Driver Group

Fires extinguished, recovery builds

13 June 2023

The interim results from Driver Group were ahead of the profits guidance provided during the pre-close update in late April. Progress on costs has been made as the rationalisation programme has kicked in. The EuAm region has generated a strong performance, with revenues and profitability at record levels and there is further scope on margins and utilisation levels. The smaller regions produced an improved performance, with expectations of delivering profits for the full year. Cash generation remained positive, with net cash amounting to over 30% of the market cap and NAV.

Despite the ongoing suspended estimates, the Group is on the path to recovery from FY22. We think the discount to the forward price/book ratio of its peers is too high, particularly in view of the cash.

- The results for the six months to March demonstrated marked progress in profitability and cash generation. Broadly static revenue was generated on a reduced fee earner headcount, while utilisation levels improved 600 basis points to 75.6%. Unsurprisingly, margins followed suit, with gross profit rising £0.5m to £6.3m and adj. EBIT improving £0.3m to £0.7m.
- November's rationalisation programme sought to reduce costs, service projects locally and via experts in the EuAm region (central business hub) and improve efficiencies Group-wide. The ERP software implementation has started favourably, measuring the efficiency of consultants/experts, and providing additional data to manage the business. The cost-cutting programme has further to go with a lease break and moves to a smaller office anticipated during Q1 '24.
- Departing experts in the ME or APAC regions have generally been replaced in EuAm where increased servicing of global projects is underway. Utilisation rates have recovered accordingly, while remaining below best practice which suggests further upside. Overall, utilisation levels improved to 75.6% in H1 '23, from 69.6% a year ago but, importantly, remaining below peak levels of 80%.
- The improving profitability, coupled with a working capital inflow as long-term debts are recovered from the ME region, further improved net cash to £5.3m or 9.8p per share. The cash provides opportunities for the Group, whether as additional share buybacks, bolt-on acquisitions or increased dividends. As the yield remains above average, we think the first two options are more likely, but we would be unsurprised to see a share buyback in the short term given the share price is back to similar levels as Q3 '22s repurchase programme.
- The combination of improving utilisation rates, falling costs, a de-risking of the ME region and new projects in South Korea suggest an improving outlook, notwithstanding the slow start to H2. We believe the Group has turned a corner and remain upbeat for the medium term, including the opportunities presented by the net cash.

Valuation

The key valuation methodology remaining open to us in the face of suspended estimates is price to book. **DRVs peer group trade at a P/B ratio of 4.5x for FY23, and by comparison, DRV sits at an 82% discount, which we feel is unwarranted due to the recovering outlook and the net cash (30%+ of market cap and NAV). We have applied a still substantial 60% discount which suggests a fair value / share of 56p.**

Company Data

EPIC	DRV
Price (last close)	32p
52 weeks Hi/Lo	35p/23p
Market cap £m	£17.0m
ED Fair Value	56p (49p)
Net cash (03/23)	£5.3m

Share Price, p

Source: ADVFN

Description

Driver is a multi-disciplinary consultancy group, with specialist commercial management, planning, programming, and scheduling, and dispute resolution support services to the engineering and construction industries.

Driver has 31 offices in 18 countries, including nine in the UK, four in Europe, four in the Americas, seven in APAC and six in the Middle East and Africa. The Group currently employs 238 fee earners.

The business is split into the following reporting divisions: Europe and Americas (EuAm), Middle East (ME) and APAC.

