

Northbridge Industrial Services



Liquidity: 'plan B' already underway

07 April 2020

Northbridge Industrial Services ("Northbridge") has produced preliminary results that were ahead of expectations across several metrics. The Group achieved a significant milestone in returning to profitability for the first time in five years. Margins continue their upward trajectory, aided by the high levels of operational gearing. Geographical expansion continued, following the opening of new depots in Singapore (Tasman) and Pennsylvania (Crestchic).

While the strong H2 2019 trading continued into Q1 2020, restrictions on trade associated with COVID-19 related lockdowns began to influence activity by the end of the period. Additionally, the sharp decline in the oil price has created uncertainty surrounding its customers' ability to invest in new projects for 2021. Management has taken immediate action on costs and use of cash to maintain its strong liquidity position. We take comfort that the shares have support from the relative strength of the balance sheet, management's recent experiences and the high asset-backed NAV.

Northbridge has issued preliminary results ahead of expectations and achieved a significant milestone in a return to profitability. Adjusted PBT of £0.3m beat our expectation of £0.2m, the latter an upgrade from break-even earlier in the year. Margins at both the gross and operating levels continued their recovery, rising to 47% and 6%, respectively, aided by the strong levels of operational gearing. It is worth noting that these levels remain somewhat below previous peaks, suggesting scope for further growth over the medium term.

Cash flow continued to be positive, driven by a marked increase in EBITDA to £8m and, following the purchase of a hire fleet from a failed competitor, capex declined. Net debt fell to £6.4m, representing **healthy net debt/EBITDA and gearing levels of 0.8x and 18%**, respectively.

While Q1 commenced strongly, aided by a robust Australian gas market at Tasman and a record manufacturing order book at Crestchic, by the end of the period restrictions linked to COVID-19 had begun to impact the Group's ability to service customers. A further concern was the collapse of the oil price in recent weeks. COVID-19 restrictions aside, we believe that existing contracts are likely to be completed but have concerns over the outlook for 2021. Should the oil price fail to improve, then at current levels investment into new or ad hoc projects could be severely impacted.

That said, the balance sheet, the cost base and geographical diversification of the order book remain in comfortably better shape than in late 2014 when the Group last dealt with a slowdown. We are not yet publishing financial estimates, preferring to wait until there is greater clarity on the length and depth of this economic downturn.

We note that management has significant experience of steadying the ship in turbulent waters / removing unnecessary costs and conserving cash and take further encouragement in the current net asset value. At 124p, the NAV currently sits on an 85% premium to the share price and gives a price-to-book ratio of 0.5x.

Company Data

EPIC	NBI
Price (last close)	67p
52 weeks Hi/Lo	185p/62p
Market cap	£19m
NAV / share (Dec '19)	124p
Net debt (Dec '19)	£6.4m

Share Price, p



Source: ADVFN

Description

Northbridge Industrial Services is a holding company focused on two divisions.

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

Tasman Oil Tools (Tasman) is a rental specialist of downhole tools to the oil & gas, geothermal energy and coal-bed methane markets.

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2019 Preliminary results

Northbridge has issued preliminary results for 2019, confirming that it had returned to profitability not only during H2, but also for the full year. This represents the first annual profit in five years and at £0.3m adj. PBT was ahead of our expectation (ED est. £0.2m). The turnaround has reflected a combination of recovering markets, geographic expansion and tight control of costs. In aggregate, these factors resulted in the significant operational gearing feeding through to EBIT.

