20 May 2019

NMCN

CONSTRUCTION & MATERIALS

NMCN.L

575p

Market Cap: £58.4m

SHARE PRICE (p)

12m high/low	785p/310p

Source: LSE Data

KEY INFORMATION

Enterprise value	£29.9m
Index/market	LSE
Next news	Interims, August 2019
Gearing	N/A
Interest cover	50.3x

NMCN IS A RESEARCH CLIENT OF PROGRESSIVE

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Sustainable development

We believe leading engineering and construction group nmcn will benefit from sustainable earnings growth, supported by environmental investment and a trend among customers seeking more stable, long-term partners after Carillion's failure. The cash-positive group's strategy prioritises margins, cash generation and risk management to prevent recurrence of loss-making legacy contracts. Based on what we believe to be conservative estimates, the shares are trading on a FY 2019E P/E of 10.3x and yield of 3.5%.

- **Focused on high spending sectors.** nmcn, which changed its name from North Midland Construction last year, sources 72% of its revenue from its Water segment. Built Environment serves sectors including high spending roads, telecoms, student housing and health sectors. Longer-term the aim is for a more even earnings and revenue balance between the two segments.
- **Driven by investment priorities and long-term frameworks.** nmcn's largest sector, Water, has been driven by six consecutive investment programmes lasting five years. The next, 'AMP 7', is budgeted at £50bn, starting in 2020, a £6bn increase, mainly in 'frameworks' with suppliers.
- **Group strategy targets financial sustainability.** After a series of loss-making legacy contracts, stronger risk management controls were imposed, followed by a six-point strategy in 2016 under incoming Chief Executive John Homer further targeting margins and cash generation. nmcn's net cash of £28m could benefit from a trend among clients selecting financially sound contractors, following the collapse of Carillion and financial troubles at Interserve and Kier.
- **Targeting sustainable earnings growth.** Our possibly conservative estimates assume the benefits of growing demand and operational improvements feeding through gradually over our three-year forecast period. In the 16 May AGM statement, chairman Robert Moyle stated: "prospects for sustainable growth are very positive across all the chosen markets", with focus on risk management and contract selection.
- **Valuation.** The shares have fallen 27% from a 12-month high of 785p and are trading on a FY 2019E P/E of 10.3x, falling to 9.8x in FY 2020E. The shares are yielding 3.5%, based on FY 2019E.

FYE DEC (£M)	2017	2018	2019E	2020E	2021E
Revenue	302.3	340.5	347.5	362.5	378.1
Adj EBITDA	14.3	12.1	12.0	12.5	13.0
Fully Adj PBT	10.6	7.9	7.4	7.8	8.3
Fully Adj EPS (p)	82.7	59.3	55.7	58.6	62.2
EV/Sales (x)	0.1x	0.1x	0.1x	0.1x	0.1x
EV/EBITDA (x)	2.1x	2.5x	2.5x	2.4x	2.3x
PER (x)	7.0x	9.7x	10.3x	9.8x	9.2x

Source: Company Information and Progressive Equity Research estimates

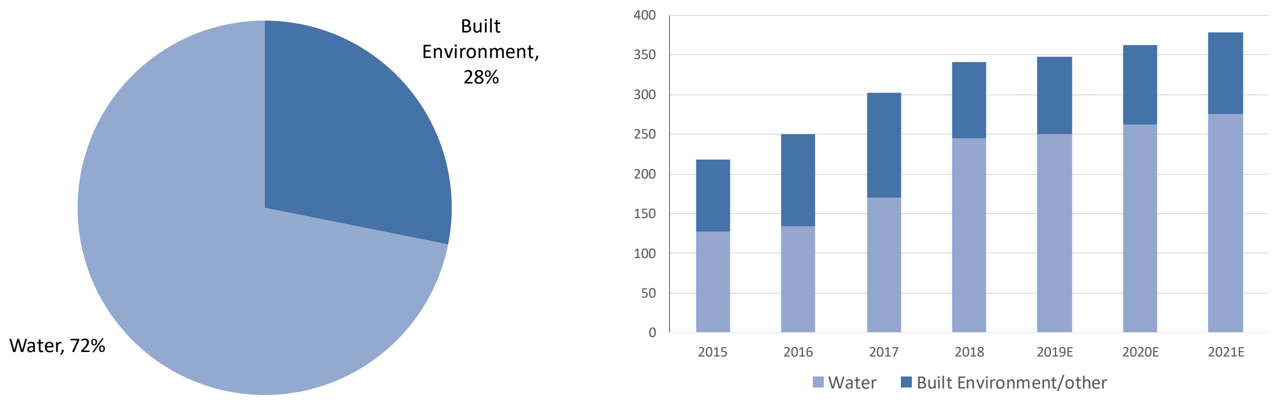
Overview: focus on sustainability

'Sustainability', in our view, is a key investment theme, highlighted on the 16 May AGM statement. Government policies favour sustainability and key infrastructure priorities, in particular water, which is being supported by huge consecutive spending programmes. As important, is an increasing selectivity among many leading public and private clients, favouring cash-positive contractors and working with them in long-term collaborative contracts. nmcn's £100m+ contract with Severn Trent is a prime example (see page 8).

nmcn in brief

The group was founded in 1946 as North Midland Construction and, together with its water-focused subsidiary Nomenca, was rebranded as nmcn last year. It now consists of two segments: Water (72% of FY 2018 revenue and a similar proportion of profit) and Built Environment. (Longer-term the aim is for a more even balance in revenue and earnings between the two segments.) Water undertakes design, major civil and mechanical engineering, construction and maintenance programmes for large water groups. Built Environment undertakes new build and refurbishment activities, a number of which address Government priorities, including housing, roads and telecoms.