David O'Brien (Analyst)
0207 065 2690
david@equitydevelopment.co.uk

Hannah Crowe
0207 065 2692
hannah@equitydevelopment.co.uk

A healthy improvement in margins during H1'23

Interim results to March			
£m	**H1 22A**	**H1 23A**	**% change, yoy**
EuAm	17.37	19.13	10.1%
ME	5.41	3.72	-31.1%
AP	1.65	1.37	-17.4%
Group revenues	24.43	24.22	-0.9%
Cost of sales	-18.55	-17.88	-3.6%
Gross profit	5.88	6.34	7.8%
GP %	24.1%	26.2%	
Operating costs	-5.50	-5.65	2.8%
EuAm	2.38	2.94	23.6%
ME	-0.33	-0.09	-72.3%
AP	-0.49	-0.14	-70.3%
Central costs	-1.10	-1.97	79.5%
Group EBIT	0.46	0.73	58.4%
EuAm %	13.7%	15.4%	
ME %	-6.1%	-2.5%	
AP %	-29.3%	-10.5%	
Group EBIT%	1.9%	3.0%	
Interest	-0.06	-0.02	-63.3%
Adj PBT	0.40	0.71	76.6%
Exceptionals	-0.27	-0.20	
Reported PBT	0.13	0.51	290.8%
Taxation	-0.31	-0.21	-33.0%
Tax %	76.9%	29.2%	
Adj. Earnings	0.09	0.50	440.9%
Adj. EPS (p)	0.20	1.00	400.0%
DPS (p)	0.75	0.75	0.0%

Source: Company

Revenues for the six months to March '23 were in-line with the guidance issued at the time of April's trading update. Revenue fell modestly (-0.9%) to £24.2m, although in view of the loss of 25 employees within the smaller regions to a counterparty and a handful of expert hires since, we think this represents a positive result and suggests a marked improvement in productivity. Overall, utilisation levels rose to 75.6%, compared to 69.6% in the comparative period. Since H1 '16, revenues have only twice fallen below H1 '23s level.

The war in Ukraine and the economic impact of inflation continues to impact confidence generally, with the deferral of some existing projects and further reducing visibility within the enquiry pipeline.

The largest region, Europe & the Americas (EuAM), delivered strong growth yoy, with revenues rising 10.1% to £19.1m. The positive momentum witnessed during Q1 strengthened in Q2, aided by a combination of a small number of expert/consultant hires in the region, replacing those lost elsewhere during H2 '22.

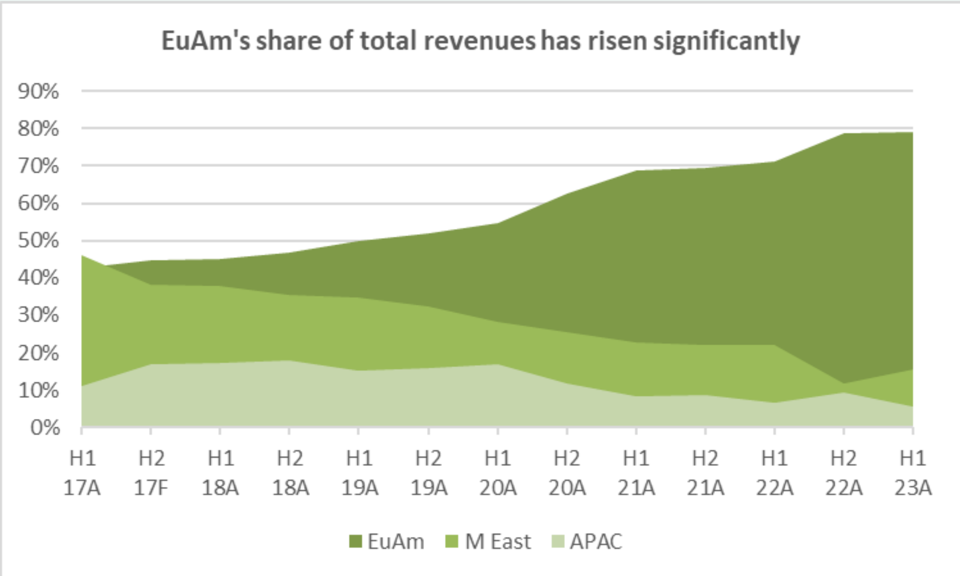
Utilisation rates improved to 76.1% (H1 ’22: 72.7%), as the region was further transformed into the central business hub, involving collaboration with global offices as per the strategy update during Q1.

