Northbridge Industrial Services

09 June 2022

Strong growth momentum continues

The decision to focus its strategy on the power reliability market continues to pay off handsomely for Northbridge. A combination of accelerating momentum within its markets, a strong pipeline of orders into H2, price increases, a rising number of projects, and growth investment in a new manufacturing facility and depot openings mean a more confident outlook for the Group. We increase estimates for the second time in as many months: adj. EPS are raised by 15.9% in FY22 and 17% in FY23, giving a CAGR from FY21 to FY23e of 30.6%.

To determine the business's fair valuation, we use a DCF model based on conservative assumptions. That leads to our fair value / share rising to 249p from 200p.

The trading update ahead of the AGM is a most encouraging message. The decision to focus the strategy of the Group on power reliability, with accelerating growth within the datacentre and renewable energy markets, and recovery in marine and energy sectors, has been vindicated. Only the Middle Eastern portion of the Tasman drilling tools business remains, with expectations of its disposal over the summer confirmed.

The number of large projects increased y-o-y, driven by the datacentre and marine markets and at improved margins relative to H1 '21. Price increases on selected products offset ongoing inflation and supply chain issues, resulting in broadly unchanged margins. Strong ongoing demand can sustain further price increases should supply chain issues continue.

Q2 witnessed the opening of the expanded UK manufacturing facility (on time and budget) and two new depots. With a bottleneck in production now removed, and a reduction in the average lead time in customer orders from 22 weeks to an estimated 14 weeks by the year end, we think the balance between rental and manufactured sales will be broadly even in FY22 as a result. The opening of the new depot in Texas and the move to a new location in Antwerp to tap into the buoyant datacentre market also bodes well and expands recurring revenues.

The positive momentum in cash generation and the proceeds from the disposal of Tasman enabled management to increase the recent share buy-back (1.05m shares, costing £1.9m) to meet future LTIP awards. Increased EBITDA estimates ensure that expectations for net cash improve modestly over our previous expectations.

Strong performance and outlook not reflected in share price

The confidence in the outlook and subsequent increase in estimates result in our fair value / share increasing to 249p, representing a 29% premium to the current price.

Key financials

Y/e Dec 31, £m	FY19A	FY20A	FY21A	FY22E	FY23E
Revenue	33.6	34.0	38.8	39.0	40.7
EBITDA	7.0	6.4	8.4	8.6	9.0
Adj. PBT	0.3	-0.2	3.0	5.2	5.8
Adj. EPS (p)	-0.8	-0.7	9.3	14.2	15.9
DPS (p)	0.0	0.0	1.0	2.0	2.8
Net Debt	-6.4	-5.4	-1.1	0.6	2.8
EV/EBITDA (x)	8.2	8.4	6.4	6.4	5.9
PER (x)	n/a	n/a	20.3	13.4	11.9

Source: Company historics, ED estimates

Company Data

EPIC	NBI
Price (last close)	193p
52 weeks Hi/Lo	204p/96p
Market cap	£56m
ED Fair Value/share	249p
Net debt (Dec '21)	£1.1m

Share Price, p

Source: ADVFN

Description

Northbridge Industrial Services ("Northbridge") has announced the intention to change its name to Crestchic Plc, following the disposal of most of the Tasman drilling tools business.

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

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Financials

The strong momentum in trading continued from Q1 into Q2, leading us to reset the FY estimates for 2022 and 2023. We highlight the scale of upgrades to our forecasts in the table below. It is worth pointing out that Q2 witnessed higher costs due to the following:

- Recruitment and training of employees for the new manufacturing facility (recently opened)
- The opening of a new branch in Texas, and
- A move from a shared facility in Antwerp to a Crestchic transformers site, with loadbanks to be introduced by the year end.

FY23 will carry a full year of such costs.