Revenue by segment, 2018, LHS (%); FY 2015 - FY 2021E, RHS (£m)



Source: Company, Progressive estimates

Sustainability of end markets

The majority of group revenue is underpinned by direct government projects or priority sectors for the administration. These include:

- **Water:** The main driver is the series of consecutive five-year Asset Management Programme (AMP) projects. The next, 'AMP 7', starting in 2020, will be worth £50bn, a £6bn increase over the current AMP 6 programme.
- **Roads:** The equivalent for the roads sector of AMP is the five-year 'Roads Investment Strategy' (RIS2), for motorways and major roads, which will run from April 2020. RIS1 was worth £15bn and the budget for RIS2 will be finalised soon.
- **Telecoms:** A lack of mobile phone and broadband coverage in large swathes of the country has become an increasingly political issue. Workloads will continue to be driven by the roll-out of broadband networks, in urban and rural environments by BT Openreach and and Virgin Media together with new market entrants.
- **Housing.** We see build-to-rent as a potential growth market, building on success in the related field of student housing. It also undertakes limited development projects.

Sustainability of client relationships

Financial strength of suppliers increasingly key in clients' decision-making

There appears to be growing evidence since the collapse of Carillion, insolvency of Interserve and failure of many other smaller construction companies, that major customers – both from the public and private side – are placing greater emphasis on the financial strength of suppliers, rather than purely price, and on collaborative working.

nmcn had net cash of £28.4m at YE 2018; Carillion was placed in compulsory liquidation in January 2018 with liabilities of £7bn; Interserve's net debt was £631m before its administration and Kier was compelled to raise £264m in a rights issue in Q4 2018 after revealing net dept of £624m at the previous quarter end.

Net cash has operational, not just financial, benefits for suppliers

Demonstrating a sufficient level of net cash is not only a benefit in terms of balance sheet ratios, and in attracting better clients, but in our view, has an operational benefit. Being in a heavily indebted position can tempt companies to bid aggressively low, or without sufficient due diligence, since construction contracts often generate disproportionately high levels of cash at the beginning of the building process, but can swing to losses before and after completion, thus compounding financial stress.

Financially robust companies do not have the same imperative to 'chase' work. A common theme we have observed over the past two or three results seasons is that managements from the better capitalised peers have emphasised 'selectivity' in bidding for contracts in their core construction segments. This has generally resulted in a lack of growth in volumes but our view is that the margins, risk profile or both have improved.

Aiming for earnings sustainability

Incoming Chief Executive led wide-ranging strategy focusing on cash, margins and risk management

The group was hit by a number of loss-making legacy contracts, which were bid for in the recession, prior to 2013. A more focused group strategy was introduced in 2017, following the arrival of John Homer as Chief Executive in mid-2016 (see management biographies, page 17). This was aimed at not only maximising underlying operational and financial performance, but equally to continue the focus on risk management, which was stepped up post-2013. Six key objectives were established:

- **Driving cash.** Improve cash management and reporting throughout the entire working process, including from the outset making the cash profile of projects part of the process of the selection and drafting of contracts
- **Prevent losses.** In our experience, the cause of most losses across the industry has been poor selection of clients or projects; inaccurate costing or programming; unclear contractual terms; and poor communications within the company and with clients and supply chains. A process of continuous improvement was a key part of the strategy.
- **Improve profit.** Preventing losses is a vital aspect of improving profitability; ongoing margin improvement will include reduction in waste and the use of lean construction techniques as well as innovative approaches to initial design
- **Develop, maintain and protect people.** Construction is very much a 'people' business; recruitment and, importantly, retention is critical, and should be fostered by ongoing personal development. The company emphasises its 'family feel'
- **Enhance brand image.** The company has introduced an Improving Customer Experience Panel (iCEP) with the aim of enhancing the retention of existing clients and attracting new ones
- **Effective communication.** The company rebranded in 2018, a move it reports has been very well received by their existing customers and continues to provide a platform to secure new ones.

Repeat work: a 'virtuous circle'

Almost all workload is for repeat clients, particularly in long-term 'framework' relationships

The company estimates that c. 90 - 95% of its current workload is for repeat customers or in 'framework' arrangements – multi-year partnerships, generally with larger clients, in which collaborative working processes are encouraged. Agreements vary from framework to framework, but can offer guaranteed levels of work or ad hoc workflows; often there is a pain-gain share arrangement; there is generally earlier involvement in the design process.

Framework relationships, if successful, have a 'virtuous circle' effect. It represents less risky work for both parties, since they know each other well and contractors generally have an input higher up the 'feeding chain'. If problems arise on contracts, they can usually be addressed earlier and more collaboratively than under traditional contracts.

If a large proportion of a contractor's work is in frameworks, there is less of a speculative bidding overhead, more standardisation of products and greater buying power. Over time partners can identify greater efficiencies, saving the client money – which could get ploughed back into expansion of scope of work. Frameworks often have in-built scope for extensions, and it is not uncommon to have 'evergreen' extension mechanisms – as long as the contractor delivers to the satisfaction of the client, they can be routinely extended without bidding processes.

Continuous improvement required for incumbents, but increasingly high entry barriers for new competitors

It is not, however, 'easy money' for contractors. Clients require continuous improvement and efficiencies; this may or may not result in margin improvement, but an increasingly secure workflow and lower risk. Conversely, for companies not in frameworks, the barriers to entry can grow over time: clients see less reason to look elsewhere and it becomes harder for new entrants to match the efficiencies realised over years in partnership.

