Northbridge Industrial Services PLC

30 September 2021

Another significant increase in our estimates

The strong interim results, combined with good visibility on the outlook into Q1 2022, cause us to revisit estimates for the second time in as many months. The favourable outlook for Crestchic continues to be driven by a combination of strong data centre markets globally and, a return of large projects. The proposed disposal of Tasman is ongoing, with management engaged in discussions with third parties and an expectation that following its sale the Group will be debt free. This positive outlook is underpinned by the Board's desire to return to the dividend list, seeking to create distributable reserves at a forthcoming General Meeting.

This encouraging news has resulted in our adj. EPS expectation for FY2021 rising by 24.3% to 8.7p, hot on the heels of the 24.9% increase in August. We have also introduced estimates for the FY22 financial year, with adj. EPS of 10.9p and a dividend of 1.5p, the first since 2014.

The interim results were strong as revenues increased 22.5% yoy, with **Crestchic improving by an impressive 44%** relative to H1 '20. The improvement in gross margins reflected the rise in the proportion of rental revenues to more normal levels. This fed through to the EBIT level, with operating margins more than doubled within Crestchic to 13% (H1 '20; 6%) and to 9.6% overall, following Tasman's return to a small loss, as its markets struggle with ongoing lockdowns and travel restrictions.

The strength of the recovery at Crestchic has stepped up a gear, leading us to increase estimates for a second time in two months. We raise our group EPS estimates by a further 24.3% to 8.7p for FY21, driven by the strong growth in the datacentre market and in the return of large projects. Other areas continue to perform well, with all regions contributing to the strong outcome.

The disposal of the loss-making Tasman division is nearing its conclusion, with the proceeds likely to result in the Group moving to a debt-free position immediately following completion. Net debt, including IFRS 16 lease, at the H1 period end stood at £4.5m. This is likely to decrease modestly in H2 despite the commencement of the construction process of the new manufacturing site located in Burton-on-Trent.

The Board has requested a General Meeting to discuss a resolution to create a positive distributable reserve, laying the groundwork for the payment of future dividends. We consider this to be significant news, signalling internal confidence in the outlook. In addition, should the forthcoming General meeting approve the change, the Board is proposing to purchase shares in the market to satisfy LTIP requirements, holding them in Treasury.

Transformation not yet reflected in current rating

We believe that Northbridge is at a very exciting stage within its recovery process. Momentum within Crestchic is strong; the Board is clearing a path to the payment of dividends; share buy-backs could become a feature and positive progress has been made on disposing of Tasman.

However, with the shares trading on a sector average, we feel that this fails to factor in the above factors, nor does it properly value the rental assets, in our view. Pending the confirmation of the final terms of the Tasman disposals, our current fair value / share rises to reflect our forecast EPS upgrade to 189p (from 152p).

We also expect further multiple expansion as investors recognise the Group's strategic focus and strong growth.

Company Data

EPIC	NBI
Price (last close)	170p
52 weeks Hi/Lo	172p/65p
Market cap	£48m
ED Fair Value / share	189p
Net debt (Jun '21)	£4.5m

Share Price, p

Source: ADVFN

Description

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

Crestchic Loadbanks ("Crestchic"), 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. The Board has stated that Tasman is non-core with divestment in FY21 a distinct possibility.

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Interim results – recovery continues

Interim results			
Six months to June, £m	**H1 20**	**H1 21**	**Change, yoy**
Crestchic rental	5.0	8.7	74.0%
Crestchic sales	6.0	7.1	18.3%
Tasman rental	4.3	3.3	-23.3%
Tasman sales	0.7	0.5	-28.6%
Group revenue	16.0	19.6	22.5%
Cost of sales	-9.1	-10.8	18.7%
Gross profit	6.9	8.8	27.4%
GP%	43.0%	44.7%	
OpEx	-6.4	-6.9	7.1%
Other operating items	0.2	0.0	-100.0%
Pre-IFRS 16 EBITDA	3.7	4.4	19.4%
EBIT	0.7	1.9	185.5%
EBIT %	4.1%	9.6%	
Share of Associates/JV	-0.3	-0.2	-25.1%
Finance costs	-0.3	-0.3	0.0%
Adj. PBT	0.0	1.3	3705.7%
Exceptionals	-7.8	-0.9	
Reported PBT	-7.7	0.4	
Taxation	0.0	-0.4	
Adj. PAT	0.0	1.0	
Adj. EPS (p)	0.1	3.5	3034.9%
Net debt	-7.4	-4.5	
Net debt/EBITDA	0.9	0.6	
Gearing, %	24.9%	16.2%	
Interest cover (x)	1.9	5.5	
NAV/share (p)	106.4	99.5	

Source: Company, ED

The results for the six months to June were outstanding. Revenues increased by 22.5% yoy to £19.6m, driven by strong trading within the core, with Crestchic delivering a 44% uplift in comparison to H1 '20. Although Q2 '20 was severely impacted by the effects of the pandemic, particularly at Tasman, H1 '21 revenues were 16.9% higher than in H1 '19. In fact, the H1 '21 top-line represented a post-2014 record.

