Marshall of Cambridge Ltd

EQUITY Development

Order books and pipeline remain healthy

1 December 2023

Encouragingly, prospects at Marshall of Cambridge remain strong, with the order book equating to 1.3x historic revenues. This augurs well for FY24 and beyond, particularly with the five-year plan focused on growing revenues and margins. However, a drive for efficiency and productivity improvements has temporarily faltered in the face of contract delays across Aerospace and Land Systems. As such, the FY23 PBT guidance from the Board stands at low-to-mid single-digit £ millions, although we anticipate the current year will represent a nadir in group fortunes.

Update on operating performance

Trading during Q3 was always likely to show a yoy fall in revenues, with the corresponding period including the Hercules Operations Integrated Support (HIOS) contract amendment, plus the completion of the Global 6000 special missions' contract in early Q3 '23 with an international customer. However, contract delays within Aerospace and Land Systems exacerbated the issue, although deliveries of those products are mostly expected in Q4 / Q1 '24.

H2 losses widened to c. £10m, modestly ahead of previous expectations and reflected further issues within the legacy contracts within Land Systems and increasing price competition in the Fleet Solutions market. One legacy contract ends in late '24, which should result in a marked reduction in divisional losses. We expect Fleet Solutions to benefit from the imminent launch of all-electric, zero-emission units and efficiency improvements post-integration of the FRIGOBLOCK dealerships.

The order book fell modestly to £470m, a shortfall of 4% from the H1 period end. The £4bn+ pipeline of potential opportunities will bolster the strategic target to deliver strong growth in revenues and margins up to the FY27 period end, with levels unchanged from June. One should appreciate that the order book does not include the Group Property division, which, excluding the phases one to three of its Marleigh development, accounts for some 660 acres of the Airport land.

The Aerospace division expects to secure additional MRO (maintenance, repair, and overhaul) work from the US Marine Corps (USMC) for servicing and more complex maintenance requirements. Negotiations continue between the UK MoD and several nation-states to purchase the UK's C-130 fleet. The Group hopes to benefit from its gain-share agreement with the MoD and future MRO contracts with the purchasers, thereby adding to its 17 international customers. In the longer term, breaking ground for its US-based MRO facility in North Carolina augurs well for the Company's goal of securing a larger share of the maintenance of the world's largest C-130 fleet.

FY24 should prove significant for the Property division, with a hearing relating to planning approval expected on phase three of the Marleigh development and further news anticipated on Cambridge East. The proposed developments remain a store of future value for the Group, with no development yet on the 460 acres set aside for Cambridge East and a further 200 acres becoming available following the airport move to Cranfield.

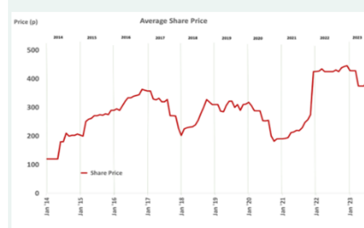
Valuation considerations

With no published estimates ahead of the retirement of the UK MoD's C-130 fleet, we use the net asset value to underpin a fair value for the Group. In June 2023, the NAV amounted to £282.5m, equating to 478p / share. That fair value stands at a 23% premium to the last matched trading price for the NVPOs.

Marshall of Cambridge Holdings Ltd

Last NVPO trade	390p
Implied market cap	£230m
ED fair value / NVPO share	478p
Ordinary share count	59.1m
Preference shares	£8.4m
Net cash (Jun '23)	£79.4m

Share Price, p



Source: James Sharp, Asset Match

Description

Founded in 1909, Marshall of Cambridge (Holdings) Ltd (MCH) is a private, family-owned company, employing c.2,050 staff. The world-class applied engineering services and technology business to the aerospace and defence sectors is the core of the Group, comprising Aerospace, Land Systems and Advanced Composites. The property division, MGP, is in the process of unlocking value from its 900-acre estate at Cambridge airport.

The non-voting private ordinary shares (NVPOs) can be traded freely via a special off-exchange matching facility administered by Asset Match.

