Northbridge Industrial Services

12 April 2022

Further upgrades to forecasts and fair value

2021 was a hugely significant year for Northbridge. Profits rose to the highest level since FY14, achieved whilst amending strategy and a restructuring of the balance sheet. Continuing revenues hit new peaks, reflecting the continued buoyancy of the data centre and renewable energy markets. Also, signs of recovery emerged within the marine and large project sectors. Trading in Q1 was ahead of budgeted levels due to record manufacturing order books and a robust rental pipeline. We have further increased financial estimates as a result, raising adj. EPS estimates by 12.2% and increasing our dividend pay-out by a third. The upgrades, coupled with a peer group comparison valuation model, mean another increase in our fair value/share assumption to 200p.

2021 proved an eventful year following a Board reorganisation, a new strategic focus, a restructuring of the balance sheet, investment in an expansion of production capacity, and entering discussions with parties interested in acquiring Tasman. Crestchic's profitability rose to the highest levels since 2014, with revenues broadly unchanged at Tasman and losses sharply reduced despite the background 'noise'. We think this represents quite an achievement.

FY22 has started strongly, with a strong rental pipeline and manufacturing orders at record levels for a fourth successive year. Demand for load banks continues to be driven by testing within the data centre and renewable energy markets, with recovery taking greater hold within the marine and project markets. Crestchic has signed its first contract to supply load banks to data centres in the Middle East, with a new rental depot opening in Texas in the current quarter as the Group seeks to enter the US data centre market.

Growth looks underpinned by the expansion of rental depots in both new and existing geographies, the new manufacturing facility (raising production by 60%), a renewed focus on fleet utilisation levels, investment in additional hire fleet, and a targeting of higher margin service-related revenues. We also anticipate growth to be further underpinned by energy transition towards renewables and cleaner fuels, coupled with regulatory drivers.

Upgrades merited

We have increased adj. EPS estimates by 12.2% for FY22, introducing expectations for FY23 some 11.4% higher. Targeted dividend cover of 4x over the medium term, allows for an increase in our FY22 dividend expectation to 2p (from 1.5p) in FY22 and to 2.8p in FY23. **These upgrades, coupled with a peer group comparison model, support an increase in our fair value/share to 200p at this early stage of the financial year.**

Key financials

Y/e Dec 31, £m	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	33.6	34.0	38.8	36.2	37.8
EBITDA	7.0	6.4	9.3	9.1	9.8
Adj. PBT	0.3	-0.2	3.0	4.5	5.0
Adj. EPS (p)	-0.8	-0.7	9.3	12.4	13.8
DPS (p)	0.0	0.0	1.0	2.0	2.8
EV/EBITDA (x)	7.6	7.8	5.9	5.6	4.9
PER (x)	n/a	n/a	18.6	14.1	12.6
Yield (%)	0.0	0.0	0.6	1.1	1.6

Source: Company historics, ED estimates

Company Data

EPIC	NBI
Price (last close)	174p
52 weeks Hi/Lo	190p/96p
Market cap	£50.6m
ED Fair Value / share	200p
Net debt	£1.0m

Share Price, p

Source: ADVFN

Description

Northbridge Industrial Services (Northbridge) has announced its 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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A transformational year

FY21 was a busy one marked by a strengthening of the Board, a strategic review of the business, a restructuring of the balance sheet, an expansion in production capacity, and discussions with interested parties in the non-core division, Tasman. One could be forgiven for thinking that profitability would likely suffer during such a tumultuous period, yet adj. PBT rose to its highest level since FY14 on a Group level. The Group further enhanced its ESG credentials, developing a road map of best practice together with associated targets at the Capital Markets Day in March 2022.

