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16 August 2019

SRT Marine Systems: Set sail for a profitable voyage

This provider of maritime systems may be under most investors' radar but the company looks set to make waves

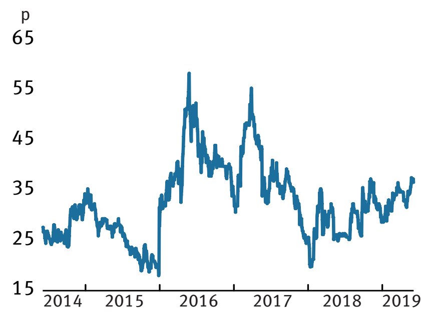
SRT Marine Systems (SRT)

Ticker	SRT
Current price (p)	38p
Target price (p)	55p
Market cap (£m)	£58.8m
52-week high (p)	38p
52-week low (p)	23.9p
Net cash (£m)	£1.1m (reported at 31 March 2019)
Shares in issue (m)	154.8m
Financial year-end	31 March
Next event	Pre-close trading update early October 2019
Company website	srt-marine.com

Simon Thompson's view:

There has been a sea change in SRT Marine System's trading prospects this year after its systems business won a major contract in the Philippines. Revenues from that contract have sent SRT's profits soaring and there is a strong chance that the company will land six further tenders in the Middle East and Philippines worth a combined £234m. An uncertain global geopolitical backdrop and heightened security risks are driving demand for SRT's cutting edge maritime surveillance and monitoring systems across national security, border control, search and rescue and fisheries management. Potential for SRT to land further massive contracts is simply not in the price.

SRT share price



Source: Bloomberg

Bull points

- Sustainable move into profitability underpinned by contracted orders and near-term pipeline of new business.
- Brexit proof: 95 per cent of sales overseas.
- Mainly government contracts.
- Record Philippines government contract win in December 2018.
- Global geopolitical backdrop and heightened security risks driving demand.
- Preference by overseas governments in Asia and Middle East for autonomous systems.
- Migrant and immigration concerns growing.
- Scalable business with high operational gearing.
- Operational structure in place to deliver on £234m near-term bid pipeline of tenders efficiently with tight control on costs.
- Marine Domain Awareness systems at start of new technology adoption cycle, and set to expand dramatically.
- Business funded to deliver step change in revenue in current financial year.
- Free cash flow set to turn positive in the current financial year.
- Trade receivables paid down post-2019 financial year-end.
- Expansion of revenue streams into satellite data sales.

Bear points

- Chequered track record.
- Execution risk on delivering contracted orders and converting bid pipeline.
- Potential for order deferrals.
- One large outstanding trade receivable being renegotiated.
- Currency risk on sterling strength.
- Customer concentration risk.

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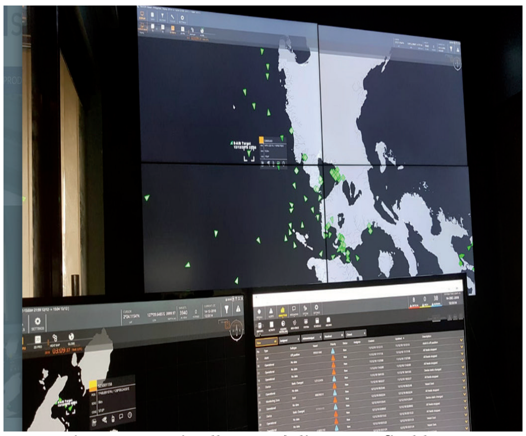

SRT Marine Systems is all set to deliver a profitable passage for investors getting on board at this stage of its journey

As a global leader in AIS, an advanced identification communications technology that is used to track and monitor maritime vessels, **SRT Marine Systems (SRT)** is now fulfilling the potential which first enticed investors to back its IPO on the Alternative Investment Market (Aim) in November 2005. The fact that the company's share price is little changed on the flotation price highlights that the long voyage reaching this inflexion point has hardly been plain sailing, but nonetheless the building blocks are all now in place to deliver a far more profitable passage for investors getting on board at this stage of the company's journey.

SRT's transceivers enable real time data communication between multiple marine entities such as vessels, buoys and coast stations and facilitate a wide range of functionality such as vessel identification and status, vessel safety, search and rescue, and environment monitoring. They are sold through a global network of value-added resellers (electronics dealers and distributors) who target commercial and leisure vessels in Europe and North America under SRT's own brands. The company also supplies AIS modules to third party original equipment manufacturers (OEMs) including Raymarine, Koden and Transas. With over 30 years' expertise in this area, SRT has a reputation for delivering cutting edge technology based on a deep domain knowledge and one that has created a high barrier to entry.

