Northbridge Industrial Services Plc

9 February 2021

Positive end to the year augurs well

The year-end close trading update from Northbridge IS confirms a second consecutive year of profitability, with estimates increasing in reflection of the strong end to the year. Tasman's momentum seen in H2 19 and Q1 20 faltered in Q2 20 due to pandemic-related manning issues at rigs, albeit with a degree of recovery emerging in Q4 20. Crestchic performed strongly, particularly within manufacturing, with datacentre testing proving to be a strong market.

While Q1 21 has started slowly, owing to the latest lockdowns in Europe, the Crestchic manufacturing order book is currently at record levels, and mass vaccinations globally should result in a better H2 at Tasman. Yet Northbridge shares are trading 9% below NAV and at a 50%+ discount to the average of its peers on a price/book and a price/sales basis.

We have increased our adj. PBT estimate for FY20F to £0.4m (previously £0.0m), reflecting a strong Q4, which included two contracts within the marine sector and a significant y-o-y uplift in manufacturing sales at Crestchic. Recovery within both divisions stalled owing to the pandemic, as loadbank testing sites were closed on account of lockdowns, and Tasman suffered from travel/visa restrictions preventing a full manning of rig crews. H2 proved much better, with stabilisation across its markets during Q3 and recovery in Q4. The latter recovery proved stronger within Crestchic, reflecting the completion of two significant marine contracts and the delivery of record manufacturing order books.

Although Q1 21 to date was slower than anticipated due to Lockdown 3, we remain confident of ongoing improvement from Q2 onwards. The Crestchic manufacturing order book is 22% higher y-o-y (set against a previous record). The rental order book at Crestchic suggests improving revenues from Q2. The vaccination programme across many regions has commenced, likely to result in a stronger H2. Momentum remains positive in Crestchic's second-largest market, North America, where the business has scope to grow from less than a 2% market share. At the same time, many of the deferred LNG/natural gas contracts are expected to start during H2, boosting Tasman.

Recovery not yet reflected in share price

It remains challenging to value NBI in conventional terms given its EPS remaining negative. However, it continues to trade at a discount to NAV and ratings more than 50% below its peers. We also note the marked FY20 EV/EBITDA discount to its largest customer, Aggreko, the subject of a potential bid. Consequently, we think that the current valuation fails to recognise the strong pipeline of opportunities and potential for further, operationally leveraged recovery.

Key financials

Y/e end Dec 31	FY 17A	FY 18A	FY19A	FY 20E
Revenue, £m	25.8	26.9	33.6	34.0
Adj. Op. profit, £m	-3.8	-1.4	1.2	1.1
Operating margin	-14.7%	-5.0%	3.5%	3.2%
Adj. PBT, £m	-4.4	-2.0	0.3	0.4
Adj. EPS, p	-17.9	-5.9	-0.8	-0.4
DPS, p	0.0	0.0	0.0	0.0
Net assets, £m	35.7	36.5	35.0	30.7
Net debt, £m	-8.7	-8.7	-6.4	-5.4

Source: Company historics, ED estimates

Company Data

EPIC	NBI
Price (last close)	100p
52 weeks Hi/Lo	158p/62p
Market cap	£28m
Net debt (Dec '20)	£5.4m

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.

David O'Brien (Analyst)
0207 065 2690
david@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

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Year-end trading update

The trading update issued by Northbridge reads positively and demonstrates the **H2 recovery in overall activity levels** (with H2 accounting for an estimated 53% of revenues - H2 19: 50%), following Covid-19 related reductions during Q2 and Q3. The driver behind the modest increase in overall estimated revenues (+1.2% y-o-y to £34m) is Crestchic manufacturing, rising by more than a third y-o-y during H2 20 or by £1.9m to £7.1m.

The substantial improvement y-o-y followed the record manufacturing order book in January 2020, resulting in a near one-fifth sequential half-yearly uplift in expected revenues in H2. The combination of **rising demand for renewable energy and datacentre growth** were the key components of the overall demand for loadbanks. Datacentres now account for 22% of Crestchic's manufacturing deliveries.

Crestchic rental, which equates to the highest margin area of the Group, saw estimated revenues decline by a short 10% y-o-y, albeit rising nearly a third on a sequential half-yearly basis as the business recovered strongly. The burgeoning growth within Crestchic's North American operations was a key driver to demand during FY20 (which included a large contract to provide loadbanks to a utility in California). There were two sizeable contracts within the marine sector during Q4, one in Europe and the other in China.

