Driver Group

Strategy on track, despite timing issues

26th September 2023

Driver Group has issued a trading update earlier than normal, citing a weak Q3 (reflecting a combination of timing issues and the later Easter) as reasons. Nevertheless, Q4 has witnessed a return to more normal patterns of trading and coupled with the rationalisation programme yet to impact results and the pipeline of orders looking more encouraging, we think the medium-term outlook appears favourable. The further improvement in net cash levels provides the Board with opportunities, not least in its capital allocation policy, including the further return of cash to shareholders. The NAV remains above the current share price.

- Typically, projects tend to differ in length and run across financial reporting periods, with several large contracts completed during March. This has resulted in timing issues, as Q3 started slowly, not helped by Easter falling later this year. The Group's largest region, Europe and the Americas ("EuAm"), delivered a yoy improvement in revenues, with the shortfall centred on the Middle East ("ME") and APAC regions. The trading shortfall in the ME region was exacerbated by the running down of the operations in Oman, in part reflecting the loss of a team in May '22.
- Nonetheless, trading in Q4 has improved, with both enquiry levels and project awards increasing during the period. We think these augurs well for FY24. Notwithstanding the modest H2 loss, the yoy turnaround in profitability is marked during FY23's reset year, versus a loss in FY22.
- The strategy remains unchanged, focused on profitable contracts, improved utilisation levels, lower costs, and further diversification by discipline and geography. The FY guidance indicates that this strategy is working, as previously a reduction in revenues resulted in a disproportionate decline in profitability. The Group is likely to return a modest H2 loss, but deliver a positive outcome for the year, strongly suggesting that the rationalisation programme is working.
- It is worth considering that a substantial proportion of the cost savings related to the closure of offices (reflecting lease breaks in the UK and a rationalisation of the network overseas), with the accompanying staff reductions kicking-in from late Q4 '23 / Q1 '24. The implementation of the new ERP system has started to provide useful management data, not least the efficiency of consultants/experts, but there is more to come from this.
- We expect a combination of the new project wins, a return to more normalised trading (evidenced by current enquiry levels), higher utilisation levels, a focus on KSA and South Korea to bolster the smaller regions, and the lower cost base to result in a rise in profitability during FY24.
- Guidance was provided on net cash levels, which sat at £5.3m or 9.8p/share (equating to 36.2% of the Group's current market capitalisation) in March and suggesting a degree of uplift during H2. This highlights the strong cash generative nature of the Group's operations. We think the net cash provides a degree of comfort and fully expect the Board's capital allocation strategy to utilise this resource over the short-to-medium term, whether by way of further share buy-backs, the acquisition of teams to further widen the Group's disciplines/geographical presence or increases to the dividend.

Valuation

We expect the NAV to decline modestly during H2, reflecting the slight reduction in profitability. However, at c.£15.8m / 29p per share, which is 8% above the current share price, this provides healthy support for the shares. With the current share price now below levels of previous buybacks and net cash higher during H2, we remain positive over the medium-term.

Company Data

EPIC	DRV
Price (last close)	27p
52 weeks Hi/Lo	34p/23p
Market cap	£14.6m
ED Fair Value / share	40p (49p)
Net cash (Mar '23)	£5.3m

Share Price, p

Source: ADVFN

Description

Driver is a multidisciplinary consultancy group, with specialist commercial management, planning, programming and scheduling, and expert witness 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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Outlook and valuation

Guidance was previously suspended to reflect the limited visibility available on projects, which tend to be lumpy and typically run across more than one reporting period. This pattern was borne out during H2 '23.

In the absence of financial estimates, the options to value a business are relatively restricted. However, net cash continues to rise, and the NAV is likely to be broadly similar to the H1 period end, with only limited movement in reserves. We therefore anticipate that the NAV will be c.£15.8m, equating to 29.1p / share, a premium of 7.8% to the current share price.

The pre-close trading update suggested that net cash will improve during H2 compared to levels at the end of H1 of £5.3m. We suggest a likely range in the table below, with the likely outcome representing a range of 10p / share to 11.5p / share or 37% to 42% of the current share price.

Potential FY23E net cash outcome

Net cash (£m)	**5.4**	**5.6**	**5.8**	**6.0**	**6.2**
Net cash / share (p)	9.97	10.34	10.71	11.08	11.45
As a % of MCap	36.9%	38.3%	39.7%	41.0%	42.4%

Source: Equity Development

With the contract pipeline looking promising for FY24 we expect an improved outlook in the new financial year via a combination of the following:

- Further declines in the cost base
- The implementation of new ERP-related management tools
- A focus on higher margin projects
- Improving utilisation levels excess capacity within EuAm contribute to delivery of local projects
- Improving enquiry levels and in turn, the pipeline, and
- Opportunities emerging in KSA and South Korea, driving growth across the smaller regions.

In view of the level of net cash, we think the Board will consider its capital allocation policy, centred on:

- Further share buy-backs
- Bolt-on acquisitions, and,
- An increase in the dividend.

Shorter-term our expectation would be a return of share buy-backs in view of the current share price, which is below the level of previous purchases.

Adjusted fair value

We think that with the strategy unchanging, signifying greater stability and coupled with an improvement in the outlook, the shares are currently undervalued, sitting below the NAV / share.

Yet reflecting the timing issues witnessed during H2, we reduce our fair value / share from 49p to 40p.

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