Crestchic

The first half demonstrated the spread of the recovery to other somnolent areas, coupled with the record manufacturing order book at the beginning of the year. Taking the latter first, the successful planning application and subsequent ground-breaking for the significant factory extension, emphasises the extent to which the current manufacturing operations are trading at capacity. Social distancing and safe working practices within the operations has temporarily reduced capacity further. In fact, these points are underpinned by the static level of manufacturing revenues, at £7.1m in H1 '21 and in H2 '20.

Nevertheless, the achieved level of manufactured sales still increased 19% versus the comparative period. Order intake has remained high YTD.

Markets

The data centre market remains key for Crestchic, with a significant contract win in the form of a major e-commerce retailer secured directly, rather than by more traditional methods via intermediaries. The hope is that this burgeoning trend will develop further over the medium term.

That delivery times have extended, represents both good news and bad. The bad news is that customers will face delays in receiving shipments, which potentially may result in some orders being lost, although in such a rapidly growing industry competitors are likely to be in a similar position. Having the hire capacity internally enables the Group to meet customer's requirements during the interim period. Upward pressure on costs, driven by a combination of supply side shortages, raw material price increases and payroll cost pressure have the potential to reduce margins. The good news is that the rising demand for loadbanks and extended delivery times, allow Crestchic to raise prices to offset the burgeoning pressure on margins.

Loadbank/transformer rental increased to £8.7m, which represented a rise of 74% versus H1 '20 and a sequential uplift of 34% compared to H2 '20. We think this level of rental turnover is the highest in the Division's history. The dual drivers of the Group's highest margin area comprised:

- Data centres
- Re-emergence of large rental projects

In terms of the data centre market, this sector continues to underpin the strong growth witnessed by Crestchic during H1. The strong demand from the data centre market led to Crestchic launching a trial rental fleet of server emulators and, commissioning of 25 additional 300kw load banks to meet the rise in demand. Other areas such as grid resilience, renewable energy and natural resources have also demonstrated good progress.

The emergence of large rental projects commenced during Q1 in Asia Pacific, initially in the marine sector. Although a portion of the contract was at relatively low margins, the overall effect was positive to gross and operating profits. From Q2 onwards, significant project work returned to other regions and sectors, and expected to last well into H2. **We think the return of projects represents a positive development, signalling that confidence has returned to its markets.**

Hire revenues equated to 55% of divisional sales, which will have been the main driver of improving gross and operating margins. Overall, hire (including Tasman) improved to 61% of Group revenues and compared to 58% a year ago.

The combination of the record manufacturing order book and the nature of the rental market provides good visibility on revenues for much of the remainder of the year.

Tasman Tools

The top-line within Tasman declined 24% to £3.8m, representing the lowest six-monthly revenue since H1 2019. The comparative period included a strong Q1, which continued the recovery in gas drilling markets in H2 2018, before the pandemic impacted trading from Q2 onwards. The recovery has been much slower than anticipated as ongoing lockdowns and travel restrictions have hampered rig operators, further compounded by deferred contracts being pushed out further to 2022 onwards. Improvements in energy prices increase the probability of such projects commencing next year, offering light at the end of the tunnel.

The lowest level of rental sales in two years led to management acting on costs, not least manpower, central costs, and capex. Those actions resulted in the loss at the EBIT level being restricted to £0.2m (H1 '20: £nil).

The rental fleet at Tasman was well stocked at the start of the year. The lower activity level has enabled selective asset sales during the period. **Combined with the strong EBITDA, the division remained cash generative during H1.**

Update on Strategy

At the time of the preliminary results in April, management redefined its strategy as the pandemic began to impact the business. Targets for return on capital were made public (they existed internally previously), thereby determining which businesses were prioritised in the distribution of capital and/or investment. What was clear was that Tasman was unlikely to consistently achieve returns above its cost of capital (12.5%).