Following the restructuring of the Group in November ’22, the focus of the smaller regions shifted in favour of larger contracts with blue chip clients. The strategy continues to concentrate on the more profitable and less risky geographical regions. The opening of the Seoul office earlier this year and the targeting of projects in the Kingdom of Saudi Arabia (KSA) remain core to the fulfilment of this strategic shift.

Revenues derived from the ME region (but completed locally and in the EuAm region), declined 31.1% to £3.7m, in line with the strategic aim to reduce risk within the business. It is perhaps worth noting that as recently as H1 ’17, ME represented the largest region in revenue terms. The reduction in the number of experts resulted in utilisation levels rising to 72.3%, from 60.9% a year earlier.

APAC has consistently been the smallest region within the Group. Revenues declined by 17.4% to £1.4m during H1 ’23, the lowest contribution to Group revenues in ten years. The slow start to the year reflected the reduction in headcount and the completion of the large contract in Singapore during H2 ’22. Utilisation levels declined to 66.1% (H1 ’22: 71.3%), notwithstanding the steady improvement in revenues into Q2. A pipeline of projects in South Korea was secured post-period end, suggesting a more encouraging outlook for H2 and beyond. We expect the work to be undertaken in Singapore and the UK.

Steady growth of EuAm cements its position as largest fee generator



Source: Company, Equity Development

Total costs decline

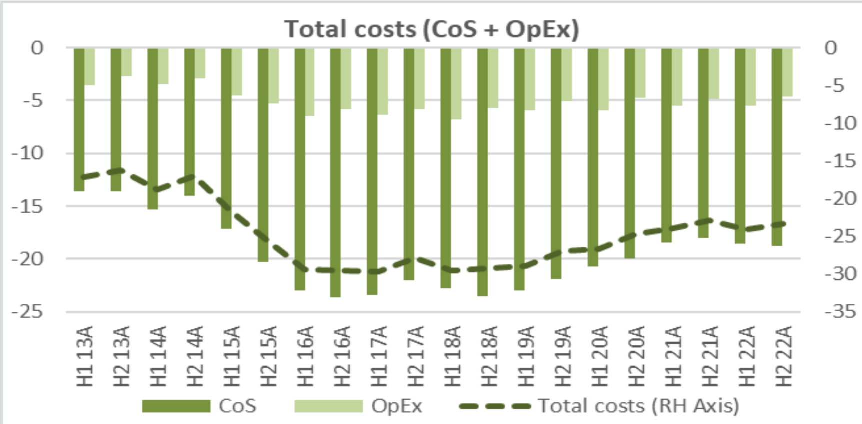
Total costs declined 2.1% yoy to £23.5m, with Cost of Sales falling 3.6% to £17.9m. However, OpEx nudged ahead to £5.7m, representing an increase of 2.8% yoy and well below inflation. However, on an underlying basis central costs rose from £1.7m to £2.0m yoy. The historic head office in Haslingden was vacated during Q3, and the move to a more appropriately sized location is imminent.

The rationalisation programme which was implemented halfway through Q1 ’23, certainly had an impact on total costs. There is further to go with a significant portion of the initial cost saving targets, with delivery occurring during H2 ’23 and FY24.

The UAE office was downsized and the office in Malaysia closed, with the local management teams and 25 staff exiting the business.

The new ERP software is resulting in improved efficiencies across the business, not least in identifying consultants’ availability to assist on projects across the global office network. Even following the improvement in productivity during H1, we remain some way from the FY18 peak utilisation levels of 80%, suggesting further upside. We think the new software should also improve the timing, skill set requirements and location of new hires.

