Marshall of Cambridge Holdings Ltd

19 June 2024

A perfect storm, but turnaround plans afoot

The early termination of the HIOS contract with the UK MoD cast a long shadow across the remainder of the Group. Despite the best efforts of Group Property and Advanced Composites, revenues and profitability declined in the prior financial year. Unfortunately, cash levels also fell, reflecting delays in the sale of the UK C-130 fleet and compounding issues on legacy contracts at Land Systems. As a result, the Board is not recommending a final dividend. Changes in Management reflect a shift in focus following the end of the HIOS contract. A strategic review process is underway to place the Group back on an even keel.

Priorities are being reassessed

- The end of the HIOS contract with the UK's MoD has highlighted stress lines across the Group, as revenues and profitability invariably declined. It has become clear that overheads are too high for trading levels that are broadly unchanged from those seen in H2 '23. Hence the programme, which is likely to mean significant changes.

- The reduction in profitability, with losses across the three engineering businesses, has led to a material reduction in cash levels and the decision to cancel the final dividend. The two main issues currently delaying the restoration of cash to prudent levels are i) the timing of the disposal of the UK C-130 fleet which has been heavily delayed and ii) further problems emerging on Land Systems' legacy contracts.

- The focus of future value creation has shifted in favour of Group Property, with the potential plans for Cambridge East and the current Marleigh development likely to result in construction for the next 20+ years.

- The Maintenance, Repair & Overhaul ("MRO") capabilities within the Aerospace division, particularly on the Hercules C-130 airframe, are world-class. The new facility in North Carolina opens in early 2025 to service US-based fleets of Hercules C-130 aircraft. Winning new business to replace the UK's C-130 fleet is vital to the turnaround of the Aerospace division.

- The Board has evolved over the last nine months to reflect a re-shaping of the Group post-HIOS. The changes include a new Interim Chair, CFO, and NED, as well as the hiring of a fresh operational board, including a new COO, to run the businesses day-to-day.

  Kathy Jenkins stepped down at the end of May from the CEO role, having served the Group for seven years, latterly as COO, then CEO. She has been replaced by the Interim Chair, Roger Hardy, who assumes an Executive role. Roger has extensive expertise within the defence sector, holding several senior positions within Babcock International.

  Gareth Williams was appointed to the role of COO, responsible for the Engineering businesses. Bob Baxter was appointed to the new role of Chief Growth Officer, focusing on business development. Deborah Freeman-Watt was recruited as MD of the Group's Property businesses.

Fair value reduced, but based on conservative assumptions

With no estimates published due to the current uncertainty, we reference an estimated NAV to assess value. The NAV used in the estimation uses the level at end December '23 minus the likely H1 '24 cash outflow. Therefore, our fair value/share declines to 432p. The NAV remains conservative, given that the Airport land is included at cost, having been purchased some 90 years ago.

Marshall of Cambridge Holdings Ltd

Last NVPO trade	380p
Implied market cap	£224.5m
ED Fair Value/NVPO share	432p
Ordinary share count	59.1m
Preference shares	8.4m
Net cash (Dec '23)	£34.9m

Share Price, p

Source: Asset Match, James Sharp & Co

Description

Founded in 1909, Marshall Group Ltd ("Marshall") is a private, family-owned company, employing c. two thousand staff.

The world-class applied engineering services and technology business to the aerospace and defence sectors is at 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 Cambridge airport estate.

The non- voting priority ordinary shares (NVPO) can be traded freely via a special off-exchange matching facility administered by Asset Match. The next auction will close on 2 July 2024. The Annual General Meeting for voting shareholders will be held on 23 July 2024. NVPO shareholders may attend if approved to do so by voting shareholders. All shareholders are invited to the preceding business update.

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FY'23 results show Group at a crossroads

