Driver Group plc

New strategic plan to further improve margins

14 December 2023

FY23 preliminary results delivered a strong turnaround in profitability on modestly lower revenues, highlighting action taken on costs and improved levels of utilisation. With a solid foundation now in place, we expect the new strategic plan to deliver an uplift in gross margins of c. 20% by the end of FY27. With plans in place to expand top line revenues plus a focus on added value expert services and related sectors, the outlook is bright and not yet reflected in the company's current valuation in our view.

Tangible progress

- The restructuring in H2 '22 signalled a turnaround in the Group's fortunes as efforts refocused on eradicating losses in the smaller regions and improving utilisation rates across the Group. On this basis, the FY23 preliminary results show successful progress, as adj. EBIT moved from a loss of £0.4m to a profit of £1m in FY23, notwithstanding a challenging Q3.

- The business model was amended, with the delivery of projects in the smaller regions undertaken locally and within EuAm, thereby positively impacting utilisation. That in turn allows the introduction of the new four-year plan. A combination of a re-branding towards higher value-added services, removing duplicated costs, targeted hiring of experts/revenue generators, a move into related sectors, and new methods of motivating regional/country heads outside of the EuAm all form the pillars of the new strategy. The objective of the strategic plan is to enhance shareholder value via an expansion of revenue and profitability, done against a carefully monitored cost base.

- The new financial year has started brightly, continuing where Q4 '23 left off. New projects have been secured, with deferred contracts commencing and utilisation levels remaining at the high levels of FY23. Encouragingly, the pipeline of enquiries continues to build with a rising proportion of larger projects targeted. Meanwhile, costs have declined as leases were surrendered and relocated into serviced offices, with the benefits evident by the end of Q1 '24.

- Net cash increased further during the period, rising to £5.8m. Consequently, the Board continues to examine its capital allocation policy. With an estimated £1m of 'excess cash' available for such purposes, several options remain open to either return cash to shareholders or to fund growth.

Valuation

Year-end cash made up 42% of the Group's market capitalisation and 36% of the NAV. This values the underlying business on modest ratings. We retain our 40p fair value / share which will be re-assessed as earnings momentum feeds through.

Forecasts

Y/e 30 Sep, £m	2021A	2022A	2023A	2024F
Revenue	48.8	45.1	42.6	43.0
Adj. PBT	2.0	-0.5	1.1	1.2
Adj. EPS (p)	2.4	-1.8	1.4	1.6
DPS (p)	0.0	1.5	1.5	1.5
P/E (x)	10.6	-14.2	18.2	16.0
EV/EBITDA (x)	2.4	9.9	4.3	4.0
Yield (%)	0.0%	5.9%	5.9%	5.9%

Source: ED estimates, Company historic data

Company Data

EPIC	DRV
Price (last close)	25.5p
52 weeks Hi/Lo	34p/21p
Market cap	£13.8m
ED Fair Value / share	40p
Net cash	£5.8m

Share Price, p

Source: ADVFN

Description

Driver is involved in the provision of specialist dispute avoidance and dispute resolution services to the global construction and engineering industries.

Driver has 30 offices in 17 countries, including nine in the UK, five in Europe, three in the Americas, six in APAC and seven in the Middle East and Africa. The Group currently employs 264 staff.

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

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Further improvement in margins

