Driver Group plc

A profitable start to the new year

23 February 2023

The new financial year has started strongly with a strong pipeline of opportunities and a lower cost base following an expanded rationalisation programme that resulted in most regions delivering a profit YTD in FY23. The results for FY22 were broadly in line with revised expectations, although the lack of forward visibility results in a continued suspension of estimates. That said, we expect FY23 to prove to be a turning point in the Group's fortunes as utilisation levels improve now that projects are serviced globally. Our fair value of 49p / share is unchanged, reflecting a combination of the net cash level, which now accounts for nearly a third of the group's value, and the shares standing on a significant discount to the historic price/book (P/B) multiple of its peer group.

The tough response to issues faced in the Middle East ("ME") is **bearing fruit**. With further aggressive cost cutting within the region and the benefit of the old team moving to a counterparty (in return for help to secure aged trade receivables in the region), the problematic region should return to profitability during FY23 (achieved in Q1). The cost cutting includes the downsizing of the Haslingden and UAE offices, closure of the office in Malaysia, and a reduction in size of the back office.

Utilisation rates for the Group fell to their lowest level on record (67.5%) for FY22. In response, projects are now serviced both locally and from the Europe & Americas ("EuAm") region). Implementation of the new ERP software is now providing real-time information, enabling **further efficiencies and tighter management of projects**. Significantly, the net reduction in staff (ME & APAC) largely reflected the transfer to the counterparty, with most hires in EuAm focussed on the higher margin Diales expert area.

A targeting of larger 'giga' projects is expected to result in a **marked improvement in utilisation levels**, with the focus predominantly on Saudi Arabia and on higher margin dispute work generally. An improved enquiry pipeline is emerging in Latin America and South Korea, and the return of international travel is also helping to drive business development, as relationships are renewed/deepened.

The Group has experienced **a strong start to the year**, with Q1 revenues 5% ahead of budget at £11.8m. Q1 EBIT amounted to £0.25m vs budgeted expectations of £0.13m. The business continued to trade profitably throughout January. Encouragingly, utilisation levels have increased to 70%. Significantly, most offices have delivered a profit YTD in 2023.

The level of net cash declined modestly to £4.7m at the end of January 2023. This followed the payment of the interim dividend (£0.4m) and the receipt of £1.2m of ageing trade receivables from the Middle East. **The positive cash levels should underpin the payment of dividends in FY23**. We expect management to keep cash available to fund the growth of the business, via organic means and / or M&A (bolt-on deals remain a possibility).

Limited forward visibility, but undervaluation apparent

We are still suspending estimates reflecting a lack of visibility and ongoing uncertainty. While this makes the construction of forward-looking valuation models difficult, we highlight the NAV and within this the level of net cash at the FY22 year end. A historic FY22 price/book ratio amounts to 1.0x, on a book value of £16.4m, which equates to **29.8p/share**. Furthermore, £4.9m or **9.1p/share of this is in cash**, representing 30.7% of the Group's NAV**.**

Comparing DRV to a wider consultancy peer group that trades on an average historic P/B ratio of 4.7x, suggests that DRV (on 1x NAV) remains significantly undervalued. We retain our fair value/share of 49p.

Company Data

EPIC	DRV
Price (last close)	29p
52 weeks Hi/Lo	45p/21p
Market cap	£15.7m
ED Fair Value/share	49p
Net cash (Sep '22)	£4.9m

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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FY22 preliminary results – an eventful year

The outcome for FY22 was broadly in line with the guidance issued at the time of the trading update in November - EBIT (£0.4m compared to the £0.3m result) and net cash (£4.8m vs the £4.9m outcome and highlighting rounding differences).