The transceiver business increased revenues by 19 per cent to £6m in the financial year to 31 March 2019, split £3.7m for OEM and module sales (up 12 per cent year on year), and branded sales of £2.3m (up 34 per cent year on year). Key drivers of demand are the voluntary adoption of the technology by leisure and commercial vessel owners, improved sales distribution, and greater market recognition of the quality and performance of the product range.

The plan is to grow this side of the business organically at 10 per cent per annum by expanding the distribution network, launching new products, and through marketing initiatives and special projects with partners. For instance, SRT signed a contract with a large government agency in North America earlier this year to supply large quantities of blue-force encrypted AIS devices including its fishing buoy tracker device. This automatic identification system transmits data – including vessel name, course and speed – encrypted so it cannot be received by standard AIS.

Management is clearly confident of beating the organic sales target as SRT chief executive Simon Tucker is factoring in a minimum of £7.2m revenue from the transceiver business in the current financial year, implying another year of 20 per cent growth.

SRT Marine Services (SRT)

Ord Price: 38p **Market Value:** £58.8m
Touch: 37.5-38p **12-Month High:** 38p **Low:** 23.9p
Dividend Yield: nil **PE Ratio:** 21
Net Asset Value: 13p* **Net Debt:** 5.5%

Year to 31 Mar	Revenue (£m)	Pre-tax profit (£m)	Diluted earnings per share (p)	Dividend per share (p)
2011	9.2	1.94	2.10	nil
2012	6.2	0.17	0.20	nil
2013	10.0	1.19	1.30	nil
2014	6.1	-1.50	-1.30	nil
2015	8.6	-0.38	0.04	nil
2016	10.7	0.27	0.33	nil
2017	11.0	1.23	1.09	nil
2018	5.3	-5.78	-4.09	nil
2019	20.6	3.18	2.36	nil
2020**	30.4	3.60	1.80	nil
% change	48%	13%	-24%	–

Normal market size: 10,000 SETSqx
*Includes intangibles assets of £6.6m, or 4p a share
** FinnCap estimates. Pre-tax profit and EPS stated after exceptional items. EPS stated on a fully diluted basis
Source: SRT Marine Services annual report, London Stock Exchange

Key profit driver

Revenues surged to £20.6m in the 2018-9 financial year, delivering a record pre-tax profit of £3.18m. This is down to a sea change in trading prospects for the systems business which provides integrated surveillance and management systems to coastguards, fishery and other maritime agencies.

Each system varies in exact configuration and scale, but at the heart is SRT's state-of-the-art GeoVS systems application that enables multiple system users to display, analyse and manage large amounts of real time and historical data derived from extensive satellite and terrestrial networks. This enables coastguards to automatically detect and manage potential threats, and fishery authorities to detect illegal, unlicensed and unregulated (IUU) fishing on a national scale.

Annual revenues earned from SRT's marine domain awareness (MDA) project work increased from £310,000 to £14.5m after the company landed a game changing contract with the Philippine government. The Peso 2.1bn deal, worth £33m at current exchange rates, is to deliver a vessel management system (VMS) configured for fisheries monitoring and management.

Sea change in trading prospects

The contract was announced in December 2018 and is being executed over a four-year period in two main phases. The first (worth £30.8m) being supply and commissioning of the equipment and systems. Phase two (worth around £2.2m at current exchange rates) is ongoing support and supply of satellite data sourced from a variety of satellite constellations into the SRT VMS system.

Each phase is divided up into multiple milestones, each with variable project delivery timings, and all with defined invoice values upon delivery and acceptance by the customer.

During the 2018-19 financial year, SRT made good progress with the project, completing several delivery milestones. The plan is to bring the system gradually on-line by Spring 2020 when it will become the world's largest single fisheries and marine environment monitoring system. The system's impressive array of sophisticated functionality enables the customer to significantly enhance the control and management of their fisheries and marine environment. It is highly scalable, too.

Indeed, the contract award could be easily expanded from the initial requirement of 5,000 of the Philippines' fisheries' largest vessels to include tens of thousands of medium and small fishing boats, as well as the seamless integration with other relevant maritime authorities. I understand that SRT is progressing discussions on three further contracts with separate government agencies and ministries in the Philippines, worth up to Peso 10.6bn (£167m at current exchange rates), with expected delivery periods of between one and four years. Each one of these potential contracts in the pipeline include ongoing recurring revenue streams through satellite data sales as well as the opportunity for further follow on system upgrades and expansion of contracts.