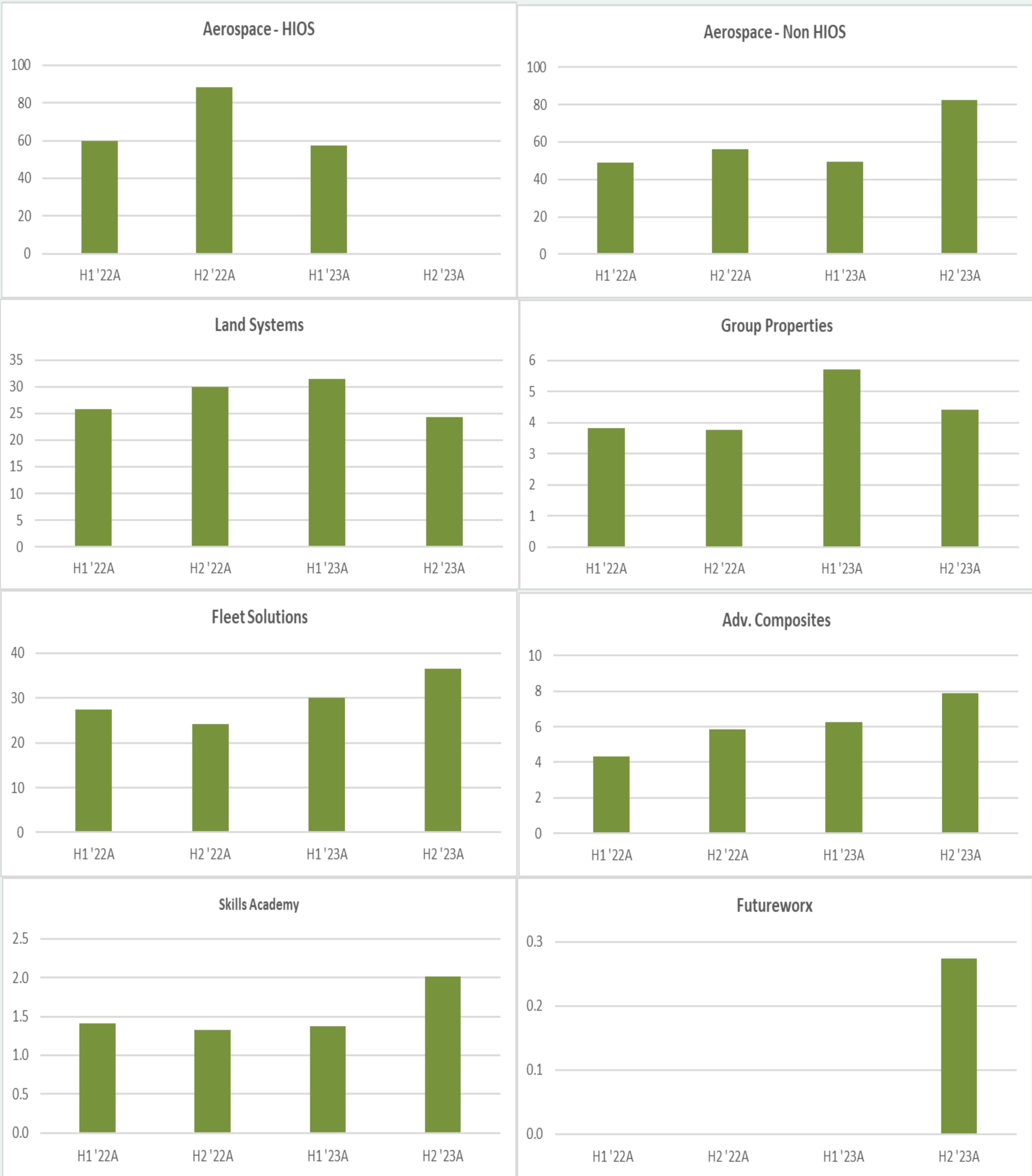
Preliminary results

£m	H1 '22A	H2 '22A	FY22A	H1 '23A	H2 '23A	FY23A	Change, y-o-y
Aerospace - HIOS	59.6	88.3	147.9	57.3	0.0	57.3	-61.3%
Aerospace - Non HIOS	48.9	56.1	105.0	49.5	82.3	131.8	25.5%
Land Systems	25.9	30.0	55.9	31.5	24.3	55.7	-0.2%
Group Properties	3.8	3.8	7.6	5.7	4.4	10.1	33.7%
Fleet Solutions	27.4	24.2	51.6	30.1	36.6	66.6	29.1%
Adv. Composites	4.3	5.8	10.2	6.3	7.9	14.2	39.2%
Skills Academy	1.4	1.3	2.7	1.4	2.0	3.4	23.9%
Futureworx	0.0	0.0	0.0	0.0	0.3	0.3	
Other	0.3	0.3	0.6	0.3	0.3	0.6	-5.4%
Internal sales	-5.3	-7.5	-12.9	-5.3	-13.4	-18.7	45.4%
Total revenue	166.4	202.3	368.7	176.7	144.6	321.3	-12.9%
Cost of goods sold	-121.1	-123.8	-245.0	-119.0	-114.4	-233.0	-4.8%
Gross profit	45.3	78.4	123.7	57.8	30.191	88.0	-28.9%
GP%	27.2%	38.8%	66.0%	32.7%	20.9%	27.4%	
OpEx	-41.0	-65.9	-106.9	-51.4	-48.2	-99.6	-6.8%
Other income	0.8	2.2	3.0	1.7	3.1	4.8	60.7%
Adj. EBIT	5.1	14.8	19.9	8.1	-14.9	-6.8	-134.4%
EBIT %	3.0%	7.3%	5.4%	4.6%	-10.3%	-2.1%	
Share of JVs	1.4	3.1	4.5	2.4	4.2	6.6	46.3%
Net interest	1.3	2.4	3.7	2.9	1.4	4.3	14.9%
Aerospace HIOS	8.0	35.5	43.5	21.2	-0.5	20.7	-52.4%
Aerospace Non-HIOS	7.3	-6.9	0.5	-1.2	-3.0	-4.1	-960.9%
Land Systems	-3.6	-11.3	-15.0	-5.3	-14.8	-20.1	34.2%
Group Properties	3.3	8.1	11.4	4.6	14.1	18.7	63.7%
Fleet Solutions	-1.3	-1.2	-2.4	-1.9	-3.7	-5.7	131.8%
Adv. Composites	-0.2	0.7	0.5	0.4	1.5	2.0	289.7%
Skills Academy	0.1	-0.2	-0.1	-0.2	-0.2	-0.4	263.9%
Futureworx	-1.2	-1.4	-2.5	-1.7	-0.3	-2.0	-20.2%
Central costs	-4.6	-3.2	-7.7	-2.6	-2.4	-5.0	-35.4%
Adj. PBT	7.8	20.3	28.1	13.3	-9.2	4.1	-85.5%
Exceptional items	0.2	-0.9	-0.7	-0.6	0.9	0.3	-143.7%
Taxation	-1.6	-4.2	-5.8	-3.0	1.7	-1.3	-77.3%
Tax %	20.6%	20.9%	41.4%	22.5%	10.0%	32.5%	
Adj. PAT	6.2	16.1	22.3	10.3	-7.6	2.8	-87.6%
Adj. EPS (p)	9.9	26.5	36.4	16.6	-14.1	2.5	-93.1%
DPS - Ord (p)	1.0	79.0	80.0	3.0	1.0	4.0	n/a
DPS - NVPO (p)	1.0	81.0	82.0	3.0	2.0	5.0	n/a
Net cash	241.7	129.3	129.3	79.4	34.9	34.9	-73.1%

Source: Company

We highlight the movement in revenues in the chart below, with the key movements from FY23: Aerospace HIOS, following the retirement of the UK's C-130 fleet as of June 2023; non-HIOS hangar repairs improving; production bottlenecks at Land Systems; the acquisition of two dealerships by Fleet Solutions; and continued positive progress by Advanced Composites.