Revised estimates

Y/e Dec 31, £m	Old FY22E	New FY22E	Quantum of change	Old FY23E	New FY23E	Quantum of change
Revenue	36.2	39.0	7.7%	36.2	40.7	12.4%
Gross profit	17.7	19.1	7.7%	18.3	19.7	7.7%
EBIT	4.8	5.5	14.9%	5.3	6.2	15.9%
Adj. PBT	4.5	5.2	15.9%	5.0	5.8	17.0%
Adj. EPS (p)	12.2	14.2	15.9%	13.6	15.9	17.0%
DPS (p)	2.0	2.0	0%	2.8	2.8	0%
Dividend cover (x)	6.1	7.2	18.0%	5.0	5.7	13.8%
Net cash/(debt)	1.0	0.6	-38.8%	2.6	2.8	6.0%
Net debt/EBITDA	-0.1	-0.1	-32.1%	-0.3	-0.3	3.6%

Source: ED

It is well worth highlighting again the high operational gearing of this business.

As the chart below highlights, this works in both directions. We estimate that by FY23 the level of gross profit feeding through to EBIT should approximate to figures last seen in FY13, yet below the peak experienced in FY14.

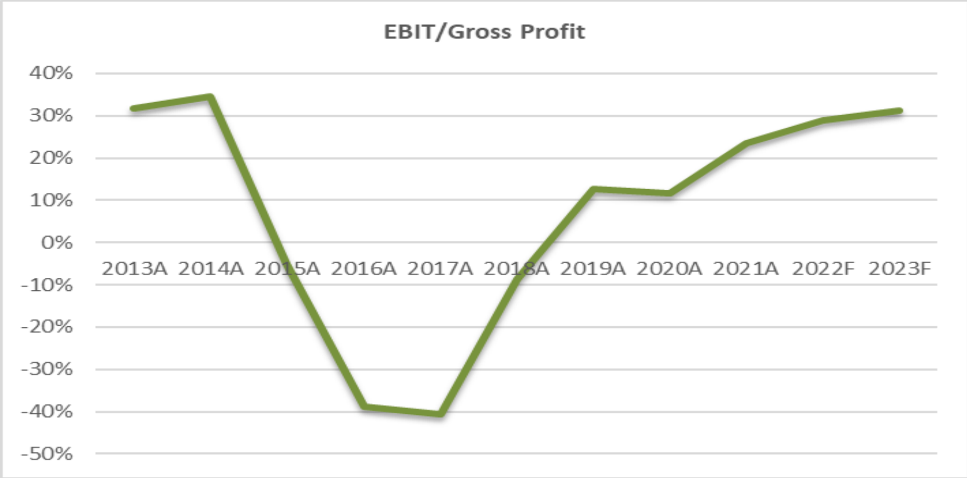
On this basis, we anticipate more to go for in terms of margin expansion, with the previous peak of 17.1% standing well ahead of our 15.2% estimate for FY23.

We estimate the driver of margin expansion will be further growth in the proportion of revenues derived from hire, instead of equipment sales. The backlog of manufacturing orders will result in a temporary increase in the proportion of equipment sales as the new factory comes on stream, declining to more normal levels by the end of FY23. In our view a rise in the proportion of rental activity to almost 60% of revenues will prove the impetus required for the expansion of margins to record levels in FY24.

The upgrade to adj. EPS and adj. PBT is consistent at 15.9% in FY22, compared to our previous estimates, rising 17% in FY23. The two-year CAGR in adj. EPS between the result in 2021 and our FY23 estimate is a staggering 30.6%, further highlighting the strong momentum within Crestchic's markets.

We have not adjusted our dividend expectations for FY22 and FY23, preferring to remain conservative for now given macro variables. However, dividend cover of 7.2x in FY22, falling to 5.7x in FY23, clearly offers **significant scope for an improved payout ratio**, further improving the total return to shareholders.