Our estimates: a conservative starting point?

Transition years in water investment cycles bring a degree of uncertainty; our starting position for FY 2019E is for a modest decline in underlying PBT

We are initiating coverage with what we suspect are conservative assumptions for revenue growth and margin progression, given the market opportunities and operational improvements discussed above. This is a year of transition between AMP cycles, which has in the past resulted in a degree of volatility for contractors, especially around the fourth quarter of the last year and the first in the following – Q4 CY 2019 for AMP 6 and Q1 CY 2020, in this case. As a result, we are initiating coverage projecting only a 2% increase in group revenue and a modest decline in underlying PBT, from £7.9m reported in FY 2018 to £7.4m.

For FY 2020E and 2021E, we are also adopting a cautious stance in revenue growth, as well as margin progression, for both segments. As we have argued, ongoing commitment to investment in nmcn's markets and the prospect for further concentration among contractor, suggest that our revenue increases of 4.3% for each of the two years could well be conservative. See page 12.

Valuation

The shares have fallen 27% from a 12-month high of 785p and are trading on a FY 2019E P/E of 10.3x, falling to 9.8x in FY 2020E. The shares are yielding 3.5%, based on FY2019E.

There appear to be no direct comparators to nmcn given its hybrid nature. The closest, in our view are: Morgan Sindall (infrastructure, fit-out, urban development and social housing); Costain (infrastructure and services); and Renew Holdings (engineering services, specialist building and land promotion). These trade on a current year P/E forecast of 8.3x, 9.0x and 10.4x respectively.

On a P/E basis, these valuations are similar, in high single digits or low double digit in the case of Renew. Two observations, from our viewpoint: the relatively modest ratings of all of these companies may have suffered due to the fate of the indebted competitors, as discussed earlier, while these are all cash-positive companies; in the case of nmcn, it is currently in the process of rolling out and demonstrating to new investors, the potential benefits of the new strategy.

Valuation, peer group comparisons

	Price (p)	Mkt cap (£m)	P/E, FY1 (x)	P/E, FY2 (x)	Yield, FY0 (%)	Yield, FY1 (%)
nmcn	**575**	**58**	**10.3**	**9.8**	**3.1**	**3.5**
Costain	328	352	8.3	7.7	4.6	4.8
Morgan Sindall	1,302	592	9.0	8.3	4.1	4.2
Renew Holdings	408	307	10.4	9.8	2.5	2.7

Source: Factset consensus. FY0 = last reported year; FY1,2 = current unreported and following year Priced at COB 16 May; comparators priced at 15 May 2019

nmcn explored

Demand for both segments is dominated by sectors aligned to government priorities, including water, roads and health. As such, we believe revenue and margins should be more sustainable than in more speculative sectors. The group does reinvest a controlled proportion of its surplus cash via its investment unit which concentrates on modestly-sized, mainly residential developments. The Water segment currently contributes 72% to group revenue; longer term, we would expect other growth sectors in Built Environment to lead to a more even balance of revenue and earnings between the two.

Water

Working for almost all water companies

The segment is involved in the design, construction, operation, service and maintenance of facilities for the water supply, sewage and flood defences. It serves almost all of the UK's water utilities companies. They are under regulatory requirements to improve the quality of water supply and efficiency of assets, most notably in cutting leakage. Security of supply is another key priority, illustrated in Severn Trent's 'Birmingham Resilience' programme to provide an alternative channel of supply to the 120-year-old Elan Valley aqueduct.

Project types

Serving clients' assets for their full life cycle

Work in this segment leans more to civil engineering (heavy construction, generally involving groundworks and major transport or utilities structures) than 'building' (predominantly above ground, for occupation by residents, workers or businesses), which is more prevalent in the Built Environment segment.

The scope of projects ranges from small, sub-£1m contracts to the group's largest job yet, for Severn Trent's Resilience programme, reported to be worth in excess of £100m. The segment undertakes a range of services that cover the full life cycle of assets and which stretch through the whole delivery process, including:

- Design
- Civil engineering
- Mechanical and electrical
- Instrumentation, controls and automation

Differentiators

Off-site manufacturing capability, asset security services and plant ownership are key advantages

Two key differentiators for nmcn are off-site manufacturing and asset security, both priorities for government. Various government departments have encouraged off-site fabrication of components to improve the efficiency and reliability of housing and non-residential delivery. nmcn has its own factories, which assemble arrays of components for speedier and more reliable fixing on-site.

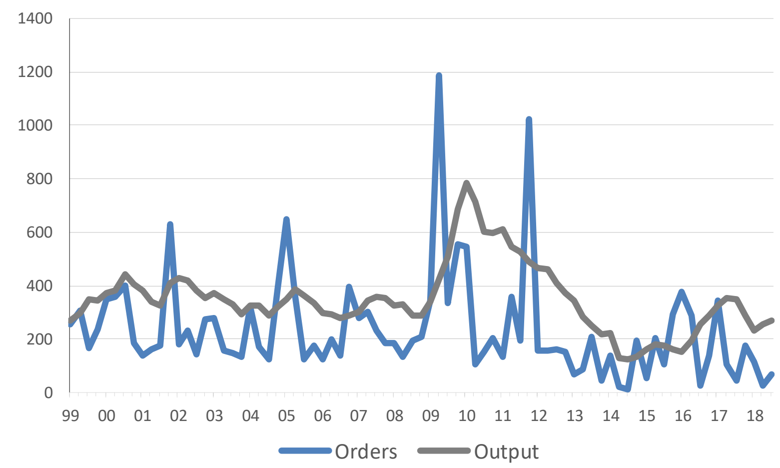
Asset security is also rising up the agenda for government and water companies, given the rise in the threat of terrorism. The group is the only Security Systems and Alarms Inspection Board (SSAIB) accredited construction company in the UK to complete a full asset security service. We this as an important potential growth area for the company.