Preliminary results

Dec 31 y/e, £m	FY20	FY 21	Change
Hire	11.5	15.5	34.8%
Sales	13.1	14.0	6.9%
Continuing revenues	24.6	29.5	19.7%
CoS	-13.6	-15.5	14.7%
Gross profit	11.1	13.9	25.8%
Gross margin, %	44.9%	47.2%	
OpEx	-6.3	-7.4	16.1%
EBITDA	4.7	6.5	38.8%
EBIT	1.8	3.8	110.9%
EBIT margin, %	7.3%	12.9%	
Net interest	-0.7	-0.5	-31.5%
Adj. PBT	1.1	3.3	201.9%
Exceptional	0.0	-0.9	
Reported PBT	1.1	2.4	122.0%
Taxation	-0.3	-0.6	68.1%
Tax, %	30.5%	17.0%	
Adj. PAT	0.8	2.7	260.8%
Adj. EPS (p)	2.7	9.6	252.8%
Dividend (p)	0.0	1.0	
Net cash/(debt)	-5.4	-1.0	-78.0%
Net debt/EBITDA	1.2	0.2	-84.2%

Source: Company

The results were modestly ahead of guidance/estimates across several metrics, with adj. PBT is most prominent at £3.3m, versus our estimate of £3m. All profits derived from Crestchic, with Tasman loss-making post-inclusion of its joint venture in Singapore and Malaysia. The results table relates to the continuing business and follows the sale of most of Tasman by the end of Q1.

Crestchic revenues increased 19.7% yoy to £29.5m, driven by a 34.5% increase in the higher-margin rental income. H1 '21 was stronger than H2, at £8.7m, reflecting a lower margin project in China (which contributed sales of £1.3m). Rental revenues exceeded the previous record (FY19, pre-pandemic) by 8%.

Revenue from manufactured sales improved 6.9% to £14.0m, reflecting the capacity constraints within the production facility in Burton-on-Trent, as highlighted by revenues of c.£7m for three successive half-years:

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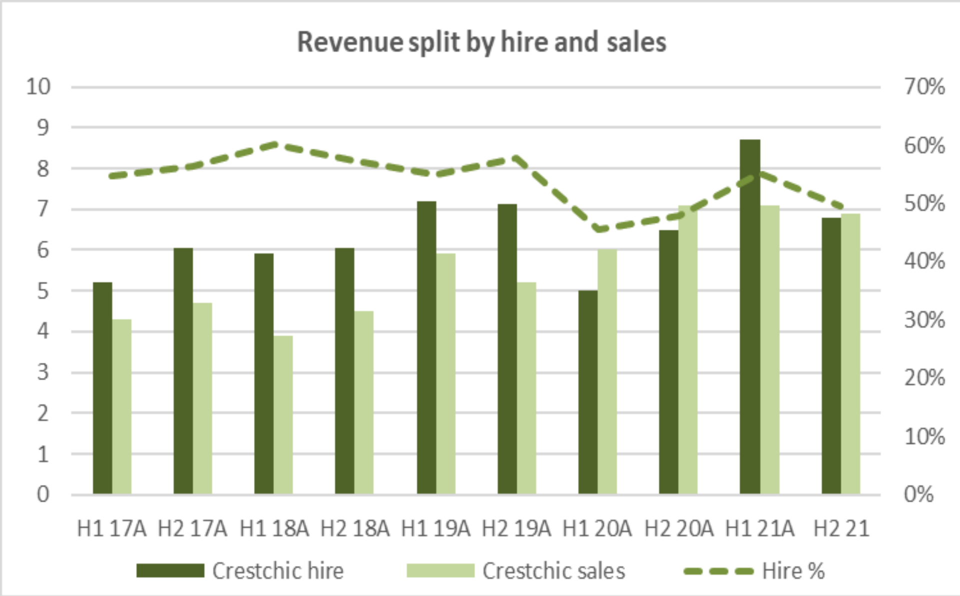
Crestchic: hire vs sales



Source: Company

In Europe, North America, and the APAC regions good growth levels were seen during FY21. A contract to supply load banks (sales, not hire) to a sizeable e-commerce retailer buoyed UK & European revenue, commencing in H1. The datacentre and renewable energy markets continued to be the main growth drivers within hire services across Europe. Hire revenues improved in North America during FY21, with capacity constraints leading to some deferral of product sales (thereby benefitting FY22).