Preliminary results							
Dec 31 y/e, £m	H1 18	H2 18	FY18	H1 19	H2 19	FY19	YoY change
Crestchic sales	3.8	4.6	8.4	5.9	5.2	11.1	32.8%
Crestchic rental	5.9	6.1	12.0	7.2	7.1	14.3	19.3%
Crestchic total	9.7	10.7	20.4	13.1	12.3	25.4	24.8%
Tasman sales	0.3	0.8	1.1	0.5	0.6	1.1	-1.8%
Tasman rental	2.5	2.9	5.4	3.2	3.9	7.1	30.0%
Tasman total	2.8	3.8	6.6	3.7	4.5	8.2	24.5%
Group revenue	12.5	14.4	26.9	16.8	16.8	33.6	24.7%
Cost of Sales	-7.6	-8.1	-15.7	-9.3	-8.5	-17.8	13.6%
Gross Profit	4.9	6.4	11.3	7.5	8.3	15.8	40.3%
<i>GP%</i>	<i>39.3%</i>	<i>44.0%</i>	<i>41.8%</i>	<i>44.8%</i>	<i>49.2%</i>	<i>47.0%</i>	
OpEx	-6.1	-6.2	-12.3	-6.7	-6.9	-13.6	11.3%
EBITDA	2.0	2.7	4.7	4.0	3.9	8.0	70.3%
EBIT	-1.1	0.1	-1.0	0.8	1.3	2.0	-303.1%
<i>EBIT %</i>	<i>-8.7%</i>	<i>0.6%</i>	<i>-3.7%</i>	<i>4.5%</i>	<i>7.5%</i>	<i>6.0%</i>	<i>-262.8%</i>
Share of post-tax results of Olio Tasman JV	-0.1	-0.2	-0.4	-0.3	-0.5	-0.8	128.6%
Finance costs	-0.3	-0.4	-0.7	-0.4	-0.5	-0.9	32.7%
Adj. PBT	-1.5	-0.5	-2.0	0.0	0.3	0.3	-115.7%
Taxation	0.0	0.3	0.3	-0.1	-0.4	-0.6	-276.0%
PAT	-1.5	-0.2	-1.7	-0.1	-0.1	-0.2	-86.1%
Diluted EPS (p)	-5.7	-0.2	-5.9	-0.4	-0.4	-0.8	-85.8%
<i>% of revenues from sales</i>	<i>33.3%</i>	<i>37.4%</i>	<i>35.2%</i>	<i>38.2%</i>	<i>34.6%</i>	<i>36.3%</i>	
<i>% of revenues from rental</i>	<i>66.7%</i>	<i>62.6%</i>	<i>64.8%</i>	<i>61.8%</i>	<i>65.4%</i>	<i>63.7%</i>	
<u>Revenues by region</u>							
UK			12.4			13.5	8.9%
Australia/New Zealand			4.8			5.6	17.9%
M. East			3.0			4.0	31.6%
Asia			3.1			4.0	27.8%
Europe			1.7			2.1	28.0%
N & S. America			2.0			4.4	123.7%

Source: Company historic data

Revenues improved by 24.7% to £33.6m and this reflects a mixture of organic and acquisition-led growth. The latter follows the shrewd purchase of an oil tool rental fleet from an insolvent competitor in Asia in November 2018. The acquisition of the hire fleet not only doubled the Group's assets in the region but reduced the average age of the kit. The purchase part-facilitated the establishment of a new depot in Singapore, serving not only the city-state but also Thailand and Vietnam. A portion of the acquired hire fleet has supported growth within the Olio Tasman joint venture in Malaysia.

Organic growth was boosted by the expansion of the **Crestchic's** core loadbank markets in **Western Europe**, reflecting:

- One-off projects across the marine and healthcare markets
- Investment in data centres, resulting in two related opportunities
- Renewable energy taking a larger share of power generation

Within the rapidly growing data centre market, in addition to the core demand for testing back-up power sources, a new market is developing in using loadbanks to simulate heat from computer servers.

Outside of Western Europe, growth was driven by:

- Further growth from recovery in the Middle Eastern energy markets
- Expansion within the renewable energy sector in developing countries
- Demand within the natural resource mining sector
- Shipbuilding in Asia and,
- An expansion of the rental fleet in the USA.