Half-yearly progression of revenues by division, £m



Source: Company

Divisional review

2023 was projected to be a challenging year, and so it proved. This is most visible in the reduction of Group revenues (declining £47.4m to £321.3m), with the other divisions either delivering y-o-y progress or a flat performance (Land Systems) compared with Aerospace (where the top-line declined 25% y-o-y to £189.1m). In the absence of the impact of the lost Hercules Integrated Operational Support (HIOS) contract and its high margins, the underperformance in other parts of Engineering attracts scrutiny.

Aerospace

The non-HIOS portion of the Aerospace division delivered revenues 25.5% higher to £131.8m, benefitting from a ramping up of the US Marine Corps MRO contract and an upgrade in the Airborne Electronic and Reconnaissance System ("AERS") programme with a customer in the Middle East. However, the £26.8m improvement in non-HIOS revenues failed to offset the reduction in HIOS. Aerostructures was relocated to a new, modern hangar in Cambridge, resulting in improved productivity levels and increased efficiencies and a temporary closure of production.

Land Systems

Revenues declined during H2 '23 due to the temporary production halt on one of the lines due to technical issues. Productivity issues remain, resulting in cost overruns on a significant contract, despite the efficiency programme undertaken during H1, which resulted in the improved standardisation and modularisation of products. Nevertheless, this was insufficient to cut the losses on legacy contracts. An increase to the loss provision was implemented during the year.

However, the division remains innovative, not least in the development of the next-generation CT scanner (Phillips) and the launch of a new power management system, which enables a unit to generate, store, and distribute power.

Fleet Solutions

The acquisition of the two FRIGOBLOCK dealerships by Fleet Solutions added £17m of revenues and £0.4m of adj. PBT, demonstrating the positive contribution from the retailer and installer of electric, low-emission refrigeration units. Stripping out the contribution from the M&A activity sees like-for-like divisional revenues decline by 3.9% to £49.6m and adjusted losses rose to £6.1m (FY22: £2.4m). Continuing the sustainable theme, trials of the 100% solar powered Titan recovery system have been adopted by customers in the pharmaceutical and online retail sectors, which augurs well for the future.

The division experienced lower margins on fixed price maintenance contracts, generally reflecting higher costs. Installation volumes declined due to competitive pricing by a key competitor. To compound the issues facing the division, a delay in the renewal of a contract with a significant customer hurt the order book (which declined 27.5% in total to £37m during FY23). Margins continued to reduce at a loss before tax level, nudging into double figures (H2 '23: -10.2% vs -4.9% in H2 '22).

The business underwent a significant restructuring in early 2024, with the aim of cutting costs and driving operational efficiencies. The number of maintenance depots have been targeted for rationalisation, with more emphasis placed on the mobile engineering force. Head count was also reduced.

Slingsby Advanced Composites

Advanced Composites has been one of the recent success stories that has benefitted from the rationalisation of the business two years ago, the change in senior management, and a rising order book (which increased 122% to £40m during FY23). Revenues improved 39.2% to £14.2m benefitting from new contract wins, not least with Rolls-Royce and MBDA, plus a new customer in the defence sector.

The contract to supply Lockheed Martin with C-130 composite cockpit panels was extended to 2029. Adj. PBT increased almost three-fold to £2.0m, emphasising the operationally geared business model.

Group Properties (MGP)

Group Properties moved to the most profitable division within Marshall of Cambridge Holdings in FY23, delivering adj. PBT of £18.7m. The business focuses on three areas:

- The management of the Group's portfolio of land and buildings
- The joint venture with the house builder, Hill Group, to deliver the 1,300+ unit Marleigh development across three phases, and
- The promotion of the Cambridge East land comprising the Cambridge Airport site and two smaller parcels of land to the north of Newmarket Road in Cambridge.

To date, 320 units have been occupied across phases one and two of the Marleigh development, with the school (September 2022), Co-Op 7/11 store, and a Pilates studio opened in 2023. The rate of occupations increased during FY23, rising from 49 to 91 and highlighting the resilience of the Cambridge housing market.

The Hill Marshall joint venture submitted two detailed planning applications for Marleigh Phase 3, including 332 units, bringing the total homes across all phases to 1,391. MGP continues to promote Cambridge East in the Cambridge draft Local Plan, now anticipated to possibly be published in late 2028. The draft Local Plan currently proposes the delivery of 7,000 homes and 9,000 jobs on the 462-acre Cambridge Airport site. The development is estimated to require 20 years of development work post planning approval.

Skills Academy

Revenues improved markedly during FY23 to £3.4m (FY22: £2.7m) reflecting the increase in the number of apprentices undergoing training (from 28 in FY22 to 67 in FY23) and the number of programmes offered (rising to 12 during the year).

The number of contracts with third parties increased, including Bombardier, Aircraft Restoration Company, Gama Aviation, Stansted Aerospace and Titan Airways.

The training facilities were moved to another site within the airfield's premises and extended to accommodate the larger intake.

Also, the business has further extended its offering into the Canadian market from pilot training to apprenticeships on an 'earn-as-you-learn' basis, which commenced in September 2023. The Skills Academy is based in New Brunswick (close to the Land System's manufacturing facility) and is partnering with the local Community College and the University of St. John. The province has secured funding of C$7m.

Futureworx

Futureworx was set up to harness emerging technologies in partnerships with third-party companies to develop new applications and services. All areas under development are at the investment stage, with one recently moving to the prototype stage. The areas in development include:

- Lilypad, the offshore wind farm inspection system using UAVs
- Heavy-lift autonomous drones, utilising hybrid-electric gas turbine powerplant, and
- The Hydrogen fuel system and supply chain development for the zero-emission aviation market.