Approximately half of the uplift in Asia reflected the low margin project in China, which was completed in H1. The recovery in the energy sector, including FPSO's buoyed Middle Eastern revenues, as major rental projects came back on stream. The re-emergence of large projects augurs well, highlighting a return in confidence in marine.

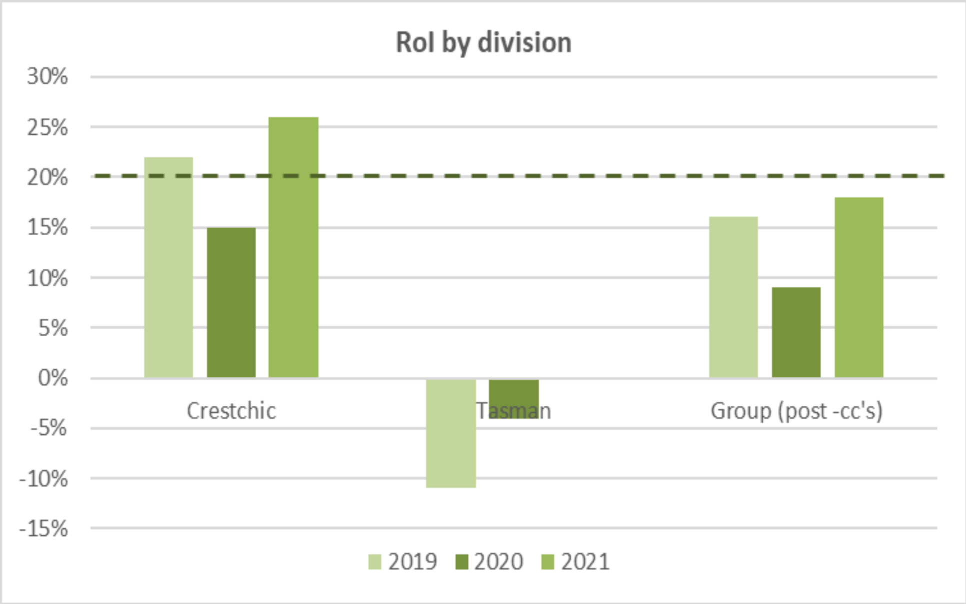
Tasman contributed revenues of £9.4m, a decline of just 0.1% yoy. This shows remarkable resilience, given the business labelled as non-core and marked for disposal in April.

The rising proportion of hire revenues, which increased to 52.5% (FY20: 46.8%) was the key driver behind the yoy increase in Crestchic's gross margins to 47.2% (FY20: 44.9%). The rising proportion of hire services more than offset supply-led inflationary pressures and rising payroll-related costs. The strong operational gearing fed through to an improved EBIT margin of 12.9% (FY20: 7.3%). EBIT increased 111% to £3.8m.

A key measure employed by management in determining whether to invest in a project is the return on investment (RoI). The chart below highlights the reasoning behind the strategic focus on Crestchic, with Tasman deemed non-core. Crestchic's RoI has been consistently at or above 15% over the last three years, even during the pandemic.

At the same time, Tasman remained in the red, including the ill-fated Olio Tasman joint venture in Malaysia and Singapore. The trend was improving but remained below the 15% Group threshold. The target was raised to 20% in the FY21 results announcement. All investment within the business is to be determined on the RoI threshold in future.

RoI across group



Source: Company

A prime example of the RoI-led investment criteria is the commissioning of the new manufacturing facility adjacent to the existing factory. Lead times on customer orders increased to 26 weeks, reflecting the Covid-19 enforced change in working practices and the facility operating at capacity. With Covid-related restrictions lifted, lead times have fallen to c. 22 weeks, with a target of 12-16 by the year-end. The new facility will begin to ship products from mid-Q3.

Following the restructuring of the balance sheet, involving the conversion of the loan note into a combination of lower interest-bearing bank debt and shares, the level of interest payable declined to £0.5m. Adj. PBT improved by a significant 202% to £3.3m, the highest level since FY14.