FY23 prelims, half-year split							
£m	**H1 '22A**	**H2 '22A**	**FY22A**	**H1 '23A**	**H2 '23A**	**FY23A**	**Change yoy, %**
EuAm	17.4	17.7	35.1	19.1	16.4	35.6	1.4%
ME	5.4	1.0	6.4	3.7	0.5	4.2	-34.5%
AP	1.7	1.9	3.6	1.4	1.6	2.9	-18.0%
Intersegment			-0.1			-0.1	
Group revenues	24.4	20.6	45.0	24.2	18.5	42.6	-5.2%
Cost of sales	-18.5	-17.2	-35.8	-17.88	-14.0	-31.9	-10.9%
Gross profit	5.9	3.4	9.3	6.3	4.5	10.8	15.8%
GP %	24.1%	16.6%	20.7%	26.2%	24.4%	25.3%	
OpEx	-5.5	-4.3	-9.8	-5.6	-4.2	-9.8	-0.3%
Other op. income	0.1	0.1	0.1	0.0	0.0	0.0	-69.2%
EuAm	2.4	2.2	4.6	2.9	2.4	5.3	15.2%
ME	-0.3	-1.5	-1.8	-0.1	-0.8	-0.9	-51.4%
AP	-0.5	-0.1	-0.5	-0.1	-0.1	-0.2	-55.6%
Central costs	-1.1	-1.5	-2.6	-2.0	-1.2	-3.2	20.5%
Group EBIT	0.5	-0.9	-0.4	0.7	0.3	1.0	-355.9%
EuAm %	13.7%	12.5%	13.1%	15.4%	14.4%	14.9%	
ME %	-6.1%	-147.1%	-28.2%	-2.5%	-165.5%	-21.0%	
AP %	-29.3%	-2.9%	-15.1%	-10.5%	-6.1%	-8.2%	
Group EBIT%	1.9%	-4.1%	-0.9%	3.0%	1.4%	2.3%	
Interest	-0.1	0.0	-0.1	0.0	0.1	0.1	-170.0%
Adj PBT	0.4	-0.9	-0.5	0.7	0.4	1.1	-318.0%
Exceptionals	-0.3	-1.8	-2.0	-0.2	-0.4	-0.6	
Reported PBT	0.1	-2.7	-2.5	0.5	-0.1	0.4	-117.3%
Taxation	-0.3	-0.2	-0.5	-0.2	-0.1	-0.3	-32.6%
Tax %	76.9%	-16.9%	-93.9%	29.2%	28.8%	29.0%	
Adj. Earnings	0.1	-1.0	-1.0	0.5	0.3	0.8	-179.8%
Adj. EPS (p)	0.2	-2.0	-1.8	1.00	0.4	1.4	-177.8%
DPS (p)	0.75	0.75	1.5	0.75	0.75	1.5	0.0%
Net cash/(debt)	3.7	1.3	4.9	5.3	5.8	5.8	18.2%
Net assets	20.2	16.4	16.4	16.5	16.0	16.0	-2.3%

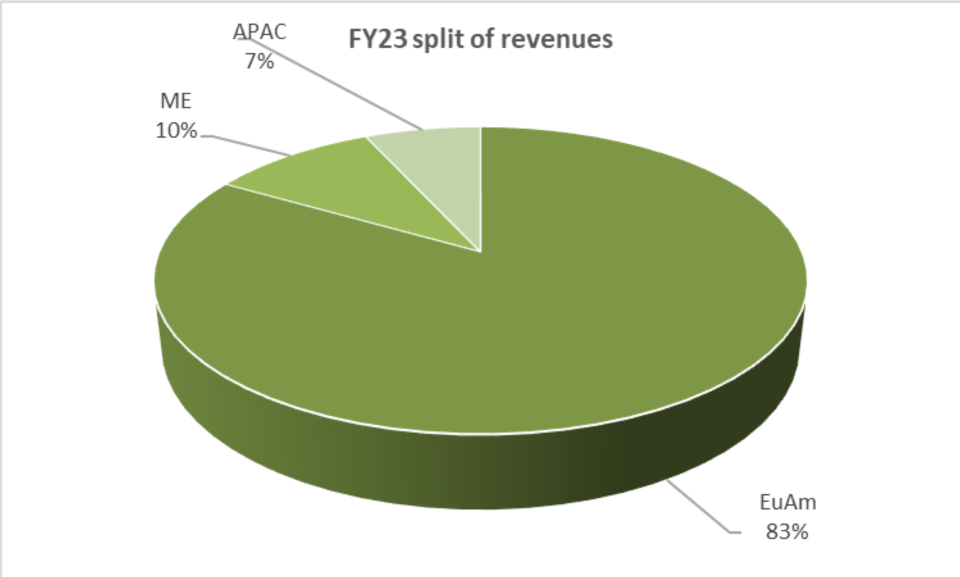
Source: Company

Revenues for FY23 were broadly similar to FY22, declining modestly (-5.4%) to £42.6m. Q3 proved challenging due to the deferral of several contracts, a later Easter, and ongoing uncertainty within the global economy. The Middle East (ME) and APAC regions were responsible for the shortfalls in activity levels.

Trading rebounded in Q4 as a combination of new wins and deferred projects commenced, a trend that has continued into Q1 '24. We think this represents an excellent outcome given the loss of 25 employees in the Middle East (ME) and APAC regions to a counterparty in May '22, thereby suggesting a marked improvement in productivity. Underlining this, utilisation levels across the Group rose to 72.5% from 67.5% a year earlier.

The opening of offices in the Kingdom of Saudi Arabia (KSA) and Korea have resulted in additional project wins, particularly within the infrastructure sector in the former. The New York and Madrid offices have combined to secure arbitration work in South America.