Incidentally, the Group's cost of capital declined following the repayment/partial conversion of the £4m, 10% loan note. The group's banking facility part-funded the repayment of the convertibles, with c.£1m of the loan notes converted to ordinary shares.

On this basis, the difficult decision was made to divest of Tasman. Within the August management trading update, management stated its aim to reduce the costs base within Tasman, to maximise profitability while the non-core business remained within the Group.

An exit from the loss-making Olio-Tasman joint venture in Malaysia is relatively imminent. Tasman has entered a short-term equipment rental contract with its soon-to-be former Malaysian partner. The depot in Singapore will be closed during Q4, once existing rental contracts complete, with no new contracts under negotiation. The exits will result in the requirement to dispose of the rental fleet's assets in late 2021.

The Board is in latter stage discussions with a potential buyer to dispose of Tasman's operations in Australia and New Zealand. Significantly, the carrying cost of the division's New Zealand intangible assets and goodwill was written down by £7.1m, believing that previous levels of profitability were unlikely to be achieved in the medium term. The carrying value of the rental fleet and associated assets of the combined Australia/New Zealand business is currently £4.7m. In view of the positive LNG/geothermal fluid markets in the region, we anticipate the assets demanding a consideration close to their current carrying value. Should that not be the case, the profitable region will be retained until a new buyer can be found.

That leaves the operations in the Middle East, where discussions are at an early stage. The combined carrying value of Tasman's assets outside of Australia and New Zealand amount to £6.3m. However, the discount to asset value is likely to be significant in the Middle East/Malaysia/Singapore. Anticipated associated provisioning is expected to be up to £7m in H2.

H1 rental asset disposals generated £0.7m, approximately half of which were sourced from Tasman.

Crestchic's return on investment has consistently remained above the Group's cost of capital in recent years, with the nadir during the pandemic at 15%, recovering to near 2019 levels of 22% during the current year.

The proposed capital reduction, to create distributable reserves and thereby enable future dividend payments, is highly significant news. The process would also allow the Company to purchase shares for treasury purposes, for example, to meet future LTIP requirements.

We think this is very encouraging. Northbridge has not paid a dividend since 2014 and on this basis, we believe the initial moves to return to the dividend list underpins management's positive view on the outlook for the business.

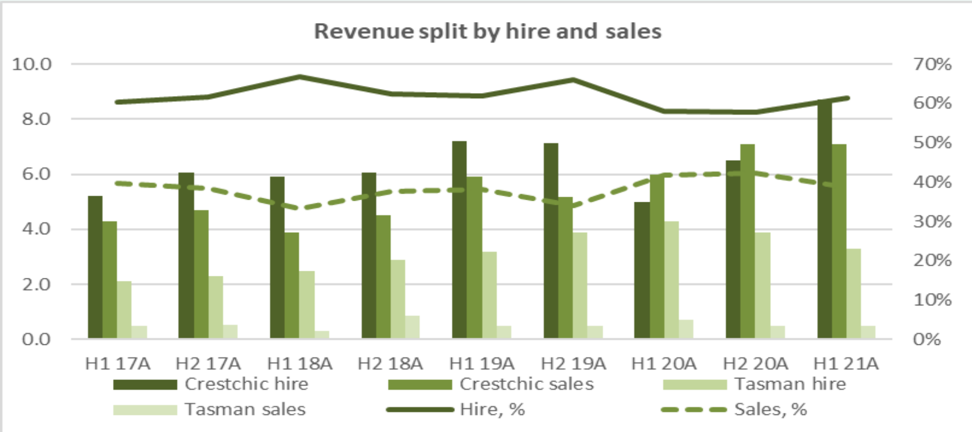
Trends in the H1 results

We split out the divisional revenue by rental or product sales in the tale on page 2. Those figures are placed in historical context in the chart below, demonstrating that the proportion of higher margin hire revenues have further to go potentially (recently peaking at 66.7% in H1 '18). Although Crestchic rental revenues are at an all-time high, the momentum in its end markets (both by product and geography) have further to go.

The cost associated with a power outage (from lost data in a data centre, to potentially the loss of life in a hospital) is significant and as a result, we expect demand for load banks and transformers to continue to improve from here.

Bottlenecks within the Group's Burton-on-Trent manufacturing facility are likely to restrict any growth in product sales during H2 at Crestchic. However, the commissioning of the new extension in Q1 2022 is expected to result in a resumption in top line growth in product sales, reflecting the 50% associated improvement in capacity. On this basis, we have only nudged up the proportion of hire revenues within our FY22F expectations for Crestchic.