The level of exceptional costs was as expected at £7.6m, of which just £0.9m related to the continuing business and reflected the restructuring of the balance sheet (£0.8m early redemption fee and £0.1m of early debt repayment charges). The remaining £6.7m reflected the write-down anticipated on the exit of Tasman (essentially complete in March 2022).

The 253% increase in continuing, adjusted, and diluted EPS stemmed from both the marked rise in adj. PBT and the decline in the tax charge to 17% (FY20: 30.5%). As anticipated, the Group paid its first dividend in seven years, demonstrating the improved confidence in the outlook. The payment amounted to 1p, covered 9.3x by adj. EPS. The high level of dividend cover is likely to prove to be a critical factor in our future pay-out estimates.

Strong cash flow resulted in net debt declining from £5.4m to £1.0m by the year-end, notwithstanding the £1m outflow associated with rising inventory levels due to supply chain pressures. Capex was lower than expected at £0.8m, with much of the commissioning of the new manufacturing facility falling in FY22. Net debt/EBITDA declined to a very comfortable 0.2x (FY20: 1.2x). With many of its competitors more heavily indebted, NBI should not have any issues with financing the expansion of its new factory and hire fleet in FY22 and beyond.

Growth expectations

Following the positive trading during Q1, coupled with the exciting growth outlook for the business, we have upgraded estimates for FY22 and introduced FY23 forecasts. We have unchanged revenue expectations, profit estimates rising by an average of 12% and an uplift in the dividend by a third. YoY growth in FY23 is expected to amount to 10% in revenues, 11% in profits, and 38% in the dividend pay-out. We expect dividend cover to decline to 4x over the medium term, from 9.3x in FY21.

Estimate changes

£m	Old FY22E	New FY22E	Change	New FY23E	YoY growth
Revenue	34.3	34.3	0.0%	37.8	10.2%
Gross profit	15.5	17.7	14.2%	18.3	3.6%
EBIT	4.3	4.8	11.3%	5.3	11.2%
Adj. PBT	4.0	4.5	12.1%	5.0	11.4%
Adj. EPS (p)	11.0	12.3	12.2%	13.8	11.4%
DPS (p)	1.5	2.0	33.1%	2.8	37.8%
Dividend cover (x)	7.3	6.2		5.0	
Net cash/(debt)	2.2	0.8	-65.4%	3.2	325.4%
Net debt/EBITDA	-0.2	-0.1		-0.3	

Source: ED

We highlighted in our note published on 11 March: *‘Capital Markets Event maps out exciting future’* the benefits of focusing on Crestchic and the exciting outlook for the markets business. The multiple drivers in our growth expectations include:

- Record manufacturing orders for a fourth successive year
- A strong rental pipeline, markedly ahead yoy
- A continuation of strong, ongoing growth within the data centre and renewable energy markets
- The return of marine and other projects, which commenced in FY21
- The opening of a new 25,000 sq ft manufacturing facility, removing current capacity bottlenecks, and increasing production by 60% from Q3
- The opening of an additional US hire depot in Texas from mid-Q2 will allow the Group to target the US datacentre market
- Short-to-medium term identification of a depot to target northern US states/Canada
- The focus within Europe has historically centred on load banks from four outlets the UK, Germany, and France, with transformers from Belgium. Further market share gains are anticipated, particularly within France and Belgium, helped by the relocation of the branch in Greater Paris and the upgrade and relocation of the transformer-only depot in Belgium to include load banks from FY23
- Limited exposure to North, South and Eastern Europe currently – with management exploring the possibility of opening depots in Italy and Spain in the short-term and Scandinavia and central Europe on a medium-to-longer term basis
- In the APAC region, the focus is currently on the marine sector, presenting opportunities elsewhere, not least in the faster-growing segments globally, data centres and energy transition

- To date, the focus in the Middle East has been on extractive industries and marine, presenting opportunities to widen the scope of sector coverage. An initial contract was signed to supply load banks for the testing of data centres, the first such significant order outside Europe
- Further expansion of the load bank and transformer fleet
- A greater focus on improving utilisation levels
- The proportion of service-related revenues remains relatively low. Service/parts revenue represents a growing and high margin area of the business
- Energy transition towards renewables and cleaner fuels, coupled with regulatory drivers, will accelerate the replacement of existing gensets over the medium to longer term, thereby requiring testing by load banks within existing infrastructure.