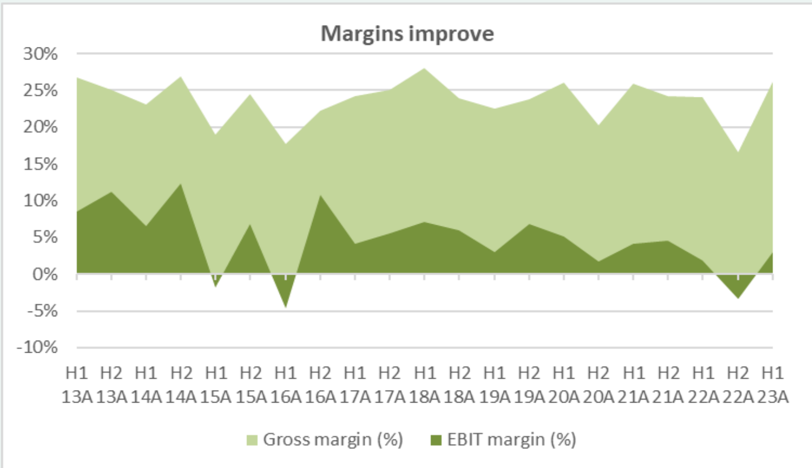
Costs fall, with more to come…



Source: Company, Equity Development

Profitability ahead of guidance, as margins rise

Gross and EBIT margins rise, with scope for further improvement



Source: Company, Equity Development

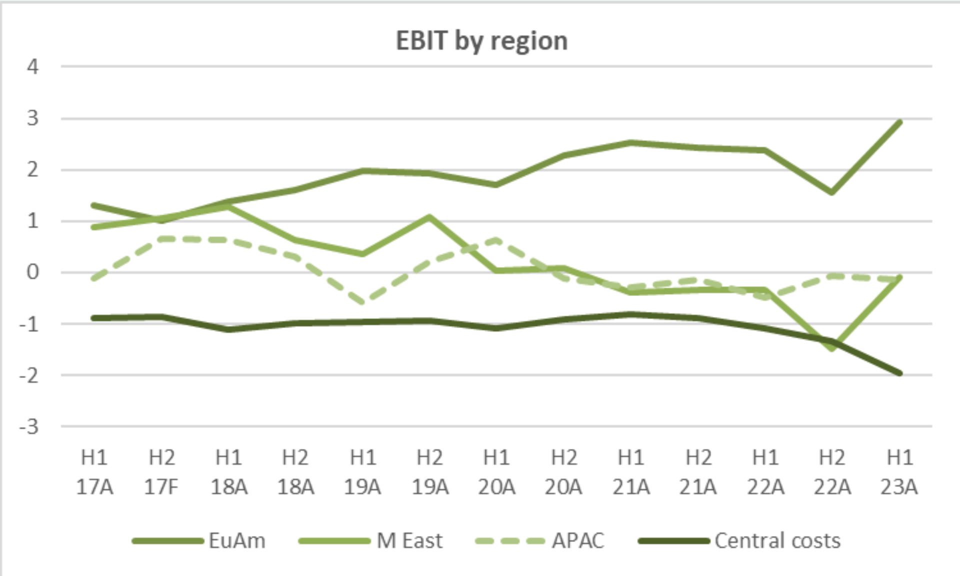
Profitability, however, was more than 10% ahead of guidance at the EBIT level at £0.73m. Gross and EBIT margins improved during the period, with the former rising to 26.2% (H1 '22: 24.1%) and at the latter to 3.0% from 1.9% a year earlier.

In the EuAm, EBIT increased 23.6% (before central costs) to £2.9m, delivering a margin of 15.4% an uplift of 168 b.p.s. The H1 EBIT is at record levels, albeit we see further upside as costs reduce further, utilisation improves towards record levels and expert/consultant headcount is increased as required, fuelling growth.

The ME region delivered a positive contribution pre-provisioning which is encouraging. The region reported a significantly lower loss at the EBIT level of £0.1m (H1 '22: £0.3m), representing the best outcome since the modest profit of H2 '20. The margin improved markedly to -2.5% from -6.1% in the comparable period. The expected closure of the Oman office (in Q4), once outstanding debts are collected from historic clients, should result in an annualised cost saving within the original £1m projection.

APAC, as in the ME region, saw its EBIT loss reduce yoy, reporting -£0.1m (H1 '22: -£0.5m). The interim results last year included a large loss-making fixed price contract in Singapore. We remain hopeful of the recently secured pipeline of work in South Korea benefitting Q4 and FY24.

