

# Marshall of Cambridge Holdings



12 March 2024

## Shaping the group for the future

Management has taken action to offset the end of the RAF C-130J support programme (Hercules Integrated Operational Support – ‘HIOS’) by implementing cost efficiencies, strengthening the senior leadership team, and focusing on converting the £4bn pipeline of opportunities into future revenues. In 2023 Property performed well, as did the smaller businesses, but Aerospace was impacted by the end of the significant HIOS contract in mid-2023. The new year has begun in the same vein as H2 ‘23, hence management is accelerating efforts to transform the group. The outlook for Q4 ‘24 and into FY25 appears brighter.

### 2023 Trading Update

The first year of the new strategic plan should prove the nadir, with recovery to come from better markets, self-help, and a focus on leveraging international opportunities. The retirement of the RAF’s C-130 fleet and its attendant work in Maintenance, Repair & Overhaul (MRO) was always going to be problematic within Aerospace and is responsible for the Group’s decline in revenue. Yet, progress was made, not least with the US Marine Corps (USMC) MRO contract and the anticipated sale of most of the UK C-130 fleet likely to boost revenues in Q4 ‘24 / H1 ‘25. With MRO work continuing on the fleet, any profit above the contractual threshold will be shared with the UK MoD on disposal.

Other businesses underperformed in profit terms, with Land Systems citing a line stop, plus low margins on two legacy contracts, while a combination of price competitiveness and inflation impacted trading within Fleet Solutions. Following its turnaround, the Advanced Composites business has gone from strength to strength, while the Skills Academy nearly doubled its intake in September.

Net cash declined from £129m to £35m during FY23. Most of the shortfall reflects higher working capital and the line stoppage, with the underperformance in profitability accounting for the remainder. The anticipated sale of most of the UK’s C-130J fleet will result in the Group being reimbursed for ongoing MRO undertakings. The inventory build ahead of the Q4 line stop at Land Systems should unwind by H2 ‘24. We expect an improvement in cash flow towards Q4 / H1 ‘25 as the businesses implement the transformation strategy and on the outcome on any sale of the C-130s.

Marshall Group Properties continues to perform strongly. Phase one of the Marleigh development is nearing completion, with sales gathering pace in phase two. Despite the challenging residential property market, the Cambridge market remains robust. The Marleigh development completed on more units in H2 compared to H1 (54 vs 37), generally at better margins reflecting a higher proportion of house sales. Also, the division benefitted from an increase in the valuation of its investment portfolio. Phase three of the Marleigh development is moving to the planning stage with vacant possession seen in early 2026 following relocation of Land Systems to new premises in Alconbury.

### Outlook and Net Asset Value

We remain optimistic over the medium term, citing: a combination of the profit share with the UK MoD on the disposal of the RAF’s C-130 fleet – potentially resulting in new international customer wins for the Aerospace division; the preferred bidder status announcement for the Canadian Armed Forces to boost Land Systems from FY25; recovery in residential property markets; an ex-property £4bn tender pipeline; 660 acres of airport land yet to be developed; and the new North American facility increasing the chances of securing additional regional C-130 MRO contracts.

We still regard the likely NAV as a useful guide to the inherent worth of the Group in the absence of financial forecasts. This should hopefully prove conservative given the potential value of the Airport land as it is developed. Our indicative value / share estimate falls slightly to 453p (from 478p).

### Marshall of Cambridge Holdings Ltd

Last matched trade	380p
Implied market cap	£225m
ED value / NVPO share	453p
Ordinary share count	59.1m
Preference shares	£8.4m
Net cash (Dec ‘23)	£35m

### Share Price, p



Source: Asset Match, James Sharp

### Description

Founded in 1909, Marshall of Cambridge (Holdings) Ltd (MCH) 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 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 (NVPO) can be traded freely via a special off-exchange matching facility administered by Asset Match. See:

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## A challenging year

Group revenues for FY23 amounted to £322m, compared to £369m in FY22, a reduction of 13% yoy.

The key variant was **Aerospace**, reflecting the cessation of the HIOS contract with the UK MoD (Hercules Integrated Operational Support) in June, which followed the retirement of the UK C-130J fleet. As such, the UK MoD contributed to six months of revenue, aided by the HIOS-related price adjustment to reflect the early retirement of the fleet, compared to a full twelve months in FY22. Although the last service of an RAF C-130J was completed in February, Marshall has continued to modernise aircraft within the fleet (as part of the gain share agreement with the UK MoD).