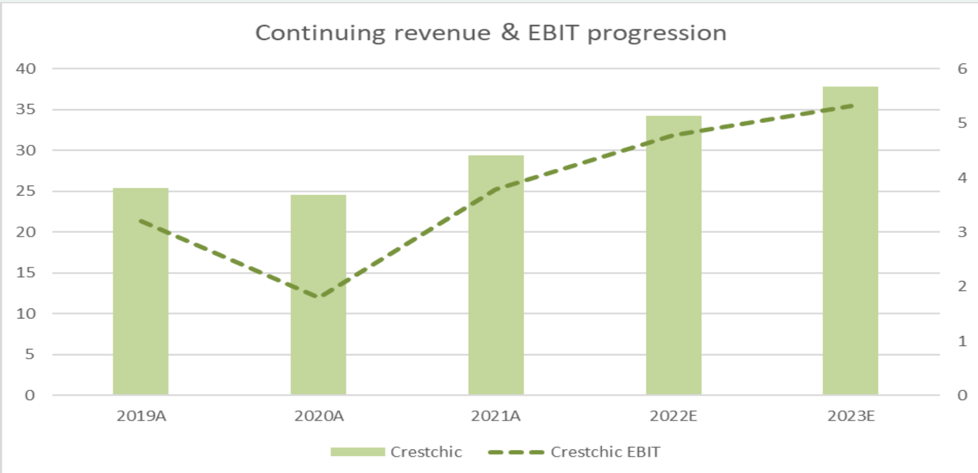
FINANCIALS

Summary Profit & Loss

Year to Dec 31, £m	2019A	2020A	2021A	2022E	2023E
Crestchic	25.4	24.6	29.5	34.3	37.8
Tasman Oil Tools	8.2	9.4	9.4	1.9	0.0
Revenue	33.60	33.98	38.81	36.20	37.80
CoGS	-17.8	-19.3	-20.9	-18.5	-19.5
Gross profit	15.8	14.7	17.9	17.7	18.3
Gross margin (%)	47.0%	43.2%	46.2%	48.9%	48.5%
Op costs	13.6	13.4	13.7	12.9	13.0
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	4.8	5.3
Op margin (%)	3.5%	3.3%	9.9%	13.2%	14.1%
Net Interest	-0.9	-0.7	-0.5	-0.3	-0.3
PBT (Adjusted)	0.3	-0.2	3.0	4.5	5.0
Exceptionals	0.0	-7.8	-7.6	0.0	0.0
PBT (Reported)	0.3	-8.5	-4.7	4.5	5.0
Tax	-0.6	-0.1	-0.7	-0.9	-1.0
PAT	-0.2	-8.7	-5.3	3.6	4.0
Ordinary Dividends	0.0	0.0	-0.3	-0.6	-0.8
Retained Profit	-0.2	-8.7	-5.6	3.0	3.2
EPS (Adjusted) (p)	-0.8	-0.7	9.3	12.3	13.8
DPS (p)	0.0	0.0	1.0	2.0	2.8
Ave no of shares (FD) (m)	28.2	28.2	28.7	29.1	29.1

Source: Company historics, Equity Development estimates

Strong growth drivers feeding through to revenue & EBIT



Source: Company historics, ED estimates

As we highlighted in our note dated 21 February, *'A flurry of good news'* there are three vital moving parts within FY22 cash flows:

- The bulk of the construction and fit-out costs of the new manufacturing facility falling within FY22
- The purchase of new equipment to drive top-line growth within the group's rental markets
- The proceeds of the disposal of Tasman, with the sale of the assets within the Middle East by June