Improvement in contribution across all regions

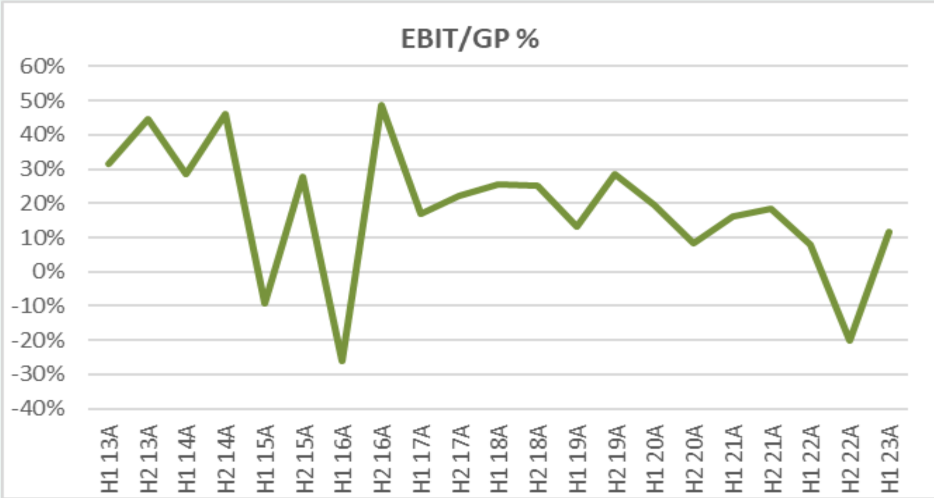


Source: Company, Equity Development

Passing an inflection point

The proportion of gross profit feeding through to EBIT improved markedly in H1 '23 and at 11.5%, represents a return to normal levels, albeit at the bottom end of the range. We see significant scope for improvement from here as costs reduce further (particularly centrally), utilisation levels improve, the progression in favour of higher margin opportunities continues and as the smaller regions return to profitability.

Operational gearing levels improving yoy



Source: Company, Equity Development

Utilisation and profitability are closely linked

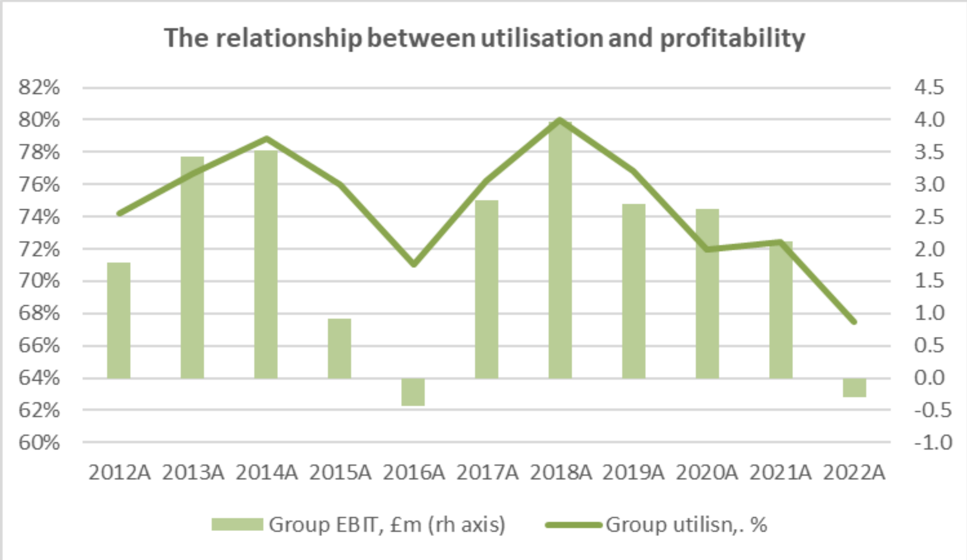
We examine the relationship between utilisation levels and profitability. We do not have the complete data set for the period in question for all regions and we choose to use Group data, as Group EBIT is stated after central costs. The correlation between utilisation levels and profitability is clear with EBIT tending to move in conjunction with the direction of utilisation. Movements in the cost base determine the break-even utilisation level and the current trend of cost rationalisation augurs well for the outlook.

