Cavendish

Company Flash

22 May 2024

Corp

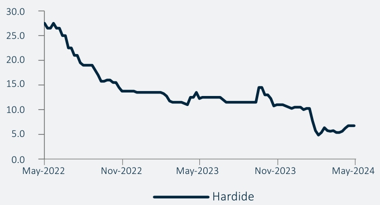
Ticker	**HDD:AIM**
Speciality Chemicals	
Shares in issue (m)	77.4
Next results	FY Nov

Price	**6.8p**
Target price	Under review
Upside	n/a

Market Cap	**£5.2m**
Net debt/(cash)	-£0.7m
Other EV adjustments	£0.0m
Enterprise value	£4.5m

What's changed?	From	To
Adjusted EPS	-1.3	-1.2
Target price	U/R	n/c

Share price performance



%	1M	3M	12M
Actual	20.0	28.6	-44.9

Company description

A provider of advanced coatings for internal and external surfaces

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* denotes corporate client of Cavendish

HARDIDE*

Stronger H2– On track for FY24E EBITDA breakeven

The past two months have returned to EBITDA profitability and positive cash flow with a recovery in oil & gas demand from earlier destocking, while Aerospace was up 400% and with volumes ramping up with Airbus. H2 is expected to be adj EBITDA profitable and cash generative. We trim FY24E revenue by £0.5m, but due to cost reductions, we maintain our existing EBITDA breakeven for the year and year end cash is expected to be stable on half year levels. We believe new management has enhanced the group's commercial focus with new ideas to accelerate revenue growth. Looking ahead, FY25 is expected to see a step-up in revenue, with a strong drop through to profitability.

- **Interims.** Revenues to 30 March reduced by 26.7% to £2.1m, as previously flagged due to softer market conditions and destocking mainly in the Oil & Gas sector at the start of the period. Gross profit declined 35% to £0.9m, with gross margins of 41%, down from 46.7%. Adj EBITDA loss widened to £0.48m from breakeven previously. Adj pre-tax loss was £0.96m, versus a loss of £0.6m. LPS at 1.6p, compared with a loss of 1.0p in the prior period. The cash balance was stable at £0.7m. Net bank borrowings were nil, with IFRS lease liabilities of £2.2m (versus £2.3m).
- **Operations.** Energy market revenues decreased by 53% to £0.8m, representing 42% of group revenues. The oil & gas market experienced a softer H1 than the prior year, with an OEM customer destocking at the start of the half year. Industrial saw sales soften by 19% to £0.8m, representing 36% of group revenue. Aerospace volumes started to significantly accelerate, with revenue growth of 400% to £0.5m, from a very low base to a now noteworthy 22% of revenues.
- **New CEO.** The new CEO has been announced as Matt Hamblin, an existing NED. Matt was previously at Keronite, where he successfully achieved commercialisation and profitable growth. Keronite is a similar coatings business to Hardide and therefore Matt brings a deep understanding of the surface treatment sector as well as greater commercial drive. Steve Paul, who was acting Interim CEO, will continue in a business development role having contributed to several important commercial initiatives.
- **Forecasts.** We reduce FY24E revenue by £0.5m to £5.0m, with growth expected in H2. We maintain our EBITDA breakeven forecast for the year, following a recent reduction in overheads. Adj pre-tax loss at £0.9m, is £0.1m improved by a lower forecast depreciation & amortisation charge. There are one-off costs of £0.4m associated with the CEO change and restructuring. Our year-end cash balance of £0.7m, is essentially level on the half year, factors in the additional one-off costs as well as the recent asset finance of £0.3m.
- **Valuation.** Our target price remains under review.