Split of revenues by region, %



Source: Company

EuAm

The Group's most significant operating region, Europe & the Americas (EuAm), which accounted for 83% of revenues in FY23 (vs. 75% in FY22), saw fee income improve 1.1% yoy to £35.6m. Utilisation improved to 74% (FY22: 72%), highest within Driver Project 3ervices (DPS) which registered a reduction in revenues to more normalised levels during FY23.

Overall, revenues in the UK were broadly static (-3.5% to £24m), which is a positive outcome suggesting an uplift in non-DPS related revenues. Meanwhile, revenues in North America declined 6.6% to £2.7m due to gaps between projects, although the hires made during the year have improved service levels. The undoubted star of the region was Europe, with revenues improving 20% to £8.8m, driven by strong performances in Spain, the Netherlands and Germany. The Group added expert services headcount within its Paris office, widening the level of expertise to be utilised by the wider business.

Pre-central costs, EBIT jumped 16% yoy to £5.3m, suggesting an operating margin of 14.9% (FY22: 13.1%).

ME

The shortfall within the ME region, where revenues declined 34% to £4.2m, was exacerbated by the running down of operations in Kuwait and Oman ahead of their closure. The bulk of headcount declines relating to the third party in May 2022 occurred within the region. New projects derived from its Qatari and newly opened KSA offices during Q4 '23 will be fulfilled on a Group-wide basis.

The reduced headcount and the policy of 'one global business' have resulted in utilisation levels rising to 71% in the region, a healthy uplift from 53% in FY22.

EBIT, as measured before central costs, improved significantly to a loss of £0.1m, from -£1.3m a year earlier. Within this time the UAE and KSA offices returned to profitability.

APAC

Fee income declined 18% to £2.9m yoy, partly due to lower headcount and a move to higher quality projects. Singapore was a drag on results during Q3, reflecting several low margin projects. The office is now under new management (incorporated into the remit of the head of the Group's profitable Australian operations) and has been subject to restructuring its operations. Work has begun to flow from Korean clients following the office launch in Seoul earlier in the year.

As with the ME region, losses at the EBIT level pre-central costs was unchanged yoy at £0.2m.

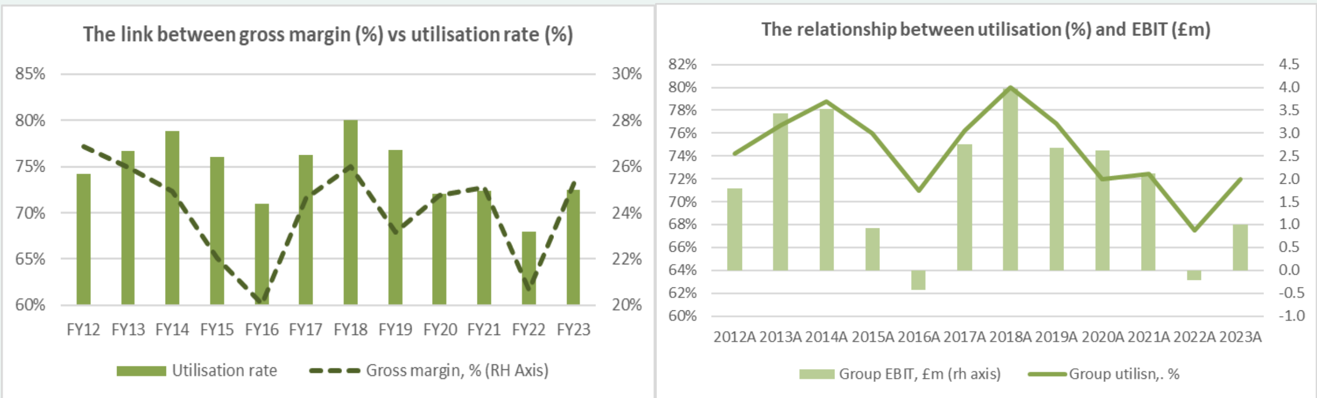
The importance of high utilisation rates

We have previously highlighted the relationship between utilisation rates and levels of profitability, which we now expand from just EBIT to include gross margins. The correlation between utilisation and profitability is obvious, as highlighted below. However, the action management has undertaken on costs from H2 '22 onwards appears to suggest that the break-even point is lower now than it was in prior years. We feel that this is encouraging, particularly given the new four-year plan to improve shareholder value through the expansion of revenues while maintaining high levels of utilisation, as the business model is fine-tuned.