Another 'USP' for the group is it has a secured supply of construction plant, with a significant owned, rather than leased, fleet.

Main drivers

The main driver of activity has been the succession of five-year AMP cycles, which can see output rise in the earlier years.

Water sector: construction output and orders, quarterly, current prices (£m)



Source: ONS

Major boost in next AMP cycle

AMP 7 will see investment rise from £44bn to £50bn

Capital expenditure by water and sewerage companies in England and Wales is primarily driven by their five-year Asset Management Plans (AMP). The AMP6 period covers the period from April 2015 to March 2020 and AMP7 from April 2020 to March 2025. Compared with the approved AMP6 plans for investment of £44bn at 2012/13 prices in improving services and resilience, and protecting the environment, only part of which is reported as constructions orders and output, the provisional company business plans forecast expenditure of £50bn in 2017/18 prices in AMP7.

Straddling these periods is the £4.2bn Thames Tideway Tunnel, the largest ever Nationally Significant Infrastructure Project (NSIP) and the biggest ever project undertaken by the UK water industry.

Flood defence work is another policy priority and expenditure is expected to remain at around £600m pa.

The Experian Construction Forecasts (see page 9) do not split their projections for the Infrastructure sector into Water and other sub-sectors, but it is part of the reason for the committee's latest estimates of growth in workload of 8%, 9% and 4% in 2019, 2020 and 2021 respectively. This makes Infrastructure the most promising sector in the forecasts for new non-residential output.

Customers

The group's biggest customer is Severn Trent, but the segment works for most of the major UK water companies.

Competitors

These include a range of the bigger construction groups. On the quoted side, this includes Costain, Balfour Beatty, Kier and Morgan Sindall. Unquoted or non-UK groups include Bam and Amey.

Case study: Birmingham Resilience

Biggest project in Severn Trent's and nmcn's history and a prime example of opportunities and benefits of collaborative working

nmcn's Frankley Water Treatment Works project is not only the biggest single contract in the company's or client Severn Trent's history. We also see it as an exemplar of how the group has forged more collaborative and sustainable relationships with clients.

The project, part of Severn Trent's Birmingham Resilience programme, will provide an arguably long-overdue alternative water supply to Birmingham to allow regular maintenance of the 70-mile long Elan Valley Aqueduct from Wales, which the second city's residents, currently 1.2 million, have relied on for some 120 years. This supplies the Victorian Frankley reservoir, to the south of Birmingham, where the water is stored and treated. An alternative pipeline from the River Severn is being bored and nmcn's project entails a major enlargement and modernisation of the neighbouring treatment works. The works are due for completion at the end of 2020.

Previous preferred contractors replaced after six-month hiatus

We view the project as highly complex, time-critical and dependent on collaborative working between contractor, client and supply chain. A joint venture of Interserve and Kier had original been chosen by Severn Trent as preferred contractor but constructionenquirer.com reported in 2017 (link) that the water company had parted company with the JV after six months of negotiations indicating "both sides were unable to agree a price". A sum of £100m had originally been mooted but the bidders were reportedly aiming for £115 - 130m. Soon afterwards nmcn, which we understand had previously lost out as preferred bidder was taken on. The company stated to the same website subsequently (link) that its deal was "worth in excess of £100m".

The scope of the workload includes major civil engineering: laying over 11km of pipes up to 2.2m in diameter; major digs for and concrete pours for treatment tanks, along with connecting pipework (below). The many above-ground structures featured high-strength cladding – a security precaution underscoring a growing trend among utility owners.

Built Environment

The segment addresses a number of infrastructure and other sectors:

- Roads: motorways, feeder roads and junction improvement
- Telecoms: high speed fibre roll-out for telecoms and broadband providers
- Housing associations: affordable housing
- Education: including schools and a strong position in student accommodation
- Health
- Private sector developers
- Public

Main drivers

The Experian forecasts are particularly strong for the infrastructure sector, which includes roads and telecoms, and anticipate a modest pick-up in Public Non-residential, following two years of decline. The big fall expected in Commercial is driven largely by a sharp decline in retail, which nmcn has no exposure to.

New construction output forecasts, non-residential, (£bn, 2018 and % change)

	(£bn)	2016	2017	2018E	2019F	2020F	2021F
Infrastructure	25.2	-3.4%	5.5%	5.4%	8.0%	9.0%	4.0%
Public	10.1	3.8%	-2.7%	-9.8%	1.0%	3.0%	nc
Industrial	5.1	-5.4%	3.0%	4.9%	nc	1.0%	3.0%
Commercial	26.1	7.6%	7.6%	-6.4%	-6.0%	-4.0%	nc
Total	**41.4**	**5.1%**	**4.5%**	**-6.1%**	**-3.8%**	**-1.8%**	**0.4%**

Source: MHCLG, Experian

Roads

The equivalent for the roads sector of AMP in the water sector is the five-year 'Roads Investment Strategy' (RIS2), for motorways and major roads, which will run from April 2020. The value of RIS1 was £15bn and the budget for RIS2 will be finalised later this year.

