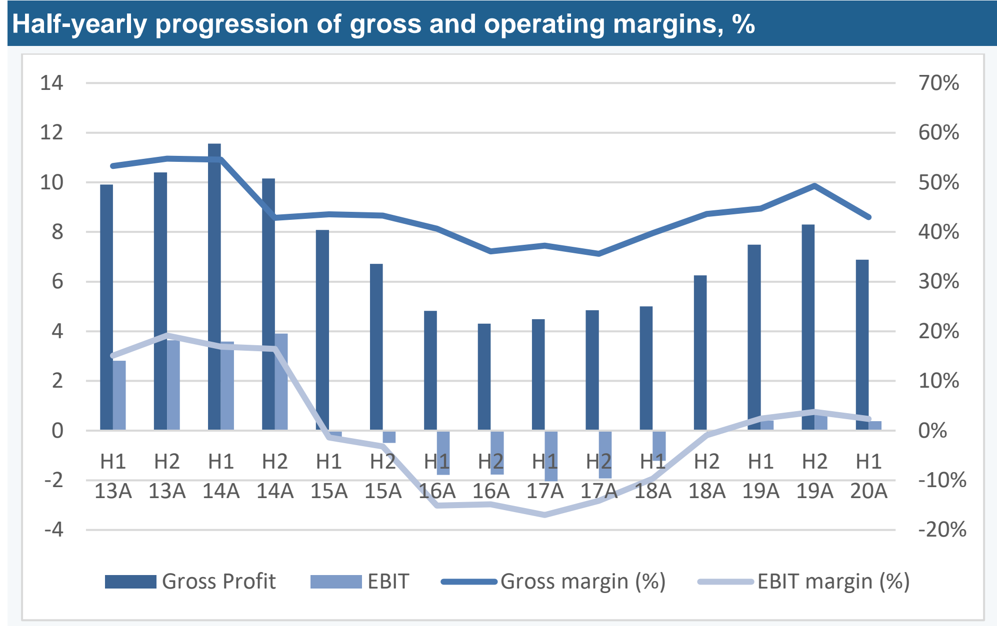
Group gross margins moved to their lowest level in two years during H1, at 43.0%, with the highest margins generally seen within loadbank/transformers rentals from Crestchic. Noticeably, revenues from this area declined at the fastest annual and sequential pace during Q2.

Hire and sales revenues (£m)



Source: Company, Equity Development

Half-yearly progression of gross and operating margins, %



Source: Company, Equity Development

High operational leverage

Previously, gross margins had been on a recovery path from the nadir in H2 2017 (35.6%), rising to 49.3% and just 544 basis points below the peak in H2 2013. Significantly, revenues were only 11% higher at £19m compared to H1 '20A.

This emphasises the level of operational gearing within the business.

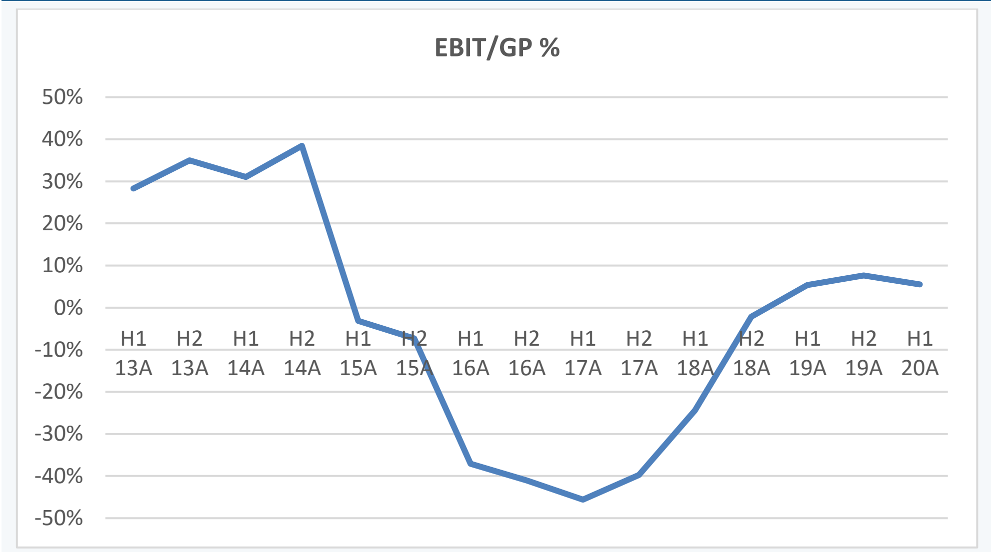
Even though revenues declined just £0.8m or 4.5% y-o-y during H1 2020A, EBIT fell 11.9% to £0.7m and represents the first sequential decline since H2 2017A. The reduction in the gross margin mix of the business exacerbated the effect of the sales decline.