"The supply of data derived from satellite systems is set to develop into a highly profitable recurring revenue stream"

That's worth noting because the supply of data derived from satellite systems to customers is set to develop into a highly profitable recurring revenue stream for SRT. This data is purchased by the company from the increasing number of competing satellite system operators and aggregated into a single satellite data solution tailored for a specific customer's requirements. In turn, this allows customers to fuse the data with that obtained from their terrestrial sensor systems and use the analytic functionality in SRT's GeoVS system to identify situations of interest at longer ranges. In addition to this, SRT's directors expect each customer to become a source of further contracts in the future as they continue to expand and evolve their systems once the initial base technology is installed.

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“SRT’s bid pipeline has progressed to a stage where other massive tenders could be converted into contract awards”

Importantly, SRT’s bid pipeline has progressed to a stage where other massive tenders could be converted into contract awards.

Bumper tender pipeline of potential contracts
Since landing the Philippine contract, SRT has reported significantly increased demand for its systems business and is in contract discussions in the Middle East. These specifically relate to three system contract opportunities with government agencies in Saudi Arabia, Kuwait and Bahrain worth up to, in aggregate, \$81m (£67m) over the next two years. These consist of:

- An extension of an existing contract that could be worth up to \$10m, with an estimated 18-month delivery period. SRT is awaiting final contract approval.

- A new follow-on contract with an existing customer, the Memorandum of Understanding (MoU) for which has been signed. The contract value is up to \$26m, with an estimated 18-month delivery period. Final specifications and pricing are under discussion.

- A new contract with a new customer, worth up to \$45m, with an estimated delivery period of 24 months. Detailed surveys and delivery planning is already underway.

These three contracts in the Middle East, combined with the three system contract opportunities in the Philippines represent a near-term system opportunities pipeline of up to £234m at current exchange rates. The board believes these contracts are in the final phases of negotiations. If successfully concluded, all are expected to be delivered and completed within a three-year period.

As well as the near-term pipeline opportunities, the company has a number of longer-term validated potential contracts, ranging in value from less than £1m to over £100m with gross profit margins anywhere between 28 per cent and 72 per cent depending on the complexity of the work involved. In aggregate, the long-term pipeline is worth £200m, implying the total potential validated systems opportunity is worth in excess of £430m. The majority of these sales opportunities are direct with government entities and are driven by a combination of national security and fisheries management concerns, some of which are provided with further imperatives by international and regional regulations such as the EU Fish Catch Certification and the IUU programme.

Please note that due to the nature of these system project contracts, typically they are government projects of

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“A new entrant would have to make a significant initial capital investment to be in a position to tender for these complex contracts”

significant size and complexity, usually it takes considerable time before they commence. This means that forecasting exact contract start dates is nigh impossible.

Although lengthy, this aspect of the sales process is valuable as it allows a relationship to develop between SRT, the end customer and the necessary network of local installation partners in the client’s country. Such relationships, combined with SRT’s market leading position in AIS marine surveillance systems, know-how and market presence, creates a high barrier to entry for potential competitors. That’s because a new entrant would have to make a significant initial capital investment to be in a position to tender for these complex contracts, but without having any certainty that it would win any of them.

Employing a staff of 58 (predominantly engineers) from its base in Midsomer Norton near Bath, Somerset, SRT has already made the requisite investment in product and project development teams to be able to fulfil these potentially huge contract awards. The company also has contacts in place with local partners who are trained and managed by SRT system delivery teams for the installation and commissioning of the projects. This set up enables the company to leverage its domain expertise with the end user to effectively become an adviser on maritime affairs, thus creating another barrier to entry.

Market opportunity

The global boat park consists of 26m vessels of which 8m are commercial and 18m are leisure. Based on an average unit price of $1,000, this implies an addressable market of $26bn for AIS transceivers. In practice, there are probably only about 16m suitable vessels to target, but even if AIS penetration rates match that of radar, at 25 per cent, then this still implies a target market of almost 4m vessels. This compares to around 300,000 vessels that currently have AIS transceivers. At last month’s annual results, thanks to increased adoption of AIS technology, SRT’s directors confidently said that “our transceivers business has established a solid pattern of annual growth which we expect to continue”.