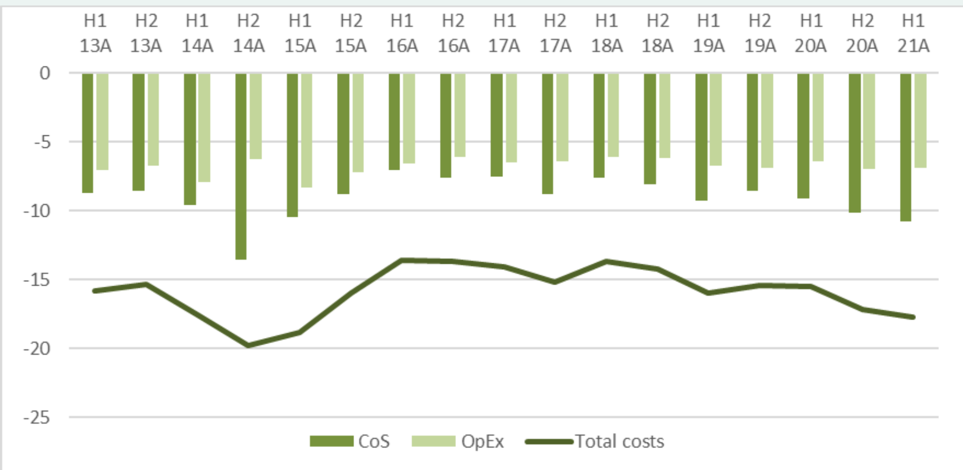
Split of revenue by hire and sales



Source: Company/ED

With regards to the cost base, overall costs rose £2.2m yoy or by 13.9% to £17.7m. Within this, CoS rose 18.7% to £10.8m, with OpEx up 7.1% to £6.9m. The latter reflected the further cost cutting measures undertaken during the period, not least to improve Tasman's chance of moving into profitability. Notwithstanding the above, costs remain at their highest level since H2 2015.

Half-yearly trend in costs

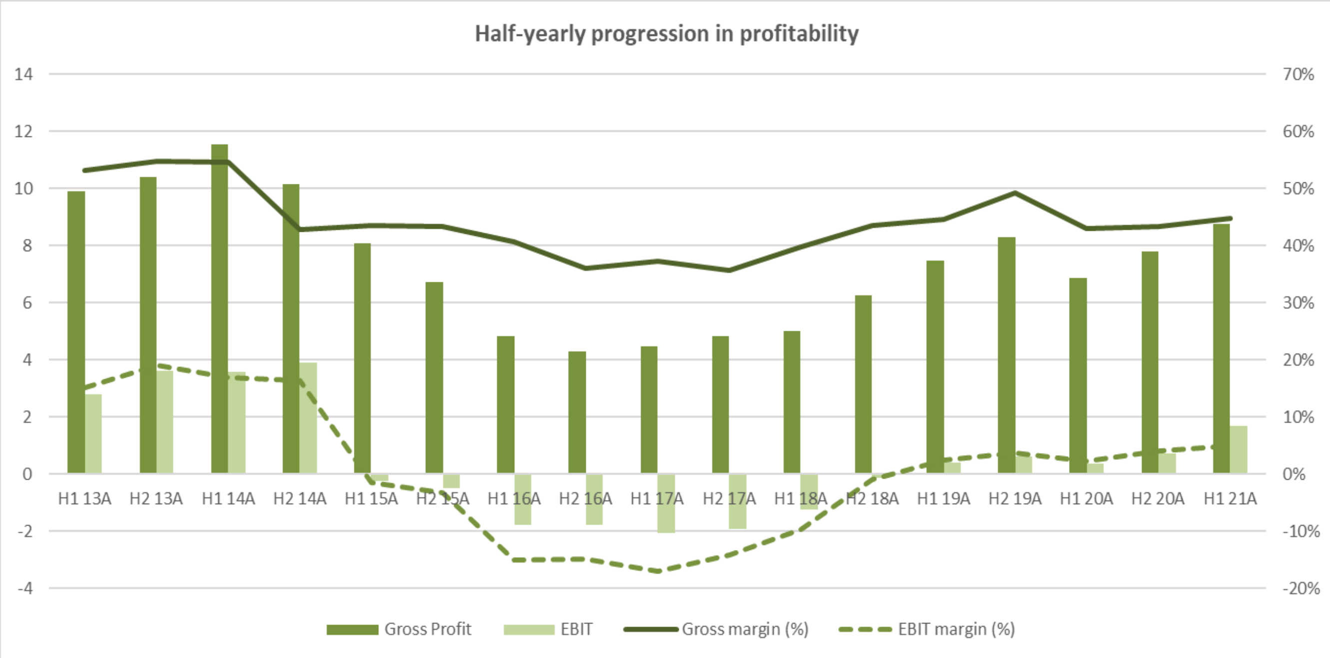


Source; Company

The improvement in the proportion of rental revenues to 61% led to further improvement in the gross margin, particularly as the Group's strongest margin area, Crestchic rental, delivered revenues some 74% higher yoy. Further improvement was seen in both EBIT and in the margin, notwithstanding Tasman returning to a loss-making position.