The marine/shipbuilding sector has been relatively quiet, particularly in Asia Pacific in recent years. However, we note the rising shipping rates currently and, in combination with the ageing merchant shipping fleets, think that the marine market could become more significant for Crestchic over the medium to longer term. Also, Crestchic's share of the North American loadbank market is currently below 2%. We think this market represents a primary growth driver over the medium-to-long term.

FY21 began strongly at Crestchic, with a third consecutive year of record orders at the Burton-on-Trent factory. We fully expect the focus of investment spend within the Group to shift in favour of Crestchic during FY21, not just in the expansion of the rental fleet but also in looking at ways to expand the manufacturing plant's capacity and in turn, reduce order lead times. Simultaneously, the expansion of the Tasman fleet reflected the strength of the recovery in its markets. The slowing of activity levels generally since Q1 20 means that the Tasman fleet will require only modest investment until FY22.

Although revenues generated by Tasman were unchanged y-o-y at c.£4.4m, they fell by more than a tenth compared to H1 20 (which was boosted in Q1 by a continuation of the strong recovery trends in its markets, pre-pandemic). By Q4, activity levels had returned to normal in Australia, and New Zealand. However, international travel restrictions affected rigs' staffing, while lower energy prices affected demand in Asia. We remain confident that the deferred LNG and natural gas contracts should start drilling in FY21 and further boost activity levels.

Q1 21 to date has proven to be a relatively quiet start to the year across both divisions. The tightening of the lockdown across Europe has affected demand for testing at Crestchic during January. However, a rising order book, coupled with vaccination programmes commencing across much of the continent, should result in a much healthier outcome in Q2. The start of the deferred contracts in H2 is likely to increase activity levels at Tasman, particularly in Australia. The rising oil price witnessed YTD could well prove positive and a pre-cursor to new contracts emerging. However, this is unlikely to impact Tasman before the end of FY22 at the earliest.

We highlighted in our recent note Returning normality highlights value (11 December 2020**) a notable 'greening' of the Group's activities** that should enhance its shares' appeal to a broader range of investors. The growth areas of Crestchic's activity focus on renewable energy and datacentre testing, with oil & gas forming a much smaller part of the business. New activity in marine/shipbuilding includes testing new electrical turbines, which tends to take much longer than in traditionally powered vessels.

The exposure to oil activities within Tasman has declined from 80% to 20% in the last six years, with natural gas/LNG/geothermal comprising much of the remainder. In FY20 Tasman delivered a carbon capture contract in Australia. The division is also looking to be at the forefront of blue hydrogen opportunities in Australia on a medium-term view.

Financials

The statement that adjusted PBT is expected to be 'slightly ahead of 2019', when reported adj. PBT was £0.3m, underpins our decision to increase our FY20 estimate from break-even to £0.4m. We anticipate that revenues will be modestly higher y-o-y (up 1.2%) or 2.8% above our previous estimate. That we are looking at top-line growth in FY20F is quite remarkable considering the pandemic related issues across several markets. One may see the upgrades to our FY20 estimates below.