It is worth noting that because of a more challenging Q3, utilisation rates declined overall for the year from 75.6% during H1 to 72.5% for the full year, suggesting an H2 average below 70%. Similarly, the gross margin in H1 of 26.2% was at the highest level since H1 '18, with an H2 gross margin of 24.1% and, further underlining the correlation between the two.

With management targeting a utilisation rate closer to 80% over the medium term, this suggests, ceteris paribus, that gross margins should rise in line with utilisation from here.

Utilisation vs gross margins



Source: Company

Improving margins

The focus on higher margin work, the cost reduction programme and improving utilisation rates contributed to improving margins at the gross and EBIT levels. FY23 gross margins rose to 25.3% vs 20.7% in FY22. Central costs declined modestly (-7%) to £4.0m, EBIT margins rose from a loss-making -0.9% in FY22 to 2.3% in FY23. This resulted in a £1.4m turnaround yoy in EBIT to £1.0m.

A recovery in EPS

The rising cash balances and higher interest rates resulted in interest receivable of a net £0.1m in FY23, an improvement of almost £0.2m from the net payable position in FY22.

As a result, adj. PBT improved to £1.1m, a turnaround yoy of £1.6m. The tax charge declined to £0.3m (FY22: £0.5m), representing a Group-wide rate of 29% on an adjusted basis.

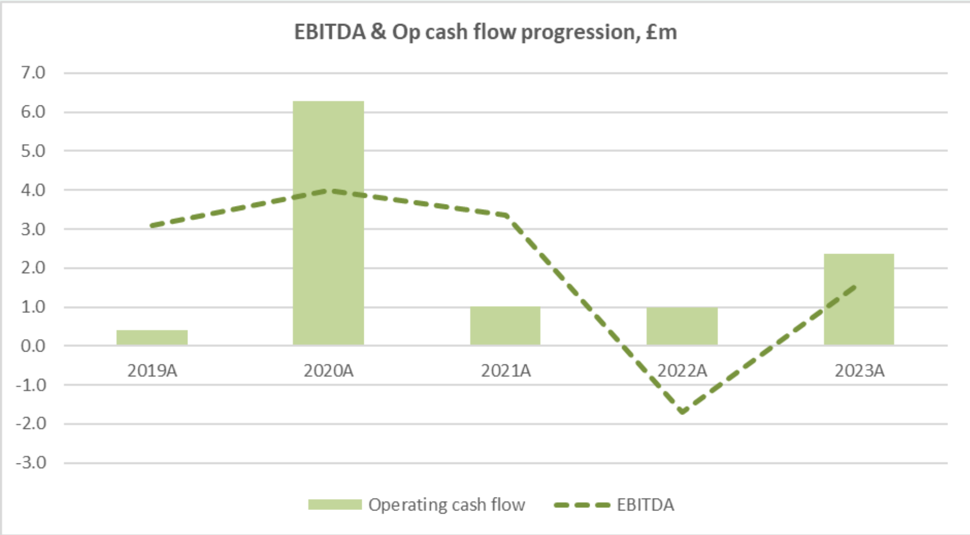
The above fed through to adj. EPS which improved from a loss / share of -1.8p in FY22 to +1.4p in FY23. Although the dividend was uncovered (0.93x), the scale of the net cash on the balance sheet provides comfort. As adj. EPS increases over the short-to-medium term and approximately £1m of excess cash is made available for capital allocation purposes, this provides the Board with options.

Net cash level continues to climb

Cash generation improved, aided by reduced working capital as long-term debtors reduced and revenues declined modestly. Capex was modest (-£0.1m), reflecting spend on IT and office relocations, with taxation lower yoy at £0.2m despite the move into profitability. The level of net interest rose to £0.1m, reflecting improved management of the treasury function and the absence of a revolving credit facility – although a new working capital facility is under discussion. The unchanged 1.5p dividend led to an outflow of £0.8m, albeit there was no repetition during the year of FY22's share buyback programme. The generation of £0.9m of cash resulted in the Group ending the year with net cash of £5.8m (FY22: £4.9m).

We highlight the improving trends within operating cash flow and EBITDA. The chart highlights the potential for further improvement in EBITDA in the short term, as demonstrated by the higher levels witnessed in FY19, FY20 and FY21.

