Northbridge Industrial Services

11 December 2020

Returning normality highlights value

We retain an upbeat view of Northbridge and the latest update confirms a second consecutive year of profitability. Considering the significant disruption experienced by the global economy from mid-Q1, the likely outcome of broadly unchanged revenues and delivery of a modest profit is a very acceptable outcome.

The outlook for the Group remains positive, with record manufacturing order books for a third consecutive year at Crestchic, aided by recovery at Tasman as deferred contracts come on stream. Add in strong growth in the underlying renewables and datacentre markets and that points to a much stronger FY21F. On this basis, we feel that a 21% discount to historic NAV and a low Price/sales multiple mean the shares are materially undervalued.

We forecast a recovery in H2 revenues, rising 6.7% sequentially and by 1.7% y-o-y, which follows a 4.8% y-o-y reduction during H1. The rebound in H2 reflects a stabilisation of its markets during Q3, with growth returning in Q4 as relative normality returned. This was driven by the strong recovery in manufactured loadbank sales from Crestchic as the record order books were invoiced. H1 revenues, driven by a strong performance in Q1 (Tasman up over 80% y-o-y), highlighted the strong momentum within the Tasman business in the early part of the year. The pipeline of projects deferred owing to the pandemic is a relatively long one and augurs well for the outlook for Tasman in FY21F and beyond.

Confirmation of the Group maintaining a profitable outcome for a second consecutive year is welcome and, if anything, a greater feat than last year's outcome, considering the disruption caused by the pandemic. We anticipate the EBIT margins will have slipped just 140 bps, which we believe to be encouraging given the marked reduction in higher margin hire revenues during Q's 2 and 3.

The pipeline of opportunities across its portfolio remains encouraging: in datacentres, renewables and the start of deferred projects, in the US loadbank sales and rental market. Significant opportunities also lie **in both existing and emerging energy markets** (hydrogen, carbon capture, grid infrastructure testing and battery farms), marine and the recovery of hire rates.

Conclusion

On a projected NAV/share of 109p, the shares are trading on an underwhelming price/book value rating of just 0.79x. In addition, a peer group comparison on a FY1 Price/sales basis confirms our belief that Northbridge remains overlooked and the valuation fails to reflect the strong pipeline of opportunities available to the Group as economies recover.

Key financials

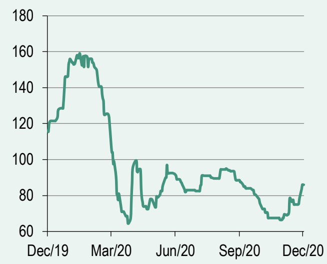
Y/e end Dec 31	FY 17A	FY 18A	FY19A	FY 20E
Revenue, £m	25.8	26.9	33.6	33.1
Adj. Op. profit, £m	-3.8	-1.4	2.0	1.5
Operating margin	-14.7%	-5.0%	6.0%	4.6%
Adj. PBT, £m	-4.4	-2.0	0.3	0.0
Adj. EPS, p	-17.9	-5.9	-0.8	-0.7
DPS, p	0.0	0.0	0.0	0.0
Net assets, £m	35.7	36.5	35.0	30.4
Net debt, £m	-8.7	-8.7	-6.4	-5.4

Source: Company historics, ED estimates

Company Data

EPIC	NBI
Price (last close)	86p
52 weeks Hi/Lo	165p / 62p
Market cap	£24m
Net Debt (June '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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Positive trading update

The trading update confirmed that the impact of the global pandemic initially stabilised during Q3, before reducing further in Q4, as a degree of normality returned. We estimate that revenues in H2 increased to £17.1m, representing a 1.7% increase y-o-y in the top-line. While this may not appear too exciting, it follows on from a H1 reduction of 4.8% y-o-y and a sequential improvement of 6.7%. Impressive resilience considering the reduction in revenues relating to a temporary, but partial, closure of Crestchic's Burton-on-Trent facility (owing to a few positive COVID-19 tests) and the ongoing disruption to rig crews impacting international activity levels at Tasman.

That said, we have left our overall **revenue expectation unchanged at £33.1m**. However, owing to the above and other factors, the split of revenues is a little different from our expectations three months ago. Crestchic has performed modestly ahead of expectations owing to activity levels in Europe, the UK and the US returning to pre-pandemic levels. Overall, routine testing within the power reliability markets, the bread-and-butter of Crestchic's business, has been buoyant during H2. In addition, H2 has benefitted from two large projects, with the provision of loadbanks to a utility in California and to a cruise ship operator in Finland.