Operational gearing



Source: Company historics, ED estimates

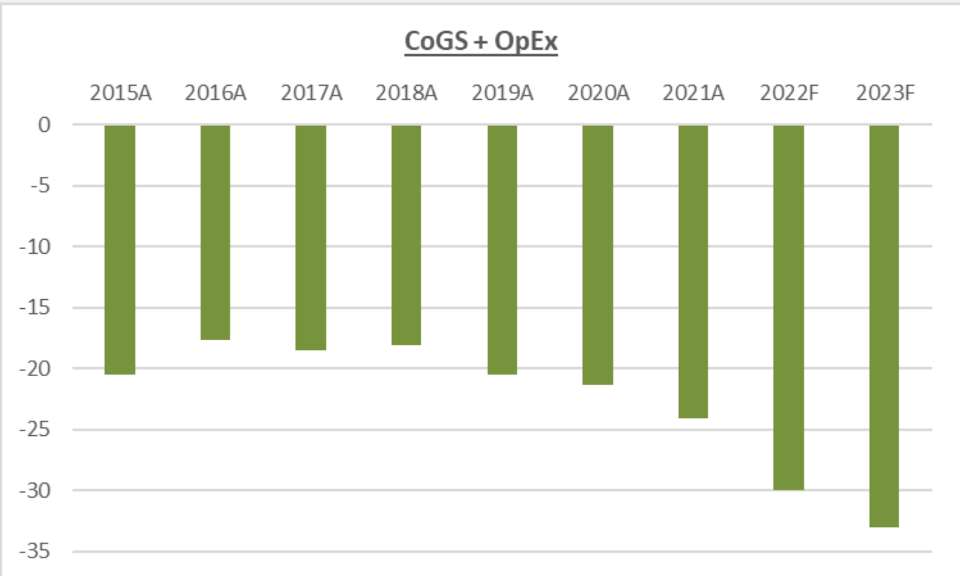
It is increasingly likely that the remainder of Tasman will be disposed of during the summer months, with the increase in energy prices providing the necessary confidence for bidders. We expect Tasman to break even during FY22, despite a modest time-related uplift to revenue expectations (£1.9m to £2.0m).

The continuing EBIT margin is higher, with returns at Crestchic rising from 14.6% in FY19 (pre-central costs) to 18.8% in FY23.

Focusing on the continuing business, the chart below focuses on the cost progression (CoGS + OpEx) within Crestchic, which includes some level of central costs associated with the non-core drilling tools business. Overall, costs on a continuing basis rise from £20.5m in FY19 to an expected £33m in FY23.

Costs within Tasman decline in line with revenues, with the final portion of the division expected to be sold during the summer of 2022. As a result, costs from the drilling tools business decline from £10m in FY20, to £9.4m in FY21 and to just £2m in FY22e.

Total costs (CoGS + OpEx), £m



Source: Company historics, ED forecasts

Financials

Summary Profit & Loss					
Year to Dec 31, £m	**2019A**	**2020A**	**2021A**	**2022E**	**2023E**
Crestchic	25.4	24.6	29.5	37.0	40.7
Tasman Oil Tools	8.2	9.4	9.4	2.0	0.0
Revenue	33.60	33.98	38.81	39.00	40.70
CoGS	-17.8	-19.3	-20.9	-19.9	-21.0
Gross profit	15.8	14.7	17.9	19.1	19.7
Gross margin (%)	47.0%	43.2%	46.2%	48.9%	48.5%
Op costs	13.6	13.4	13.7	13.6	13.6
Other operating income	-0.1	0.4	0.0	0.0	0.0
Associates/JVs	-0.8	-0.6	-0.4	0.0	0.0
Operating profit	1.2	1.1	3.8	5.5	6.2
Op margin (%)	3.5%	3.3%	9.9%	14.1%	15.2%
Net Interest	-0.9	-0.7	-0.5	-0.3	-0.3
PBT (Adjusted)	0.3	-0.2	3.0	5.2	5.8
Exceptionals	0.0	-7.8	-7.6	0.0	0.0
PBT (Reported)	0.3	-8.5	-4.7	5.2	5.8
Tax	-0.6	-0.1	-0.7	-1.0	-1.2
PAT	-0.2	-8.7	-5.3	4.2	4.7
Minority interests	0.0	0.0	0.0	0.0	0.0
Earnings	-0.2	-8.7	-5.3	4.2	4.7
Ordinary Dividends	0.0	0.0	-0.3	-0.6	-0.8
Retained Profit	-0.2	-8.7	-5.6	3.6	3.9
EPS (Adjusted) (p)	-0.8	-0.7	9.3	14.2	15.9
DPS (p)	0.0	0.0	1.0	2.0	2.8
Ave no of shares (FDil) (m)	28.2	28.2	28.5	29.3	29.3

Source: Company historics, Equity Development estimates

The likely net cash outcome at the end of FY23 is broadly unchanged versus previous expectations. The critical moving parts versus our prior estimates include:

- Increased profitability expectations, thereby expanding EBITDA expectations
- Rising working capital to fund the increase in revenues
- Rising tax payments in FY23
- Higher than anticipated share buy-backs to satisfy potential awards under the LTIP

The net effect is a modest improvement in our FY23 net cash outcome of £2.8m (previously £2.6m). We anticipate net cash at the end of FY22 to amount to £0.6m.