Operating cash flow and EBITDA improved in FY23



Source: Company

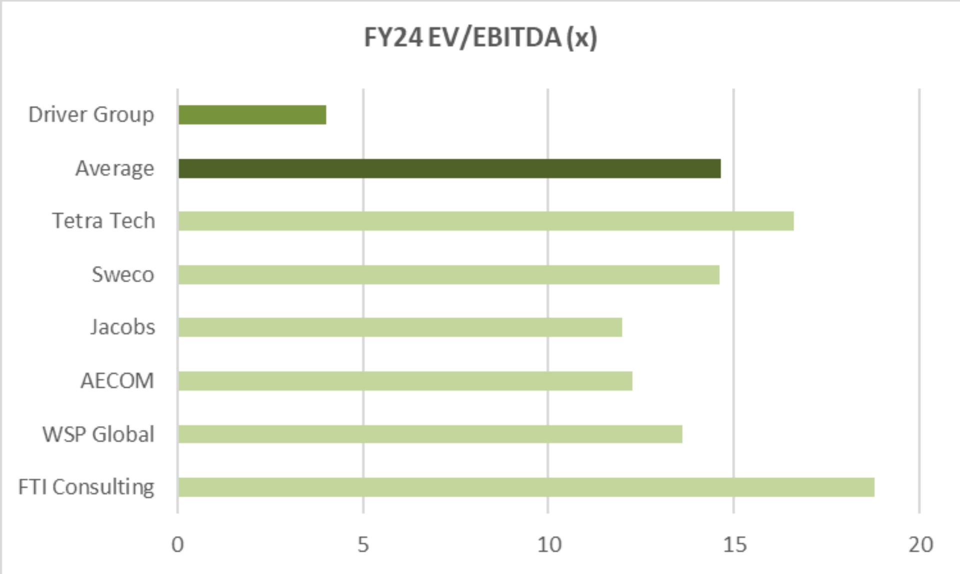
Shareholders will be consulted on the capital allocation strategy and the £1m of surplus cash to be returned via:

- Funding further organic expansion of operations
- M&A, adding teams within core competencies and in adjacent areas
- Increased dividends, and
- Continued share buybacks.

Valuation

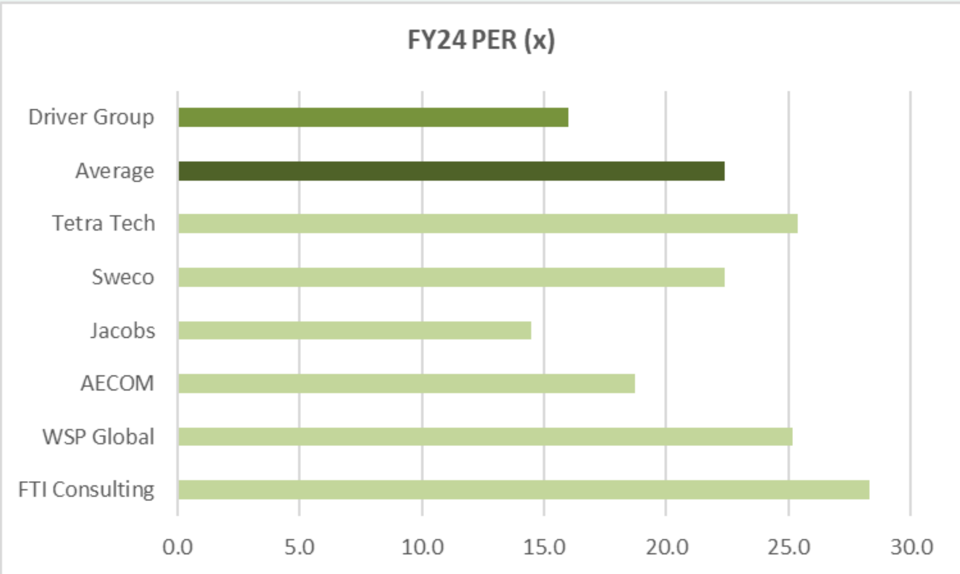
We have constructed comparison valuation models, based on the Group's estimates to September 2024 and compared to its larger consultant peers. Our comparisons consider FY24 EV/EBITDA, PER and P/Book ratings. Although a size-related discount is appropriate, we think the reality is too high, at 73% on an EV/EBITDA basis, 29% on PER basis and a more significant 85% on a price/book basis.