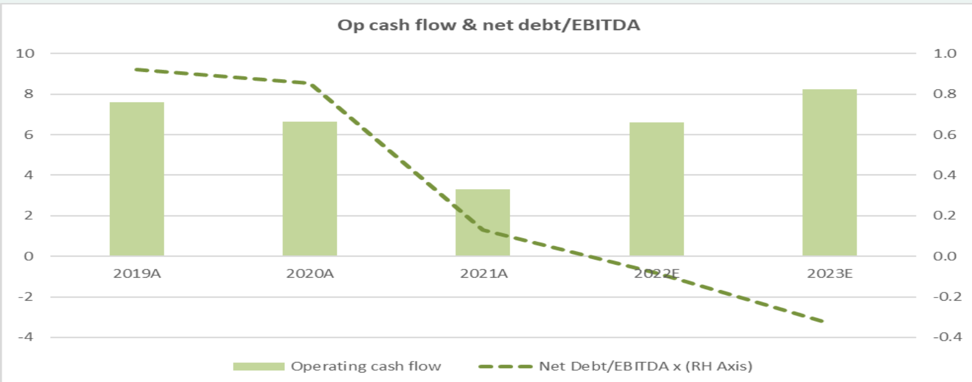
We anticipate net cash at the end of FY22 of £0.8m. This represents a modest reduction in our previous expectation of £2.2m. The increase in working capital relates to supply chain issues, with capex focused on the new factory, plus expansionary hire fleet additions. The increase in the pay-out to 2p, from 1.5p, plus a higher than anticipated share buy-back programme completes the more measured move to net cash.

Summary Cash Flow

Year to Dec	2019A	2020A	2021A	2022E	2023E
Operating profit	1.2	1.1	3.8	4.8	5.3
Depn. & Amortn.	5.8	5.3	4.6	2.9	2.6
Working capital movement	0.6	0.2	-1.0	-1.2	-0.5
Other	0.0	0.0	-0.4	0.0	0.0
Operating cash flow	7.6	6.6	7.0	6.5	7.4
Net Interest	-0.9	-0.7	-0.5	-0.3	-0.3
Taxation	-0.6	-0.5	-0.5	-0.8	-0.9
Net capex	-2.2	-2.6	-0.8	-6.2	-4.3
Operating FCF	4.0	2.8	5.2	-0.8	1.8
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	-1.0	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	4.4	2.0	1.7
Opening Net Cash/(Debt)	-8.7	-6.4	-5.4	-1.0	1.0
Closing Net Cash/(Debt)	-6.4	-5.4	-1.0	1.0	2.6

Source: Company historics, Equity Development estimates

Cash flow to exceed pre-pandemic levels by FY23E, with a move to net cash



Source: Company historics, Equity Development estimates

We note the growth in working capital and tangible assets over the period of our estimates. The driver of both reflects:

- The new manufacturing facility
- Growth in the rental fleet
- Expansion of the hire depot network

The assets held for sale represent the assets minus liabilities at the year-end associated with Tasman. We anticipate the disposal of the assets from the Middle East to conclude by mid-year '22, thus finalising the disposal of the oil field services business.

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	15.4	17.2
Investments/other	0.9	1.0	2.8	2.8	2.8
Net Working Capital	5.8	5.2	2.8	4.0	4.5
Assets held for sale			4.7		
Capital Employed	43.9	35.1	26.8	26.5	28.8
Other	0.0	0.0	0.0	0.0	0.0
Net Cash/(Debt)	-6.4	-5.4	-1.0	1.0	2.6
Provisions Liabilities/Charges	-2.2	-2.0	-2.3	-2.3	-2.3
Net Assets	35.2	27.7	23.4	25.3	29.2

Source: Company historics, Equity Development estimates

Valuation

We have constructed our fair value/share based on a discounted cash flow (DCF) and a peer group comparison model.

DCF

We have constructed a DCF model for Northbridge, using conservative assumptions of a 2.5% terminal growth rate (markedly below inflation) and a discount rate of 8.25% (equating to the long-term average) to determine a measure of fair value for the Group.