The main clients are local councils and Highways England, which has been one of the public sector's prime movers in encouraging collaborative working practices, such as frameworks and 'early contractor involvement' in which information and decision-making are shared at early stages in project design – leading to greater efficiencies and, importantly, less risk of disruptions and disputes later on.

Private rental sector and student housing

Institutional investors see build-to-rent as next front, after student housing in longterm income from housing

One of the segment's focus sectors, 'PRS' or build-to-rent (BTR), is in its early phases of what many observers predict could be a major growth sector and which the Government is promoting among its multi-tenure approach to increasing housing supply (see below).

The British Property Federation's Build to Rent Q1 2019 report estimates the total pipeline of BTR houses or apartments grew by 13% YoY to 140,090. Slightly over half this total is units in planning – an 18% YoY increase – indicating the scope for further growth through the construction cycle.

BTR is seen by government as preferable to buy-to-let, which is mainly focused on existing homes, and is seen by many institutional investors as a new future front in income producing asset classes in addition to student housing. BTR arguably requires better quality design and more robust finishing than open market housebuilding for sale, since poor construction and specifications can depress or disrupt future income flows.

There has been a major boom in student housing provision, which nmcn has shared in. It has been an area in which institutional investors have been highly active, both in the primary side, financing new developments, and as the market has matured, selling on equity stakes in a very active secondary market.

We believe there is scope for further healthy volumes of work, but that the market is segmenting into strong developers targeting top-tier universities. We believe these owners are likely to favour strong construction companies with established records.

Affordable housing

Savills predicts up to 100,000 new council homes; local authorities have substantial land holdings

Although nmcn currently has only modest exposure to affordable housing, we believe this is a growth area also supported strongly by government.

The administration of Theresa May has placed far greater emphasis on social housing than predecessor David Cameron's government. The February 2017 Housing White Paper, Fixing our broken housing market, proposed a multi-tenure approach to support the aim of building 300,000 homes a year by the mid-2020s.

The highest profile political move recently is Prime Minister Theresa May's proposal at the Conservative Party conference in October 2018 to free local authorities from the centrally-regulated borrowing caps that had restricted the number of new council houses they could build.

Savills has calculated that councils will be able to borrow an extra £10 - 15bn, sufficient to build 100,000 new homes. Last year 3,280 local authority homes were started; in 1978, the year before Margaret Thatcher came to power, it was 110,170. This may take some time to enact, since legislation has to pass through parliament, but the pledge received near-universal support from key social housing bodies and would appear to chime with Labour Party policy on housing. An important issue for volumes is councils often have major land holdings, but previously had little financial incentive to build.

Social housing starts, GB

	2015	2016	2017	2018E	2019F	2020F	2021F
Starts (000)	31.6	31.9	34.6	32.6	33.0	34.0	39.0
Change (%)	*-4.8%*	*0.9%*	*8.5%*	*-5.8%*	*1.2%*	*3.0%*	*14.7%*

Source: MHCLG, Experian.

nmcn Investments

The property-focused segment invests the company's cash reserves in selectively identified residential speculative developments and small vertically integrated, off-site build supply chain acquisitions. These mainly involve modestly sized, high quality bespoke housing developments.

These potentially allow higher returns, but the company closely monitors exposure and risk through strict monitoring at board level. All projects are undertaken by the group's own construction operations. An example is the Roundhills Farm development, Sutton in Ashfield, a JV between nmcn and developer Brooklyn Ellis worth £3.7m – the first such venture between the two companies. The Nottinghamshire project is a typically bespoke development, consisting of 11 properties, based around three barn conversions, with eight newbuilds (see below).

Clients

There is a wider range of clients than in the Water segment, ranging from major government departments, local authorities, health trusts etc; on the private side, broadband providers, developers etc.

Competitors

Likewise, a wider range. On the quoted side, 'hybrids' such as Kier, Galliford Try, Morgan Sindall etc; a wide range of unquoted companies, including regional players.

Roundhill Farms

Source: nmcn

Financials

Revenue growth of 12.7% during FY 2018 mainly reflected a major increase in the Water segment, driven by new framework awards, work on the Frankley project and increased activity during the transition from AMP 6 to AMP 7 cycles. By contrast, there was a fall-off in revenue in Built Environment, as the result of reduced activity levels for a major telecoms company, which has been the cause of a number of losses. This was the first year that the results were stated under the new segment structure.

The 2017 prior-year revenue of £302m had been restated upwards by £10.5m principally due to the adoption of IFRS 15, which governs the recognition of revenue on contracts, using the full retrospective approach. Under IFRS 15, £8.1m of this £10.5m increase (the balance is due to non-profit affecting reclassifications) has been added to both revenue and post-exceptional operating profit, which was restated upwards from £1.2m to £9.3m.

Looking forward, we believe we have adopted a conservative stance for Water revenue growth pending greater clarity on the award and phasing of AMP 7 workload. In Built Environment, the year-end order book was up 22%, again suggesting we have been conservative in our assumption of low digit growth going forward.

The margin for Water slipped slightly in FY 2018 as the segment invested in building up organisational resources for future growth, suggesting the future profile of our margin expectations may be on the cautious side.

There was a significant fall in operating profit in FY 2018, as a result of large swing in corporate expenses. In reality, it was more that FY 2017 expenses that were particularly low rather than there was a jump in underlying overheads in FY 2018. The expense line contains a number of moving parts, including credits for internal plant hire, which can vary significantly from year to year. We see FY 2018 as being a more representative base for forecasting future corporate expenses.