Peer group comparison: FY1 EV/EBITDA (x)



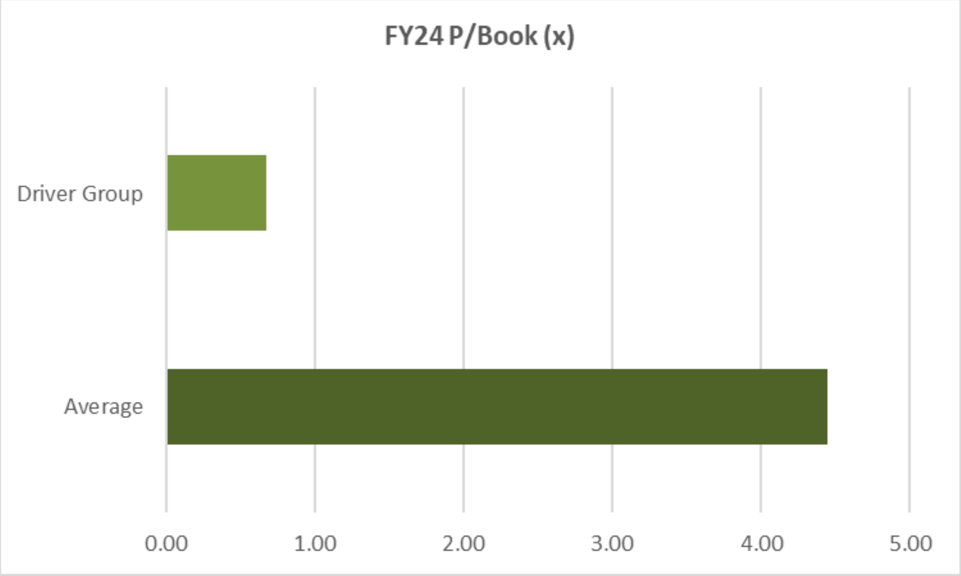
Source: KoyFin

Peer group comparison: FY1 PER (x)



Source: KoyFin

Peer group comparison: FY1 P/Book (x)



Source: KoyFin

We note that the level of cash continues to rise, notwithstanding returns of cash to shareholders by way of dividends. **At the end of September cash accounted for 42% of the Group's market capitalisation (£13.8m) and 36% of the NAV.**

On stripping out the cash from the market capitalisation, the resultant £8m equates to FY1 ratings of 7.3x EBIT or 9.5x adj. EPS. We feel that the current valuation ignores the subsequent action taken on costs during Q1 '24, as well as the impact of the targeted expansion of revenues and margins, as set out in the strategic review.

Net cash as a % of mkt cap & NAV

	FY22A	FY23A
Net cash, £m	4.9	5.8
Net cash / share (p)	9.4	11.1
Cash as a % of market cap	35.8%	42.4%
NAV, £m	16.4	16.0
NAV / share (p)	31.1	30.4
Net cash as a % of NAV	30.1%	36.5%

Source: Company

The Group's shares currently sit at a 16% discount to NAV, which, we feel this represents an anomaly given the level of net cash. Significantly, the shares trade on an 85% discount to the price/book rating of its larger consultant peers (vs 4.6x on a FY23 basis), which we believe to be unwarranted.

While there are arguments aplenty to increase our current fair value/share of 40p, we will revisit once we see further evidence of earnings momentum.

Transformative progress

We note the progress made by the Board in placing the business on a sound footing following the restructuring, which commenced in November 2022, which has improved processes and nearly eradicated losses in the two smaller regions, ME and APAC.

The next stage in the business transformation is implementing a new strategic review to markedly improve shareholder returns from current levels. The steps involve:

- A rebranding of the business from Driver Trett (associated with claims) to Diales (higher margin experts), a premium brand
- Increased adoption of the hub and spoke operational model
- Overhaul of business development and marketing
- Hiring of revenue generators and experts, and
- A move into related sectors.

The key to improving shareholder value is a further expansion of margins. We envisage the above strategy will underpin this goal. The highest margins are within Diales, the expert services business, which accounts for 40% of fee income, while the claims business (Driver Trett) amounts to approximately half of revenues. Diales aims to grow into the leading brand in its market niche, at a faster pace than other segments of the business and in turn, improving the weighted average Group gross margin.

Rebranding the Group allows a centralisation of certain services such as business development and marketing, without duplication of costs (as currently under a multi-brand format).

A focus on hiring in favour of rainmakers and experts will, in turn, increase utilisation levels as the proportion of larger projects rises (thereby minimising downtime) and shift the focus of the Group in favour of added-value projects.