While local activity levels have returned to normal for Tasman in China, Australia and New Zealand, international travel restrictions affecting the staffing of rigs, combined with lower energy prices have reduced activity levels elsewhere in Asia. In addition, several predominantly LNG/natural gas projects were deferred, albeit this has positive implications for FY21. It is perhaps worth noting that in H1 2020 Tasman delivered its strongest revenue levels since before the oil crisis in the mid-2010s (rising 80%+ y-o-y). We think this suggests that once travel restrictions are lifted that Tasman's revenues will rise relatively rapidly?

We highlighted following the release of half-year results that growth in the US market has been significant. In fact, outside of the UK, North America now represents the largest generator of revenues within Northbridge. Not bad for a business that was only established in 2016! North American orders for loadbanks amounted to £4.7m from H2 2020 onwards, which represents approximately 14% of FY20F revenues. With a market share of below 2%, we expect the North American market to continue to be a major growth driver for Northbridge moving forward.

The order book at Crestchic's manufacturing operation looks set for **a third consecutive record start to the year** for FY21F. While manufactured sales tend to be at lower gross margins than rental, we expect the profile of capex to shift in favour of the Crestchic hire fleet during FY21F, reflecting a backlog of enquiries for rental projects. As the proportion of rental activity improves, we would forecast the RoCE to follow.

Expectations

We have left profitability estimates unchanged, suggesting EBIT of £1.5m (representing a margin of 4.6%, versus 6.0% in FY19A) and adj. PBT of £0.001m. While this represents a £0.3m reduction y-o-y, it is the second consecutive year of profitability and set against difficult markets. We are encouraged by this, expecting the combination of:

- A return to normality
- Further strong growth in the US
- Continued improvements within the renewables and datacentre markets and,
- The commencement of several deferred projects within Tasman

to drive revenues higher and with continued strong cost controls, Northbridge to become more profitable in FY21F and beyond. Once, adj. EPS is consistently positive then we would naturally expect Northbridge to return to the dividend list.

Continued greening of Group strategy

The second half of Northbridge's trading update focused on the changing markets in which it operates and the accelerating trend away from fossil fuels. The business has to date been very flexible and clearly this approach needs to continue if it is to take advantage of the growing trends within its markets.

We have already seen evidence of this across each division. **Tasman** has seen the proportion of downhole tools rented into oil-based projects rapidly diminish from c.80% of activity levels in 2015 to a quarter of this currently. The gap has been filled by increased natural gas/LNG/geothermal energy production, with carbon capture storage developing. We anticipate that this trend is like to gain further momentum, with shortages of gas becoming increasingly apparent in both Australia and New Zealand, likely to result in the deferred gas projects commencing from Q1 2021.

Crestchic is increasingly being called upon to provide load banks to improve the reliability of energy networks and to support utilities in California and in turn, to help prevent power outages during wildfires. In view of changing energy markets, it comes as no surprise that the major focus for capex in FY21F will be on Crestchic, in the expansion of its rental fleet. One should bear in mind that the highest gross margins across the Group are derived from the rental of load banks. Investment in this area should result in rising RoCE.

Projected global energy demand is anticipated to increase by 68.2% overall or by a CAGR of 1.7% to c.37,000 TWh by 2050 (*source: BNEF, New Energy outlook, 2020*) and reflects the rise in the global population and increasing electrification generally. In addition to the projected demand growth, three key trends within the ongoing energy transition have emerged:

- Decentralisation
- Decarbonisation
- Digitalisation

The proportion of renewables is expected to grow by three-quarters to almost 70% of the total by 2050. Two key drivers of renewables are the Paris Agreement, which seeks to limit the increase in the average pre-industrial global temperature to less than 2%, by 2030 and, the net zero target of a growing number of governments by 2050, representing an overall balance between emissions produced and removed from the atmosphere.

Renewable sources, such as solar; wind; hydro; tidal; geothermal and, biomass tend to be situated in relatively remote locations and thereby placing strains on the existing grid infrastructure. The predictability of energy generation tends to be significantly lower than with traditional power stations, thereby creating volatility of production.

The digitalisation of energy generally has focused to date on smart grid infrastructure, energy management software, building energy controls and smart meters. Emerging trends, incorporating the use of both data and AI, include:

- Fault prediction and dynamic maintenance
- Investment optimisation, whether in terms of well drilling success or to improve the resilience of a local/regional grid infrastructure
- Energy efficiency
- Better prediction of demand, and
- Attraction/retention of energy customers

Digitalisation also translates into the production and reliable storage of data. The datacentre market continues to offer a substantial opportunity for the future growth of Crestchic. Gartner has suggested **the market will grow by 6% during 2021, with further growth out to 2024**, driven by cloud storage; the Internet of Things; submarine cable projects (especially in the east coast of the US) and, regional tax incentives.