2022 prelims, half-year split

£m	H1 21	H2 21	FY21	H1 22	H2 22	FY22	YoY growth
Revenue	25.0	23.8	48.8	24.4	22.5	46.9	-3.8%
Cost of sales	-18.5	-17.9	-36.4	-18.4	-18.7	-37.1	2.0%
Gross profit	6.5	5.8	12.2	6.0	3.6	9.6	-21.4%
Gross margin, %	25.9%	24.3%	25.1%	24.6%	16.0%	20.5%	-18.3%
OpEX	-5.5	-4.8	-10.3	-5.6	-4.4	-10.1	-2.3%
Other operating income	0.1	0.1	0.2	0.1	0.1	0.2	-13.9%
Op Profit	1.0	1.1	2.1	0.5	-0.8	-0.3	-113.7%
Operating margin, %	4.2%	4.5%	4.3%	1.9%	-3.4%	-0.6%	-114.3%
Net interest	0.0	-0.1	-0.1	-0.1	0.0	-0.1	-9.1%
Adj. PBT	1.0	1.0	2.0	0.4	-0.8	-0.4	-119.5%
Exceptional items	-0.2	0.1	-0.1	-0.3	-1.8	-2.0	
Reported PBT	0.8	1.1	1.9	0.1	-2.6	-2.4	-230.4%
Taxation	-0.3	-0.5	-0.7	-0.3	-0.2	-0.5	-38.3%
Tax, %	28.7%	45.7%	37.1%	76.9%	-19.0%	-117.6%	
Adj. PAT	0.7	0.5	1.3	0.1	-0.9	-0.9	-167.4%
Adj. EPS (p)	1.3	1.1	2.4	0.2	-2.9	-2.7	-212.5%
DPS (p)	0.75	0.75	1.5	0.75	0.75	1.5	0.0%
Net cash/(debt)	7.2	-0.8	6.5	3.7	1.3	4.9	-23.8%
Net assets	20.8	21.3	21.3	20.2	16.4	16.4	-23.1%

Source: Company, ED

The modest decline in revenues (-£1.9m or -3.8%) to £46.9m reflected a significant reduction in headcount in the Middle East (ME) and Asia Pacific (APAC) regions, following 25 employees leaving to join a counterparty in May 2022, subject to a £2m fee and help in recovering trade receivables. Overall headcount fell by the same number to 302, as numbers in the Europe & Americas region ("EuAm") increased by 16 to 246. Utilisation fell to the lowest level in recent history at 67.5%.

Revenues in the EuAm region increased 3.8% to £35.1m, reflecting a strong performance in the UK, as the North-East office secured additional work within the pharmaceutical and petrochemical industries for the Project Services division. The North American business continued its trend of doubling headcount since inception during the pandemic, with a strong performance achieved in Paris following its prior year restructuring and the addition of a new expert witness to increase the Diales team. Growth was experienced in both Germany and the Netherlands, although the leadership in Canada was restructured following the illness of one of its management team.

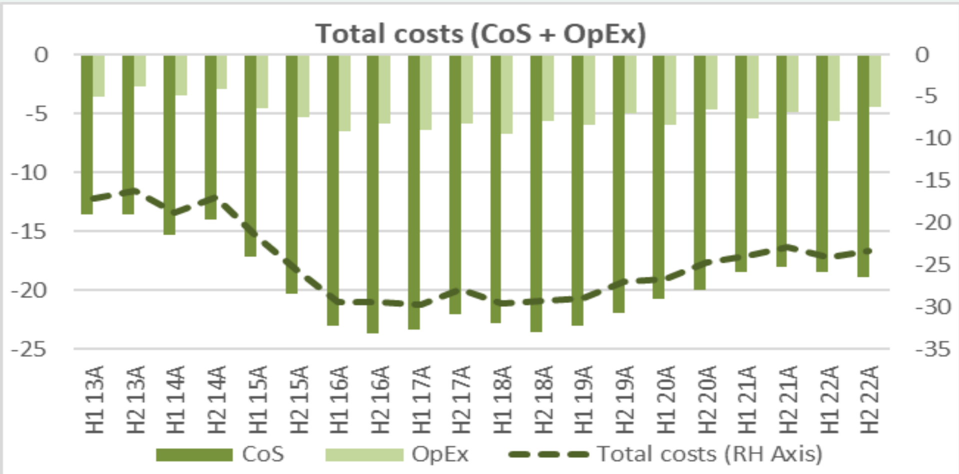
The combination of a difficult Q2 and the transfer of the management and several employees of the ME and APAC regions had a marked impact on revenues, with the top-line in the former declining 26.2% yoy to £8.1m. Headcount in the region fell by 30 to 35 and utilisation levels declined to new lows, at 52.6% (FY21: 72.3%).