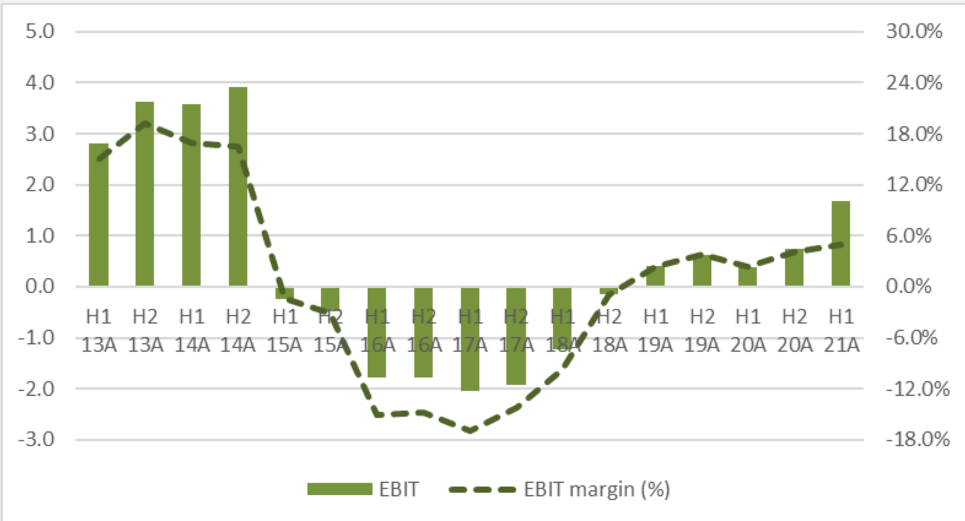
In fact, Crestchic's EBIT margin more than doubled to 13.2% (H1 '20: 6.0%).

Half-yearly trends in profitability



EBIT almost tripled to £1.9m (rising 186% yoy). Factoring in the modest losses from Tasman, Group EBIT margins more than doubled to 9.6% (H1 '20: 4.1%).

Half-yearly trend in EBIT, £m / Margin %

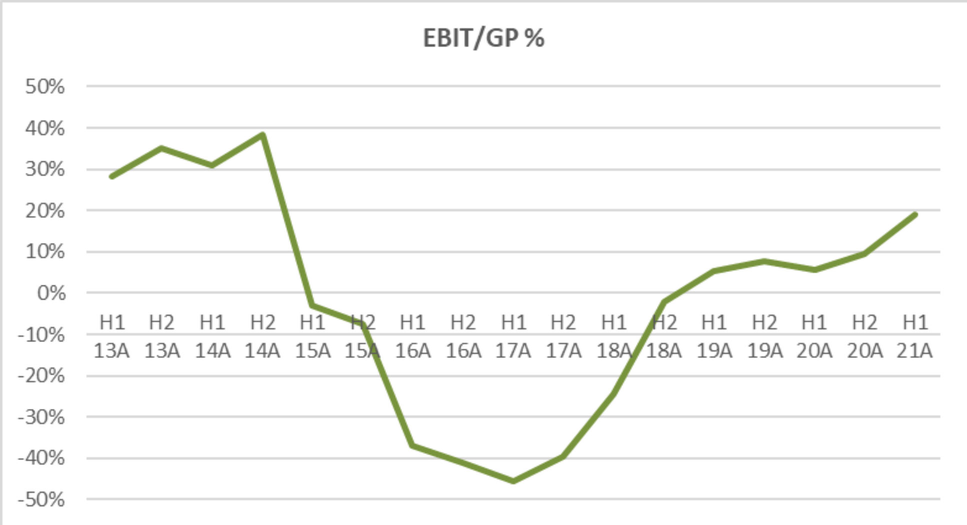


Source; Company

We believe there is significant upside in profitability for Crestchic and in turn, the Group. Although the gross profit to EBIT conversion ratio represented the highest level in recent years at 19.1%, it remains some way below the 38.4% level achieved in H2 ’14.

