Driver Group Plc

A sturdier foundation, with positive momentum

11 November 2022

Management has undertaken a significant rationalisation programme, successfully commissioned new ERP software, and explored means of reducing central costs to place the Group on a sounder footing moving forward, following an extremely challenging FY22 for Driver Group. The actions are paying off, with Q1 '23 moving into profit, with further progress anticipated from Q2 onwards.

With estimates suspended, we have left the fair value/share unchanged at 49p. The shares continue to trade below NAV, which is backed by £4.8m of net cash.

- FY22 proved to be an eventful year for DRV. Record losses were reported in the Middle East (ME), although APAC returned to profitability during H2 (following a loss on a large, fixed price contract in Singapore during H1). An external Counterparty acquired management, 25 staff, and some contracts in exchange for a £2m advance payment on debtors, plus an agreement to assist in the recovery of a further £1.5m of trade debtors. The subsequent slimming down of the ME & APAC regional footprint has reduced overheads by an annualised £3m.
- The slimming down of the two smaller regions enables management to apply its longer-term strategy to the regions, that is a focus on large contracts with blue chip clients. Although much of the servicing of such projects will be facilitated locally, consultants from the EuAm region will contribute to ensure that utilisation levels across the Group remain high.
- The implementation of the new ERP software has begun to improve the level of data available in managing the business, further improving efficiency levels. The software also identifies where consultants are underutilised and available to assist on projects from across the office network, thereby further improving utilisation levels.
- We have continued to suspend financial estimates, in view of the ongoing uncertainty. However, we think that a combination of the continued headcount expansion (dependent upon skills demanded and utilisation levels), additions to the office network and a focus on higher margin areas should underpin top-line growth over the short-to-medium term. With costs markedly lower in the Group's two smallest regions, and strong operational gearing in the group overall, we anticipate an improved result moving forward.
- Even after the expenditure of £0.5m on share repurchases, net cash at the year-end is £4.8m, a strong position for the Group. We expect that some progress will be made during FY23 on receiving the £1.5m of longer-term trade debtors, providing additional options. We think a further return of cash to shareholders is likely, with the funding of organic growth geographically and by sector also a good use of funds.
- While it is difficult to assess the valuation of a business with no published estimates**, what is very clear is the direction of travel**. The significant cost reductions across the business, coupled with the focus on higher margin areas is highly likely to result in a marked turnaround in profitability during FY23. In fact, the new year has started strongly, with further progress likely in Q2. **The one known is the net asset value at H1 '22, of £20.2m or 39p/share. Of this, net cash amounts to £4.8m. Its global consulting peer group trades on a prospective December '22 price/book ratio of 4.5x, significantly ahead of DRVs 0.7x. As such, we retain our previous fair value/share of 49p.**

Company Data

EPIC	DRV
Price (last close)	29p
52 weeks Hi/Lo	69p/21p
Market cap £m	£15.6m
ED Fair Value	49p
Net cash	£4.8m

Share Price, p

Source: ADVFN

Description

Driver is a multidisciplinary 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 299 staff.

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

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Restructuring completed

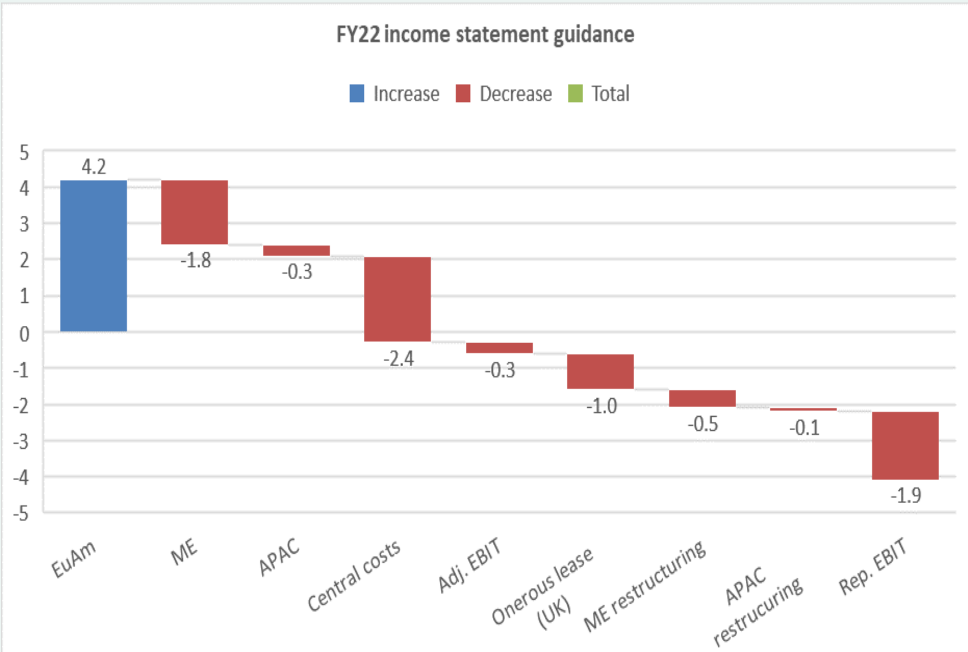
FY22 proved to be very challenging for Driver Group (DRV), resulting in a change in strategic focus and a necessary rationalisation programme. Initially, management sought to reduce costs by £1m, although an escalation of the issues facing the Group's Middle Eastern (ME) business required a tougher response. The management and 25 staff (alongside several contracts) were transferred to an unnamed Counterparty, which facilitated the downsizing of the UAE office and closure of the Group's presence in Malaysia. This has resulted in overall savings of £3m, on an annualised basis.