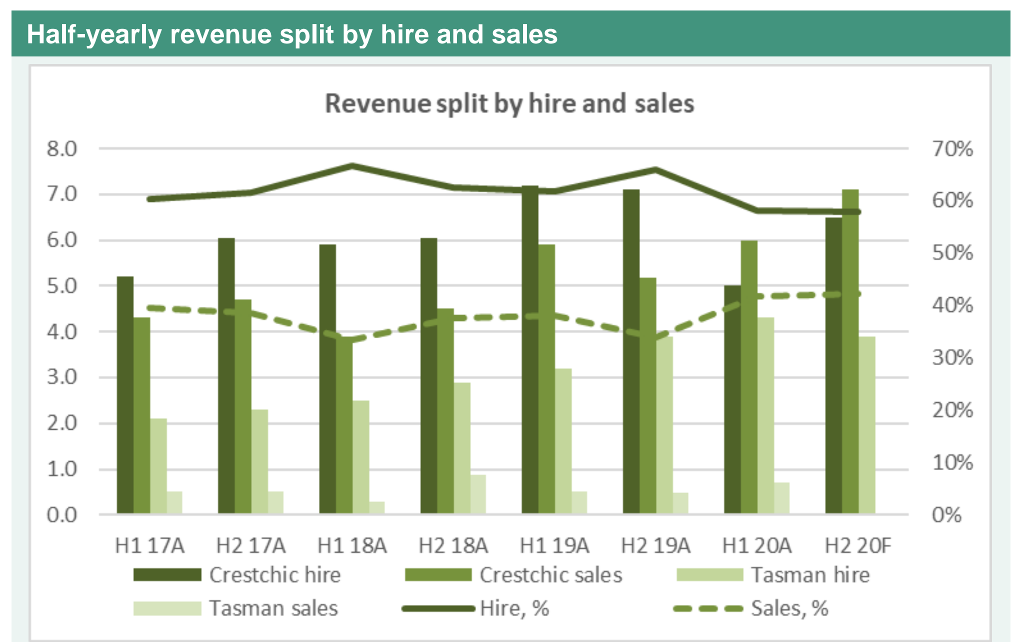
Change in Estimates

	Old	New	Change
FY2020F revenue (£m)	33.1	34.0	2.8%
FY2020F EBIT (£m)	0.7	1.1	55.0%
FY2020F Adj. PBT (£m)	0.0	0.4	n/a
FY2020F EPS (p)	-0.7	-0.4	47.3%
FY2020F Net debt (£m)	-5.4	-5.4	0.1%

Source: Equity Development

We are encouraged by the improvement in profitability despite the reducing proportion of higher-margin rental revenues, falling to less than 58% and the lowest level for several years. By comparison, rental peaked at 66% of revenues in H2 2019. Crestchic sales moved to the highest revenue-generating area during FY20, with Crestchic rental falling to second place.

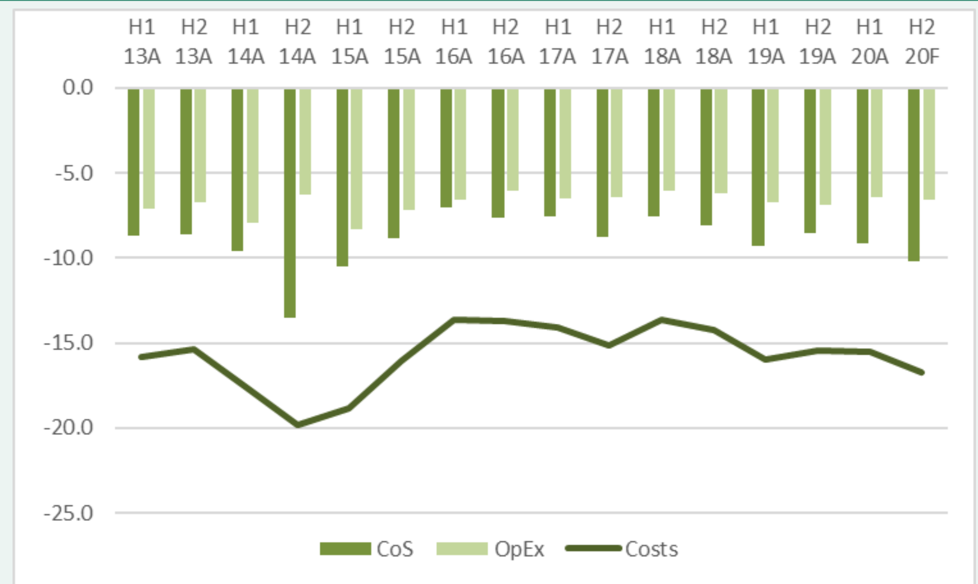
Half-yearly revenue split by hire and sales



Source: Equity Development

The reduction in rental as a proportion of revenues is behind gross margins declining to 43.2% in FY20 (FY19: 47.0%). That profitability improved on broadly static sales reflects the **continued focus on costs**, combined with the £0.4m contribution from various governments re furlough payments. Operating expenses declined during H2 to £6.6m (H2 19: £6.9m).