On this basis, we think that the recovery in profitability has much further to go.

Operational leverage – more to go for



Source: Company

Other notable features of the results include:

- The loss from the Olio Tasman joint venture improved to £0.2m (H1 ’20: £0.3m)
- Finance costs were broadly unchanged yoy at £0.3m
- Adj. PBT moved from breakeven in H1 ’20 to £1.3m in H1 ’21, representing the strongest level of profitability since H2 2014
- The exceptional charge of £0.9m reflected the refinancing of the balance sheet, with the convertible loan note transferred to a combination of bank debt and shares. The additional finance costs reflect an early redemption fee of £0.8m and £0.1m of early debt repayment charges
- The exceptional charges in H1 ’20 amount to the impairment of the carrying value of the intangibles relating to Tasman New Zealand, plus the write-off of a sum owed to the Olio Tasman joint venture
- Adj. PAT rose from breakeven last year to £1m in H1 ’21, resulting in 3.5p of Adj. EPS (H1 ’20: 0.1p)
- Net debt, including IFRS 16 leases, declined markedly yoy to £4.5m (H1 ’20: £7.4m), highlighting the Group’s strong cash flow, coupled with the debt restructuring as highlighted above
- The level of net debt remains low not only by historical standards but also relative to many of its peers, enabling management to fund a pipeline of opportunities. Net debt/EBITA fell to 0.6x (H1 ’20: 0.9x), on a 12-month trailing basis.

Financials

We have upgraded estimates for FY21F and introduced initial projections for FY22F. Several assumptions are made within those changes, including:

- Crestchic FY21F revenue to improve modestly from previous expectations
- Crestchic FY21F EBIT to rise a further 14.7% and follows the 17.2% upgrade in August
- No M&A, including disposals, factored into financial projections, despite the potential sale of Tasman
- Tasman revenues to rise modestly from previous expectations
- Tasman Asia, comprising Malaysia and Singapore to be closed by the year end
- Unchanged FY21F Tasman EBIT, of breakeven (H1 loss of £0.2m)
- Group Adj. PBT to rise a further 20%, following the 19% upgrade in August
- Group Adj. EPS to rise a further 24.3% in FY21F, following August's 24.9% rise
- No dividend payable, representing no change on previous assumptions.

We have released initial estimates for FY22F. Again, we have assumed at this stage that the Australian, New Zealand and Middle Eastern segments of Tasman will be retained, with a full-year benefit of the cost cutting undertaken during FY21 feeding trough.

We remain very positive on the outlook for Crestchic: not least within the data centre market (including a full-year benefit from the contract with the major e-commerce retailer) but also meaningful growth emanating from other sectors, and continued improvement in the number of long-term projects. Nevertheless, we have **conservatively** suggested a near 10% revenue growth, a marked decline in the pace compared to FY21.

Our assumptions are that gross margins improve as the proportion of rental revenues rises modestly (to c.62%) and OpEx to increase modestly below the level of the top-line, reflecting the cost cutting during FY21. We also expect the ongoing strong cash flow to lead to a repayment of net debt and for modest net cash by the year end. With net interest payable likely to fall and with no joint venture losses following its closure, we expect adj. PBT to rise 33% and adj. EPS to improve 25%. Significantly, we have introduced a dividend payment into our estimates, which should this occur, will be **the first one since FY 2014**.

Changes to estimates

	Old FY21F	New FY21F	% change	New FY22F	% change
Crestchic revenue	29.3	29.6	1.0%	32.5	9.8%
Tasman total	7.8	8.0	2.6%	7.0	-12.5%
Group revenue	37.1	37.6	1.3%	39.5	5.1%
Crestchic EBIT	5.0	5.5	10.0%	5.8	5.5%
Tasman EBIT	0.0	0.0	n/a	0.0	n/a
Central costs	-1.6	-1.6	n/a	-1.4	-12.5%
Group EBIT	3.4	3.9	14.7%	4.4	12.8%
Adj. PBT	2.5	3.0	20.0%	4.0	33.3%
Adj. EPS (p)	7.0	8.7	24.3%	10.9	25.3%
DPS (p)	0.0	0.0	n/a	1.5	n/a