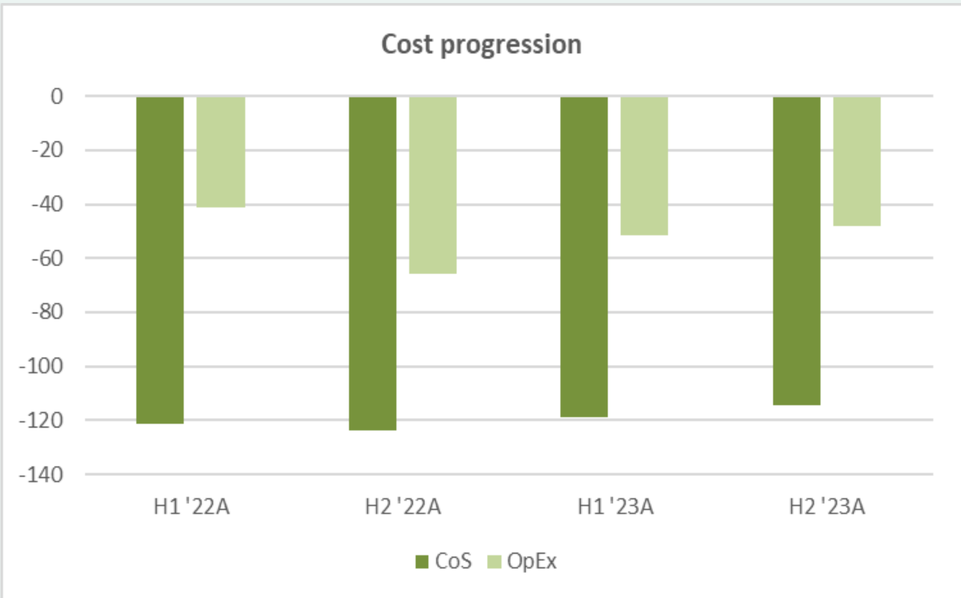
Progress was made in establishing Lilypad's route to market via a Memorandum of Understanding with an offshore energy service provider. The heavy-lift autonomous vehicles can carry payloads of up to 250kg over a range of almost 100km from offshore platforms and ground pads with military, commercial and off-shore applications. Marshall is partnered with ISS Aerospace on both Lilypad and the heavy-lift drones, with the latter receiving £0.5m of funding from the UK's Defence Technology Exploitation Programme (DTEP). Futureworx joined the HyFIVE consortium, including GKN Aerospace, Parker Meggitt, and the Universities of Manchester, Bath and Cardiff. The HyFIVE project will be funded by the UK Government providing £20m, plus £17m from industry.

Futureworx is in its second year of operation and, as a result, still in the early stages of investment. Revenue amounted to £0.3m in FY23, compared to zero in 2022. The scale of losses declined modestly, helped by the grant funding, to £2m, from £2.5m in FY22.

Costs remain high

What is clear is that costs remain too high across many of the engineering divisions, with only Advanced Composites being profitable throughout the year. We highlight the movement in the cost base during the last two reported years. With revenues falling 12.9% and as we have seen by 100% within Aerospace HIOS, one would have expected a commensurate cost reduction, albeit with a short lag. The Group's cost of sales (CoS) declined just 3.9% during H2 '23 and by 4.8% y-o-y. Similarly, operating expenses (OpEx) were reduced by 6.8% y-o-y and 6.2% during H2 '23.

Group costs – CoS and OpEx



In the next chart we break down the costs by division, defined by cost of sales and operating expenses.

Previously, the HIOS contract demanded a larger headcount within the **Aerospace** division, but the ramp up of international contracts has proven slower than hoped in replacing the lost HIOS-related volume throughput. One wonders to what degree the sale of the UK C-130 fleet will result in additional and ongoing MRO work. Divisional costs declined 17.5% y-o-y, representing the only division where a fall in costs was recorded.

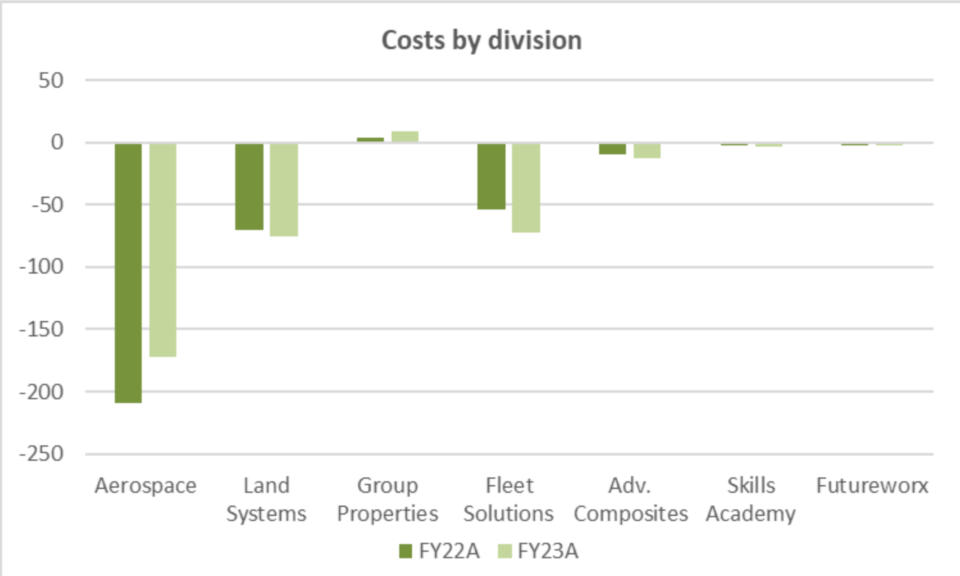
The issues at **Land Systems** are deep-seated and a move to a new facility is required as phase three of the Marleigh development moves closer to reality (which incorporates the land where the production site currently sits).

The standardisation and modularisation of the products have resulted in limited improvements in productivity as the legacy contracts moved towards full production volumes. However, investment in capital equipment is required to see productivity rise to the required levels. Divisional costs increased by 7% y-o-y to -£75.8m.