The next auction for the shares is set to close on 8 December, with details from: marshall@assetmatch.com

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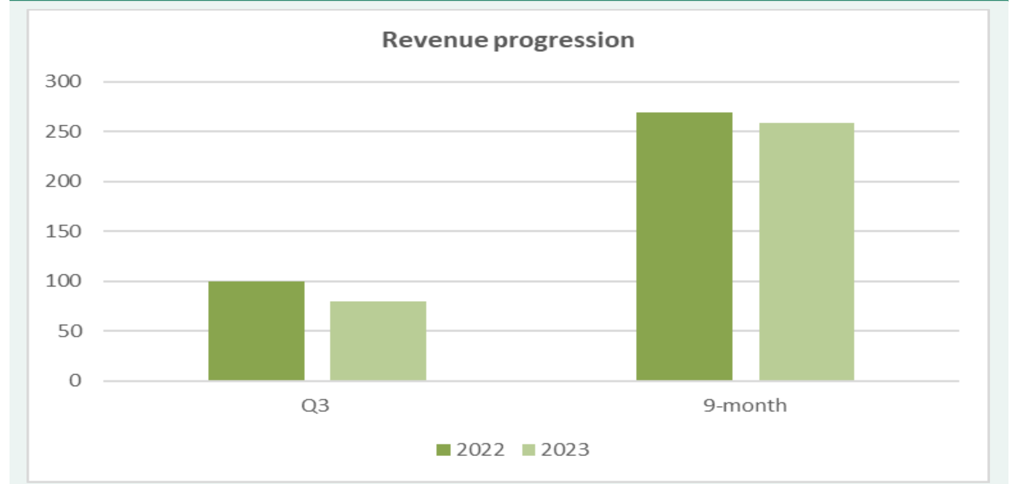
Q3 trading update

The first part of a five-year plan typically involves establishing a foundation to achieve the targeted goals, which in this case involves increased revenues and margins while future-proofing the business. The issue with the two largest businesses year to date has been legacy contracts, the retirement of the UK MoD's Hercules C-130J aircraft fleet (Aerospace) and the GASKET and DVOW contracts within Land Systems.

The former has been a major contributory factor in Q3 revenues, reducing 20.5% yoy to £79.2m, while the two Land Systems contracts have been mainly responsible for the increase in H2 losses.

Q3 and 9-month revenue comparison with 2022 (£m)



Source: Company

However, what remains encouraging is the pipeline of work the Group is currently bidding on, representing £4bn+ of potential orders at margins that would markedly improve profitability beyond previous peaks within the core business by the end of the five-year plan.

In the shorter term, the order book remains at c. 1.3x historical revenues, or £470m, notwithstanding the completion of the HIOS contract in June. The 4% reduction in the overall order book highlights the combination of order delays and slower order intake during Q3.

Efficiency improvements are targeted across the Group to raise margins, not least the roll-out of the new ERP system, which should complete in early FY24.

A further factor in the reduction in revenues during Q3 was the pushing out of orders into Q4 and FY24 by Aerospace and Land Systems customers. In Aerospace, MRO work is typically lumpy with temporary delays as all operational aircraft require servicing to maintain air worthiness and improve mission success. Plus, the negotiations associated with the disposal of the UK's C-130J fleet remain ongoing, pushing any likely sales of airframes into FY24.

Delays to legacy contracts and lost orders impacted Q3 revenues within Land Systems. Also, Advanced Composites has witnessed some delays in customer call-offs, albeit its order book remains healthy. An aggressive pricing environment within the Fleet Solutions market, coupled with new products from its main competitor, has impacted core revenues. However, acquiring the FRIGOBLOCK dealerships during H1 has offset much of the shortfall due to the competitive landscape.

The completion of the Global 6000 contract, involving the adaptation of two Bombardier business jets for special mission purposes, frees up capacity within Engineering Solutions and for international customers within the Aerospace division. Simultaneously, the capability of the business was extended to include the new ARC (Adaptable-Role-fit-Capability) suite of products, commencing with radar in March.

Elsewhere in Aerospace, hangar volumes have begun to recover following the cessation of the HIOS contract (UK MoD), reflecting improving wins with the USMC, involving a wider MRO remit.

Land Systems delivered higher revenues yoy, continuing the trend seen during H1, albeit it proved problematic as legacy contracts witnessed delays and cost pressures/productivity issues notwithstanding recent efficiency improvements. Elsewhere within the division, trading was in line with expectations.

YTD, the Group's property division, has completed on 60 properties at Marleigh, resulting in 195 overall over phases one and two. Completions during Q4 remain broadly on track. Although the FY23 outcome will be modestly below expectations at the start of the year, we consider this to be a positive outcome given the challenging housing market witnessed across the UK.

The expansion of the UK apprenticeship training (record numbers), the securing of additional external customers and a widening of the remit in Canada from pilot training to apprenticeship 'earn as you learn' programmes improved revenues yoy during Q3.

Board and Executive appointments

David Heaford was appointed as Chief Financial Officer at the beginning of October. David has enjoyed a career spanning 20 years as an Executive member of various Boards, with experience across finance, technology, and real estate. David joins from Landsec where, as Managing Director, he was responsible for running a £4bn property development pipeline. David qualified as a Chartered Accountant with KPMG, before taking up a corporate finance role with an automotive business and then roles within technology businesses (HP and Cisco) in strategy, planning and finance. David replaces Interim CFO Doug Baxter. We wish Doug a long and happy retirement.