A loss-making contract which was completed during the year, coupled with the closure of the office in Malaysia following the transfer of employees to a counterparty resulted in revenues reducing 9% to £3.7m, notwithstanding the double-digit improvement in Australia. Headcount in the region declined by 11 to 21, much of which reflected the closures in Malaysia and Hong Kong, with the region serviced from Australia, Singapore and the EuAm region and resulting in utilisation levels only declining modestly to 68.1% (FY21: 69.9%). The management team was changed during the period, better able to take advantage of business opportunities in the region.

Costs of sales (CoS) increased 2% yoy, part-reflecting the loss-making contract in the APAC region and lower margin contracts in ME, which largely moved with the counterparty. OpEx declined 2.3% to £10m, driven by a 21.1% sequential decline over H1 levels, with overall costs declining 3.0% over the six months.

We note the ongoing efficiency drive and the lower cost base moving into the new financial year.

Total costs, £m



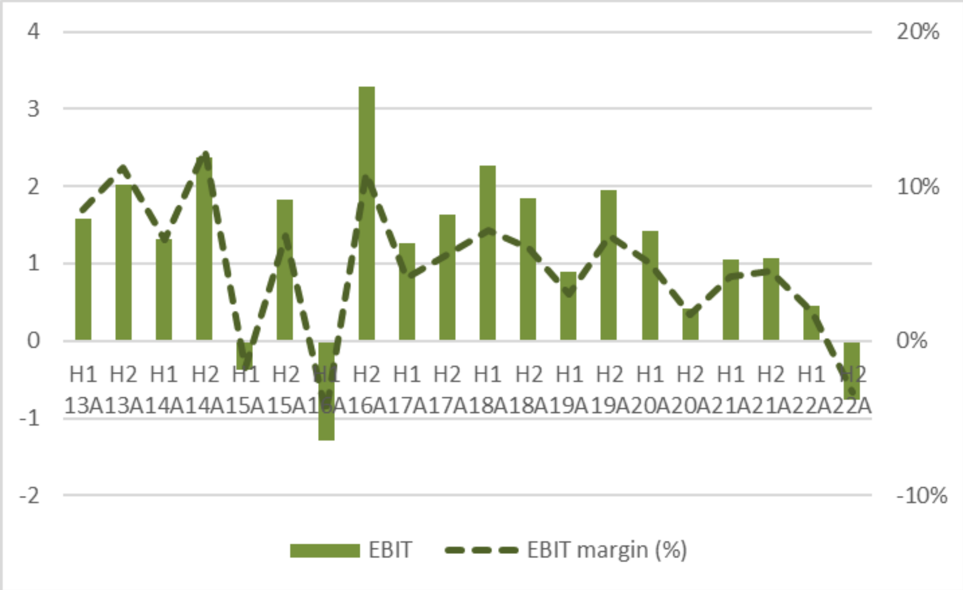
Surce: Company, ED

We note the move to an overall loss of £0.8m in H2 '22 at the operating level and for the first time since H1 2016. This is despite the on-going profitability in the EuAm region and a near breakeven result in APAC during H2. It was the ME region which provided the drag on overall profitability.

Moving forwards, the reduction in the cost base in the latter region, coupled with a decrease in central costs (the Group's previous head office in the North-West was down-sized) augur well for the future.

Interest payable amounted to £0.1m for the full year, broadly unchanged yoy. Net cash levels continued at relatively high levels. The RCF with its banks was cancelled post-year end and will be replaced with a new working capital facility.