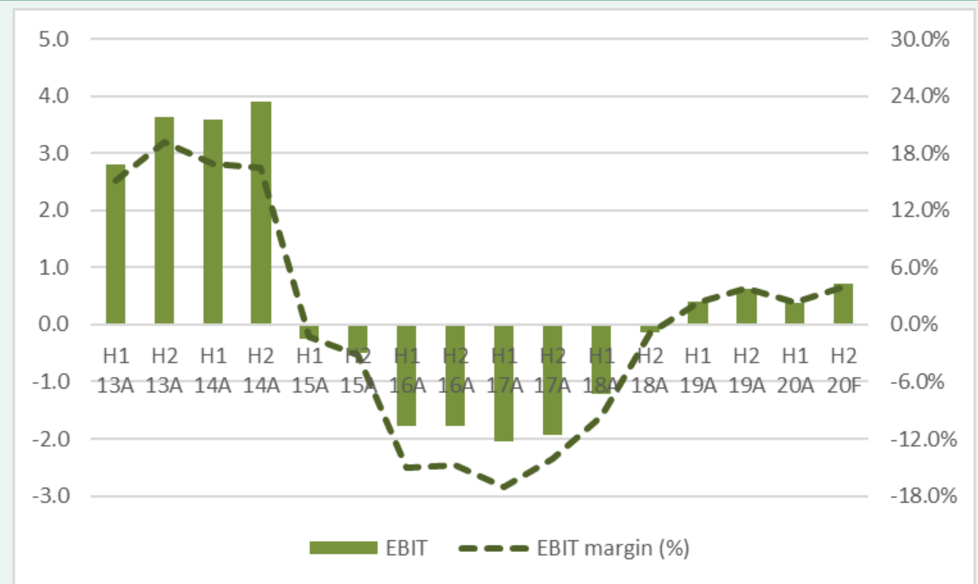
Costs gradually rising



Source: Equity Development

The net effect resulted in EBIT margins modestly below H2 2019 levels, with some way to go to match the Group peak of 19.2% in H2 2013. Given the start-stop nature of FY20, **we think the outcome, particularly in margin terms, is very encouraging.**

EBIT margins modestly lower

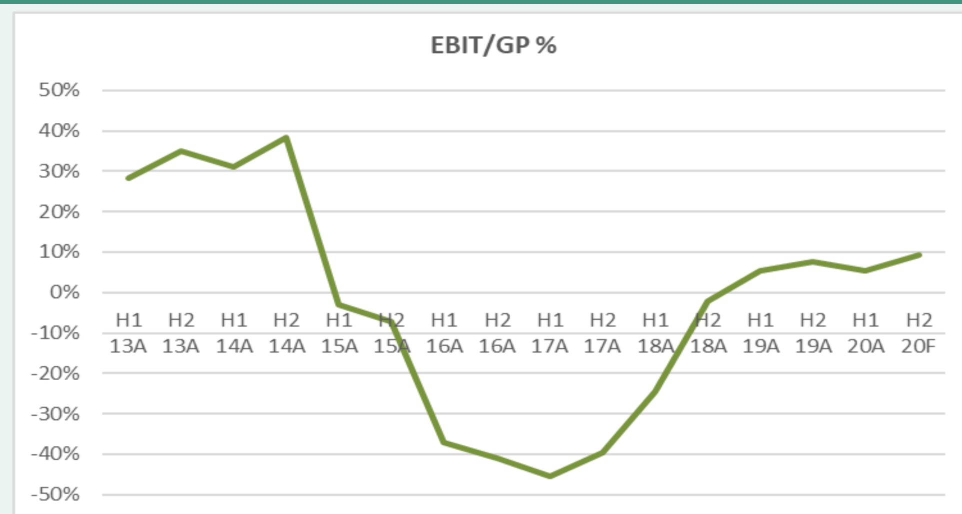


Source: Equity Development

Such is the operationally geared nature of the Group's business, that an additional £0.9m of revenues results in £0.4m of extra profits, compared to the previous estimate. It is worth noting that from the recent high of 9.2% conversion of gross profit into EBIT remains significantly below the peak of the last cycle, which amounted to 38.4% in H2 2014.

We find this positive, believing that further increases in revenues should result in an improved bottom-line.

Further operational gearing likely as revenues rise further



Source: Equity Development

Summary Profit & Loss

Year to end Dec, £m	2016A	2017A	2018A	2019A	2020E
Crestchic	19.3	20.2	20.4	25.4	24.6
Tasman Oil Tools	4.5	5.6	6.6	8.2	9.4
Revenue	23.8	25.8	26.94	33.60	34.00
CoGS	-14.7	-16.3	-15.7	-17.8	-19.3
Gross profit	9.1	9.5	11.3	15.8	14.7
Gross margin (%)	38.4%	36.8%	41.8%	47.0%	43.2%
Op costs	12.7	12.9	12.3	13.6	13.0
Other operating income	0.0	-0.2	0.0	-0.1	0.0
Operating profit	-3.6	-3.8	-1.4	1.2	1.7
Op margin (%)	-14.9%	-14.7%	-5.0%	3.5%	5.0%
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**	**0.4**
Exceptionals	-1.4	0.0	-0.7	0.0	-7.8
PBT (Reported)	-5.5	-4.6	-3.1	-0.5	-8.0
Tax	-0.8	-0.2	0.3	-0.6	-0.5
PAT	-6.3	-4.8	-2.8	-1.1	-8.2
Earnings	-6.3	-4.8	-2.8	-1.1	-8.5
EPS (Adjusted) (p)	**-20.6**	**-17.9**	**-5.9**	**-0.8**	**-0.4**
DPS (p)	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Ave no of shares (Fully Dil) (m)	24.0	25.9	28.8	28.2	28.2