However, we expect an improving share of rental (as opposed to product sales) in H2, reflecting a recovery in its markets from August and which should result in gross margins rising, albeit remaining below the levels of H2 2019A.

The chart below highlights that the operational gearing has much further to go before it reaches previous peak levels (38.4% in H2 2014A). Revenues then were 50% higher than H1 2020 levels, at £23.7m.

We continue to be encouraged by this relationship, believing that the stalled recovery will re-commence from early 2021 and that management will continue to carefully monitor the cost base.

The recovery in EBIT as a % of GP has further to go…



Source: Company, Equity Development

Despite the reduction in gross and operating profit, we think that given the incredibly tricky Q2 and the impact on the higher-margin hire services revenues, the outcome was nevertheless encouraging in the circumstances.

Particularly pleasing was the move at the EBITDA level to a meaningful profit for Tasman of £1.3m before central costs. By contrast, the division was break-even in H1 2019A at the EBITDA level. On this basis, the recovery to not just profitability but also positive cash generation continues an upwards trajectory at Tasman.

After depreciation of £2.6m; amortisation of £0.7m; net interest of £0.3m and, a reduced loss on the joint ventures (see below), adj. PBT increased to £0.035m (H1 19A: £0.022m). Taxation was nominal, resulting **in the first positive EPS since H2 2014, at 0.1p per share.**

In-line with previous results, no dividend was announced. We expect that as profitability builds and cash flow strengthens, the Board will seek to reinstate a dividend.

JV loss reduced

The loss associated with the joint ventures declined by 18.9% to £0.3m, of which two-thirds was generated by Olio Tasman, the Group's joint venture in SE Asia. The remaining third came from the associate operation in Saudi Arabia. Olio Tasman generated a significant increase in revenues in Q1, with the lockdowns associated with the COVID-19 pandemic having an impact from Q2 onwards.

Despite the disruption, revenues improved 55.8% to £2.2m, partly reflecting a renegotiation of several loss-making contracts in Q4 2019. The Saudi joint venture was established during H1 to service a deferred contract with the largest oil company in the region.

Exceptional costs

Activity levels within Tasman NZ have been depressed in comparison to business levels pre-2015 recession in the oil and gas industry. Further pandemic related interruptions resulted in management taking the view that activity levels are unlikely to return to the previous peak

levels. The forthcoming closure of an aluminium smelter in August 2021, which utilises 13% of the country's electricity consumption, represents a further negative.

As a result, Northbridge has taken the difficult decision to write-off the entire goodwill associated (£7.1m) with the acquisition in 2013. The business remains profitable, however, with geothermal renewable energy a critical source of revenue for Tasman NZ.

A further £0.6m impairment was recognised on the working capital investment in Olio Tasman and highlighted the impact of COVID-19 on the business, deferring payments to Tasman.

Movements in cash and the balance sheet during H1

EBITDA amounted to £3.2m during H1, represented a 6.3% shortfall from levels reported in H1 2019. Operating cash flow after movements in working capital amounted to £3.7m, which represented a substantial rise from the £3.0m reported a year earlier.

Capex of £2.1m was double the level of H1 2019 and highlighted the increase in activity levels during Q1, particularly at Tasman. The additions to the hire fleet are underpinned by new contracts, albeit include some which were then delayed owing to the COVID-19 related lockdowns.

Three loadbanks were purchased to service the requirements of a customer in the US. The start of the pandemic resulted in tighter control of capital expenditure, with such projects only allowed to proceed if the anticipated RoCE and payback periods were within relatively strict criteria and reflected underlying project wins.

The record order books at Crestchic, coupled with concerns over the ability to secure components, led to management stockpiling the said items within the Burton-on-Trent facility. As order book deliveries occur, the high inventory will fall.

The sequential reduction in activity levels generally during Q2 (apart from Crestchic manufacturing), resulted in an unwinding of working capital. The recovery across the Group since August, should reverse H1 working capital trends during H2.

Net debt declined modestly to £6.3m (December 2019: £6.4m). The Group's banking facility and loan notes (£4.0m) were extended by 12 months to June 2022.