Of course, SRT doesn’t have the market all to itself as there are rival producers of AIS transceivers, although only Alltek Marine, an Asia Pacific communication solution provider listed in Taiwan since 2004, provides a complete range of AIS devices. Other AIS suppliers include JRC from Japan, which specialises in Class A devices for big commercial ships; Weatherdock AG, a private German company, which focuses on the cheaper Class B devices and search and rescue transceivers (SART); Vesper Marine of New Zealand; and ICOM in the

"No pull quote this page, can we have images of lighthouses or commercial fishing boats?"

UK which supplies Class B devices. Florida-based ACR/ARTEX supplies emergency and survival equipment so is only focused on the SART segment of the AIS market.

That said, the real opportunity for SRT lies in exploiting the increasing opportunities across the globe for the adoption of sophisticated large scale fisheries vessel monitoring and management systems (VMS) and integrated coast guard surveillance command and control marine domain management (MDM) systems. SRT's directors have also identified new opportunities in areas such as environment monitoring. The plan is to develop a dedicated sales division to tap demand in this area and use its core SRT-MDA system with customised configuration to deliver a robust and innovative solution.

It makes sense to do so because MDM is likely to have the largest market share in the marine safety market in the coming years as government authorities, transport and shipping organisations adopt advanced surveillance and tracking solutions for better safety and security of the maritime business. The maritime security service market is driven by factors such as ungoverned marine regions, increased awareness about maritime security, and use of advanced and integrated technologies and solutions.

Importantly, AIS has become a critical path identification technology that is an integral sensor system in MDA systems for ports, waterways, coastal surveillance and fishery management. While radar shows where a vessel is located, AIS offers greater detail without visual inspection and providing information in radar shadows. Also, it doesn't lose targets in sea, rain and snow.

SRT's position in AIS gives the company a strategic position in the MDA market, and one that can be leveraged through its innovative GeoVS maritime display, data analytics and management system. In effect, it is selling 'Big Data' systems for the marine environment. Highlighting a vessel will reveal its ownership, next of kin, where it's been for the past few weeks, its licence and owner's address.

Admittedly, there are a number of large defence and surveillance companies supplying large scale/national MDM systems. These include Raytheon, Saab, Lockheed Martin, Signalis (Airbus), Elman, Selex (Finmeccanica/Leonardo) and Harris which has partnered with exactEarth to deliver satellite-based AIS solutions. However, defence companies supplying these systems look to build high-value weapons-system sales into the packages, whereas SRT only provides civil defence and security systems. Furthermore, these larger defence groups do not match SRT's specific AIS domain expertise on the civil side.

The uncertain global geopolitical backdrop is another driver of demand for SRT's maritime surveillance and monitoring systems across national security, border control, search and rescue and fisheries management. Governments in Asia and the Middle East now have a preference for autonomous systems rather than those supplied by third party nations, and there is increasing recognition of the need for day-to-day management of civilian maritime activities given heightened security risks in the region. The rise of nationalism and protectionism is another reason for governments to increase their control and security of economic zones, including coastal and fishing waters, as are migrant and immigration concerns. This can only add weight to the case for the adoption of SRT's MDA systems.

High operational leverage and funded for profitable growth

The game changing Philippines contract award could just be the tip of the iceberg for SRT. Landing any of the six contracts in the £234m near-term bid pipeline would transform the company's profits. Chief executive Simon Tucker notes that "our business model has always been based upon using local partners for installation. The value in our systems is the core technology that we have developed over many years. As such our overheads are relatively fixed and not correlated to revenues."

To put the cost base into perspective, SRT's cash overheads were £6.6m in the 2018-19 financial year, although the reported figure was £5.9m due to favourable foreign exchange gains (the company doesn't hedge out currency risk on overseas contracts). This figure excludes non-cash exchange rate movements, depreciation and amortisation charges, and development spend capitalisation.

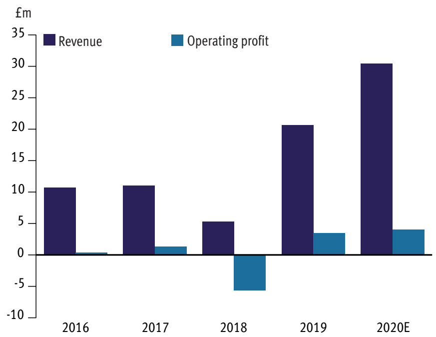
Of course, SRT still needs to make some extra investment to deliver on the huge near-term bid pipeline which is why the cost base is set to grow over the next two years to accelerate development and increase SRT's project delivery support team who work closely with the local installation partners in the field.