Excluding the HIOS/RAF fleet MRO (maintenance, repair, and overhaul) contract, Aerospace revenues improved modestly yoy. The bright spot was the improvement in the run-rate of US Marine Corps-related MRO activity in Cambridge during H2, with other international customers active during the year. The division currently has 17 international C-130 MRO customers in total.

Elsewhere within engineering, all other sub-divisions registered growth in the top-line, albeit within **Fleet Solutions (MFS)**, the acquisition of two FRIGOBLOCK dealers underpinned the yoy divisional uplift, following its acquisition for c. £4m during Q2.

**Land Systems** delivered a modest uplift in the top-line yoy as the legacy contracts moved to volume production. The progress witnessed during H1 was however offset by a temporary line stoppage during H2.

Progress within **Advanced Composites** and in the **Skills Academy** was, by comparison, more positive. During the year, Advanced Composites delivered the 200<sup>th</sup> composite C-130 cockpit panel to Lockheed Martin and several new projects commencing within the aerospace and marine sectors. Following its relocation into larger premises in Cambridge, the Skills Academy reported a significant increase in the number of apprentices admitted to the September intake, with the level of training opportunities commenced in Canada also markedly higher yoy.

The Group's **Property** division (MGP) performed strongly during FY23, registering 91 units sold, representing an increased run rate from H1's 37 completions. The ground floor commercial units were also let during the year and overall, the investment properties benefitted from improved valuations.

## Profits down, action on costs initiated

The early retirement of the UK MoD's fleet of Hercules C-130J aircraft has significant consequences for Marshall, with a cost base geared towards supporting the RAF and the Aerospace division's international customers. With the RAF activity diminished, the cost base needs adjustment. While Aerospace was understandably the most significant drag on profits during H2, it was not alone.

The legacy contracts within Land Systems moved into volume production during FY23, following a root-and-branch transformation in processes during FY22. Nevertheless, further action was required to improve efficiency, via a greater standardisation of product. Performance was also hampered by the temporary halt in production due to engineering issues in H2 (a temporary line closure). With additional contracts at better margins coming on stream, we should see a dilution of the negative impact from legacy contracts from Q4 '24. A likely significant contract award from the Canadian Armed Forces, to be manufactured in Moncton, New Brunswick, should ramp up during FY25.

Although revenues improved due to the higher margin FRIGOBLOCK dealerships purchased by Fleet Solutions, returns were affected by the combination of ongoing price competition in the Thermo King refrigerated transport, which resulted in a loss of installation contracts and inflationary pressures impacting fixed price service contracts. An ERP system was implemented in June, generating additional management data while also improving efficiencies within the business.

Conversely, despite the housing market being dominated by higher mortgage rates and concerns over the UK entering recession during CY23, the margin mix of sales on the Marleigh development improved yoy. The better mix reflected a higher proportion of home sales versus apartments, reversing the trend of CY22. The number of completions is now over the 300 level, with several occupations within phase two.

Raw material price inflation has subsided from the higher levels witnessed during H1, which should result in improved margins as we move through FY24, and the market starts to recover.

At Group level there is clear recognition of the importance of rightsizing the cost base post-HIOS, driving profitable growth via better execution, and converting opportunities into new orders to improve profitability. A Chief Growth Officer was appointed in Q1 to drive additional revenues from the existing client base, which includes blue-chip OEMs such as Boeing and Lockheed Martin. He will oversee a global team with a presence in the UK, North America, the Middle East, and Northern Europe.

### **Net cash declined as working capital increased**

The combination of higher working capital and reduced profitability resulted in net cash levels declining to £35m (FY22: £129m). The higher working capital reflects programmes within Land Systems and expenditure undertaken on the Centre Wing project for the RAF, with payment once the airframes are sold. The ramp-up of production on legacy contracts within Land Systems resulted in an increase in inventory, which was exacerbated by the line stoppage during H2.