Key estimates		**2020A**	**2021A**	**2022A**	**2023A**	**2024E**
Year end:		**Sep**	**Sep**	**Sep**	**Sep**	**Sep**
Revenue	£m	4.8	3.6	5.0	5.5	5.0
Adj EBITDA	£m	-0.5	-1.5	-1.0	-0.1	0.1
Adj EBIT	£m	-1.2	-2.6	-2.2	-1.0	-0.7
Adj PBT	£m	-1.3	-2.7	-2.3	-1.2	-0.9
Adj EPS	p	-2.4	-4.6	-3.9	-1.9	-1.2
DPS	p	0.0	0.0	0.0	0.0	0.0
Key valuation metrics						
EV/sales	x	0.9	1.2	0.9	0.8	0.0
EV/EBIT (adj)	x	-3.7	-1.7	-2.1	-4.5	0.0
P/E (adj)	x	-2.9	-1.5	-1.7	-3.6	-5.7
Dividend yield	%	0.0%	0.0%	0.0%	0.0%	0.0%
Free cash yield	%	-89.4%	-43.2%	-25.1%	1.1%	-11.7%

Stronger H2– On track for FY24E EBITDA breakeven

Income statement		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Sales	£m	3.6	5.0	5.5	5.0
Gross profit	£m	1.3	1.9	2.6	2.4
EBITDA (adjusted)	£m	-1.5	-1.0	-0.1	0.1
EBIT (adjusted)	**£m**	**-2.6**	**-2.2**	**-1.0**	**-0.7**
Associates/other	£m	0.0	0.0	0.0	0.0
Net interest	£m	-0.1	-0.1	-0.2	-0.2
PBT (adjusted)	**£m**	**-2.7**	**-2.3**	**-1.2**	**-0.9**
Total adjustments	£m	-0.2	0.0	0.0	-0.4
PBT (stated)	£m	-2.9	-2.3	-1.2	-1.3
Tax charge	£m	0.1	0.1	0.1	0.1
Minorities/Disc ops	£m	0.0	0.0	0.0	0.0
Reported earnings	£m	-2.8	-2.2	-1.1	-1.2
Adjusted earnings	**£m**	**-2.6**	**-2.2**	**-1.1**	**-0.8**
Shares in issue (year end)	m	55.0	57.9	58.9	77.4
EPS (stated)	p	-5.2	-3.8	-1.9	-1.5
EPS (adjusted, fully diluted)	**p**	**-4.6**	**-3.9**	**-1.9**	**-1.2**
DPS	**p**	**0.0**	**0.0**	**0.0**	**0.0**

Growth analysis		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Sales growth	%	-24.4%	39.4%	9.7%	-9.1%
EBITDA growth	%	-226.2%	36.0%	84.8%	169.4%
EBIT growth	%	-114.6%	17.6%	53.3%	30.5%
PBT growth	%	-107.2%	16.0%	48.8%	23.0%
EPS growth	%	-93.8%	14.2%	51.8%	37.4%
DPS growth	%	n/m	n/m	n/m	n/m

Profitability analysis		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Gross margin	%	36.4%	37.5%	47.5%	48.0%
EBITDA margin	%	-41.3%	-18.9%	-2.6%	2.0%
EBIT margin	%	-72.8%	-43.0%	-18.3%	-14.0%
PBT margin	%	-75.6%	-45.5%	-21.3%	-18.0%
Net margin	%	-72.1%	-43.8%	-19.9%	-16.0%

Valuation analysis		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
EV/EBITDA	x	-3.0	-4.7	-31.2	0.0
EV/EBIT	x	-1.7	-2.1	-4.5	0.0
P/E	x	-1.5	-1.7	-3.6	-5.7