*Source: ED, *Based on the assumption that Tasman disposals are not guaranteed.*

Summary Profit & Loss					
Year to Dec, £m	**2018A**	**2019A**	**2020A**	**2021E**	**2022E**
Crestchic	20.4	25.4	24.6	29.6	32.5
Tasman Oil Tools	6.6	8.2	9.4	8.0	7.0
Revenue	26.94	33.60	33.98	37.60	39.50
CoGS	-15.7	-17.8	-19.3	-20.2	-20.8
Gross profit	11.3	15.8	14.7	17.4	18.7
Gross margin (%)	41.8%	47.0%	43.2%	46.4%	47.3%
Op costs	12.3	13.6	13.4	13.5	14.3
Other operating income	0.0	-0.1	0.4	0.0	0.0
Operating profit	-1.4	1.2	1.7	3.9	4.4
Op margin (%)	-5.0%	3.5%	5.0%	10.4%	11.1%
Net Interest	-0.7	-0.9	-0.7	-0.5	-0.4
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	-7.9	0.0
PBT (Reported)	-2.7	0.3	-8.0	-4.9	4.0
Tax	0.3	-0.6	-0.1	-0.5	-0.8
Earnings	-2.4	-0.2	-8.1	-5.4	3.2
Ordinary Dividends	0.0	0.0	0.0	0.0	-0.4
Retained Profit	-2.4	-0.2	-8.1	-5.4	2.8
EPS (Adjusted) (p)	-5.9	-0.8	-0.7	8.7	10.9
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

Summary Cash Flow

Year to Dec, £m	2018A	2019A	2020A	2021E	2022E
Operating profit	-1.4	1.2	1.1	3.5	4.4
Depn. & Amortn.	6.0	5.8	5.3	4.7	4.7
Working capital movement	0.4	0.6	0.2	-1.3	-0.8
Other	0.0	0.0	0.0	-0.9	-0.5
Operating cash flow	5.0	7.6	6.6	6.0	7.8
Net Interest	-0.7	-0.9	-0.7	-0.5	-0.4
Taxation	-0.7	-0.6	-0.5	-0.5	-0.8
Net capex	-3.9	-2.2	-2.6	-3.8	-2.5
Operating FCF	-0.1	4.0	2.8	1.2	4.1
Net (Acquisitions)/Disposals	-1.1	-0.1	0.0	0.0	0.0
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	2.2	3.5
Opening Net Cash/(Debt)	-8.7	-8.7	-6.4	-5.4	-3.2
Closing Net Cash/(Debt)	-8.7	-6.4	-5.4	-3.2	0.3

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	4.1
Tangible Assets	28.9	25.6	24.5	23.8	21.8
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	35.5	34.1
Other	0.0	0.0	0.0	0.0	0.0
Net Cash/(Debt)	-8.7	-6.4	-5.4	-3.2	0.3
Provisions Liabilities/Charges	-2.3	-2.2	-2.0	-2.0	-2.0
Net Assets	36.5	35.2	27.7	30.3	32.4

Source: Company historics, Equity Development estimates

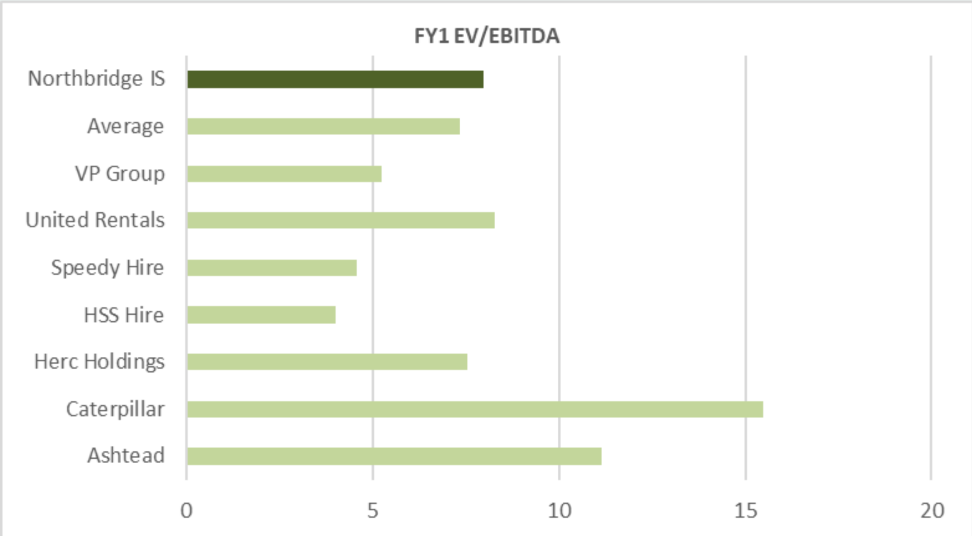
Valuation

At first glance it appears that on an FY1 EV/EBITDA and FY1 PER basis, that Northbridge is nearing a fairer level. However, the asset base of all rental companies is critical, as it is this that generates revenue. Looking at the significant discount that Northbridge trades on a FY1 price to book ratio relative to its peers, we believe there is a significant discrepancy and similarly on a FY1 EV/Sales basis.