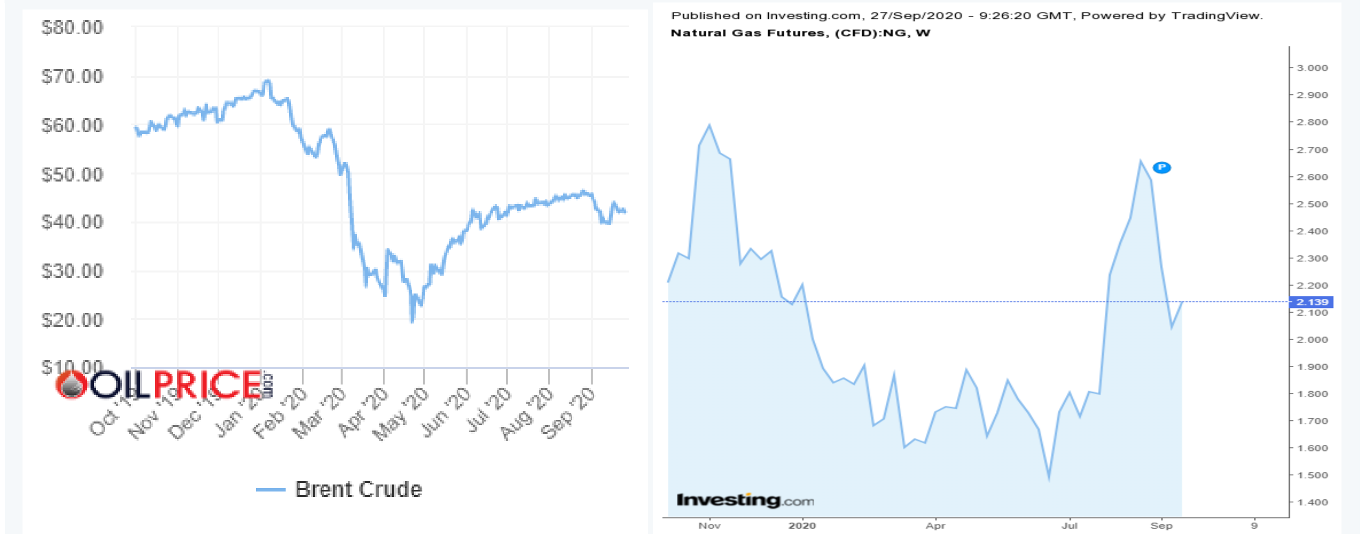
Net debt/equity, as measured on a 12-month rolling basis remains at a comfortable level of 0.9x.

Financials: forecast for 2020

We have re-introduced estimates for FY2020, although the visibility beyond the end of the year remains limited. The potential for a second wave of COVID-19 to further disrupt revenues remains, and as a result, we are not producing estimates for FY2021 at this stage. The main drivers of H2 revenues include:

- The pandemic disrupted hire revenues within **Crestchic** between May and July. Recovery commenced in August
- Although the change to working practices has continued at the Group's Burton-on-Trent facility, most workers have returned and with new engineers hired, and capacity increased, the pace of catching up on the record order book has accelerated during Q3
- While certain aspects of loadbank demand remain sluggish (shipbuilding in Asia is operating at a marked reduction in capacity and demand in the Middle East hit by travel restrictions), the datacentre, renewable energy, and power distribution infrastructure continue to offer the most promising opportunities
- One-off projects in healthcare markets, with power outages potentially life-threatening
- Europe, China, and UK hire are beginning to recover, albeit slowly, with an uptick seen in small to medium voltage tests in the UK at Crestchic
- A rebound in **Tasman** rentals from August
- With oil and gas prices some way above Q2 lows, more drilling projects have become viable, with several deferred projects commencing during H2 2020
- Within the Group's largest market for Tasman, Australia, oil drilling projects account for less than a fifth of revenues, with natural gas almost three-quarters and the remainder due to carbon capture.
- New Zealand has broadly returned to normal
- The recovery in Malaysia remains slow paced
- Focus moving towards a green recovery, with increased emphasis on renewable energy and gas as a source of power. The Australian market is exhibiting such trends currently
- International travel and quarantine regulations currently remain the largest issue still affecting trading