The reduction in headcount, the focus on recruitment of experts within the EuAm central business hub, contributed to produce an improvement in utilisation levels (to 75.6%), resulting in profitability improvements during H1 '23, with margins increasing to 3.0%.

Costs are expected to reduce further as the Group right sizes its office requirement and exits the remaining expensive leases. This should result in profitability improving further. With the new ERP software in place, we think this should provide the Board with greater control on the timing of hiring decisions, driving growth but also maintaining high levels of utilisation/productivity.

Significantly, peak utilisation levels stood at 80% in FY18, matching peak EBIT of £4.0m. EBIT margins were markedly higher (6.3% in FY18) than we saw during H1 '23, suggesting scope for improved profitability moving forward as utilisation rises over the medium term. In fact, peak EBIT margins were seen in FY13 at 9.4% and remained at similarly high levels in FY14 (+9.0%). In each case, utilisation levels were higher than in H1 '23 at 76.7% (FY13) and 78.8% (FY14).

Utilisation levels and profitability are closely linked



Source: Company, Equity Development

Adj. Earnings up over 400% yoy

Net interest remained modest, reflecting the high net cash, resulting in adj. PBT rising 77% to £0.71m (H1 '22: £0.40m) and before share based payments of £0.20m vs. £0.27m in the comparable period. Taxation declined by a third to £0.21m, resulting in adj. earnings of £0.5m, an increase of 441% yoy.

Adj. EPS climbed accordingly, to 1p, with an unchanged dividend of 0.75p proposed. The dividend is expected to be paid on 27 October 2023.

A healthy balance sheet

In terms of the balance sheet, the key movements involved:

- A significant decline in 'right of use assets' to £0.4m, compared to £2.1m a year ago. This reflects the closure of offices as part of the rationalisation programme/strategic review
- A working capital inflow of £0.7m, aided by inflows from the long-term debtors in the Middle East (+£1.8m) but following the payment of the £0.9m derivative
- Net cash rising to £5.3m from £4.9m at the year end and £3.7m a year ago, and,
- Net assets declining to £16.5m yoy but modestly higher than at the year-end (+£0.1m).

The NAV / share increased to 30.6p, with net cash / share at 9.8p or 32% of the period end NAV.

Strong cash generation

Significantly, the cash inflow from operating activities increased by £3.0m yoy to £1.9m. The largest constituents of this turnaround were:

- A £0.5m improvement in profitability yoy
- A net £0.7m inflow from working capital, and
- A reduction in tax paid

Capex was modest, below £0.1m, and mostly comprised IT and software. Since the start of FY22, the Group has exited £1.7m of leasehold properties, with more to come between now and Q1 '24. The share buyback programme was completed in September 2022, costing £0.5m. We discuss potential uses of the net cash later in the document.

Estimates remain suspended – changes afoot?

We continue to suspend financial estimates to reflect the limited visibility with regards to projects, which naturally tend to be lumpy and regularly run across more than one reporting period. Summer is typically quieter in the northern hemisphere as staff take vacations. The economic uncertainty resulting from the Ukraine war and its knock-on effects continue to further restrict visibility.

However, the rationalisation programme is progressing, with further benefits to emerge during the latter part of calendar 2023 (including Q1 of FY23/24), as leases are terminated, and the dual operating costs associated with the move into new premises end.

Headcount reduced significantly following a team's recruitment by a counterparty, with experts tending to be replaced in the EuAm region, to ensure higher utilisation levels. The focus on added-value areas should ensure, ceteris paribus, that margins continue to improve from H1 levels.

The Group has introduced new ERP software to provide management with greater visibility on changes in the business and an ability to react better to any issues.