The **Group Property** division has costs, as any developer would. However, the rental income stream from the Group's businesses and third-party tenants is the main source of revenues, with the contribution from the Marleigh development is a joint venture contribution, post-costs. As a result, overall costs are positive and increased during the year.

Fleet Solutions delivered a 33.7% rise in its cost base to £72.3m, which can only in part be due to the two FRIGOBLOCK acquisitions. Profitability improved at **Advanced Composites**, notwithstanding a 26.1% increase in its cost base to £12.2m, reflecting the effect of new contracts. Expansion of its operations resulted in costs increasing by a third y-o-y during FY23 to £3.8m at the **Skills Academy**.

Breakdown of costs (CoS + OpEx) by division, £m



Source: Company

Profitability improves in three out of eight divisions

When looking at divisional profitability, in this instance, adj. PBT, the stand-out areas were Group Property and Advanced Composites. The former has delivered consistent y-o-y gains as the first phase of the Marleigh development has matured and the second phase commenced. Following its restructure in FY21, Advanced Composites has consistently improvement in margins – now reaching into double digits.

Elsewhere, the picture is gloomier, with the three engineering businesses experiencing a further deterioration in performance, with losses increasing during H2 '23.

Although the two smallest businesses, Skills Academy and Futureworx delivered some improvement during H2 '23, they remain loss-making.

Adj. PBT of just £4.1m (FY22: 28.1m) represents a poor return and an EBIT margin of -2.1% (FY22: 5.4%), excluding HIOS, which contributed to H1 adj. PBT of £21.2m, the remainder of the Group delivered an adj. PBT loss of £16.6m and an EBIT margin of -2.2%.

Half-yearly progression of adj. PBT by division, £m

Source: Company

Change is inevitable

With the company reporting that there has been little improvement to trading in the current financial year, maintaining a status quo no longer seems appropriate. Simply put, the continuation of losses is rapidly reducing cash levels. While there was previously an expectation that growth within the Group Property and larger engineering businesses could be simultaneously funded from internal cash resources and external financing (including the leasing of premises), this is no longer the case.

As such, the Group finds itself at a crossroads. The Board believes that the Group remains a going concern – and the auditors have signed off the accounts on this basis – but a material uncertainty statement has been included within the Report and Accounts for FY23. One should refer to said statement, which pays reference to several stress tests, including the modelling of a range of 'severe but plausible' scenarios, including:

- A further delay in the re-sale of the UK's C-130 fleet
- Further deterioration within a portfolio of legacy contracts within Land Systems

We comment later on the recent rumour on the timing of the sale of the MoD's C-130 fleet, which if true suggests an announcement may occur in due course. Time will tell. Significantly, milestone payments on the legacy contracts within Land Systems will not be received by the Group until the units are delivered to the customer. On that basis, ongoing technical and productivity issues may result in less frequent cash inflows related to the contracts.

Should the situation deteriorate further, in line with the scenarios within the going concern statement, further urgent action on costs is required. While the Board started to address the cost structure during FY23, further action will be required, notwithstanding the tick-up in volumes within Aerospace and several meaningful contractual wins by Land Systems. The likely steps required might include:

- A reduction in costs to more appropriate and competitive levels, including a lower headcount
- Sale of non-core assets
- A re-shaping of the divisional structure of the business, determining which of the Engineering and smaller divisions will be retained in the longer term, and

Recommendation of no final dividend relating to FY23 as stated in the annual report. One would expect the review to include international activities and not just those domiciled in the UK.

The capital demands of the property development opportunity, potentially generating a substantial stream of profits over circa two decades, in contrast with the requirement to simultaneously fix and develop all three problematic engineering subsidiaries. **The Cambridge East development remains the most critical source of longer-term value creation.** Our best estimate is that construction on the Cambridge East development, should the Group's current endeavours prove successful, is unlikely to commence much before the end of this decade.

The C-130 operational support provided by the **Aerospace** division is world-class. Further contract wins, whether with the prospective owners of the UK's fleet, the US Dept of Defence or other nation states, should form a springboard to a return to profitability. Achieving target returns on capital will then depend very much on attaining and maintaining a competitive cost base. Hiring is underway at the Group's facility in North Carolina, with the leasehold facility expected to commence MRO operations in early 2025.

The restructuring process at **Fleet Solutions** commenced during Q1 '24, with several depots targeted for rationalisation. Also, trials of the Marshall solar-powered freight refrigeration system, Titan, were successful, resulting in fuel savings, plus reduced noise and emissions and, significantly, adopted by one pharmaceutical logistics specialist and an online retailer.

Cash event looming?

In the short-term, the most significant potential influx of cash is likely to emerge from the conclusion of discussions between the UK Government and senior politicians of other nation states on the disposal of the UK's fleet of C-130J's. To date, this has proved slower to conclude than expected.

With a profit share arrangement with the MoD, Marshall should strongly benefit from the preparatory and overhaul work undertaken on the fleet following the end of the HIOS contract. Such an end game is likely to free up working capital.

While there is little hard evidence yet on the timing of any disposal, expressions of interest and inspections of the airframes have been received. One should be aware that any disposal requires approval from the relevant US authorities, which could further impede the fleet's sale.

Part of the UK's retired fleet of Hercules C-130Js

Source: Janes

Given the scale of the losses reported for FY23, with the trend further deteriorating during H2 as the HIOS contract ended and bottlenecks in production continued within Land Systems, we expect that cash levels fell further during H1 '24. As a result, the Group has arranged a £25m line of funding with its key banker, Barclays Bank, in addition to the existing £18m overdraft facility.

The Company has also received an uncommitted UK trade debtor loan. Overall, the Company has access to total funding facilities of £53m, providing an adequate cushion.