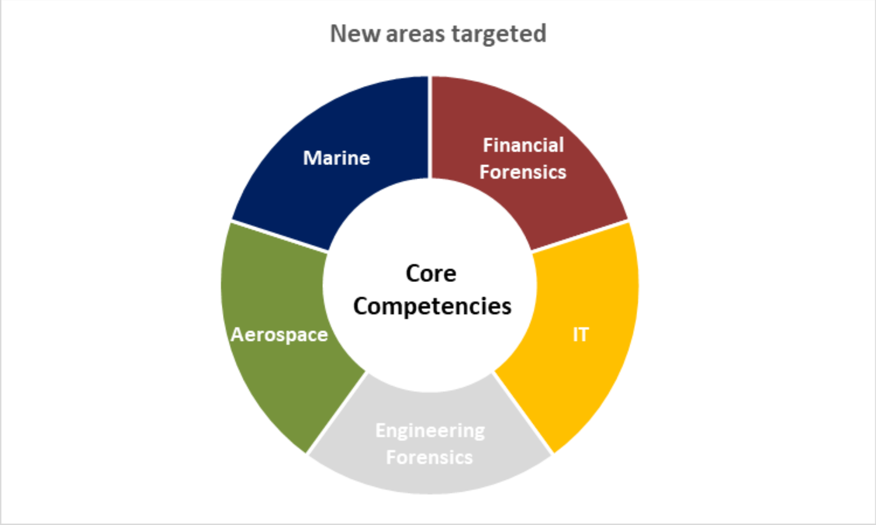
The office network carries significantly less staff than 18 months ago, with those deemed peripheral closed or downsized and two opening concurrently in Seoul and Riyadh. The focus on winning projects locally, delivered mainly from the UK and European offices, improves the utilisation of experts while reducing risk and the possibility of losses locally.

Experts within the Group require a defined path to grow and develop. The Board is considering ways to motivate senior staff within the smaller international regions, including enhanced local ownership. Depending on how this idea progresses, such a move could have implications regarding Group headcount outside of the EuAm region, thereby reducing risk but incentivising revenue and profit generation.

The Group works in several related areas, utilising internal and external specialists on projects. However, gaps exist in coverage relative to the service capability in the Group's core competencies. To be considered a one-stop shop in marine, financial forensics, IT, aerospace and engineering forensics, further hires would be required. The quickest routes to achieve this would be to acquire specialists or via strategic partnerships, paving the way for M&A activity in the future and thereby reducing any related risks.

Such M&A would be for relatively small amounts, with a rapid return on investment and cash generative from an early stage.

Areas to target



Source: Company

Much attention has been paid to the cost base, right sizing the workforce and office footprint to fit the Group's needs. One such instance followed the surrender of the lease for the previous head office in Haslingden (December 2023), resulting in significant cost savings. There are other instances whereby offices are now operating from smaller, serviced accommodation (London). The ERP software has enabled the management team to root out inefficiencies within processes and improve utilisation levels by minimising downtime.

The Group's headquarters is in Bristol, its registered office (including business development) in London and the Group's finance function was relocated to Blackburn. While this may appear inefficient, relocating/hiring staff would be disproportionately costly and internal controls minimise any associated inefficiencies.

One should be aware that despite the transformation process, the underlying business model is unlikely to change – in that projects are lumpy and subject to delays resulting in variations to utilisation levels, which in turn can affect profitability. The delivery of projects has already changed (hub and spoke model), with further developments noted above, and the cost base is expected to decline further in relative terms. As such, we consider the plan to improve margins sound, but the exact timing of the delivery of targeted returns remains unclear.

Aside from the targeted expansion of the expert business, Diales, a further positive is the move into related sectors such as marine, financial forensics, IT, engineering forensics and aerospace. This will likely result in a marked expansion in fee income and coupled with the improved margin, we expect shareholder value to improve considerably ahead of the FY27 year end.

Financial outlook

With a good start to the new financial year's trading and a growing pipeline of enquiries, we see an improved top-line outlook in FY24 vs FY23.

The recruitment of additional headcount to supplement core and targeted areas and, importantly, staff retention remains positive. Nevertheless, staff costs remain lower than in FY22, partly reflecting the loss of 25 employees to a third party in H2 '22. Staff growth is predominantly focused on the EuAm region, except where new offices are opened within the smaller regions.

Elsewhere, costs have declined as leases were surrendered and relocations into smaller serviced offices completed. The full benefit of the cost reduction programme should occur by the end of H1 '24.

Re-introduction of estimates

We have added estimates for the current year. This reflects the improved confidence generally and of the savings emerging from the cost reduction programme, which enable a small margin for error. We note that projects tend to be lumpy, subject to delays, which may impact utilisation levels and in turn, profitability. On this basis, we expect to revisit estimates as the year progresses.