Half-yearly EBIT (£m) and EBIT progression



Source: Company, ED

Exceptional costs totalled £2.0m, comprising:

- £0.6m equating to reorganisation costs in ME and the APAC regions
- £1.0m due to onerous lease costs relating to the Haslingden office, and
- £0.5m of share-based payments

Adjusted PBT amounted to a loss of £0.39m. A tax expense of £0.46m resulted in an adj. PAT of £0.85m and a reported PAT of £2.89m. Adj. EPS declined to -2.9p (FY21: +2.4p).

However, management demonstrated its confidence in the outlook and the Group via the return of £1.3m to investors during FY22. This came via a £0.5m share buy-back programme and a FY dividend of 1.5p per share, or £0.8m.

Following the agreement with the counterparty to help recover ageing trade receivables and the appointment during the year of a new CFO, the cash generated from working capital inflows amounted to £2.7m and followed an outflow of £2.3m in FY21.

A further £1.2m was received following the year end, taking the total to £1.85m from the recovery of the ageing debtors in Oman. At the year-end net cash amounted to £4.9m, with the decline from £6.5 at the start of the year due to a cash outflow at the operating cash level, notwithstanding the working capital inflows; taxation; dividend, share buy-backs; interest and capex.

Net assets reduced to £16.4m (FY21: £21.3m), reflecting a combination of the losses (including exceptionals) and £0.2m of exchange differences – which largely reflected weaker Asian currencies relative to the US dollar.

Looking forward

Our estimates continue to be suspended, which reflects a combination of:

- Limited forward visibility
- The ongoing hostilities in the Ukraine, and
- The imminent retirement of the Chairman at the AGM

The uncertainty created by the pandemic is largely consigned to history, although this continues to have a limited effect in China. However, the business is 'lumpy' in nature with projects typically varying in size and duration and 'live' for several quarters. Generally, the ability to predict the business outcome beyond a six-week window tends to be difficult.

The war in Ukraine has resulted in deferred projects, as resolutions are generally not feasible currently due to the sanctions on Russian companies. DRV tends to represent those seeking redress against Russian companies.

Positives such as the completion of the rationalisation programme, with the ongoing focus on central costs, not least the back office. In addition to the ongoing overhead reduction there is a continued focus on staff retention, utilisation, and cash collection.

The recruitment of fee earners will reflect project wins but considering the contract pipeline is not expected to decline from current levels following the reductions during FY22 in Asia Pacific and the Middle Eastern regions. As highlighted earlier, contracts will be serviced on a global basis, using both local staff and specialists who are based in the EuAm region. In the EuAm region a further six higher margin Diales experts were recruited during FY22, out of a net 16 hires, which augurs well for FY23 in our view.

The implementation of the ERP software provides real time information enabling an improved utilisation of resources across the Group and a greater efficiency within the business.

We are encouraged by the pipeline of very large 'giga' projects especially in Saudi Arabia (KSA) and elsewhere in the Middle East, focused on higher margin dispute work. An improved enquiry pipeline is emerging in Latin America and South Korea. The return of international travel is driving business development, as relationships are renewed/deepened due to face-to-face meetings.

The Group has experienced a strong start to the year, with revenues 5% ahead of budget during Q1, at £11.8m. Utilisation levels increased to 70% during Q1 '23 versus 67.5% for FY22.

Significantly, most regions delivered a profit YTD, with EBIT of £0.25m during Q1, versus a budget of £0.13m. The recovery continued into January.

The level of net cash declined modestly to £4.7m at the end of January 2023. This was stated following the payment of the interim dividend (£0.4m) and the receipt of £1.2m of ageing trade receivables from a customer in the Middle East. Other than dividends payments, we do not expect further returns of cash to investors.

Rather, we expect management to keep cash available to fund the growth of the business, including the potential addition of bolt-on acquisitions, specialist fee earner teams, and/or selective office openings.

In conclusion

We retain our fair value/share of 49p.

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