Capex included:

- The new facility in New Brunswick, Canada
- The planning application for Cambridge East, Cranfield, and North Works
- The roll-out of the new ERP system
- The acquisition of two FRIGOBLOCK dealerships and,

The new leasehold facility at the Piedmont Triad Airport, North Carolina, will be completed in late FY24, opening in Q1 '25. Further capex will commence during H2 on the new 15,000 sq m production facility in Alconbury Weald for Land Systems, opening during FY25.

With H1 '24 profitability likely to mirror H2 '23, we expect continued pressure on profitability levels and cash consumption. A combination of market recovery and new customer wins should begin to feed through during late 2024 to early 2025, resulting in improvements to said trends.

Nevertheless, with interest from the defence departments of several nation-states in the RAF's C-130 fleet, we remain optimistic that most of the aircraft will be disposed of during H2 '24. Previous MRO work will be invoiced to the UK MoD at the point of disposal.

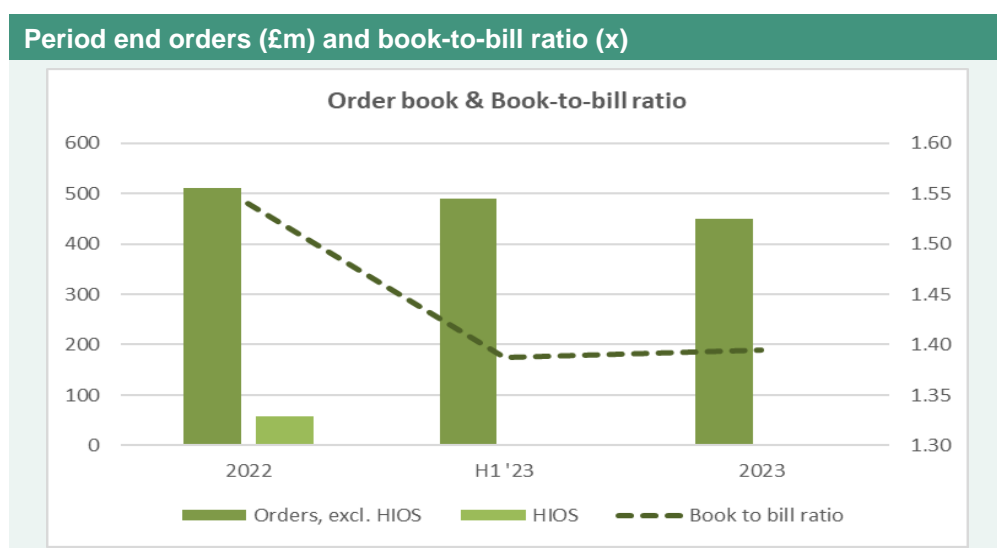
## Looking Forward

### A significant order book

Notwithstanding the end of the HIOS contract with the UK MoD in June 2023, the order book (which excludes Marshall Group Properties) looks healthy at £449m. At current revenue run rates this represents a book-to-bill ratio of 1.4x, unchanged from the end of the H1 '23 period.

The pipeline of tenders was not highlighted within the trading update, but apparently stood at a considerable level of c. £4bn at the end of September, excluding the Group Property division. The potential Cambridge East development and the remainder of the airport land equates to c. 660 acres, which will be developed over the next 20 years. Consultations on the Cambridge East development remain ongoing, with the Local Plan expected to be published by the end of CY24. Planning applications for the third phase of the Marleigh development, totalling 421 dwellings were submitted in Q4 '23, with vacant possession of the North Works site anticipated by Q4 '25.

Land Systems North America is the preferred bidder for a contract to replace the logistics vehicle fleet of the Canadian Armed Forces, as part of a consortium that includes General Dynamics, Mercedes Benz, Soframe and Manac. If successful, Marshall Canada will supply a range of interchangeable containerised mission modules capable of being mounted onto trucks. The contract award is likely to be announced in Q2 '24 and, if secured, will commence during FY25, with the Group's contribution manufactured at its new production facility in Moncton, New Brunswick, which opened in October 2023.



Source: Company data, ED

Marshall Aerospace, the UK MoDs resale partner, is under a gain share contract and is storing the C-130J aircraft ahead of their sale. However, the timing of revenues associated with the disposal of the RAFs fleet have been pushed back, with negotiations at the ministerial level between the UK and the governments of interested parties. Any further modification work will be undertaken and paid for on completion of any deal. We understand that expressions of interest from other countries have been submitted, but timing is subject to MoD approval.