The combination of:

- A declining cost base, with more to come in Q1 '24
- New ERP-related management tools
- A focus on higher margin work
- The EuAm operating as the engine room of the business (central business hub) – in part resulting in rising utilisation levels
- Headcount expansion reflecting skills demanded, utilisation levels and new office openings
- A more benign environment, and
- Opportunities emerging in South Korea and in KSA, driving growth in the smaller regions

...should result in some improvement in visibility levels and, as such, provide greater confidence for the Board to issue forward guidance to investors.

H2 '23 started slowly, reflecting the late Easter and the extra Bank Holiday in the UK to celebrate the King's coronation. With the Group increasingly western hemisphere centric, holidays such as Chinese New Year, Eid and Ramadan will have less impact on the business, with Christmas and Easter increasingly disruptive. Notwithstanding this the EuAm region remains highly profitable and following the increase in experts in the region, there is an inbuilt growth capability, particularly should one consider the possibility of utilisation levels increasing further.

The two smaller regions, ME and APAC, accounting for just 21% of revenues during H1, have been slimmed down to reduce any risk to the wider Group following the strategic review of November 2022. Additional contracts in each will undoubtedly result in improving levels of utilisation – certainly necessary in APAC following the below 70% reading during H1 – and in turn, improved profitability levels. Encouragingly, the recent contract wins in South Korea from the relatively recently established Seoul office, should see the region move back into the black for the year. In view of the strong sequential half-yearly turnaround in the ME region during H1, we would not be surprised were it to deliver profits for the whole of FY23.

In the event of rising profitability, in part reflecting a markedly more efficient operation and the targeting of added value projects, we expect net cash levels to rise further subject to further share buybacks during H2 ‘23.

The cash clearly provides options for the business. However, before one gets too carried away it is worth mentioning that currently the Group voluntarily has no revolving credit facility in place with any bank and is constantly utilising the cash to fund the business. The process to investigate a new working capital facility is underway. The possibilities for the use of cash over the short-to-medium term include;

- Further share buybacks
- Bolt-on acquisitions
- An increase in the dividend

Since the Board is in the process of deciding when to re-instate guidance, we think a move to a progressive dividend policy is unlikely in the very short term. We wouldn’t hold out against this happening in FY24 and beyond. One should bear in mind though that the payment of a yield of 4.8% (on unchanged expectations) remains very generous and highlights, we think, the undervalued nature of the shares.

We think it would make sense for the Board to explore bolt-on acquisitions to expand its reach. Should this happen, we think this is likely to amount to the purchase of teams in related areas, rather than to widen the geographical coverage. However, to date the focus has been on removing cost from the business and in turn improving utilisation levels and profitability. As this has further to go, albeit with the end in sight, we think acquisitions have not been a priority to date. This may well change over the medium term.

Of the three options we think a buyback of shares is more likely, particularly as the share price is back to levels of the last such programme of June to September of 2022.

Valuation

The options to value a business are relatively limited in the absence of financial estimates, precluding the use of discounted cash flow and peer group comparison models. However, we note the level of cash continues to rise, as highlighted in the table below. Cash currently represents 31% of the market capitalisation and 32% of NAV.