In addition, although all companies are in recovery mode following a pandemic afflicted 2020, our view is that Northbridge is at an earlier stage of recovery, held back by the breakeven (at best) Tasman, which is in the process of being divested.

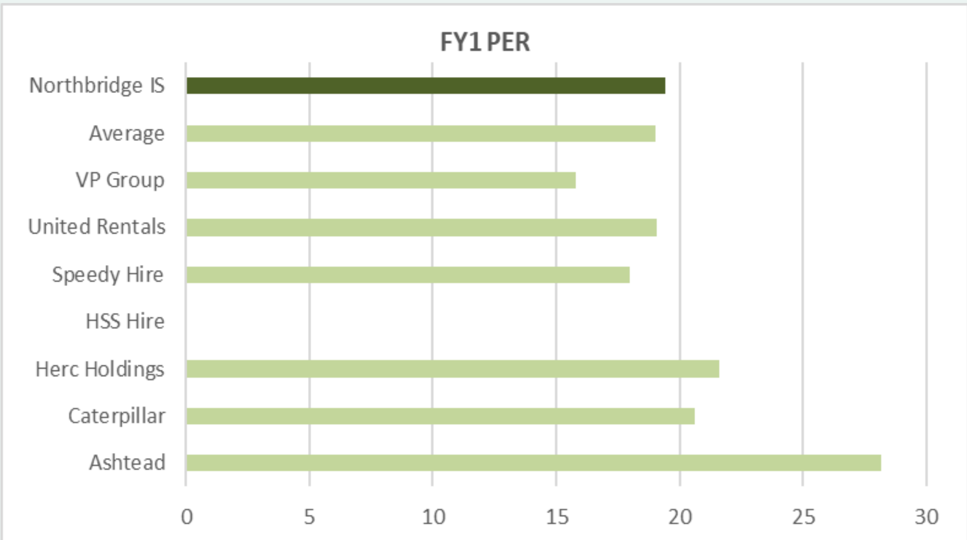
For these reasons, we feel that Northbridge should trade at a premium to the average of its peer group, and we increase our fair value by the full extent of the EPS upgrade to 189p (from 152p). We expect to revisit our fair value assumptions following any disposal relating to Tasman.

Peer group comparison: FY1 EV/EBITDA (x)



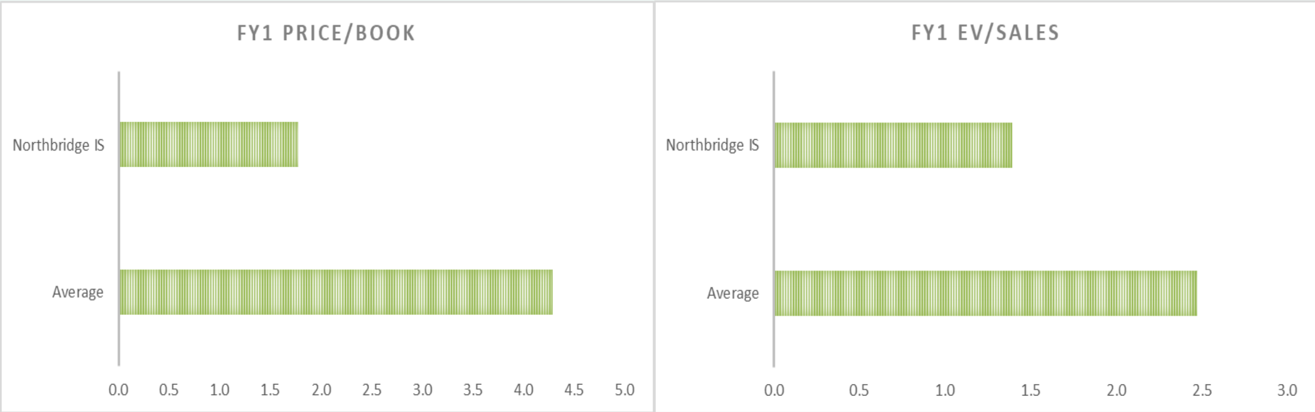
Source: Market Screener

Peer group comparison: FY1 PER (x)



Source: Market Screener

Peer group comparison: FY1 Price/Book and FY1 EV/Sales



Source: Market Screener

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