Nick Shattock has been appointed as an independent Non-Executive Director. A qualified lawyer, Nick has a longstanding career within the real estate sector, having previously held the position of Deputy-CEO of Quintain and NED of the MoD's Infrastructure Organisation. Nick also holds NED positions with DLUCH's Ebbsfleet Development Corporation.

Gareth Williams was appointed as Chief Operating Officer (non-Board position). Gareth joins from Thales, where he was Vice President of Operations and International, responsible for the Group's cyber security. Gareth is also currently advising the Cabinet Office on Cyber Security. Gareth spent seven years at General Dynamics, latterly within their Land Systems division.

An encouraging medium-term outlook

Guidance has been provided for the current year only. As a result, we are not issuing estimates for the medium term, although we remain optimistic given the order book, the pipeline of opportunities and the five-year plan. In the short term, the outlook for FY23 has nudged downwards, reflecting:

- The delay/cancellation of orders within Aerospace and Land Systems
- Additional challenges within Land Systems' legacy contracts, and
- Competitive pricing challenges within the Fleet Solutions market.

Consequently, guidance has modestly reduced to a profit of low-to-mid single-digit £ millions. Following the withdrawal of the UK's C-130J fleet from service and the corresponding end of the HIOS-related price adjustment, H2 2023 was always likely to move to a loss. We estimate that the expected H2 loss has increased to c. £10m on a reported basis.

However, we remain optimistic going forward. FY23 is year one of the Group's five-year plan to increase shareholder value, predominantly through:

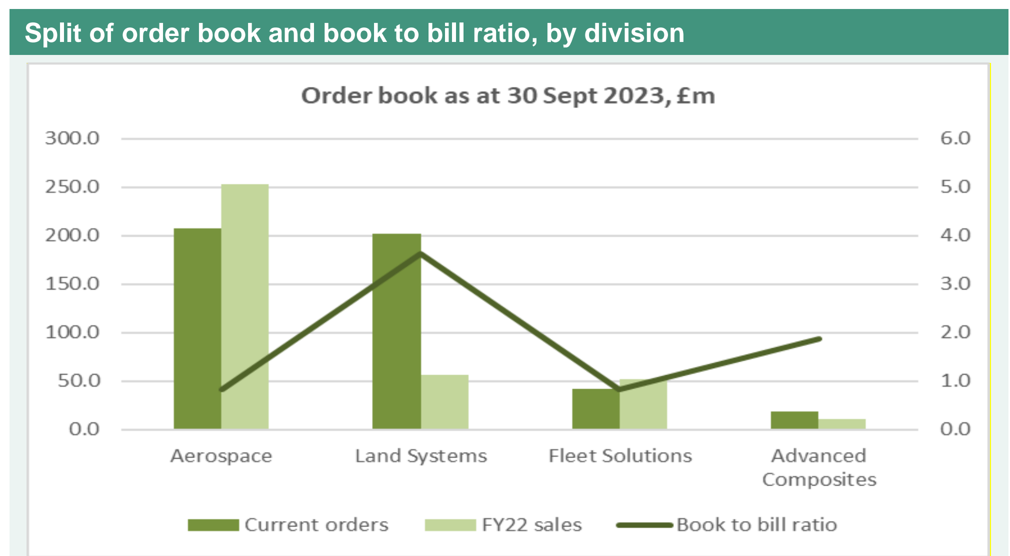
- Leveraging core expertise to grow revenues and margins, and
- Utilisation of the Marshall Motors cash to future-proof the business, including new facilities, the use of technology and new methodologies

We have assumed that the focus on improving revenue and margins will result in the Board's consideration of which businesses can achieve the objectives of the five-year plan. There has already been the disposal of other underperforming assets recently (Aeropeople and Martlet Capital) and we believe the resolve remains to cull others, should a suitable RoCE not be deemed attainable.

Significantly, the current order book has only slipped modestly during Q3 (-4% to £470m), reflecting a combination of contract losses and order intake modestly below expectations, reflecting a slippage in the timing towards Q4 and H1 '24. The £470m order book equates to 1.3x historic revenues.

The order pipeline is unchanged from the position at the half-year end, with opportunities the Group is bidding on amounting to £4bn+. The lion's share of the pipeline is attributable to the Aerospace and Land Systems divisions.

Split of order book and book to bill ratio, by division



Source: Company

Aerospace

While it remains unlikely the UK MoD's Hercules fleet will be sold in the current year, there remains much interest from several nation-states. We remain hopeful that sales covering the bulk of the fleet will complete during FY24. Marshall will target modification upgrades/MRO contracts with the new purchasers, utilising hangar capacity well into FY25. Success is expected to increase the number of customers for its MRO services above the current 17.