The model suggests a fair value per share of 232p, representing a 33% uplift on the current share price.

Northbridge DCF calculation

	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F
Free cash flow	2.8	3.8	3.9	4.0	4.1	4.2	4.4	4.5	4.6	4.7
WACC (%)	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25
Timing factor	0.25	1.25	2.25	3.25	4.25	5.25	6.25	7.25	8.25	9.25
Discount rate	0.98	0.91	0.84	0.77	0.71	0.66	0.61	0.56	0.52	0.48
Present value	2.8	3.5	3.3	3.1	3.0	2.8	2.7	2.5	2.4	2.3
Sum of discounted cash flows	28.2									
Terminal growth rate (%)	2.50									
Terminal value	39.2									
Net debt	1.0									
Equity value	68.3									
No. of shares (m)	29.4									
Value per share	232.3									

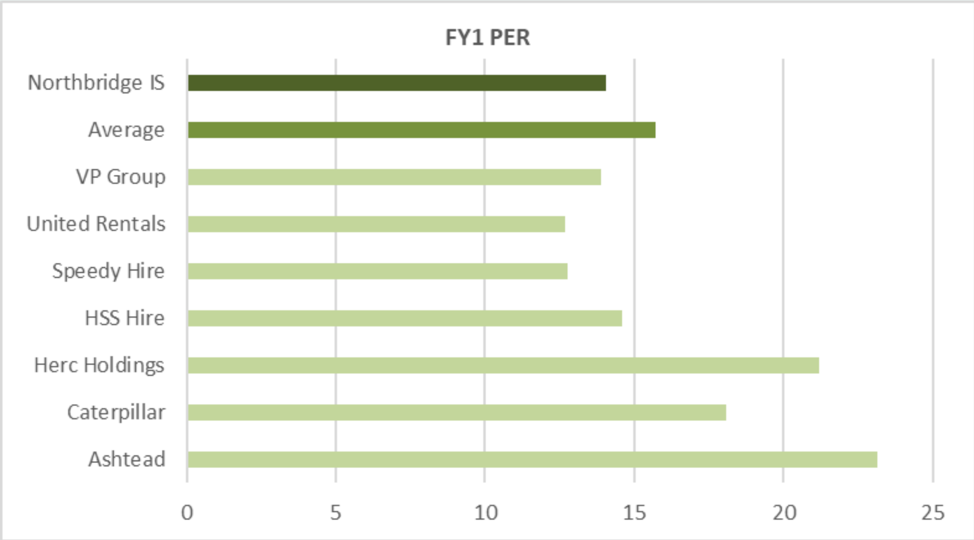
Source: Equity Development

Peer group comparison

We have focused on a global peer group centred on hire services. Taking the average of the forecast year one (FY1) estimates for price-earnings, EV/EBITDA, EV/Sales, and price/book results in an average fair value of 226.5p before a size discount is applied.

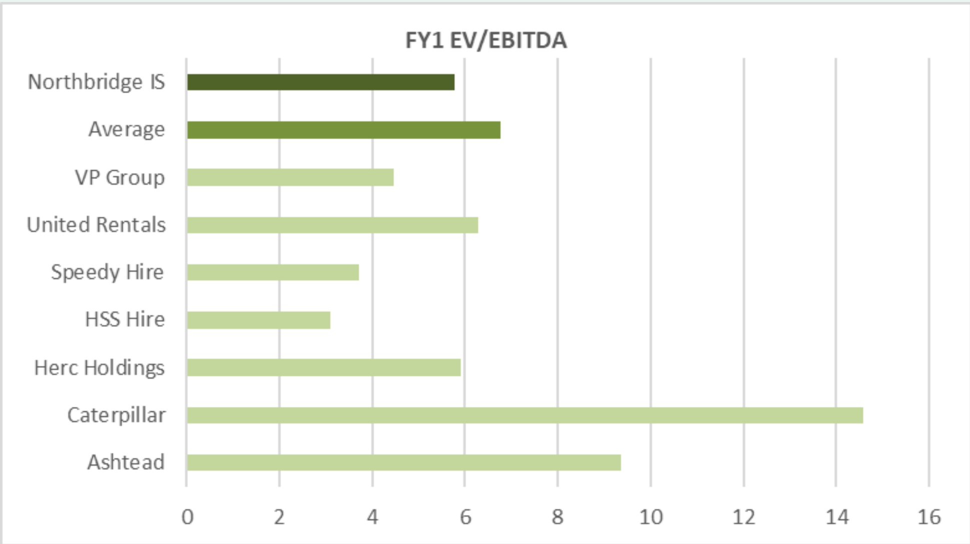
It is well worth reminding readers that the hire fleet is valued at depreciated cost, which represents a significant discount to the current market value.