Source: Company historics, Equity Development estimates

We have left our net debt estimate unchanged at £5.4m (or £1.5m excluding the convertible shares). The £0.4m jump in operating profit is offset by the working capital increase (+£0.3m) and the modest rise in capex (+£0.1m). The rise in working capital is indicative of a strong end to FY20.

Summary Cash Flow

Year to end Dec, £m	2016A	2017A	2018A	2019A	2020E
Operating profit	-3.6	-3.8	-1.4	1.2	1.1
Depn. & Amortn.	7.1	7.2	6.0	5.9	5.3
Working capital movement	-0.2	-0.9	0.4	0.6	-1.0
Other	-1.5	0.0	0.0	0.0	0.0
Operating cash flow	1.8	2.6	5.0	7.7	5.4
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	-3.2
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

Within the balance sheet, the largest swing y-o-y is the reduction in intangible assets, reflecting the write-down of the £7.1m of goodwill associated with the Tasman NZ acquisition in 2013. The exceptional cost was in recognition that the business was unlikely to reach previous peak levels.

Summary Balance Sheet

Year to end Dec, £m	2016A	2017A	2018A	2019A	2020E
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	6.8
Capital Employed	54.9	47.4	47.4	45.0	39.3
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	30.7

Source: Company historics, Equity Development estimates

Outlook

We note two important comments on the outlook for FY21 within the statement:

- **Record factory order book for the third consecutive year**
- **Rental activity in Q1 to date is slower, particularly in Europe.**

FY21 began with order books for loadbanks 22% ahead of a year earlier. Revenues from the sale of loadbanks and transformers represented approximately 39% of revenues in H2 20. Growth in H2 20 of manufacturing revenues increased 82% from recent lows seen during in H2 18. We would expect to see lead times rise during FY21 as a result and we wonder how close the factory is trading relative to capacity? That said, we expect revenues from Crestchic manufacturing to reach record levels in FY21.

When considering rental activity levels, one should bear in mind that Q1 20 represented a post-2014 peak at Tasman, so y-o-y comparisons in H1 will undoubtedly be difficult, particularly given the complexity of manning rigs due to Covid-19 related restrictions. The update mentioned a slow start to the year in Europe within rental, which relates to Crestchic and the hire of load banks. Europe's current lockdown on Crestchic is likely to continue well into Q2 until the vaccination roll-out programme begins to lift restrictions.

We anticipate that orders will build, and once restrictions begin to ease, recovery should gather pace quite quickly. It is worth mentioning the momentum that was built within Tasman ahead of lockdown 1, and as contracts commence post-deferral, we would expect such trends to materialise once again. The rapid growth in the data centre market represents a cornerstone of the record order books at Crestchic, and we expect this to continue during FY21.

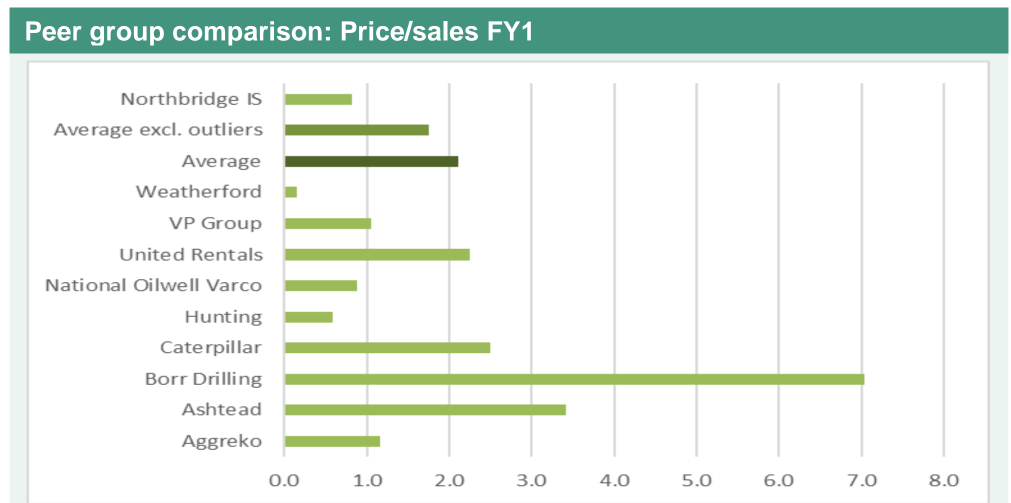
In summary, the pipeline of medium to long term opportunities augurs well for Northbridge as it positions itself to benefit from an anticipated further 'greening' of energy production and the increased requirement for power reliability/security.