The Aerospace division should also benefit from the gain/share agreement with the MoD, rewarding it if sale considerations are ahead of expectations.

To date, the division has secured a more significant proportion of MRO work on the US Marine Corps' (USMC) fleet of C-130's, reflecting the quality and timeliness of the work undertaken. Activity levels with USMC increased and is expected to result in further aircraft arriving in Cambridge during Q4 for short and longer interval maintenance.

The breaking of ground on the Group's first aerospace MRO facility in the US, in North Carolina, should, ceteris paribus, prove helpful in securing additional contracts with the US DoD, who operate approximately half of the global C-130 fleet.

We understand that the Group's MRO facility in the Middle East could also work on existing C-130 fleets operating within the region.

Land Systems

The order pipeline remains strong within the non-legacy contracts, which is encouraging. The portion of the pipeline of potential opportunities relating to Land Systems stands at c.£1.7bn and is significantly expected to be at good margins. With approximately 80% of the output of the UK facility exported, the opening of the new facility in New Brunswick, Canada (October 2023) is a very welcome addition, particularly as it bids on contracts across North America.

The legacy contracts include one with the UK MoD and one with the Netherlands armed forces. The UK contract (GASKET) ends in late 2025, suggesting a marked reduction in losses after that. Meanwhile, productivity levels have improved, and the new facility (Alconbury Weald, Cambridgeshire, expected in 2025) should increase efficiencies on the remaining legacy contract, DVOW.

The completion of the GASKET contract, plus the addition of new contracts should see the division return to profitability during FY25.

Group Property

In the shorter term the economic uncertainty resulting from a combination of higher interest rates and a perception of a modest reduction in job security results in deferrals in decision-making. However, in our opinion a combination of supply constraints and a tight labour market should result in any downturn in prices and activity being limited in duration. Recent commentary from the Bank of England suggests that with inflation falling, albeit remaining ahead of longer-term targets, interest rates are unlikely to decline in the short term. The rhetoric has changed from rises to declines, albeit not in the short term, and we believe this to be significant.

The response from Marshall of Cambridge, notwithstanding the positive momentum witnessed during FY23 (to date), is to focus on building apartments at generally lower price points, thereby increasing the chance of completion.

Note that the £4bn+ order pipeline excludes Marshall Group Properties. Ultimately, excluding the Marleigh development and Land North of Cherry Hinton (LNCH, disposed of during FY22), approximately 660 acres will be developed in the next 20+ years on the current airfield site.

Planning outcomes will likely prove very significant in FY24 and FY25, as decisions are made on phase three of Marleigh and Cambridge East developments. The former is expected to deliver 422 units, with the latter a further 7,000 units as well as creating 9,000+ jobs, if approved.

Fleet Solutions

We see that Trane Technologies (owner of Thermo King) has stated that it now offers zero-emission, all-electric solutions across every segment of the cold chain in EMEA, covering light commercial vehicles through to units for heavy goods vehicles.

Once potential customers have the confidence to move from cash conservation mode to growth investment, they are likely to upgrade to the all-electric, zero emission options and away from the cheaper, price competitive environment of diesel units.

We anticipate that profitability within the two FRIGOBLOCK dealerships made earlier this year will improve, reflecting a combination of integration within Fleet Solutions and efficiency improvements.

Slingsby Advance Composites

The pipeline remains robust, with several orders slipping into FY24 and suggesting a positive outlook. As the new ERP system is installed in early 2024, we expect further efficiencies to feed through from H2 onwards.

Skills Academy

The combination of the new base in Cambridge, an increase in the intake of students from 70 to 200 in September 2024, and further progress in Canada augurs well for the business moving forward. The division should move into profit in FY24.

Valuation

As at the half-year end, the uncertainties in the short term outlined previously makes deriving worthwhile financial estimates very difficult.

In turn, valuations based on its peer group or discounted cash flows then become imprecise at best. We have instead preferred to base our fair value on net asset value. While there have undoubtedly been movements during Q3, as cash has been utilised within the capex programme (ground broken at the new facility in North Carolina), this has been largely offset by a revaluation of properties at its Cambridge base.

The update failed to provide an up-to-date NAV so, based on our assumptions above, we continue with a fair value equating to the valuation as at the end of June of £282.5m. This equates to 478.2p / share and represents a premium of 23% to the last traded price.

We believe that this valuation remains conservative, as the Airport land is carried at cost and was purchased some 90 years ago. Also, it is worth noting that, even including the potential Cambridge East development (460 acres), there remains up to a further 200 acres with no development plans yet.

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