The Group started the year with a record order book for manufactured sales at Crestchic, which continued to benefit activity until early Q3. As a result, revenues declined modestly during H2 at the loadbank manufacturer. Rental sales were broadly an even split between H1 and H2 at Crestchic but ahead strongly (rising 19.3% y-o-y).

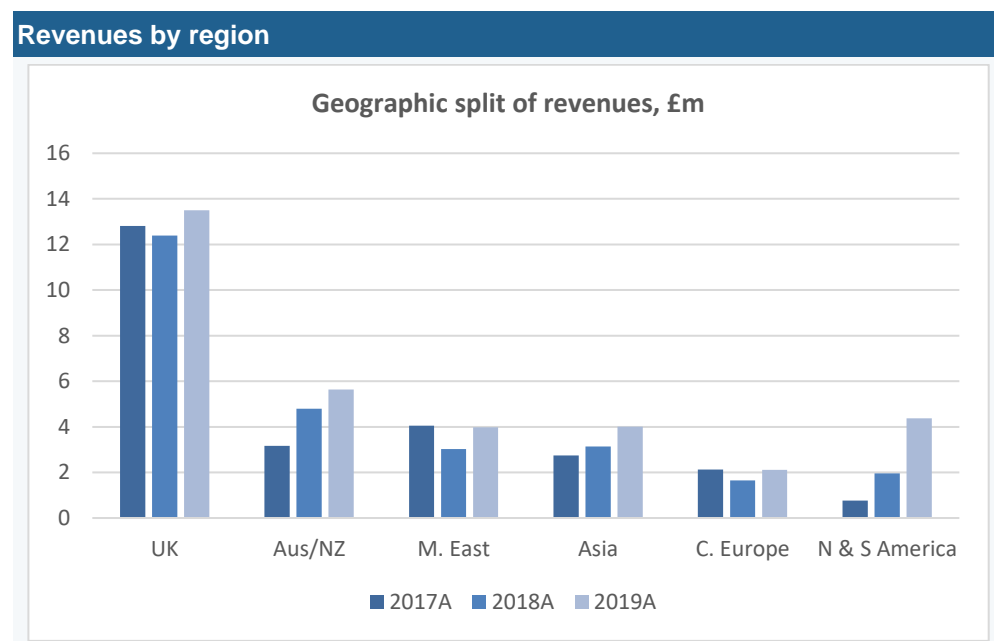
The continued recovery in energy markets - whether oil, gas or geothermal - was behind the near one quarter uplift in **Tasman's** revenues during 2019. Rental, which accounted for all the improvement in revenues, saw the most significant rise in the Australian market as revenues climbed 34% y-o-y. This natural gas and LNG demand (under long-term, index-linked contracts) for both domestic use and export markets (Asia) was responsible for the uplift. Growth in New Zealand and specifically in gas and geothermal markets was by comparison, more modest. Sales of equipment at Tasman formed a small part of the business and was static at £1.1m.

Olio Tasman, the Group's joint venture in Malaysian markets made good progress in terms of its top line, despite being in only its second full year of operation. The proportion of tools hired from Tasman's fleet to the joint venture steadily increased. What is perhaps more encouraging is that during H2 2019 several historic contracts were **renewed at improved rates**, which bodes well for 2020.

The driver of top-line growth was higher-margin rental activity, with overall sales from this area rising £3.9m, or by 22.6%, to £21.4m. Nevertheless, the strong early year order book for manufactured sales at Crestchic led to a modest decline in the proportion of revenues derived from rental, to 63.7% (2018: 64.8%). While each division grew at a similar pace, rising 24%-25% y-o-y, Crestchic added £5.0m of revenues during 2019, compared to £1.6m at the smaller (but higher margin) Tasman Oil Services (reflecting 86.3% of divisional sales arising from rental).

In terms of markets, the UK remains the largest for the Group. However, it was also a market that witnessed the slowest growth during 2019, rising by 8.9% to £13.5m of revenues and 40.2% of overall turnover (2018: 46.0%). Crestchic was the driver of UK, European and USA revenues, with Tasman having a more significant impact in Asia and the Middle East.