Board & Senior Leadership

We have already highlighted several changes to the leadership of the Group, initially to reflect a re-shaping of the Group post-HIOS and to execute the now-historic five-year plan. The changes during the last 12 months are as follows:

- The Chairman, Jonathan Flint, retired in March after five years of service with the Group. He was replaced by Roger Hardy, who was initially appointed on an interim basis, until a longer-term replacement is identified. Roger has extensive experience in the defence sector, previously holding senior positions within Babcock International.

- Kathy Jenkins stepped down from her CEO role in May, after seven years with the Group, latterly as COO, then CEO. Roger has stepped up to the position of Interim Chair and acting CEO on an interim basis. An executive search firm will be appointed to search for a new CEO.

- James Buxton will retire from his position of Non-Executive Director at the AGM in July following 10 years' service with the Group. He will be replaced by Nick Shattock, who was appointed to the Board in October 2023. Nick has extensive experience in the property sector, previously as a Director of Quintain and running a development consultancy business in the regeneration mixed-use market.

- David Heaford joined the Group as Chief Financial Officer in October 2023. David previously ran a multi-billion-pound mixed-use development pipeline for Landsec Plc, following a career in various strategy and finance roles across the real estate and technology sectors. David replaced Interim CFO Doug Baxter, who retired following his handover period with David.

The Chair will be supported in the daily operational management of the Group by the CFO, David Heaford, Gareth Williams, Bob Baxter and Deborah Freeman-Watt. Gareth was appointed to the new role of COO in November 2023, responsible for the Engineering businesses. Bob was appointed Chief Growth Officer, focusing on global strategy, business development and sales across all engineering business lines. Deborah was recruited as Managing Director of the Group's Property businesses from Landsec plc in May 2024.

Neither Gareth, Bob, nor Deborah will sit on the Group's Board, but rather form a vital part of the Operational Board.

Group Financials

Given that trading will continue in the same vein as H2 '23 the Board has decided to conserve cash and not recommend a final dividend for 2023.

The continued losses and the necessity to conserve cash are behind the decision on the dividend and tempers the outlook for FY24, which, in immediate terms, is looking at further cash draining from the business. The ongoing underperformance within the three larger Engineering businesses highlights that costs remain uncompetitive. The Company also announced a strategic portfolio review of all its businesses.

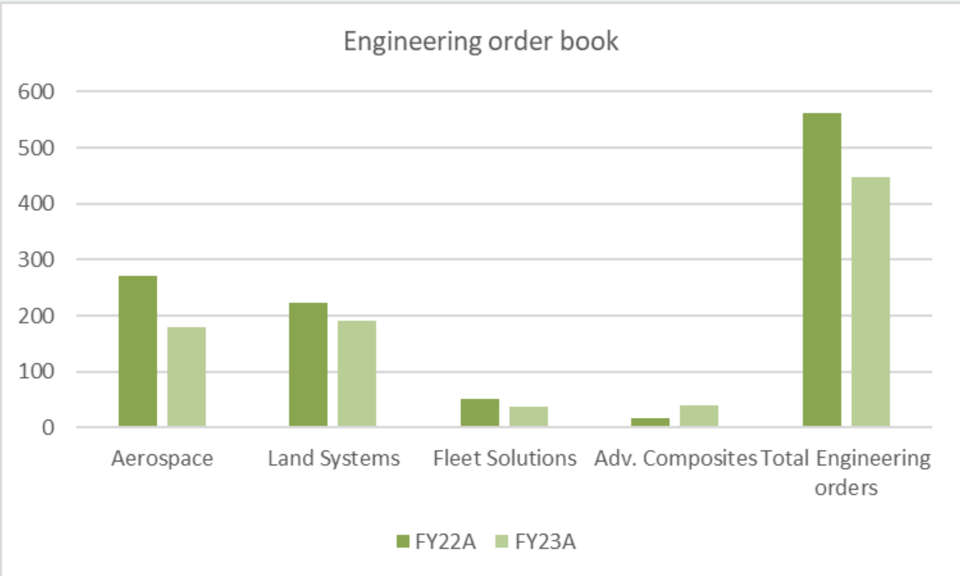
The business transformation programme aims to return the Group to a prudent net cash position.

What could change to accelerate revenue growth? The recruitment of a Chief Growth Officer (Bob Baxter, in early February 2024) is beginning to translate into increased opportunities, especially within Aerospace and Land Systems. The Board remains hopeful of:

- The re-sale of the UK RAF's fleet of Hercules C-130 transport aircraft (decisions by Q4 '24/Q1 '25), with their new owners potentially entering long-term MRO arrangements with the Aerospace division
- Securing an MRO contract on the early warning radar airframes (two) supplied to a customer in the Middle East (decision by FY24 end)

Overall, the pipeline of opportunities remains at approximately £4bn, excluding Group Property, with the actual year-end order book of £449m as of December 2023 (FY22: 569m, including the final six months of the HIOS contract, coupled with the run-down of contracts at Fleet Solutions). Recent movements include long-term wins in Aerospace North America and the Middle East). However, despite recent sizeable wins, the outlook within Land Systems has deteriorated, reflecting ongoing productivity and technical issues in Cambridge.

Year-end engineering order book, by division (£m)



Source: Company

The scope of securing longer-term MRO contracts with the purchasers of the UK C-130J fleet also remains, as has occurred in previous years.

Recent wins include:

- Canada's Dept. of National Defence has awarded the Logistics Vehicle Modernisation (LVM) contract to a consortium led by General Dynamics and Marshall Canada. The project is split between two contracts, one for vehicle acquisition (1,000 light trucks and 500 heavy trucks) valued at C$1.5 bn and one for providing in-service support valued at C$1.8bn over 25 years. Marshall will provide the 10 - and 20ft mission modules to be mounted onto the trucks. The modules will be produced at the Group's New Moncton facility.