Intrinsic value of the Group

Despite the increase in the adj. PBT estimate, we anticipate that adj. EPS will remain negative in FY20. On this basis, it continues to be challenging to compare NBI with its peers by way of PER multiples.

Instead, we have compared the peer group on a projected current year Price/Sales and Price/Book bases, which highlights the valuation discrepancy between NBI and its peers. We have excluded the outliers in reaching the average price/sales multiple for the peer group, of 1.75x. By contrast, Northbridge trades on a price to sales multiple of 0.82x, suggesting a discount of 53.1%. We highlight this in the chart below.

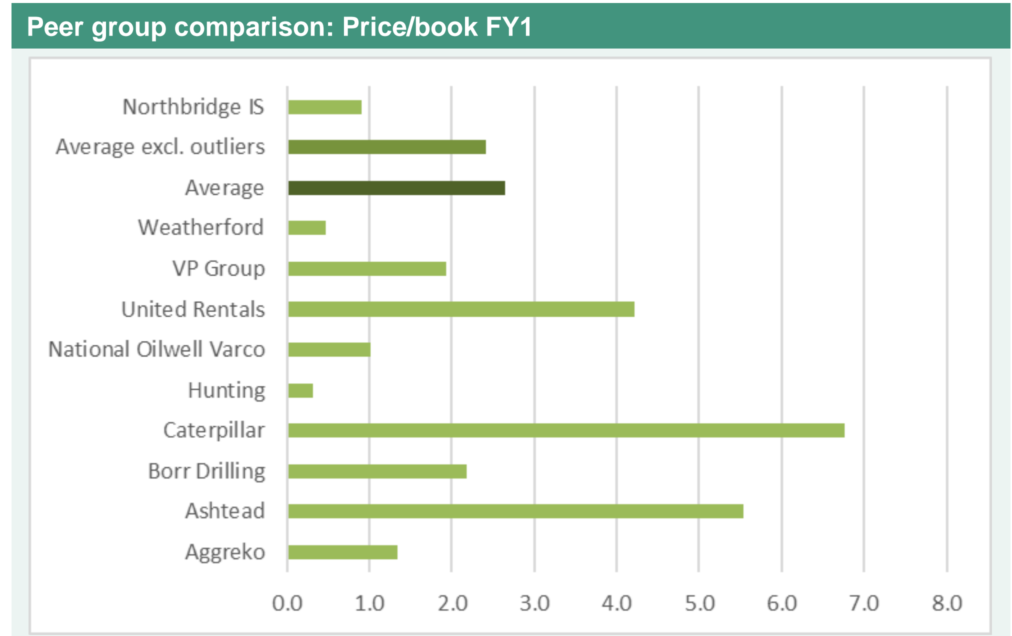
Peer group comparison: Price/sales FY1



Source: Reuters, ED

Similarly, we have compared the share prices of peers relative to net asset values. Northbridge IS sits at a 62.4% discount to its peers, with a price/book value of 0.91x.

Peer group comparison: Price/book FY1



Source: Equity Development

Trade value

Nor should one ignore the latest announcement on 5 February from the Group's largest customer, Aggreko PLC. It confirms press speculation regarding ongoing discussions between itself and a consortium of TDR Capital LLP and I Squared Capital LLC concerning a cash offer for the company at a price of 880p per share (adjusted for dividends paid or proposed), valuing the business at £2.25bn.

The potential offer comes after a strong end to the year in which Aggreko highlighted that it was trading ahead of expectations following the continued recovery in activity levels across all its markets.

Aggreko is currently trading on an FY20 EV/EBITDA multiple of 8.7x, which compares to just 5.2x at Northbridge.

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

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Equity Development, 15 Eldon Street, London, EC2M 7LD

Contact: info@equitydevelopment.co.uk | 020 7065 2690