Earnings model, 2018 - 21E

Year-end Dec (£m)	2017	2018	2019E	2020E	2021E
Revenue					
Built Environment	131.8	95.9	97.8	100.2	102.7
Change (%)	*13.5%*	*-27.3%*	*2.0%*	*2.5%*	*2.5%*
Water	170.5	244.6	249.8	262.2	275.4
Change (%)	*26.9%*	*43.6%*	*2.0%*	*5.0%*	*5.0%*
Group revenue	**302.3**	**340.5**	**347.5**	**362.5**	**378.1**
Change (%)	*20.7%*	*12.7%*	*2.0%*	*4.3%*	*4.3%*
Group results					
Built Environment	10.1	7.6	7.8	7.8	8.0
Margin (%)	*7.7%*	*8.0%*	*8.0%*	*7.75%*	*7.75%*
Water*	15.3	20.9	21.2	22.7	24.1
Margin (%)	9.0%	8.5%	8.5%	8.65%	8.75%
Total	**25.4**	**28.5**	**29.1**	**30.5**	**32.1**
Margin (%)	*8.4%*	*8.4%*	*8.4%*	*8.4%*	*8.5%*
Corporate expenses	(14.7)	(20.5)	(21.5)	(22.5)	(23.6)
Total operating profit	**10.7**	**8.0**	**7.6**	**8.0**	**8.4**
Non-recurring items	(1.4)	(1.9)	-	-	-
Net interest	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)
PBT, reported	**9.1**	**6.0**	**7.4**	**7.8**	**8.3**

Source: Company, Progressive Equity Research estimates

Losses from 2014 (see below) are largely the result of a series of legacy contracts on unfavourable terms entered into at the height of the recession prior to 2013, which carried a higher than normal contractual and commercial risk. Only one legacy contract now remains to be resolved.

On dividends, the company has guided towards a cover of 2 - 3x. The 623,000 dilutive shares reflect the current three-year PSP schemes.

Profit & loss account / per share data

Year-end December (£m)	2014	2015	2016	2017	2018	2019E	2020E	2021E
Group revenue	**193.2**	**217.6**	**250.5**	**302.3**	**340.5**	**347.5**	**362.5**	**378.1**
COGS	(188.2)	(206.0)	(233.7)	(276.9)	(312.0)	(318.5)	(332.0)	(346.0)
Gross profit	**5.0**	**11.6**	**16.8**	**25.4**	**28.5**	**29.1**	**30.5**	**32.1**
Operating expenses	(7.8)	(10.8)	(14.6)	(14.7)	(20.5)	(21.5)	(22.5)	(23.6)
Group operating profit	**(2.8)**	**0.8**	**2.2**	**10.7**	**8.0**	**7.6**	**8.0**	**8.4**
Exceptionals	-	-	-	(1.4)	(1.9)	-	-	-
Interest	(0.1)	(0.2)	(0.2)	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)
PBT, reported	**(3.0)**	**0.6**	**2.1**	**9.1**	**6.0**	**7.4**	**7.8**	**8.3**
Underlying tax	(0.0)	0.6	0.6	(2.2)	(1.5)	(1.4)	(1.5)	(1.6)
Underlying tax rate (%)	*(0.7)*	*(106.4)*	*(27.7)*	*20.5*	*19.5*	*19.0*	*19.0*	*19.0*
Reported tax	(0.0)	0.6	0.6	(1.9)	(1.2)	(1.4)	(1.5)	(1.6)
Net attrib. profit	**(3.0)**	**1.3**	**2.6**	**7.2**	**4.8**	**6.0**	**6.3**	**6.7**
PBT pre-exc & g/w	**(3.0)**	**0.6**	**2.1**	**10.6**	**7.9**	**7.4**	**7.8**	**8.3**
Wtd. ave. shares (million)		10.2	10.2	10.2	10.2	10.2	10.2	10.2
Diluted shares (million)		10.2	10.2	10.2	10.7	10.8	10.8	10.8
EPS, basic (p)		12.3	26.0	71.2	47.7	59.1	62.2	66.0
EPS, dil., pre-exc. + g/w (p)		**12.3**	**26.0**	**82.7**	**59.3**	**55.7**	**58.6**	**62.2**
DPS - declared (p)		**3.0**	**4.5**	**6.0**	**18.0**	**20.0**	**21.0**	**22.0**
NAV (p)		-	100.7	125.1	179.4	219.8	261.7	306.3
Dividend cover (x)		-	5.8	13.8	3.5	3.0	3.0	3.0
EBITDA		**2.8**	**4.6**	**14.3**	**12.1**	**12.0**	**12.5**	**13.0**
Free cash flow		3.2	7.3	9.1	20.3	(2.1)	9.7	10.1
FCFPS (p)		31.6	72.1	89.2	199.9	(20.7)	95.4	99.6
NAV (p)		125.1	126.4	179.4	219.8	261.7	306.3	100.7