For now, we estimate that revenues are likely to grow modestly (+0.9%) to £43m, with gross and EBIT margins rising to 25.5% and 2.6% respectively. We expect growth in adj. PBT and adj. EPS of c.14% yoy. We have left the dividend estimate at an unchanged at 1.5p, suggesting dividend cover of 1.1x and strong yield support of 5.9%.

Conclusion – medium term outlook

The new four-year strategic review builds on the business's root-and-branch transformation which began in November 2022 and will underpin the targeted 20% uplift in gross margins from 25.3% in FY23 to the end of FY27.

Summary Profit & Loss

Year to Sep, £m	2020A	2021A	2022A	2023A	2024F
Europe & Americas	31.0	33.7	35.1	35.6	36.0
Middle East	14.4	10.9	6.4	4.2	4.2
APAC	7.7	4.1	3.6	2.9	2.9
Revenue	53.1	48.8	45.1	42.6	43.0
CoGS	-39.9	-36.5	-35.8	-31.9	-32.0
Gross profit	13.1	12.2	9.3	10.8	10.9
Gross margin (%)	24.7%	25.1%	20.7%	25.3%	25.5%
Op costs	-10.6	-10.3	-9.8	-9.8	-10.0
Other Op. income	0.1	0.2	0.1	0.0	0.2
Operating profit	2.6	2.1	-0.4	1.0	1.1
Op margin (%)	4.9%	4.3%	-0.9%	2.4%	2.5%
Net Interest	-0.1	-0.1	-0.1	0.1	0.1
Associates	0.0	0.0	0.0	0.0	0.0
PBT (Adjusted)	2.5	2.0	-0.5	1.1	1.2
Exceptionals	-1.5	-0.1	-1.5	-0.6	0.0
PBT (Reported)	1.0	1.9	-2.0	0.5	1.2
Tax	-0.4	-0.7	-0.5	-0.3	-0.4
PAT	0.6	1.1	-2.4	0.1	0.8
Minority interests	0.0	0.0	0.0	0.0	0.0
Earnings	0.6	1.1	-2.4	0.1	0.8
Ordinary Dividends	0.0	0.0	-0.8	-0.8	-0.8
Retained Profit	0.6	1.1	-3.2	-0.6	0.1
EPS (Adjusted) (p)	4.0	2.4	-1.8	1.4	1.6
DPS (p)	0.8	0.0	1.5	1.5	1.5
Ave no of shares (FD) (m)	54.7	54.3	54.9	54.0	54.0

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to Sep, £m	2020A	2021A	2022A	2023A	2024F
Operating profit	2.6	2.1	-2.9	0.4	1.1
Depn. & Amortn.	1.4	1.2	1.2	0.9	0.9
Working capital movement	2.3	-2.3	2.7	1.5	-0.8
Other	0.0	0.0	0.0	-0.2	0.0
Operating cash flow	6.3	1.0	1.0	2.6	1.2
Net Interest	-0.1	-0.1	-0.1	0.1	0.1
Taxation	-0.5	-0.8	-0.5	-0.2	-0.4
Net capex	-0.3	-0.5	-0.6	-0.1	-0.2
Operating FCF	5.3	-0.4	-0.2	2.3	0.7
Net (Acquisitions)/Disposals	0.0	0.0	0.0	0.0	0.0
Dividends	-0.7	-0.4	-0.8	-0.8	-0.8
Share Issues	0.0	0.0	-0.5	0.0	0.0
Minority payment	0.0	0.0	0.0	0.0	0.0
Other financial	-1.8	-1.0	0.0	-0.6	0.0
Increase Cash/(Debt)	2.8	-1.7	-1.5	0.9	-0.1
Opening Net Cash/(Debt)	5.4	8.2	6.5	4.9	5.8
Closing Net Cash/(Debt)	8.2	6.5	4.9	5.8	5.8

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Sep, £m	2020A	2021A	2022A	2023A	2024F
Intangible Assets	3.2	3.5	3.8	3.7	3.0
Tangible Assets	0.5	0.4	0.4	0.4	0.4
Investments/other	2.1	2.1	1.6	1.4	1.4
Net Working Capital	7.4	9.8	6.5	5.5	6.3
Capital Employed	13.2	15.8	12.2	10.9	11.1
Other	-1.0	-1.0	-0.8	-0.8	-0.8
Net Cash/(Debt)	8.2	6.5	4.9	5.8	5.8
Provisions Liabilities/Charges	0.0	0.0	0.0	0.0	0.0
Net Assets	20.4	21.3	16.4	16.0	16.1

Source: Company historics, Equity Development estimates

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