Yet the **most spectacular growth** experienced during 2019 was in **North America**. Additional hire fleet was sent to the region and by the end of the year the business has moved into a new dedicated depot. Revenues in the Americas more than doubled (+123.7%) to £4.4m, ensuring that the region is now the third-largest revenue generator for the Group as a whole.

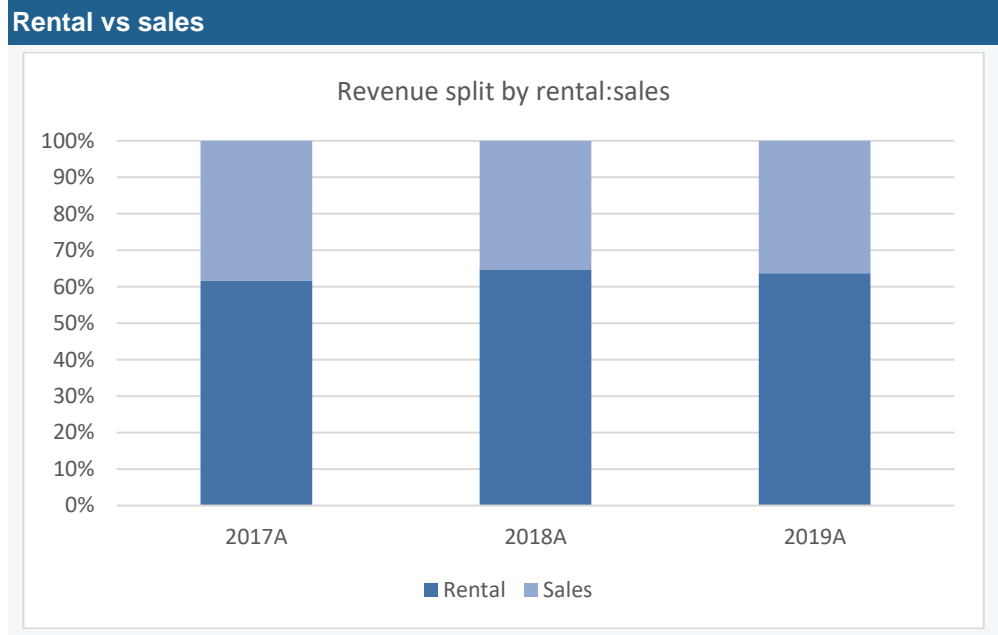


Source: ED, Company data

Segmental

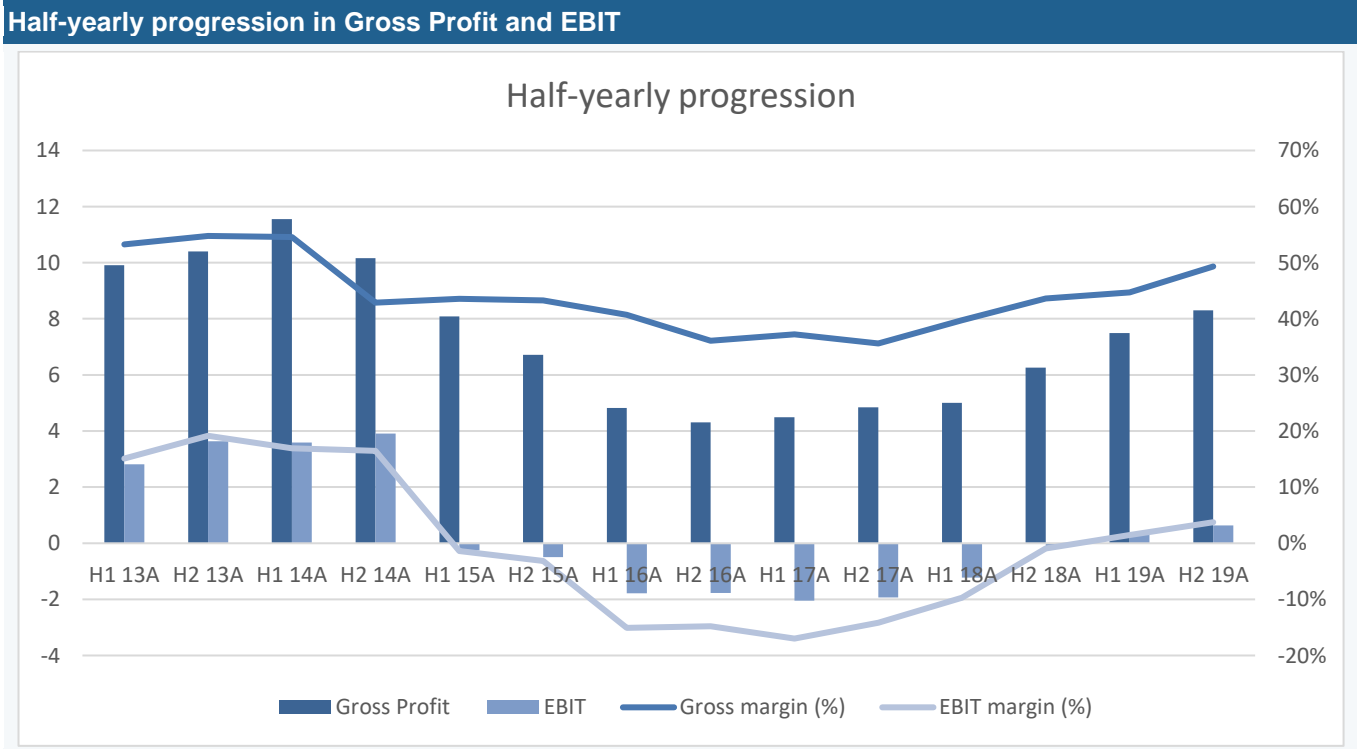
Rental continues to be dominant in terms of revenue generation, accounting for 63.7% of turnover (2018: 64.8%) and rising by 22.6% compared to 2018. Growth in rental revenues is critical for Northbridge owing to their significantly higher gross margin relative to sales of products. The driver for rental revenue growth was Crestchic, rising by £2.3m, compared to an additional £1.6m of rental sales at Tasman (but representing a more robust underlying increase, from a smaller base). Rental has remained in a relatively narrow range of 61.8% to 66.7% of Group revenues, which may be seen in the chart below.