Source: Company, Progressive Equity Research estimates

Cashflow and balance sheet

Year-end December (£m)	2015	2016	2017	2018	2019E	2020E	2021E
Adjusted cashflow statement							
Group op. profit, inc exc	0.8	2.2	9.3	6.1	7.6	8.0	8.4
Depreciation	2.0	2.4	3.6	4.2	4.4	4.5	4.6
Intangible amortisation	-	-	-	-	-	-	-
Other, non-cash	(0.1)	(0.3)	(0.4)	0.5	-	-	-
Changes in working capital	1.7	3.9	(0.9)	12.5	(10.0)	1.5	1.6
Operating cash flow	**4.4**	**8.2**	**11.6**	**23.2**	**2.0**	**13.9**	**14.6**
Capex	(0.9)	(0.8)	(2.3)	(2.3)	(5.0)	(5.5)	(6.0)
Interest	(0.4)	(0.2)	(0.1)	(0.1)	(0.2)	(0.2)	(0.2)
Tax	0.0	0.1	(0.1)	(0.5)	(1.4)	(1.5)	(1.6)
Free cashflow	**3.2**	**7.3**	**9.1**	**20.3**	**(4.6)**	**6.8**	**6.9**
Acquisitions	-	-	-	-	-	-	-
Dividends - paid	-	(0.2)	(0.6)	(0.9)	(1.9)	(2.1)	(2.2)
Financing	(2.0)	(2.4)	(2.8)	(3.1)	-	-	-
Change in net cash/(debt)	**1.2**	**4.8**	**5.7**	**16.3**	**(6.5)**	**4.7**	**4.6**
Summary balance sheet							
Intangible fixed assets	-	-	-	-	-	-	-
Tangible fixed assets	12.8	13.7	18.2	19.9	20.5	21.5	22.9
Investments	0.7	1.4	1.2	0.9	0.9	0.9	0.9
Working capital	(5.3)	(9.2)	(18.0)	(30.5)	(20.5)	(22.0)	(23.6)
Provisions, others	(0.3)	(0.6)	(0.6)	(0.5)	(0.5)	(0.5)	(0.5)
Retirement benefit liabilities	-	-	-	-	-	-	-
Net cash/(debt)	2.4	7.4	12.0	28.4	21.9	26.6	31.2
Net assets	**10.2**	**12.7**	**12.8**	**18.2**	**22.3**	**26.5**	**30.9**

Source: Company, Progressive Equity Research estimates

Financial and operational indicators

Year-end December (£m)	2015	2016	2017	2018	2019E	2020E	2021E
Growth in turnover (%)	12.6	15.1	20.7	12.7	2.1	4.3	4.3
Growth in operating profit (%)	(129.8)	164.6	379.4	(25.8)	(5.3)	5.3	6.0
Growth in net attrib. profit (%)	(141.8)	110.6	174.4	(33.1)	24.0	5.3	6.1
Growth in EPS (%)		110.6	218.7	(28.3)	(6.1)	5.3	6.1
Growth in DPS (%)		50.0	33.3	200.0	11.1	5.0	4.8
Growth in NAV (%)		24.5	24.3	43.4	18.6	18.8	16.9
Gross margin (%)	5.3	6.7	8.4	8.4	8.4	8.4	8.5
Operating margin (%)	0.4	0.9	3.6	2.3	2.2	2.2	2.2
Net margin (%)	0.6	1.1	2.4	1.4	1.7	1.7	1.8
EBITDA margin (%)	1.3	1.9	4.7	3.6	3.4	3.4	3.4
Interest cover (x)	3.5	12.5	57.4	96.1	50.3	51.5	53.0
Dividend cover (x)	4.1	5.8	13.8	3.3	3.0	3.0	3.0
Average employees	1,183	1,280	1,422	1,536			
Employment costs	53.4	58.7	69.5	78.6			
Ave employee cost (£000)	45.1	45.9	48.9	51.2			
Employment cost inflation (%)		1.8	6.5	4.8			
Sales per employee (£000)	183.9	195.7	212.6	221.8			

Source: Company, Progressive Equity Research estimates

Risks and responses

This is a selection of the main risks that contracting groups in general face and what we see as nmcn's approaches to mitigate them.

Government and macro-economic risks

Much of the group's workload is in the public or regulated sectors and there is a risk that pressure on government finances could result in future investment being curtailed. If this coincides with – or is influenced by – a broader economic downturn it could also result in private work being curtailed.

This is clearly a risk, but water is one of the Government's leading priorities, and there is a broad range of other sectors covered. Many staff could be redeployed into other sectors should demand patterns change.

Loss-making contracts

These have been a regular concern in the construction sector and nmcn has suffered from loss making legacy contracts dating from the last downturn. Losses can arise from wrongly priced bids, delays and disputes.

The company's 2017 strategy focused on reducing the risk of lost making bids and subsequent poor execution by, for instance, avoiding large, complex fixed-price contracts; greater control of contractual terms and improved internal reporting.

Client and supply-chain failures

This is becoming more of a risk for the sector, highlighted in the problems at Carillion, Interserve and Kier, which triggered further failures among suppliers. On the client side, the retail sector in particular has seen a wave of company failures hit their supply chains.

The new strategy also improved monitoring of creditworthiness of clients and suppliers and tighter creditor controls.

Skills shortages

This is a concern across the industry, particularly amid the uncertainty surrounding Brexit.

Personnel development is at the core of the six-point strategy. The group reports that its training and development initiatives show good results and has an active apprenticeship scheme with what it claims is an industry-leading 10% engagement.

Pensions

This has frequently been a major issue for contracting businesses, since they employ large numbers and have relatively small balance sheets.

nmcn operates defined contribution personal pension schemes, with no pension deficit.

Interest rate risk

This impacts the whole economy as well as construction and property sectors.

Most assessment of the future trajectory of base rates look fairly benign but, being cash positive, the group should appear to clients less at risk financially than indebted rivals.