Mr Tucker expects to see "a gradual increase in overheads to an annualised rate of around £8.5m by the end of the year, rising by a further £1m the year after, based on delivering all the £234m contracts in this projection plus several more which are in the pipeline".

If SRT wins all six tenders in the pipeline then, factoring in a gross margin of 40 per cent and contract fulfilment over 36 months, the cumulative gross profit of £93.6m could generate operating profit of close to £66m. That's a huge sum in relation to the £3.4m operating profit SRT reported on revenue of £20.6m in the 2018-19 financial year, and the £4m operating profit forecast by analysts at FinnCap for the 12 months to 31 March 2020.

This is a company that has the capability to increase annual revenues from £20m in the 2018-19 financial year to around £80m and only incur an additional £2m of operating costs in order to do so. That's serious operational leverage.

SRT high gross margin underpins step change in operating profits



Source: SRT Marine Systems annual report and accounts, FinnCap forecasts (18 July 2019)

SRT Marine Systems gross margin underpins significantly higher profits as business scales up

Financial year to 31 March	Revenue	Gross profit	Gross profit margin
2016	£10.7m	£5.2m	48.6%
2017	£11.0m	£7.2m	65.5%
2018	£5.3m	£2.3m	43.2%
2019	£20.6m	£9.3m	45.3%
2020E	£30.4m	£11.1m	36.5%

and supports step change in operating profits....

Financial year to 31 March	Revenue	Operating profit	Operating profit margin
2016	£10.7m	£0.32m	3.0%
2017	£11.0m	£1.28m	11.6%
2018	£5.3m	-£5.65m	-106.0%
2019	£20.6m	£3.45m	16.7%
2020E	£30.4m	£4.00m	13.2%

Source: SRT Marine Systems annual report and accounts, FinnCap forecasts (18 July 2019)

Funding in place

Importantly, SRT has the funding in place to support such a step change in revenue and profits. It raised £7m of new equity through share placings pitched at 25p and 30p, respectively, in May 2018 and January 2019. The directors also refinanced the company's debt facilities in May 2018 and have a three-year loan note facility of £10m in place with LGB Corporate Finance (£5m drawn down at 31 March 2019) fixed at an annual interest rate of 8 per cent. This may seem a tad on the high side, but interest costs are tax deductable and the post tax interest charge is well below the company's cost of equity. SRT had cash of £3.94m on its balance sheet at the 31 March 2019 financial year-end, so effectively had £9m of free cash available including £5m of untapped debt facilities.

Although receivables ballooned from £4.4m to £18m over the course of the 12 month trading period, this was down to the need to invest in working capital on the Philippines contract and because major project milestone completions fell towards the end of the financial year. It's worth noting that the Philippines contract is a special case in that the end customer's cash budget for the project was approved and allocated over four years in anticipation of the French government providing a loan. When this was

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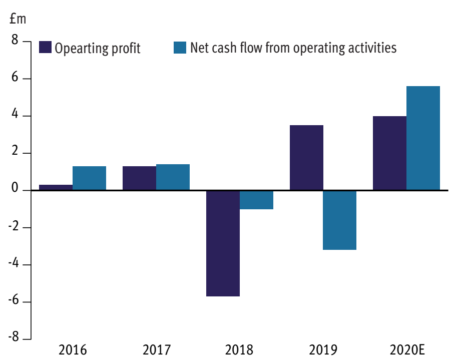
withdrawn due to a UK company (SRT) winning the tender, SRT agreed to continue to install the system within 15 months (accounting for 90 per cent of the contract value) and allow extended payment terms on the invoices to match the customer's cash budget availability. The result was a working capital gap for SRT on the project during the first 12 months which was bridged by using the LGB loan facility. However, all other contracts are cash positive from the start due to the margins and delivery profile.

Since the 31 March 2019 financial year-end, SRT has received over £4m of cash payments as per the agreed project payment schedules on the Philippines contract. House broker FinnCap anticipates that the company will end the current financial year with net cash of £2.7m on 31 March 2020, implying headroom of almost £13m. This also highlights a much improved cash flow performance as SRT is predicted to generate free cash flow of £3.8m in the current financial year, reversing £8.5m of outflow in the past two financial years.