While we have seen modest improvements in rental rates from the nadir within energy markets, there is still some way to go to achieve previous peaks.



Source: ED, Company data

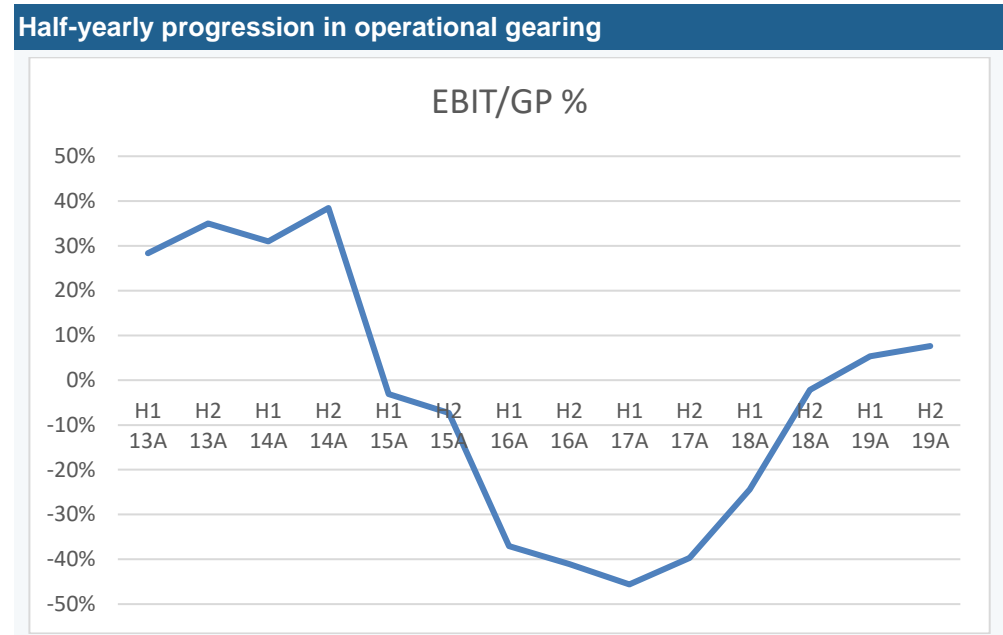
We highlight below the progression of gross and operating profit. The driver of the return to profitability has been the recovery in revenues, coupled with a keen control of the cost base. 2019 represented a year of expansion geographically, as new depots in Singapore (Tasman) and Pennsylvania (Crestchic) opened, with costs also rising due to staff pay increases and an increase in the hire fleet. Notwithstanding this expansion, **overall costs (CoS and OpEx) rose just 12.6%** to £31.4m, which comprised a 13.6% increase in the cost of sales to £17.8m and an 11.3% uplift in operating expenses to £13.6m.