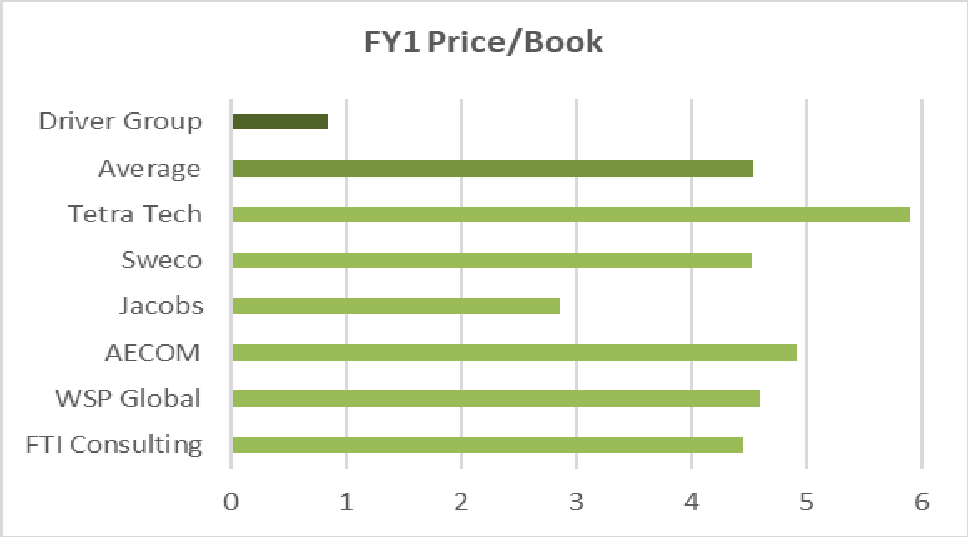
Net cash as a % of mkt cap and NAV increases further

	H1 '21	FY '22	H1 '22
Net cash, £m	3.678	4.931	5.277
Net cash / share (p)	6.7	9.0	9.8
Cash as a % of market cap	21.2%	28.5%	31.1%
NAV, £m	20.155	16.358	16.498
NAV / share (p)	36.7	29.8	30.6
Net cash as a % of NAV	18.2%	30.1%	32.0%

Source: Company

The larger consultancy peer groups trade on a FY23 price/book ratio of 4.54x, which compares to 0.83x for Driver Group. We think a discount of 81.7% is unwarranted, particularly in view of the level of net cash on the balance sheet and the recovery in profitability. **As such, we suggest a 60% discount to its average peer group rating, which amounts to a fair value of 56p. This figure represents a premium to the current share price of 76.3%**

FY1 Price/Book



Source: MarketScreener, Equity Development

Contacts

Andy Edmond
Direct: 020 7065 2691
Tel: 020 7065 2690
andy@equitydevelopment.co.uk

Hannah Crowe
Direct: 0207 065 2692
Tel: 0207 065 2690
hannah@equitydevelopment.co.uk

Equity Development Limited is regulated by the Financial Conduct Authority

Disclaimer

Equity Development Limited ('ED') is retained to act as financial adviser for its corporate clients, some or all of whom may now or in the future have an interest in the contents of this document. ED produces and distributes research for these corporate clients to persons who are not clients of ED. In the preparation of this report ED has taken professional efforts to ensure that the facts stated herein are clear, fair and not misleading, but makes no guarantee as to the accuracy or completeness of the information or opinions contained herein.

This document has not been approved for the purposes of Section 21(2) of the Financial Services & Markets Act 2000 of the United Kingdom ('FSMA'). Any reader of this research should not act or rely on this document or any of its contents. This report is being provided by ED to provide background information about the subject of the research to relevant persons, as defined by the Financial Services and Markets Act 2000 (Financial Promotions) Order 2005. This document does not constitute, nor form part of, and should not be construed as, any offer for sale or purchase of (or solicitation of, or invitation to make any offer to buy or sell) any Securities (which may rise and fall in value). Nor shall it, or any part of it, form the basis of, or be relied on in connection with, any contract or commitment whatsoever.

Research produced and distributed by ED on its client companies is normally commissioned and paid for by those companies themselves ('issuer financed research') and as such is not deemed to be independent as defined by the FCA, but is 'objective' in that the authors are stating their own opinions. This document is prepared for clients under UK law. In the UK, companies quoted on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

ED may in the future provide, or may have in the past provided, investment banking services to the subject of this report. ED, its Directors or persons connected may at some time in the future have, or have had in the past, a material investment in the Company. ED, its affiliates, officers, directors and employees, will not be liable for any loss or damage arising from any use of this document, to the maximum extent that the law permits.

More information is available on our website www.equitydevelopment.co.uk

Equity Development, 2nd Floor, Park House, 16-18 Finsbury Circus, London EC2M 7EB

Contact: info@equitydevelopment.co.uk | 020 7065 2690