Peer group comparison: FY1 PER



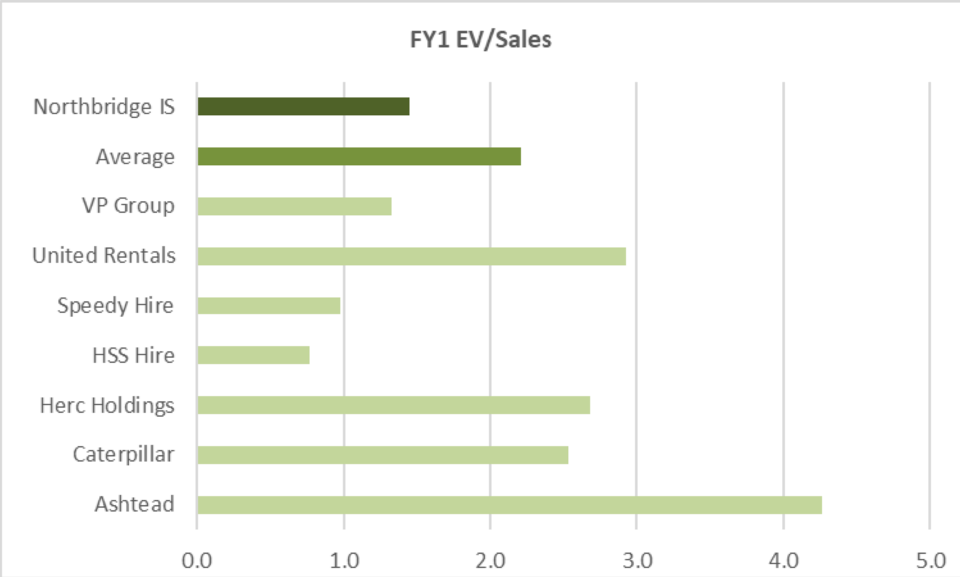
Source: Market Screener, ED

Peer group comparison: FY1 EV/EBITDA



Source: Market Screener, ED

Peer group comparison: FY1 EV/Sales



Source: Market Screener, ED

Peer group comparison: FY1 Price/Book

Source: Market Screener, ED

Taking the averages of the DCF and the peer group comparison models and applying a 10% size discount results in a fair value/share of 200p.

What appears clear is that continuing growth within the datacentre market (recent entry into the US), renewable energy and the recovery of the marine and project markets should be well ahead of the 2.5% growth we have conservatively attributed within our DCF model.

Average fair value / share (p)	
	Fair value (p)
DCF	232.3
PER	194.6
EV/EBITDA	175.7
EV/Sales	272.3
Price/Book	233.8
Average	**221.7**
Apply a 10% discount	199.6

Source: ED, Market Screener

In addition, it is worth noting that **the Group currently trades on an FY1 PEG multiple of 0.4x,** where a reading of less than one signifies that the shares are lowly rated versus the market.

Furthermore, consolidation continues within the sector, with the latest deal being the recent acquisition of **Comrent** by Ashtead within the load bank rental market in the US. No disclosure on either multiples or the consideration was provided by Global Environment Fund, the previous owner. The portfolio within the US-based private equity firm focuses on growth companies that promote sustainability and the combined Sunbelt/Comrent fleet is the largest in North America.

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