Source: ED, Company data

With overall revenues rising 24.7% y-o-y, far outstripping the growth in costs, both gross and operating margins rose markedly to 47.0% and 6.0%, respectively. Looking at the H2 margins, this emphasises the further benefit of operational gearing on growing sales.

The gross margin increased to 49.2%, meaning there is further if the Group can emulate the 54.8% recorded in H2 2013. Meanwhile, the H2 2019 EBIT margin increased 472 basis points to 3.8%, a level significantly below the record in H2 2013 of 19.2% and again suggesting scope for strong medium-term upside.



Source: ED, Company data

Adjusted PBT amounted to £0.3m and representing a y-o-y turnaround of £2.3m, following a net interest charge of £0.9m (2018: £0.7m) and a loss arising from the joint venture (representing the loss-making contracts which have since been renewed at improved levels) of £0.8m (2018: £0.4m). Taxation of £0.6m payable (2018: credit of £0.3m), led to a significantly reduced loss at the earnings level of £0.2m (2018; loss of £2.4m) and adjusted EPS of -0.8p per share (2018: -5.9p).

Operating cash flow was strong, driven by EBITDA of £8.0m (2018: £4.7m), representing an improvement of 70.3% and was driven by the recovery in profitability and high depreciation levels. The Group generated a modest increase in cash generated from working capital, at £0.6m (2018: £0.4m), mainly reflecting the seasonal unwinding of working capital ahead of the Christmas break. The increase in the receivables from joint ventures was markedly higher in 2019 at £1.4m.

Expenditure on the hire fleet remained high at £3.7m (2018: £4.5m), although net capex post-disposals was somewhat lower. The level of net debt fell £2.3m to £6.4m by the 2019-year end, leaving the Group in a comfortable position.

Cash flow movements

Dec 31 y/e, £m	2018A	2019A	Change
Operating profit	-1.4	1.2	
Depn. & Amortn.	6.0	5.9	
Working capital movement	0.4	0.6	
Other	0.0	0.0	
Operating cash flow	5.0	7.7	53.4%
Net Interest	-0.7	-0.9	
Taxation	-0.7	-0.6	
Net capex	-3.9	-2.2	
Operating FCF	-0.1	4.1	
Net (Acquisitions)/Disposals	-1.1	-0.1	
Dividends	0.0	0.0	
Share Issues	2.4	0.0	
Minority payment	0.0	-1.4	
Other financial	-1.1	-0.4	
Increase Cash/(Debt)	0.1	2.2	
Opening Net Cash/(Debt)	-8.7	-8.7	
Closing Net Cash/(Debt)	-8.7	-6.4	
EBITDA	4.7	8.0	
Net debt/EBITDA	1.9	0.8	
Gearing	23.7%	18.3%	
Net capex/depreciation	0.7	0.4	