Appendix

Board biographies

Robert Moyle

Executive Chairman. Joined the group as a site engineer in 1973. Appointed Executive Divisional Director of the Utilities Division and to the group board in 1984. Appointed Chief Executive in 1990, implementing a strategy of development that has taken the Group from the position of a regional to that of a national contractor. Robert took on his new role as Executive Chairman in 2016

John Homer

Chief Executive. Joined the Group in June 2016 following a successful career in the construction industry over the last 30 years, holding executive positions at BAM Construct UK and Galliford Try. Most recently he has been a managing director at Morgan Sindall Construction. He is a Chartered Surveyor and has extensive experience of solution delivery for a range of high-profile public and private sector clients.

Dan Taylor

Chief Financial Officer. Joined in 2013 having rapidly progressed his career since completing his degree and becoming a Chartered Accountant. Heads up the nmcn Investments arm.

Andy Langman

Managing Director, Nomenca and member of the Executive Administration Board. Joined in 1998 during the formation of the subsidiary company, and was appointed to the Board of North Midland Construction. Over the past seventeen years, he has overseen Nomenca's growth within the specialist mechanical, electrical, instrumentation, control and automation (MEICA) field and focusing on developing repeat business through long term relationships in both contracting, product development and maintenance.

Stuart Proud

Executive Director for Operations and member of the Executive Administration Board. Joined the group in 1977 as a civil site engineer, reaching director status in 2005. In 2009 he led the integration of the head office civils and MEICA teams into the NMCNomenca delivery division; to service the Group's long-term strategic client Severn Trent Water over the AMP5 programme.

Ian Elliott

Senior Independent Non-Executive Director. On board since 2006. Previously Managing Director of an engineering consultancy business and Director of Engineering and Procurement with Severn Trent Water.

David Rogers

Independent Non-Executive Director. On board since 2011. Partner in the national law firm Weightmans in the firm's construction team. An experienced commercial litigation lawyer and has specialised in construction and engineering disputes for more than 30 years.

Mike Holt

Independent Non-Executive Director. On board since 2018. Currently a non-executive director, and chair of the audit and risk committee, of Schroders Asian Total Return Investment Company and a non-executive director, and chair of audit, at AIM quoted Real Good Food plc. Between 2010 and 2017, he was CFO of Low & Bonar, an international performance materials group and prior to that he was CFO of Vp, the specialist equipment rental group.

Margaret Amos

Independent Non-Executive Director. Recently appointed. An expert in finance, transformation and programme management. She has over 27 years' experience with Rolls Royce in a number of senior positions including Finance Director - Engineering, IT and Corporate as well as Director of Business Planning.

Financial Summary: nmcn

Year end: December (£m unless shown)

PROFIT & LOSS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue	302.3	340.5	347.5	362.5	378.1
Adj EBITDA	14.3	12.1	12.0	12.5	13.0
Adj EBIT	10.7	8.0	7.6	8.0	8.4
Reported PBT	9.1	6.0	7.4	7.8	8.3
Fully Adj PBT	10.6	7.9	7.4	7.8	8.3
NOPAT	8.5	6.4	6.1	6.4	6.8
Reported EPS (p)	71.2	47.7	59.1	62.2	66.0
Fully Adj EPS (p)	82.7	59.3	55.7	58.6	62.2
Dividend per share (p)	6.0	18.0	20.0	21.0	22.0
CASH FLOW & BALANCE SHEET	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Operating cash flow	11.6	23.2	2.0	13.9	14.6
Free Cash flow	9.1	20.3	(4.6)	6.8	6.9
FCF per share (p)	89.2	199.9	(45.4)	67.1	67.6
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals					
Shares issued					
Net cash flow	5.7	16.3	(6.5)	4.7	4.6
Overdrafts / borrowings	5.0	4.9	4.9	4.9	4.9
Cash & equivalents	17.0	33.4	26.8	31.5	36.1
Net (Debt)/Cash	12.0	28.4	21.9	26.6	31.2
NAV AND RETURNS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Net asset value	12.8	18.2	22.3	26.5	30.9
NAV/share (p)	126.4	179.4	212.7	252.6	295.2
Net Tangible Asset Value	12.8	18.2	22.3	26.5	30.9
NTAV/share (p)	126.4	179.4	212.7	252.6	295.2
Average equity	11.9	14.6	17.8	22.3	26.6
Post-tax ROE (%)	60.7%	33.2%	33.7%	28.3%	25.2%
METRICS	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue growth		12.6%	2.1%	4.3%	4.3%
Adj EBITDA growth		(15.3%)	(1.6%)	4.2%	4.6%
Adj EBIT growth		(25.8%)	(5.3%)	5.3%	6.0%
Adj PBT growth		(25.2%)	(6.2%)	5.3%	6.1%
Adj EPS growth		(28.3%)	(6.1%)	5.3%	6.1%
Dividend growth		200.0%	11.1%	5.0%	4.8%
Adj EBIT margins		2.3%	2.2%	2.2%	2.2%
VALUATION	**2017**	**2018**	**2019E**	**2020E**	**2021E**
EV/Sales (x)	0.1	0.1	0.1	0.1	0.1
EV/EBITDA (x)	2.1	2.5	2.5	2.4	2.3
EV/NOPAT (x)	3.5	4.7	4.9	4.6	4.4
PER (x)	7.0	9.7	10.3	9.8	9.2
Dividend yield	1.0%	3.1%	3.5%	3.7%	3.8%
FCF yield	15.5%	34.8%	(7.9%)	11.7%	11.8%

Source: Company information and Progressive Equity Research estimates

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