Summary Cash Flow					
Year to Dec 31, £m	**2019A**	**2020A**	**2021A**	**2022E**	**2023E**
Operating profit	1.2	1.1	3.8	5.5	6.2
Depn. & Amortn.	5.8	5.3	4.6	3.1	2.8
Working capital movement	0.6	0.2	-1.0	-1.5	-0.9
Other	0.0	0.0	-0.5	0.0	0.0
Operating cash flow	7.6	6.6	6.9	7.2	8.1
Net Interest	-0.9	-0.7	-0.5	-0.3	-0.3
Taxation	-0.6	-0.5	-0.5	-0.8	-1.1
Net capex	-2.2	-2.6	-0.8	-6.2	-4.3
Operating FCF	4.0	2.8	5.1	-0.2	2.3
Net (Acquisitions)/Disposals	-0.1	0.0	0.0	4.2	0.5
Dividends	0.0	0.0	0.0	-0.5	-0.7
Share Issues	0.0	0.0	1.1	-1.9	0.0
Minority payment	-1.4	-0.3	0.0	0.0	0.0
Other financial	-0.3	-1.5	-1.9	0.0	0.0
Increase Cash/(Debt)	2.3	1.0	4.3	1.7	2.2
Opening Net Cash/(Debt)	-8.7	-6.4	-5.4	-1.1	0.6
Closing Net Cash/(Debt)	-6.4	-5.4	-1.1	0.6	2.8

Source: Company historics, Equity Development estimates

Net assets are broadly unchanged versus previous estimates, rising to £29.5m by the end of FY23 (from £29.2m previously). The move to a modest net cash position during FY22, further improving in FY23, results in a net debt/EBITDA ratio of -0.3x in 2023.

We think that **the strength of the balance sheet could allow management to accelerate its depot network expansion**, further widening the geographical reach of the Group.

Abbreviated Balance Sheet					
Year to Dec 31, £m	**2019A**	**2020A**	**2021A**	**2022E**	**2023E**
Intangible Assets	11.6	4.5	4.3	4.3	4.3
Tangible Assets	25.6	24.5	12.1	15.2	16.7
Investments/other	0.9	1.0	2.8	2.8	2.8
Net Working Capital	5.8	5.2	2.8	4.2	5.1
Assets held for sale			4.7		
Capital Employed	43.9	35.1	26.8	26.6	29.0
Other	0.0	0.0	0.0	0.0	0.0
Net Cash/(Debt)	-6.4	-5.4	-1.1	0.6	2.8
Provisions Liabilities/Charges	-2.2	-2.0	-2.3	-2.3	-2.3
Net Assets	35.2	27.7	23.3	24.9	29.5

Source: Company historics, Equity Development estimates

Valuation

We have constructed a discounted cash flow (DCF) model for Northbridge, based on conservative assumptions of a weighted average cost of capital (equating to the discount rate) of 8.25% and a terminal growth rate of 2.50% (which is markedly below the rate of inflation).

The model suggests an equity value of £73.0m, which equates to a fair value / share of 249p.

Northbridge DCF calculation

£m	**2022F**	**2023F**	**2024F**	**2025F**	**2026F**	**2027F**	**2028F**	**2029F**	**2030F**	**2031F**
Free cash flow	3.2	4.2	4.3	4.4	4.5	4.6	4.7	4.9	5.0	5.1
WACC (%)	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25
Timing factor	0.42	1.42	2.42	3.42	4.42	5.42	6.42	7.42	8.42	9.42
Discount rate	0.97	0.89	0.83	0.76	0.70	0.65	0.60	0.56	0.51	0.47
Present value	3.1	3.7	3.5	3.4	3.2	3.0	2.8	2.7	2.6	2.4
Sum of discounted cash flows	30.4									
Terminal growth rate (%)	2.50									
Terminal value	42.0									
Net debt	0.6									
Equity value	**73.0**									
No. of shares (m)	29.4									
Value per share, p	**248.6**									

Source: Equity Development

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