SRT operational cash flow set to improve



Source: SRT Marine Systems annual report and accounts, FinnCap forecasts (18 July 2019)

SRT Marine Systems cash flow generation

	2016	2017	2018	2019	2020E
Operating profit	£0.3m	£1.3m	-£5.7m	£3.5m	£4.0m
Net cash flow from operating activities	£1.3m	£1.4m	-£1.0m	-£3.2m	£5.6m
Free cash flow	-£0.3m	-£0.1m	-£3.1m	-£5.4m	£3.8m
Closing net cash	£0.9m	£0.8m	-£2.3m	-£1.1m	£2.7m

Source: SRT Marine Systems annual report and accounts, FinnCap forecasts (18 July 2019)

Not only is SRT well funded to fulfil its contracted order book, the company has the balance sheet strength to deliver on the six major contracts it's chasing in its near-term bid pipeline. Current assets of £24.2m are almost four times higher than current liabilities of £6.3m, highlighting a strong liquidity ratio.

The other point worth noting is that SRT's operating profit of £3.45m in the last financial year is stated after non-cash charges for depreciation (£107,253), amortisation of intangibles (£1.29m) and share based payments (£96,257). Therefore, the company's cash profit is nearer to £4.9m, significantly higher than the reported operating profit. Cash profit is commonly expressed as earnings before interest, taxation, depreciation and amortisation (Ebitda). The respective forecasts for the 2019-20 financial year are cash profit of £5.6m and operating profit of £4m. This means that SRT should be able to easily fund the £2m planned capital expenditure for the current financial year, and still produce a sizeable cash inflow to support other potential contract wins.

It's worth flagging that £1.1m of SRT's trade receivable balance relates to one customer and there is a further sum of £2.6m included in pre-payments and accrued income

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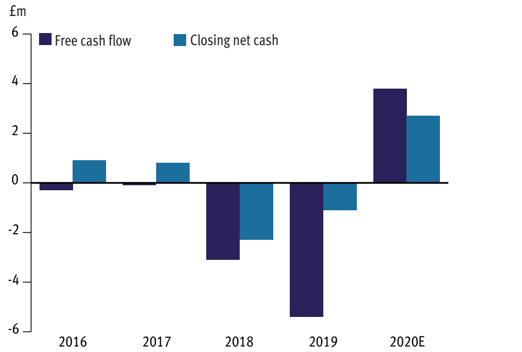
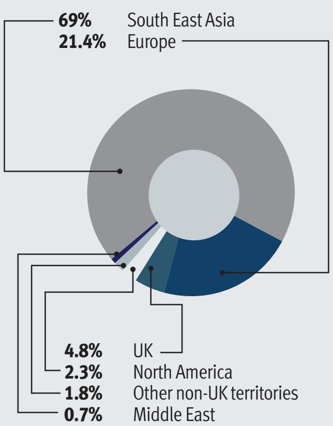
SRT Marine Systems forecasts healthy free cash flow to boost cash position



Source: SRT Marine Systems annual report and accounts, FinnCap forecasts (18 July 2019)

SRT Marine Syatems revenue by geographic region (2018-19)



Source: SRT Marine Systems 2019 annual report

from the same customer. The trade receivable remains unpaid, and the accrued income balance has not been recovered because the contract it relates to has been put on hold. The reason for this delayed contract is straight forward. The end customer (a government) decided that after signing the contract for the delivery of a monitoring system with the intent of buying transponders at a later date that they wanted to change the contract and include the transponders from the start. Such a change involves a lengthy process to sort out. Importantly, Mr Tucker says the process is now "virtually complete and expect the contract to recommence within the next couple of months".

In addition, SRT is already working with the same customer for a follow-on Phase II contract, adding further weight to the likelihood that the trade receivable balance will be settled as well as full recovery of the accrued income balance in accordance with the terms of the contract. As a result no provision has been made against either sum. Clearly, if this £3.7m cash can be recovered in the current financial year, then it will boost SRT's net cash position further still.

Brexit proof

Another bull point in the investment case is SRT's international exposure; 95 per cent of sales are non-UK.