In return, DRV secured a £2m advance payment covering a significant portion of trade receivables owed by customers, with the Counterparty additionally agreeing to help with the collection of the outstanding £1.5m.

A presence has been maintained within the smaller regions (ME and APAC), ensuring that the Group is able to provide a global offering to its client base. Within the ME & APAC regions, the focus has adjusted to larger contracts, derived from blue-chip clients. The overriding strategy remains one of focusing operations on the more profitable and less risky geographical regions.

Guidance has been provided on the likely outcome for FY22, with the preliminary results to be released in early February. The results will be audited by the Group's newly appointed practice, Kreston Reeves, with the change made as part of the targeted cost cutting programme.

FY22 income statement guidance



Source: Company

The EuAm region, comprising work secured by the UK, European and North American offices, delivered EBIT of £4.2m in FY22, with the UK benefitting from a strong performance within Project Services and several expert hires. The addition of fee earning consultants in both Europe and the Americas was a further positive.

The loss in the ME region increased to record levels, namely £1.8m, reflecting the lowest activity levels in several years as confidence was slow to return following the end of the pandemic. Although activity levels also declined in the APAC region, the loss of £0.3m stemmed from a large, fixed price contract in Singapore (now completed) and resulting in the appointment of a new Director of Operations in the city state.

Central costs increased to £2.4m, resulting in adjusted EBIT of -£0.3m. The Group's former head office in Haslingden, Lancashire, was too large. Following the move to Bristol this has resulted in an onerous lease provision of £1.0m. Moving forward, the cost reduction associated with moving to a smaller admin-related office should see central costs declining in FY23, ceteris paribus.

The costs associated with the office closures, moves and staff reductions in the ME and APAC regions amounted to £0.6m, resulting in reported EBIT of -£1.9m for FY22.

Net cash provides options

Net cash at the end of H1 amounted to £3.7m. Significant movements in the intervening period have included the £2m received from the Counterparty and expenditure on the share buy-back programme. The latter amounted to £0.5m, completed in early September. Year-end net cash increased to £4.8m, providing the Group with several options.

We think the likely options at the Group's disposal include:

- A further return of cash to shareholders, either via a new share buy-back exercise or a special dividend
- Improvements in the dividend outlook
- Selective new offices/consultant hires
- Bolt-on acquisitions.

In the short-term, our expectation is that a further return of cash to shareholders is likely, while a focus on organic growth into related sectors in existing, profitable territories will be considered by the Board.

Looking forward

We continue to suspend financial estimates, reflecting ongoing uncertainty with regards to the recovery from the pandemic and the disruption caused by the war in the Ukraine and, a general lack of visibility. However, with the rationalisation programme largely complete and the implementation of the new ERP software beginning to identify further efficiencies and improve utilisation levels, we anticipate that FY23 should see a markedly improved outlook for profitability.

The change in management within the ME and APAC regions, aided by a lower headcount and a focus on larger contracts with blue-chip clients, augurs well. The focus of the contracts is expected to be higher-margin dispute work predominantly in Oman, Saudi Arabia, and Qatar. The APAC region will target Australasia and Southeast Asia, including South Korea. The contracts will be serviced both locally and via offices in the EuAm region, thereby improving utilisation levels across the Group. With annualised costs savings of up to £3m, albeit on a lower revenue base, one should expect the smaller regions to return to the black in FY23.

The profit driver of the Group has long been the EuAm region. An expansion of its focus into related sectors, with new fee earners added as utilisation levels rise, should ensure a profitable future for the region. There are plans to target eastern Canada, in addition to a cross-fertilisation of clients from across the Americas. In fact, Q1 to date is profitable, with further progress likely from Q2 onwards.

Fair value

With no estimates, the construction of valuation models is made difficult. However, taking the book value at the half year of £20.2m or 39p per share. One should be aware that of this value, £4.8m or 24% is represented by cash. Looking at its larger, consultancy peer group they trade of a FY22 price/book ratio of 4.5x, suggesting that Driver Group's 0.7x remains too low. On that basis, we retain our fair value of 49p per share.

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