Driver Group

Welcome news of progress

27 April 2023

The pre-close trading update from Driver Group was encouraging, with static revenues (signifying rising productivity), improving profitability and margins, and the move into the black for the first time in two years within the Middle East region. Cash levels continued to improve, highlighting the collection of doubtful debts and higher profitability. We expect the solid foundations put in place by the management team over the last 12-18 months will provide a strong base from which to grow meaningfully over the medium term.

- **Revenues were broadly static yoy at £24.2m** (H1 '22: £24.4m), with momentum building during Q2 following an encouraging start to the year (5% ahead of budget during Q1). What is noteworthy is the higher levels of productivity as staff levels declined yoy. We think there is much further to go as utilisation rates rise over the medium term, targeting the previous peak of 80% in FY18, compared to 67.5% in FY22.

- **Profitability improved from £0.4m to £0.65m yoy during H1** and suggesting margins markedly improving in Q2 (Q1 EBIT of £0.25m vs c.£0.4m in Q2 '23). The strengthening momentum reflects the turnaround into profitability in the Middle East and steady progress within the EuAm region. Higher levels of utilisation from the 69.6% reported in H1 '22, as the servicing of contracts is undertaken both locally and within the EuAm region. Some cost cutting was undertaken last year, with 25 employees departing to a counterparty in May 2022, therefore providing a lower base by the September year end.

- **The EuAm region was the pick of the regions**, aided by a higher margin mix of business as the proportion of experts rose and higher utilisation rates reinforced the margin improvement. The UK and Europe continue to perform solidly, with the enquiry pipeline in the Americas showing encouraging progress.

- **Following four consecutive half-yearly losses, the Middle East returned to profitability**. The turnaround reflected a combination of lower headcount, a focus on larger projects, higher margin dispute work, and the servicing of contracts globally all contributing to the improvement in the region.

- **The performance of APAC demonstrated progress, with Australia continuing to be the jewel in the regional crown**. Progress continues to be made in terms of a focus on South Korea with regards the enquiry pipeline. There has also been progress in reducing the losses reported by the region, aided by the global servicing of projects and the rationalisation programme previously undertaken, albeit there is further work to do.

- **The balance sheet strengthened with the level of net cash improving £0.3m during the period to £5.2m** and from £3.7m a year ago. The unwinding of the debtor book was a significant factor in this improvement, with a large proportion of the improvement in profitability converted into cash. It is worth bearing in mind that the net cash amounts to 9.5p per share or 35% of the market capitalisation of the Group.

Fair value / share unchanged

Although our estimates remain suspended pending further visibility, we note the NAV (FY22 end: £16.4m or 30.3p / share) and net cash account for 35.1% of the market cap (as of March 2023). DRV's wider consultancy peer group, trades on an average prospective P/B ratio of 4.4x, suggesting that a re-rating of DRV shares looks overdue now that an inflection point has been passed.

Our fair value/share remains 49p.

Company Data

EPIC	DRV
Price (last close)	27p
52 weeks Hi/Lo	38p/21p
Market cap	£14.6m
ED Fair Value/share	49p
Net cash (Mar '23)	£5.2m

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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The outlook is improving

We note the marked increase in profitability and, in turn, the improvement in margins yoy during H1. We think this process has further to go in the medium term. Operating margins have improved from 1.9% in H1 ’22 to c.2.7% in H1 ’23. However, our estimates remain suspended which primarily reflects the limited forward visibility and is not uncommon in project-based businesses.

That said, we think that good foundations have been laid, which augur well for the medium term, including:

- The ongoing cost reduction programme
- Hires made in the EuAm region, with net reductions yoy in the ME and APAC regions
- Rising utilisation levels
- A strengthening of the management teams

Although the cost rationalisation programme was previously announced, a combination of property-related savings as offices are downsized and headcount reductions have yet to fully emerge. We expect the run-rate of costs to have adjusted by the end of Q4, reflecting the timing of lease breaks and replacement hires made in the UK. This combination and the imminent closure of the Oman office should reduce the run-rate of costs by c. £0.5m by the end of Q4, subject to new consultant hires.

We note the broadly static revenues yoy (-£0.2m to £24.2m), as suggested in the trading update. However, it is worth noting that 25 employees departed in May 2022 to join a counterparty, with headcount still lower yoy despite consultant/expert hires in the EuAm region. As a result, productivity levels have increased as utilisation levels improved from FY22’s record lows (the range is typically 71% to 80%, with FY22 reporting 67.5%).

We remain convinced that the new working practices, whereby work is won locally but undertaken globally, is already leading to an improvement in utilisation levels. We think there is a long way to go to achieve 2018’s record level of 80%, suggesting there is greater potential over the medium term.

Growth throughout the Americas and a return to profitability in the ME region and reducing losses in APAC highlight the impact of the upgrades in the management teams over the last 12 months. Also, this highlights our belief that the Board’s strategy is beginning to work and provides encouragement for the medium-term outlook.

Fair value

The continued suspension of estimates makes the construction of forward-looking valuation models difficult. We note the year end (September 2022) book value of £16.4m, which equates to 30.3p / share and which values the Group on a historic price/book value of less than 1.0x. However, £5.2m or 9.5p/share equates to cash, representing 35.1% of the Group’s market capitalisation**. DRV’s wider consultancy peer group trades on an average prospective P/B ratio of 4.4x, suggesting that DRV remains significantly undervalued. We therefore retain our fair value/share of 49p.**

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