SRT Marine Systems revenue by geographic region (2018-19)

Region	Percentage
South East Asia	69.0
Europe	21.4
UK	4.8
North America	2.3
Other non-UK territories	1.8
Middle East	0.7

Source: SRT Marine Systems 2019 annual report

Bearing this in mind, the company doesn't hedge currency risk. At the 31 March 2019 financial year-end, SRT had net foreign exchange asset exposure to the following overseas currencies: US dollars (£4.2m); Philippine peso (£9.47m); and euros (£354,600). The respective year end exchange rates to sterling were £1:US$1.30, £1:€uro 1.16, and £1: peso 68.64. Since then, sterling has fallen by 7 per cent against both the US dollar and euro, and by 8.2 per cent against the peso. Based on the aforementioned foreign exchange exposures, this implies a windfall gain of £776,000 on SRT's Peso exposure, £294,000 on the US dollar exposure, and around £24,820 on the euro position. In other words, all things being equal, there could be £1m plus upside to analysts' operating profit forecasts of £4m

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for the current financial year. The positive currency movement not only de-risks current earnings estimates, but adds further weight to SRT being able to at least deliver the 16 per cent rise in operating profits that analysts predict for the current financial year.

Of course, a sterling rally would negate some of the potential for SRT to report higher profits due to favourable currency movements, but as things stand the UK does seem to be heading to leave the EU without a trade deal in place, thus opening up the possibility of further sterling weakness and making SRT's overseas earnings even more valuable to UK shareholders.

Major shareholders

There is an absence of an institutional presence on SRT's shareholder register with five of the top seven shareholders being private individuals, including chairman Mr Rogers. Perhaps, this is a reflection of SRT's chequered history and one that has seen the company swing from healthy profits to losses in the past decade.

However, this caution now looks misplaced given the progress SRT has made since the end of 2018, and the momentum behind its lucrative MDA projects work with overseas governments. It could play into investors' hands as the lack of large institutional shareholders on the register is good for liquidity. In fact, the shares are readily tradable in 50,000 bargain sizes, well above the normal market size of 10,000, and on a relatively tight bid-offer spread, too. It's worth pointing out that private retail interest will be the dominant driver of investor demand in light of the lack of institutional shareholders. That doesn't negate in any way from the investment case as the company is still only a £58m market capitalisation company, so the potential for greater private retail interest in the shares could spark a sharp re-rating given SRT's relatively small size.

SRT Marine Services major shareholders

Shareholder	Shares held (m)	Percentage of share capital
Robert Persey and spouse	16.1	10.5%
Simon Rogers	13.5	8.8%
Jonathan Horne	9.0	5.8%
Hargreaves Lansdown Nominees Limited	8.2	5.3%
Ian and Caroline Laing	8.0	5.2%
David and Sandra Brierwood	5.0	3.2%
Barclays Direct Investing Nominees Limited	4.7	3.0%
Total		**41.8%**

Source: SRT Marine Services 2019 annual report; London Stock Exchange filings

Meet the management

It's fair to say that SRT's board know the company well. **Chief executive Simon Tucker** was appointed as commercial director in 2004 and promoted to his current role in 2008. He has over 16 years experience of running international businesses.

Chief operating officer Neil Peniket is a Chartered Electrical Engineer and has worked in the electronics industry for 18 years in the defence and mobile telecommunications sectors with companies including GEC-Marconi, UbiNetics and Aeroflex. He joined SRT in 2005 and is responsibilie for the delivery of all technology, product development and manufacturing of SRT products.

Chief financial officer Richard Hurd is a qualified accountant and has several years of combined commercial and professional practice experience. He joined the company in January 2009 as Financial Controller and was appointed to the board later that year.

Chairman Kevin Finn is a respected international businessman. His strategic and operational experience in the automotive sector is highly relevant to SRT given that Mr Finn has experience of managing complex product supply chains, the operation of large dealer networks, big data systems, and negotiation of international contracts.

Non-executive director Simon Rogers was a founder investor in SRT and one of the main backers of the buy-out from Securicor which preceded the company's Aim listing in November 2005. Prior to that he worked as UK marketing director of software company Lotus Development in the late 1980s, after which he established and sold two media businesses and served on the boards of a number of small and medium size businesses.

The other **non-executive director** is **Simon Barrell** who joined SRT in July 2019. He is a qualified, experienced finance director, latterly specialising in mergers & acquisitions, and the management of Aim flotations.

In aggregate the board were paid basic salaries of £459,000 in the 2018/19 financial year and received bonuses of £136,150 – remuneration that doesn't seem out of line with the £3.45m operating profit SRT reported for the latest 12 month trading period, nor projections of SRT making £4m of operating profit in the current financial year.