Source: Company historic data

Abbreviated Balance Sheet

Dec 31 y/e, £m	2018A	2019A
Intangible Assets	12.3	11.6
Tangible Assets	28.9	25.6
Investments/other	0.0	2.0
Net Working Capital	6.2	5.8
Capital Employed	47.4	45.0
Other	0.0	-1.3
Net Cash/(Debt)	-8.7	-6.4
Provisions Liabilities/Charges	-2.3	-2.2
Net Assets	36.5	35.0
NAV per share (p)	129.4	124.2

Source: Company historic data

The balance sheet remains in good shape, as highlighted by a net debt/EBITDA ratio of 0.8x (2018: 1.9x) and gearing of just 18.3% (2018: 23.7%), well within their covenants.

Outlook and inherent value

Financial projections temporarily have limited weight in the context of the current unprecedented environment, with valuation methodologies similarly challenged. Nevertheless, we take comfort in the high level of support offered by the Group's net asset value. By the end of 2019, the Group's NAV amounted to 124p per share, despite the 4p per share fall during the year which primarily reflects the decline in tangible fixed assets.

Indeed, the Group's NAV is still at a substantial premium (85%) to the current share price. The price to book value ratio currently stands at a lowly 0.5x.

Management has provided a detailed review of the impact to date and short-term expectations for the disruption to trade resulting from the COVID-19 pandemic. Overall, trading during Q1 was strong, mirroring the continued recovery witnessed during H2 2019. Tasman, driven by the improving confidence in the Australian gas markets and the newer depot, delivered higher rental activity. Crestchic was buoyed by a very encouraging start to the year, as highlighted by a record manufacturing order book.

However, by the end of Q1, COVID-19 had begun to impact all areas of the business. In reflection of the COVID-19 related lockdowns in place across the globe, the provision of engineers and/or equipment to sites and across borders began to prove more difficult. Where access was possible, many sites reported difficulty in sourcing crews to run operations. The ability to provide dedicated customer support in the current environment has also proved extremely difficult. These trends have impacted the rental activities of both Crestchic and Tasman. On a more positive note, manufacturing orders and long-term energy servicing contracts remain largely intact, which offers encouragement over the medium term.

Complicating matters, the recent oil price collapse coupled with the COVID-19 related reduction in demand for oil and its by products, has resulted in a rising proportion of the products placed in storage. Management as a result remain concerned regarding investment into the energy sector from late 2020. It is worth noting, however, that at the current oil price, the Board has few concerns over its existing contracts other than possible site closures due to COVID-19.

The issue is whether we see a recovery in the price of oil during H2 2020. Should that not be the case, a low oil price is likely to impact decisions to commence drilling in ad hoc projects. More importantly, investment decisions are likely to be deferred on new wells/fields.

Despite these concerns, Crestchic is relatively well placed, as a high proportion of the testing that it undertakes could well be deemed 'essential' in many instances (energy sector and healthcare).

Action being taken

Management has commenced its plan to ensure the business survives the current sharp economic shock/recession. We have already discussed the strength of the balance sheet. Their plan includes:

- Negotiations re fixed costs
- Restricting capex
- Utilising Government support mechanisms, where necessary

Conclusion

The business is more diversified than was the case moving into the last recession in the oil & gas industry (2015 onwards), with a much lower cost base and significantly lower debt levels. Furthermore, note that the redemption of the £3.9m loan note can be deferred for up to a year, although the rate of interest would rise in that instance to 10%.

What the above suggests to us is that while trading within the second and third quarters may well prove difficult, the Group is financially strong, with sufficient cash flow to keep it solvent, all other things being equal. Finally, it is worth reiterating that the business is asset rich (freehold properties and a hire fleet) and is trading on a current price-to-book ratio of just 0.5x.



Investor Access

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