Brent crude and Australian natural gas futures are some way above Q2 lows



Source: Oilprice.com, Investing.com

Summary Profit & Loss

Year to Dec, £m	2016A	2017A	2018A	2019A	2020F
Crestchic	19.3	20.2	20.4	25.4	23.2
Tasman Oil Tools	4.5	5.6	6.6	8.2	9.8
Revenue	**23.8**	**25.8**	**26.94**	**33.60**	**33.08**
CoGS	-14.7	-16.3	-15.7	-17.8	-19.1
Gross profit	**9.1**	**9.5**	**11.3**	**15.8**	**14.0**
Gross margin (%)	*38.4%*	*36.8%*	*41.8%*	*47.0%*	*42.4%*
Op costs	12.7	12.9	12.3	13.6	13.0
Other operating income	0.0	-0.2	0.0	-0.1	0.3
Operating profit	**-3.6**	**-3.8**	**-1.4**	**1.2**	**1.3**
Op margin (%)	*-14.9%*	*-14.7%*	*-5.0%*	*3.5%*	*4.0%*
Net Interest	-0.6	-0.6	-0.7	-0.9	-0.7
Associates	0.0	-0.2	-0.4	-0.8	-0.6
PBT (Adjusted)	**-4.1**	**-4.4**	**-2.0**	**0.3**	**0.0**
Exceptionals	-1.4	0.0	-0.7	0.0	-7.8
PBT (Reported)	-5.5	-4.6	-3.1	-0.5	-8.3
Tax	-0.8	-0.2	0.3	-0.6	-0.2
PAT	-6.3	-4.8	-2.8	-1.1	-8.5
Minority interests	0.0	0.0	0.0	0.0	0.0
Earnings	-6.3	-4.8	-2.8	-1.1	-8.5
Ordinary Dividends	0.0	0.0	0.0	0.0	0.0
Retained Profit	-6.3	-4.8	-2.8	-1.1	-8.5
EPS (Adjusted) (p)	**-20.6**	**-17.9**	**-5.9**	**-0.8**	**-0.7**
DPS (p)	0.0	0.0	0.0	0.0	0.0
Ave no of shares (FDil) (m)	24.0	25.9	28.8	28.2	28.2

Source: Company historics, Equity Development estimates

Beyond 2020 there is greater uncertainty. However, in the absence of further COVID-19 disruptions to business, we think there are several medium-term positives, not least:

- Further deferred contracts pushed out to 2021
- The recovery re-commenced from August, signifying a return to normality in 2021?
- The operational gearing of the business, aided by most revenues derived from the higher-margin hire services
- Exposure to long term growth markets at **Crestchic** – datacentres/cloud computing, renewable energy, and power infrastructure networks
- A less than 2% market share of the North American loadbank/transformer market, which implies significant potential growth available to Crestchic
- Recovery in the Middle Eastern energy markets
- An ageing global shipping fleet will need replacing, with Asian shipyards long-term customers of Crestchic
- The natural resource mining sector represents a key area for Crestchic's services
- Defence projects within the marine sector
- Further expansion of the rental fleet in the USA
- Within **Tasman**, an emphasis on cleaner fuels such as gas, LNG, geothermal and, carbon capture will drive demand for its services
- Demand for gas for feedstocks for recyclable plastics and the production of "blue" hydrogen are long term growth markets
- Hire rates for drilling pipe and accessories remain at low levels, with significant scope to increase them as activity levels recover further
- Gas reserves are at their lowest levels for 70 years
- Tasman's focus is almost three-quarters gas in Australia, with Australia currently one of the largest LNG exporters globally

Summary Cash Flow

Y/E 31 Dec, £m	2016A	2017A	2018A	2019A	2020F
Operating profit	-3.6	-3.8	-1.4	1.2	0.7
Depn. & Amortn.	7.1	7.2	6.0	5.9	5.3
Working capital movement	-0.2	-0.9	0.4	0.6	-0.7
Other	-1.5	0.0	0.0	0.0	0.0
Operating cash flow	**1.8**	**2.6**	**5.0**	**7.7**	**5.3**
Net Interest	-0.6	-0.6	-0.7	-0.9	-0.7
Taxation	-0.4	-0.3	-0.7	-0.6	-0.5
Net capex	-0.1	-0.2	-3.9	-2.2	-3.1
Operating FCF	**0.8**	**1.4**	**-0.1**	**4.1**	**1.0**
Net (Acquisitions)/Disposals	-1.3	-0.3	-1.1	-0.1	0.0
Dividends	0.0	0.0	0.0	0.0	0.0
Share Issues	5.3	0.0	2.4	0.0	0.0
Minority payment	0.0	0.0	0.0	-1.4	0.0
Other financial	0.0	-0.4	-1.1	-0.4	0.0
Increase Cash/(Debt)	**4.8**	**0.7**	**0.1**	**2.2**	**1.0**
Opening Net Cash/(Debt)	-14.3	-9.5	-8.7	-8.7	-6.4
Closing Net Cash/(Debt)	**-9.5**	**-8.7**	**-8.7**	**-6.4**	**-5.4**

Source: Company historics, Equity Development estimates

Important numbers within the cash flow include an EBITDA of £6.0m for the full year, representing a 15% decline from the £7.1m reported in 2019A. The unwinding of the working capital (£0.5m of cash generated during H1), as the recovery picks up in Q's three and four and moves to more normal trading levels by the year-end. As a result, we anticipate operating cash flow to amount to a healthy £5.3m for the full year, with interest, taxation and capex resulting in an operating free cash flow of £1m.