One answer to the issue of volatility in supply from renewables is to store energy, with the cost of batteries declining and the technology developing rapidly. Battery storage requires load banks to commission and load test high voltages and, in the case of renewable energy sources, to test the reliability of supply and to prevent damaging surges.

Much has been spoken of **the hydrogen economy**. Hydrogen is a light, storable and energy dense gas, which produces no direct emissions of pollutants or greenhouse gases. Hydrogen is generally supplied from fossil fuels (blue hydrogen), with approximately 6% of global natural gas production and 2% of global coal used in the production of hydrogen. Demand for hydrogen has risen more than threefold since 1975 (*source: IEA*). The carbon dioxide emissions produced from the conversion of natural gas/coal are captured and stored underground using carbon capture.

Currently, hydrogen is predominantly used by industry, including oil refining and in the manufacture of ammonia, methanol, and steel. The opportunity for hydrogen use is in the fuelling of:

- Cars
- Trucks
- Shipping
- Aviation
- Generators (fuel cells)
- To heat and produce electricity for multi-family dwellings and,
- Commercial buildings, as well as in
- Power generation.

Additional growth markets for Crestchic include both in the short and over the medium term:

- Datacentres / cloud computing
- The US, where currently Crestchic has **less than a 2% share** of the North American loadbank/transformer market
- Recovery of Middle Eastern energy markets
- An ageing global shipping fleet
- Defence projects within the marine sector

Whereas for Tasman, other growth markets outside of LNG/natural gas/geothermal include:

- Gas used in the production of blue hydrogen to start a hydrogen economy
- Gas as a feedstock for recyclable plastics
- Hire rates have remained under pressure during 2020, reflecting the combination of lower energy prices, reduced activity levels and lower rig counts. We expect rates to improve from 2021
- Gas reserves remain at their lowest level in 70 years, suggesting an improvement in activity levels.

Financials

Following the trading update we have fine-tuned our revenue estimates by division, albeit our expectations for profitability remain unchanged. Notwithstanding the disruption to manufacturing during Q4 within the Crestchic manufacturing operation in Burton-on-Trent, sales have continued the strong progress seen during H1, with the rental of load banks benefitting from the project in California and healthy progress in the US generally.

The reduction in revenue expectations for Tasman highlights the ongoing international travel restrictions and lower energy prices, but nevertheless, revenues should still beat the FY19A divisional outcome.

Income statement

Year to Dec, £m	FY 18A	H1 19A	H2 19A	FY 19A	H1 20A	H2 20F	FY 20F	*YoY change*
Crestchic sales	8.4	5.9	5.2	11.1	6.0	6.2	12.2	*9.7%*
Crestchic rental	12.0	7.2	7.1	14.3	5.0	7.1	12.1	*-15.5%*
Crestchic total	20.4	13.1	12.3	25.4	11.0	13.3	24.3	*-4.6%*
Tasman sales	1.1	0.5	0.6	1.1	0.7	0.7	1.4	*25.1%*
Tasman rental	5.4	3.2	3.9	7.1	4.3	3.1	7.4	*4.6%*
Tasman total	6.6	3.7	4.5	8.2	5.0	3.8	8.8	*7.8%*
Group revenue	**26.9**	**16.8**	**16.8**	**33.6**	**16.0**	**17.1**	**33.1**	***-1.5%***
Cost of Sales	-15.7	-9.3	-8.5	-17.8	-9.1	-9.9	-19.1	*7.0%*
Gross Profit	**11.3**	**7.5**	**8.3**	**15.8**	**6.9**	**7.1**	**14.0**	***-11.2%***
GP%	*41.8%*	*44.8%*	*49.2%*	*47.0%*	*43.0%*	*41.8%*	*42.4%*	*-9.8%*
OpEx	-12.3	-6.7	-6.9	-13.6	-6.4	-6.6	-13.0	*-4.6%*
EBITDA	**4.7**	**4.0**	**3.9**	**8.0**	**3.7**	**3.0**	**6.6**	***-16.8%***
EBIT	**-1.0**	**0.8**	**1.3**	**2.0**	**0.7**	**0.9**	**1.5**	***-24.4%***
EBIT %	*-3.7%*	*4.5%*	*7.5%*	*6.0%*	*4.1%*	*5.0%*	*4.6%*	
Share of PAT of Olio Tasman JV	-0.4	-0.3	-0.5	-0.8	-0.3	-0.3	-0.6	*-27.2%*
Finance costs	-0.7	-0.4	-0.5	-0.9	-0.3	-0.4	-0.7	*-19.4%*
Adj. PBT	**-2.0**	**0.0**	**0.3**	**0.3**	**0.0**	**0.0**	**0.0**	***-96.9%***
Taxation	0.3	-0.1	-0.4	-0.6	0.0	-0.2	-0.2	*-63.7%*
PAT	-1.7	-0.1	-0.1	-0.2	0.0	-0.2	-0.2	*-19.3%*
Diluted EPS (p)	**-5.9**	**-0.4**	**-0.4**	**-0.8**	**0.1**	**-0.8**	**-0.7**	***-19.3%***