- A seven-year contract has been agreed upon with the Swedish Armed Forces to build up to 500 command and control shelters and ancillary equipment as the recent NATO member seeks to modernise and upgrade its capabilities. The contract is expected to generate over £100m over its duration. Marshall Land Systems is to manufacture the units in its facilities in the UK and Canada.

However, the start-up phases of the contracts will require funding in the form of working capital, the training of new employees, and capital equipment to ensure the contracts commence well and hit production targets.

The Group's new facility in North Carolina will be utilised to undertake MRO contracts on new customer wins, whether arising in North America or beyond. Existing facilities in the UK or in the Middle East, may be considered too distant by some potential customers. We expect the UK facilities to be downsized from current levels following the airport move at the latter stages of the current decade.

Also, a US base should help to secure additional MRO contracts with the US DoD, having proven itself on the USMC airlifters. Further international contracts are being sought at the Group's base in the Middle East.

Meanwhile, the Group's Property division – the latter stages of the Marleigh development and Cambridge East - will be core to value creation moving forward, but it will require cash in the shorter term as the division moves through the planning system.

Typical vehicle to be produced under the Canadian LVM contract win

Source: ADS Advance

An example of a Command & Control shelter for Sweden

Source: Cambridge independent

Historic Financials

Summary Income Statement					
Year to Dec, £m	**2019A**	**2020A**	**2021A**	**2022A**	**2023A**
Aerospace		229.3	232.7	252.9	189.1
Land Systems		44.2	40.6	55.9	55.7
Advance Composites		10.3	8.3	10.2	14.2
Aerospace & Defence	307.6	283.8	281.6	319.0	259.0
Property	7.8	8.1	7.9	7.6	10.1
Fleet Solutions	53.0	45.7	54.3	51.6	66.6
Skills Academy		0.0	2.0	2.7	3.4
Other		13.2	3.9	0.6	0.9
Intercompany	-6.5	-17.1	-6.7	-12.9	-18.7
Revenue	361.8	333.7	343.1	368.7	321.3
Y-o-Y growth (%)		-7.8%	2.8%	7.5%	-12.9%
CoGS	-238.5	-250.7	-255.0	-245.0	-233.3
Gross profit	123.3	83.0	88.1	123.7	88.0
Gross margin (%)	34.1%	24.9%	25.7%	33.6%	27.4%
OpEx	-112.6	-69.9	-114.6	-106.9	-99.6
Profit on sale of land & buildings	0.0	0.0	21.1	0.0	0.0
Other income	1.2	2.6	3.4	3.0	4.8
Adj. EBIT	11.9	15.7	-2.0	19.9	-6.8
Adj. EBIT %	3.3%	4.7%	-0.6%	5.4%	-2.1%
Share of JVs		0.4	3.5	4.5	6.6
Associates	0.0	0.0	4.5	0.0	0.0
Net Interest	-6.6	-0.1	0.0	3.7	4.3
PBT (Adjusted)	5.3	16.1	6.0	28.1	4.1
Exceptionals	-4.4	-0.5	10.7	-0.7	0.3
Reported PBT	0.9	15.6	16.6	27.4	4.4
Adj. Tax	-6.7	-4.6	-1.4	-5.8	-1.3
Adj. PAT	-1.3	11.5	4.7	22.3	2.8
Minority interests	-3.9	-0.6	0.0	0.0	0.0
Pref. dividends	-0.7	-0.7	-0.7	-0.7	-0.7
Earnings	-6.0	10.1	3.9	21.5	2.0
EPS (Adjusted) (p)	35.3	41.3	2.3	36.4	2.5
DPS (p) - Voting, ordinary	1.0	7.0	4.0	80.0	4.0
DPS (p) - NVPO	3.0	9.0	6.0	82.0	5.0
Ave no of shares (FD) (m)	59.1	59.1	59.1	59.1	59.1

Source: Company historics

Cash

The high net cash position at the start of FY23 (£129.3m), benefitting from the disposal proceeds of its motor retail business (Marshall Motor Holdings Limited), markedly declined to £34.9m by the year-end. Significant movements included:

- £56.8m of the outflow related to an increased working capital requirement
- £32.2m related to a combination of capex and acquisitions

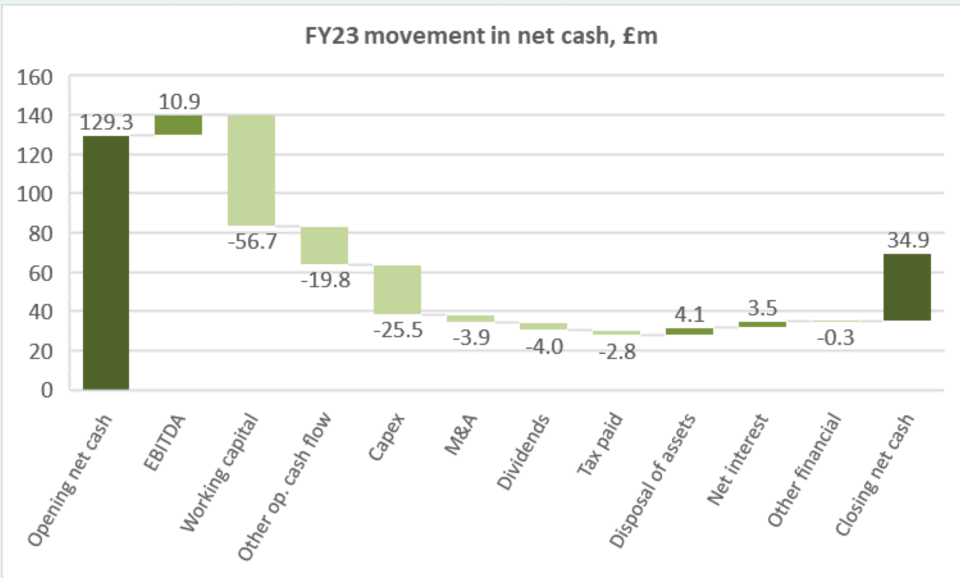
We can see this more clearly in the chart below, which covers the movement in net cash during the year. Aerospace saw the largest contribution on a divisional basis to the increase in working capital, representing an outflow of £48.6m. This reflected the ending of the HIOS agreement (and unwinding of advance payments), coupled with the preparation work undertaken on the C-130 fleet ahead of disposal. Land Systems contributed to a £20.8m rise in working capital, reflecting the legacy contracts and a temporary production halt on one line due to technical issues. By contrast, the Property division reduced its working capital by £9.7m.