Cash flow		**2021A**	**2022A**	**2023A**	**2024E**
Year end:		**Sep**	**Sep**	**Sep**	**Sep**
EBITDA	£m	-1.5	-1.0	-0.1	0.1
Net change in working capital	£m	-0.3	0.0	0.4	-0.1
Other operating items	£m	-0.2		-0.1	-0.4
Cash flow from op. activities	**£m**	**-1.9**	**-1.0**	**0.2**	**-0.4**
Cash interest	£m	-0.1	-0.1	-0.2	-0.2
Cash tax	£m	0.1	0.1	0.2	0.1
Capex	£m	-0.3	-0.3	-0.1	-0.1
Other items	£m				
Free cash flow	**£m**	**-2.3**	**-1.3**	**0.1**	**-0.6**
Acquisitions / disposals	£m	0.0	0.0	0.0	0.0
Dividends	£m	0.0	0.0	0.0	0.0
Shares issued	£m	0.8	0.5	0.0	0.8
Other	£m	-0.1	-0.2	0.4	0.1
Net change in cash flow	**£m**	**-1.6**	**-1.0**	**0.4**	**0.2**
Opening net cash (debt)	£m	2.2	0.6	-0.4	-0.0
Closing net cash (debt)	**£m**	**0.6**	**-0.4**	**-0.0**	**0.2**

Cash flow analysis		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Cash conv'n (op cash / EBITDA)	%	n/m	n/m	n/m	n/m
Cash conv'n (FCF / EBITDA)	%	152.0%	138.2%	-40.3%	-609.7%
U/lying FCF (capex = depn)	£m	-3.1	-2.2	-0.7	-1.3
Cash quality (u/l FCF / adj earn)	%	118.5%	101.1%	63.7%	163.7%
Investment rate (capex / depn)	x	0.3	0.2	0.1	0.1
Interest cash cover	x	n/a	n/a	1.0	n/a
Dividend cash cover	x	n/a	n/a	n/m	n/a

Working capital analysis		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Net working capital / sales	%	10.8%	7.3%	1.1%	3.4%
Net working capital / sales	days	39	27	4	12
Inventory (days)	days	51	35	16	22
Receivables (days)	days	59	70	49	54
Payables (days)	days	71	78	61	64

Balance sheet		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Tangible fixed assets	£m	5.7	5.4	4.6	4.1
Goodwill & other intangibles	£m	0.1	0.1	0.0	0.0
Other non current assets	£m	1.9	1.7	1.7	1.5
Net working capital	£m	0.4	0.4	0.1	0.2
Other assets	£m	0.4	0.5	0.3	0.3
Other liabilities	£m	-2.2	-2.1	-2.4	-2.5
Gross cash & cash equivs	£m	1.5	0.7	0.7	0.7
Capital employed	**£m**	**7.9**	**6.5**	**5.1**	**4.4**
Gross debt	£m	0.9	1.0	0.8	0.5
Net pension liability	£m	0.0	0.0	0.0	0.0
Shareholders equity	£m	6.9	5.5	4.3	3.8
Minorities	£m	0.0	0.0	0.0	0.0
Capital employed	**£m**	**7.9**	**6.5**	**5.1**	**4.4**

Leverage analysis		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Net debt / equity	%	net cash	5.9%	0.5%	net cash
Net debt / EBITDA	x	n/a	n/a	n/a	net cash
Liabilities / capital employed	%	12.0%	15.5%	15.1%	11.9%

Capital efficiency & intrinsic value		2021A	2022A	2023A	2024E
Year end:		Sep	Sep	Sep	Sep
Adjusted return on equity	%	-37.5%	-39.7%	-25.5%	-20.8%
RoCE (EBIT basis, pre-tax)	%	-33.3%	-33.0%	-19.9%	-16.0%
RoCE (u/lying FCF basis)	%	-39.1%	-33.9%	-13.8%	-30.0%
NAV per share	p	12.6	9.6	7.3	5.0
NTA per share	p	12.4	9.4	7.3	5.0

Overview

Hardide's half year results confirmed recent trading comments, with a softer start to the year experienced as some OEMs temporarily reduced demand. This now appears to be recovering and normalising and recent months have seen a marked pick up in momentum with the Company achieving positive EBITDA and cash flow in the past two months and reiterated commitment to achieving EBITDA breakeven for FY24E and indicates prospect for a more meaningful profit in FY25E.

New management show a greater commercial focus to accelerate revenue growth on a cost base that has been further right sized. Indeed, management estimate it has lowered the breakeven point by around 20% in revenue terms in the past 18-month, equating to around £1.5m.