We therefore anticipate an improved outlook once the disposal is announced. Our hope is a desire on the part of the purchasers to seek MRO contracts with Marshall, in-line with historical trends and thereby adding to the 17 international customers already using Marshall for Hercules' MRO.

One should pay attention to the potential of the new North American facility at Piedmont Triad International Airport, North Carolina, which is expected to open during Q1 2025. The division is hiring employees to man the facility once open, with 240 roles anticipated.

The facility's focus will be to accommodate the USMC contract and attract additional North American MRO contracts. The region accounts for approximately half of the C-130 airframes currently operational globally.

Marshall, via its Futureworx division, is part of the HyFIVE consortium, including GKN Aerospace and Parker Meggitt, who will develop a world-leading hydrogen fuel system and supply chain supporting future zero-emission aviation. The project is to be part-funded by the government. The division has also commenced customer demonstrations of its unmanned drone product, Lilypad.

Any recovery in the housing market should, all things being equal, result in rising selling prices from H2 onwards. Margins should also benefit as fewer incentives and lower marketing efforts are required to sell units. The mix of house/apartments will, however, have a greater bearing on the margin, as we saw in FY23.

### Changes in the management team

In keeping with a re-shaping of the business, post-HIOS and to execute the new five-year strategic plan, the Board and senior management team is evolving, with individuals boasting the requisite business experience and relationships having joined the Group.

Recent evidence of this includes:

- The Chairman, Jonathan Flint, will retire at the end of March after five years' service with the Group. The process to appoint a new Chair is underway, with an Interim hire likely ahead of Jonathan's departure.
- James Buxton will retire at the AGM, following 10 years' valuable service as a Non-Executive Director.
- Nick Shattock was appointed as a Non-Executive Director and James' replacement in October 2023. He has a background in leading large-scale mixed-use developments and is a former deputy CEO at Quintain.
- David Heaford was appointed Chief Financial Officer in October 2023, with significant previous experience across the real estate and technology sectors including being Director of Development at Landsec Plc, the FTSE 100 real estate company.
- Gareth Williams joined Marshall in November 2023 as Chief Operating Officer, having previously held senior positions at both Thales and General Dynamics (UK).
- Bob Baxter was appointed to the newly created role of Chief Growth Officer in February 2024, to lead global strategy, business development and sales. Bob has successfully led business growth initiatives across several multi-national Aerospace businesses prior to joining Marshall.

As part of the Board's ongoing commitment to shareholder communication, Cynthia Alers also joined Marshall as Head of Investor Relations in January of this year and leading public relations firm Hudson Sandler was retained in July 2023.

### Five-year strategic plan

It is worth reminding readers that the strategic plan, which commenced at the beginning of 2023, was designed to deliver enhanced shareholder value to stakeholders. The transformational benefits of the new strategy were always expected to flow through from year two onwards.

We believe the investment in new facilities, cost efficiency programmes, on-going re-development of the Airport land in Cambridge (with a 20+ year horizon), and successful tenders (c. £4bn pipeline) will ultimately deliver on the Board's goals.

## In summary

Continuing difficult trading into Q1 of 2024, focused on the three larger engineering businesses and an unlikely improvement ahead of the latter stages of the year, creates uncertainty. As such, we withhold estimates for FY24 and beyond at this stage.

Bolstered by a refocused and strengthened management team, we expect that the second year of the five-year plan (post-HIOS) should see a turnaround in activity levels, aided by a combination of the strong order book and further efficiency improvements.

We continue to rely on NAV as a guide to current value / share. Although the level of net cash has declined from £79.4m in September 2023 (when the NAV was reported with the H1 results) to £35m at the December year-end, a significant portion of the decline was switched into working capital, inventory, and capex.

Maintaining our conservative approach, we have estimated that approximately two-thirds of the shortfall in net cash during H2 fed into inventory / investment assets. That indicates a NAV of c. £267.5m, which equates to 452.8p / share.

Lastly, when considering the valuation of the airport land one should not forget it is being carried at cost and was purchased some 90 years ago. If approved, the Cambridge East development will utilise approximately 460 acres and a further 200 acres with no associated development plans.



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