We, therefore, anticipate **net debt declining to £5.4m** by the year-end. This equates to gearing of just 17.8% and net debt/EBITDA at a comfortable 0.9x.

On this basis, we think the Group will have the headroom to take advantage of **opportunistic bolt-on acquisitions.**

Abbreviated Balance Sheet

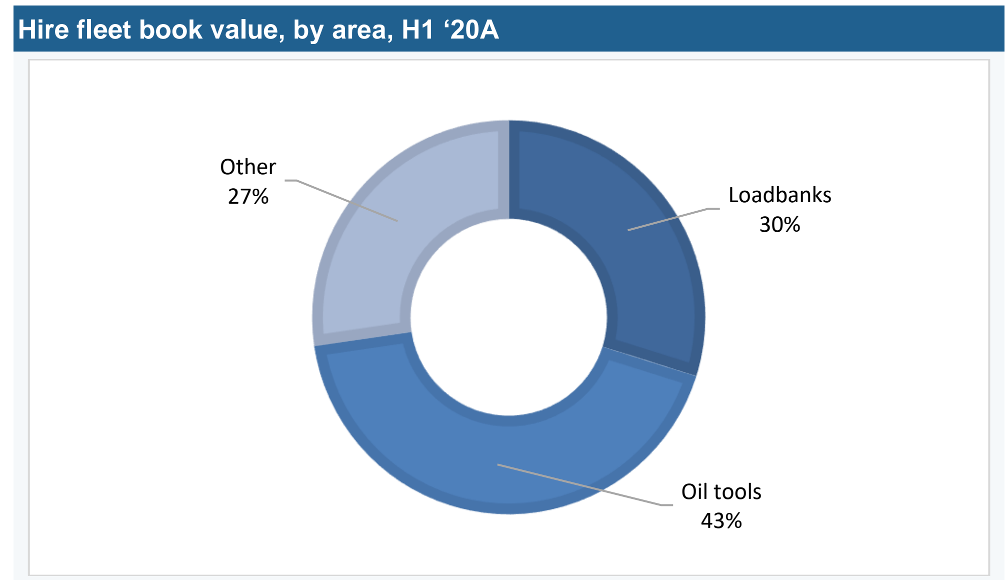
Y/E 31 Dec, £m	2016A	2017A	2018A	2019A	2020F
Intangible Assets	14.1	12.8	12.3	11.6	4.5
Tangible Assets	35.6	29.3	28.9	25.6	26.0
Investments/other	0.0	0.0	0.0	2.0	2.0
Net Working Capital	5.2	5.3	6.2	5.8	6.5
Capital Employed	**54.9**	**47.4**	**47.4**	**45.0**	**39.0**
Other	0.0	0.0	0.0	-1.3	-1.1
Net Cash/(Debt)	**-9.5**	**-8.7**	**-8.7**	**-6.4**	**-5.4**
Provisions Liabilities/Charges	-3.6	-3.0	-2.3	-2.2	-2.2
Net Assets	**41.8**	**35.7**	**36.5**	**35.0**	**30.4**

Source: Company historics, Equity Development estimates

The Group incurred capex of £2.1m during H1 20. H2 should see a further £1m of spend, taking the total for the year up to £3.1m. Generally, this expenditure is project related, focused on an anticipated revenue stream, with short payback periods and the opportunity for further rentals thereafter. The anticipated H2 capex mostly reflects deferred projects commencing for Tasman.

The majority of the H1 expenditure related to purchases of drill pipe for the Asian and Australian markets, although a project in California required the purchase of three used loadbanks. The consideration for the loadbanks is below the anticipated revenues on the project. Significantly, the record order book at Crestchic has prevented the manufacture of loadbanks for the hire fleet.

Hire fleet book value, by area, H1 '20A



Source: Company

Intrinsic value of Group

The net asset value declined following the reduction in the write-off of the goodwill associated with the acquisition of Tasman NZ in 2013. On an underlying basis, we anticipate the net asset value rising to £30.4m by the year-end. The NAV is underpinned by several freehold properties, as well as the hire fleet. The hire fleet alone has a net book value of £26.1m and a replacement value of approximately £50m-plus.

On a projected NAV/share of 109p, the shares are trading on an underwhelming price/book value ratio of just 0.77x. This apparent undervaluation is corroborated by examining trailing EV/EBITDA multiples: we calculate that Northbridge trades at a 40% discount to its peer group.

Investor Access

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