The Energy sector declined by 53% now contributing 42% of revenues, due to the destocking. Pleasingly the aerospace segment saw rising component schedules, with revenues up 400%+ and now contributing a meaningful 22% of group revenues in the period. Industrial revenues declined by 19% to form 36% of group revenues with demand also recovering from some customer inventory adjustment.

Outlook

In the two months since the half year-end, the group has seen an improved revenue run rate, at a higher gross margin and combined with the lowered cost base it has achieved adj EBITDA breakeven.

The company reiterates its expectation to achieve a small positive adj EBITDA for FY24, with a stronger H2 anticipated as energy customer demand continues to recover and with additional volumes expected in the aerospace sector and the new initiative in consumable industrial coatings achieving some traction. Some further gains are also expected from management action on cost efficiencies. An expected H2 below the line charge of £0.4m relates to the one-off restructuring costs and CEO transition cost.

The group's cash position looks more stable, with a cash balance of over £0.7m at the period end, helped by the placing £0.75m in February. Since the period end liquidity has improved further by an additional $315k asset backed loan. The company is also targeting to be in a run rate cash flow positive trading position by the end of FY24.

Interim highlights

Six months to 30 March (£m)

- Revenue decreased 27%, or down £0.8m, to £2.1m reflecting the softer demand conditions at the start of the period. This mainly reflected a decline in US revenues, which declined by 47% versus an 8% decline in the UK.
- Gross profit decreased 35.6% to £0.87m by 565bps to 41.0%, which is a negative revenue drop through effect on a fairly fixed cost of manufacturing base, with cost of sales down by less than 19%. Gross margin has since recovered in the past two months to 48.3%, ahead of previous levels, responding to higher throughput and cost efficiencies.
- Overhead costs were around £0.1m lower than the prior period, due to cost savings, which more than offset the underlying inflationary effects.
- Adj EBITDA moved from breakeven to a loss of £0.48m, principally due to the lower revenues. It is important to recognise the business recovered to an adj EBITDA breakeven in the final two months of the period, reflecting better throughput, improved margins and lower costs. Depreciation and amortisation costs reduced from £0.54m to £0.40m.
- After flat interest costs of £0.08m Adj pre-tax loss increased by £0.35m to £1.0m.
- Adj LPS at 1.6p, versus LPS of 1.0p previously.
- There were no below the line charges in the period.
- The cash balance held steady at £0.7m, partly reflecting the £0.75m net placing proceeds in February.

Strategy and commercial development

The group's strategy continues to be to grow customer opportunities in existing markets and to diversify its revenue streams into new and growing markets.

Traditional revenue streams continue to have significant short- and medium-term potential – with recovery in the oil & gas market, new products and customers in aerospace and coated turbine blades for power generation. New product areas in tooling and for the medium-term in Hydrogen manufacturing and storage are also being investigated.

It has also identified a range of new initiatives:-

- The supply of pre-coated products for end users in industrial spares markets, a direct sell with no pre-qualification.
- Offer Hardide coatings as a design in solution, with sales won on specification not price and designed to solve customer problems.
- Increased presence in the North American market through targeted business development, leveraging the capacity of the Martinsville facility.
- Development of new markets in emerging areas such as Hydrogen manufacture and storage. This is being grant funded and is seeing encouraging initial results.
- Opportunities to sell, lease or licence capacity in partnerships with certain customers.

Geographic performance

Figure 1: Operational performance by location

	Revenue			EBIT		
	1H24	1H23	% change	1H24	1H23	% change
UK	1.4	1.5	-8%	-0.2	-0.3	-28%
US	0.7	1.4	-47%	0.0	0.5	-98%
Corporate				-0.6	-0.6	-1%
	2.1	**2.9**	**-27%**	**-0.9**	**-0.5**	**67%**

Source: Company data

Operational analysis

The group continues its strategy of growing its revenue base and diversifying its customer base. While the decline seen in Energy in the period was a temporary issue, now apparently recovering, the growth in aerospace volumes is finally coming through, with a rising number of components approved and with Airbus production schedules also increasing.