Mr Rogers has an 8.8 per cent equity stake, so has significant skin in the game. Mr Tucker, Mr Peniket and Mr Hurd have share options over 1.5m, 750,000 and 450,000 shares, respectively, which are exercisable at 0.1p a share until 8 August 2026. Only the first tranche of these options can be currently exercised as the second and third tranche only vest if SRT's share price hits 75p and 125p, respectively. Mr Tucker also has options over 2.2m shares (exercise price of 9p and expiry on 18 February 2020), and Mr Hurd has options over 500,000 shares (exercise price of 20p and expiry on 18 December 2022). There is clearly an incentive for the directors to deliver operationally to reap the benefits of the unvested share options, thus aligning their interests with those of outside shareholders.

Risk assessment
Of course, there are risks involved in any investment and there are several to consider in the case of SRT:

■ **Nature of SRT's customers.** Customers tend to be governments and so can be subject to significant risk, including but not limited to: the forecasting of project commencement dates and project delivery schedules, political and financial change and uncertainty, cancellation and/or changes to contracts without notice nor the possibility for redress, negotiation and/or compensation. In addition, different customers and countries have different procurement and legal processes, which are often opaque, and can mean that projects are undertaken where contracts are not legally enforceable.

Payment terms are frequently extended and variable, and in the event of non-payment may not be collectable.

■ **System execution risk.** The implementation of a system contract contains a wide range of execution risks. These risks are mitigated through forming long term partnerships with local installation partners and investing in customer support and system project delivery teams.

■ **Contract delivery.** Delivery schedules can be variable due to factors such as manufacturing supply chain issues and local in-country issues including availability of hosting infrastructure, import and customer co-operation issues. This can lead to delays in project delivery and therefore revenue delays.

■ **Attracting and retaining employees with appropriate skills.** SRT's ability to execute its strategy is dependent on the skills and abilities of its staff. The company undertakes ongoing initiatives to foster good staff engagement and ensure that remuneration packages are competitive in the market.

■ **Investing for the future.** The directors acknowledge that its chosen market places are still in their early stages and as a result the company needs to continue to invest in order to meet the challenges that a growing market will bring. This involves adding to the existing product and system portfolio as well as evolving current technology offerings. Indeed, SRT earmarked £1m of the £4m equity raise in January 2019 to strengthen its systems delivery team so to enable delivery of multiple system contracts within required timetables.

■ **New accounting standards.** The recently introduced IFRS15 accounting standard may change the company's revenue recognition in respect of the systems business with regards to the amount of revenue which can be recognised upon completion of any given milestone irrespective of the agreed contractual value of the milestone. That said, the company's ability to deliver contracts through to completion and under contracted timescales is more important than when the accounting revenue is recognised during this process.

■ **Execution risk.** As SRT enters multiple project contracts, project execution risk will become an increasing challenge, albeit the company has strengthened senior management and is increasing resources in key areas such as systems delivery and product development in order to handle the ramp up in contracts. There can be no certainty that the company will be able to convert its bid pipeline, albeit the signs are very positive especially as the Philippines fisheries contract has validated the technology for large MDA systems, and raised the company's profile amongst potential customers, too.

■ **Customer concentration risk.** In the 2018/19 financial year, two customers accounted for more than 10 per cent of SRT's annual revenue of £20.5m: £13.8m earned under the aforementioned Philippines fisheries contract; and £2.2m with a customer in Belgium. Clearly, as long as SRT delivers operationally on its major contracts, then this is not an issue. However, it's worth flagging up that the six contracts in the near-term bid pipeline have a combined value of £234m, so the concentration risk is likely to increase if SRT is successful in its tenders.

■ **Impairment charges on contract order deferrals.** In the 2017-18 financial year, SRT recorded a £1.5m impairment charge after a customer in South East Asia postponed a MDM system due to budget issues.

This charge was related to a contract with a Swiss based systems integrator who in turn had a contract with the Indonesian government and involved some initial equipment deliveries. SRT was informed by the customer in 2018 that the contract had been stopped pending a review of all projects due to a change of leadership in the Indonesian government. Unlike all SRT's other projects, the company had no relationship or contact with the end customer. As such SRT decided to take the equipment back to use in another project and impair the revenue that had been taken to ensure a clean slate and no overhang for

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the future. The project is still pending, but in the meantime SRT has developed direct relationships with other maritime agencies in Indonesia who have been carefully observing SRT's Philippines projects. Moreover, as a rule now, SRT always directly engages with the end customer alongside its local installation partners – this ensures that the company can easily make its own judgements and ensures that it knows the situation. SRT's contracts in the Philippines and Middle East are good examples of how this is working in practice.

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