Source: Company historics, ED estimates

With healthy EBITDA of £6.0m for the full year, a modest expansion of working capital and net capex of £3.1m, **we expect borrowings to decline £1.0m to £5.4m by the year-end.**

The £3.1m of capex is largely focused on an expansion in Tasman's rental asset base and reflects on-going projects. While spend within Crestchic was relatively modest, three used loadbanks were purchased for the ongoing project in California. We anticipate that the immediate focus of capex beyond FY20F to turn to expanding the Crestchic rental fleet.

Summary Cash Flow					
Year to Dec, £m	**2016A**	**2017A**	**2018A**	**2019A**	**2020F**
Operating profit	-3.6	-3.8	-1.4	1.2	0.7
Deprecn. & 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

Abbreviated Balance Sheet					
Year to 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

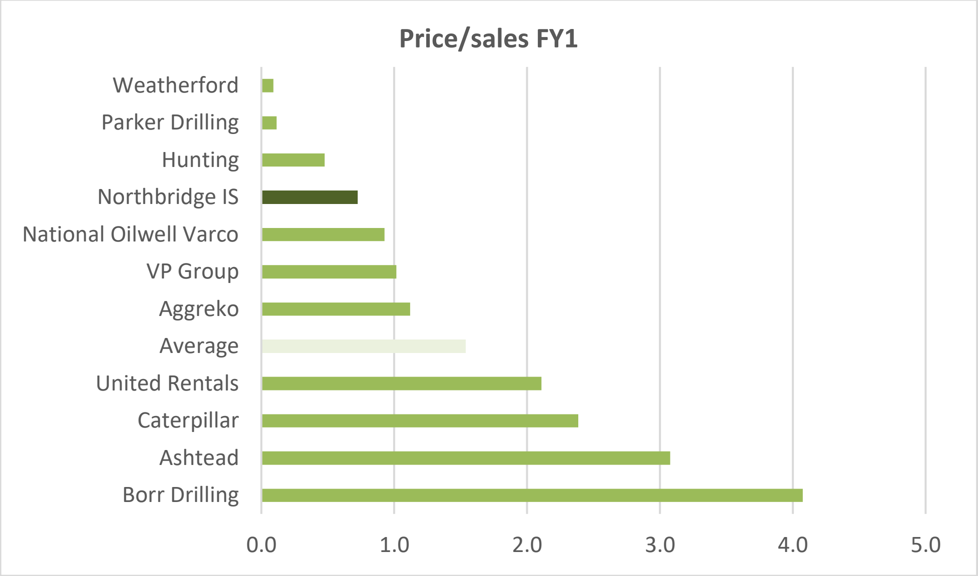
Source: Company historics, Equity Development estimates

Intrinsic value of the Group

On the basis that we anticipate the Group to break-even during FY20F and in reflection of the tax charge, we anticipate Adj. EPS to be negative this year. So, it continues to be difficult to compare NBI with its peers by way of PER multiples.

We have compared the peer group on a projected current year Price/Sales basis which, we believe, highlights a discrepancy between NBI and its peers. The peer group trades on an average price/revenue multiple of 1.54x, which represents a significant premium to Northbridge's 0.73x. We highlight this in the chart below.

Peer group comparison: Price/sales FY1



Source: Reuters, ED

Outlook

On a projected NAV/share of 109p, the shares are trading on an underwhelming price/book value rating of just 0.79x. We think the pipeline of medium to long term opportunities, as Northbridge positions itself to benefit from an anticipated further 'greening' of energy production and the increased requirement for power reliability / security, augurs well for the Group.

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