Capex, amounted to £25.5m and related to:

- Group Property (-£7.9m)
- Land Systems (-£6.5m)
- Aerospace (-£4.5m)
- Fleet Solutions (-£2.9m) and
- Advanced Composites (-£1.0m).

Preparatory work for phase three of Marleigh and expenditure on planning was responsible for the largest portion of expenditure (Group Property). At the same time, investment in the new production capacity at Moncton, New Brunswick in Canada amounted to £4m. Included within the total capex figure is £2.9m for further implementation across the Group of the new ERP system; £1.8m is for the investment of two potential streams of revenue within Futureworx and product modularisation within Land Systems.

Net cash bridge in FY'23



Source: Company

Moving forward, the bulk of the working capital is expected to unravel as the UK C-130J fleet is disposed of, thereby generating cash. Disposing of non-core assets is to be examined as a further means of generating cash.

The Board has stated its commitment to reinstating the dividend as and when prudent.

Summary Cash Flow

Year to Dec, £m	2019A	2020A	2021A	2022A	2023A
EBITDA	67.3	15.0	-0.5	36.7	10.9
Working capital movement	24.5	-12.7	-34.7	8.4	-56.7
Other	-19.7	-1.2	-0.6	0.8	-19.8
Operating cash flow	72.1	1.1	-35.8	45.9	-65.6
Net Interest	-7.1	-0.3	-0.4	1.1	3.5
Pref. dividends	-0.7	-0.7	-0.7	-0.7	-0.7
Minority payment	-2.6	0.0	0.0	0.0	0.0
Taxation	-3.4	1.1	-2.3	-1.8	-2.8
Cash earnings	58.3	1.1	-39.2	44.5	-65.6
Net capex	-45.6	-19.2	12.8	-15.9	-23.1
Post capex cash flow	12.7	-18.0	-26.4	28.6	-88.8
Dividends	-3.3	-3.3	-3.3	-48.2	-3.3
Free cash flow	9.4	-21.3	-29.6	-19.6	-92.0
Net (Acqns)/Disposals	-28.2	0.0	0.0	199.0	-3.9
Share Issues	-0.7	0.0	0.0	0.0	0.0
Other financial	-3.0	-0.2	4.4	-8.9	1.4
Increase Cash/(Debt)	-22.5	-21.5	-25.3	170.5	-94.5
Opening Net Cash/(Debt)	-2.4	5.6	-15.9	-41.2	129.3
Closing Net Cash/(Debt)	-24.9	-15.9	-41.2	129.3	34.9

Source: Company historics, Equity Development estimates

NAV

Net assets were broadly flat y-o-y, with the reduction in cash replaced by an increase in fixed (Canadian production facility) and intangible assets (goodwill and software) and a near doubling of working capital.

The pension debt declined further during the year to £1.7m (FY22: £2.3m), helped by purchasing a buy-in policy with Aviva and a positive performance in the scheme's assets.

The NAV at the end of the period amounted to £271.3m (FY22: £272m), which equates to 459p / share. One should appreciate that this represents a conservative estimate given that the remainder of the airport land is held at cost and was purchased approximately 90 years ago.

Abbreviated Balance Sheet					
Year to Dec, £m	**2019A**	**2020A**	**2021A**	**2022A**	**2023A**
Intangible Assets	87.0	13.1	12.0	15.2	21.4
Tangible Assets	271.7	100.8	87.4	97.0	115.8
Investments/other	7.9	42.3	5.3	8.1	17.5
Net Working Capital	-17.9	17.2	110.0	62.4	116.7
Capital Employed	348.6	173.4	214.7	182.7	271.3
Other	-28.1	-18.9	-19.0	-23.3	-17.4
Net Cash/(Debt)	-24.9	-15.9	-41.2	129.3	34.9
Provisions	-25.1	-11.8	-18.0	-14.4	-15.8
Pension liability	0.0	-4.6	0.0	-2.3	-1.7
Net Assets	270.6	122.1	136.5	272.0	271.3
Non-controlling interest	-64.9	0.0	0.0	0.0	0.0
Shareholders' Funds	205.6	122.1	136.5	272.0	271.3

Source: Company historics, Equity Development estimates

Valuation thoughts

The uncertainties in the short term prevent the publication of financial estimates, which, in turn, results in any valuation models based on its peer group or discounted cash flows imprecise at best.

We consider the net asset value to be a better approximation of value in the short term. The Group's cash level as of the end of FY23 was £34.9m. Although we can see an influx of cash as the working capital unwinds and most of the UK MoD's C-130 fleet is sold, the continuing losses will offset this.

The possibility remains that underutilised assets may be disposed of to boost cash levels.

We estimate that the NAV has declined from £271.3m (FY23) to c.£250m currently, equating to 423p/share, still representing a premium of 11% to the last traded share price at the most recent auction.

We note that either a significant rationalisation of the cost base or the disposal of assets is required to prevent a further deterioration in cash levels. Considering the risks to 'going concern' status, it is important that the action on the loss-makers is undertaken with some haste.

What is also clear is that Group's value essentially sits within the confines of the Group's Property division/significant land bank. The valuation of the Airport land remains conservative, being carried at cost. On this basis, we think the upside is potentially significant. However, action is required to ensure the Group does not run out of cash due to the losses within the three larger engineering businesses.

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