Figure 2: Operational performance

	Revenue	Proportion	Growth
Energy	0.8	42%	-53%
Industrial	0.8	36%	-19%
Aerospace	0.5	22%	400%
	2.1	**100%**	**-27%**

Source: Company data

Energy (42% of sales)

As mentioned, the decline in Energy revenues was largely due to some customer OEM destocking at the start of the period. In addition, there was also some effect from lower energy market activity levels, with some impact from land-based drilling regulations in the US and some effect of Russian sanctions. Trading has already started to recover as destocking effects reverse.

There were no revenues in the power generation sector in the period, or indeed in the prior period, with the initial set of turbine blades supplied in 2022 being field tested. The customer indicates that there should be follow on sales towards the end of this calendar year. Sales of spares are also being investigated for the maintenance and aftermarket.

Industrial (36% of sales)

While revenues declined by 19% in the period, which was attributed to some OEM customer destocking management indicates that demand has now largely recovered.

Aerospace (22% of sales)

There was a very strong pick up in aerospace revenues in the period, increasing 400% and now starting to be a more meaningful revenue segment for the group, after many years of development and trials with OEMs.

With an increasing number of components on Airbus airframes, the group has a good visibility of the pipeline of scheduled demand through until 2025. Airbus is also expecting to increase production rates on several of its main airframes.

Cash flow and finances

The cash outflow from operations widened in the period, reflecting the increased EBITDA loss from £0.1m in H1 2023 to £0.5m. Net working capital continued to be tightly managed and released £0.1m. After interest paid of £0.07m the net cash outflow from operating activities was £0.44m.

Investing activities remained at a low level, with well invested facilities. Capex in the period was £0.1m, versus depreciation of £0.3m.

The placing in February raised net proceeds of £0.75m. The group paid £0.1m in lease repayments and £0.12m in loan repayments.

This left the group's cash balance at the period end at £0.7m, steady on the September year end level.

The group ended the period with net debt, excluding IFRS lease liabilities was nil. This consisted of cash balances of £0.7m (versus £0.7m in September 2023), offset by loans of £0.7m (versus £0.7m), while IFRS lease liabilities stood at £2.2m (versus £2.3m).

Post the period end the group secured a further $315k of asset backed lending, with American National Bank and Trust Company, part of Atlantic Union Bank, with a fixed interest rate of 7% with the loan amortising over the period until May 2031. This increases liquidity currently to about £1.0m.

The group's debt maturity profile indicates £0.26m of loans and £0.19m of lease liabilities are due within a year. These are similar levels noted a year ago.

The group confirms a positive going concern statement. It also comments that revenues would need to reduce by a further 15% below the latest base case forecasts for the remainder of the year and into the following financial year, and without further costs savings before it would require further funding.

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UNDER REVIEW: recommendation and/or forecasts are under review pending further clarity as to the company's financial and/or operational position
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Distribution of investment recommendations as per 22/05/2024

	Corporate client no.	Corporate client %	Total no.	Total %
Buy	3	2.0%	13	7.8%
Hold	0	0.0%	3	1.8%
Sell	0	0.0%	0	0.0%
Under Review	0	0.0%	0	0.0%
Corp	140	95.2%	151	90.4%

Temporary movements by stocks across the boundaries of these categories due to share price volatility will not necessarily trigger a recommendation change. All recommendations are based on 12-month time horizon unless otherwise stated.

Recommendation history

Company	Disclosures	Date	Rec	Price	Target price
Hardide	2,6,8,9,10,11	28 May 14	Corp	84.0p	84.0p

Source: Cavendish

A list of all the recommendations produced/issued by the relevant Sales Person / Research Analyst on any financial instrument or issuer disseminated during the preceding 12 months is available upon request free of charge. Please contact the appropriate Cavendish analyst or your Cavendish contact on 020 7220 0500.

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