

Positive momentum picking up steam

21 October 2021

Today's trading update from Driver Group is optimistic, highlighting a material improvement in activity levels during Q4 and a positive start to Q1 '22. The rise in demand for the higher-margin expert services, combined with a decline in the impact of the pandemic on decision making, a restructuring of the Middle East / APAC regions, and new offices, have resulted in renewed positive momentum. We have introduced estimates for FY21 and FY22, with the latter reflecting these strong growth drivers. Year-end net cash is expected to amount to £6.5m or 11p / share, representing 22% of the market capitalisation. The cash position reinforces our belief that the shares remain lowly valued, underpinned by our valuation models.

Driver Group has updated the market on trading, following the end of the year to September. Adjusted PBT is expected to be in-line with market expectations. The start of H2 continued to be affected by uncertainty and the resultant delays, reflecting ongoing COVID-19 and related lockdowns across several territories. Nevertheless, the UK and Europe performed well for much of H2, resulting in the Group performance being broadly unchanged from H1. The rise in headcount, coupled with the two office openings (Madrid and New York) and move out of lockdown, combined positively. The increase in the number of technical experts within Diales has resulted in the brand adding new service lines and helping to improve the margin mix.

- The outcome is notwithstanding ongoing issues in the Middle East and APAC regions. The latter bore the brunt of the COVID-19 related delays, exacerbated by the loss of a team in Singapore, which further disrupted the business. Two new and experienced team members have since been added. Regional utilisation levels remained below the previous year and was despite securing a new long-term contract in South Korea. The closure of the Project Services activity in parts of the Middle East combined with the lower headcount to reduce revenues during FY21.
- Trading picked up from July as territories began to exit lockdowns. As a result, Q4 trading levels were materially ahead of the remainder of FY21, enabling the smaller regions (Middle East and APAC) to return to profitability and thereby reducing the scale of the FY21 regional losses.
- The visibility of the forward order book is generally short, limited to a few months. However, the upbeat trading in Q4 '21 has continued into Q1 '22, underpinning expectations for FY22. We assume that the pandemic's impact on project decision making should decline further from here, with pent up demand for the Group's services resulting in a continuation of the positive Q1 trading throughout FY22.
- The Group's strategic plan was implemented during the year, including an increase in the proportion of revenues derived from added-value expert assignments, the focused recruitment of key talent (expert & technical), and the removal of cost from the property portfolio. The scope of the lower margin Project Services division was reduced during the year, both in the Middle East and the APAC region.

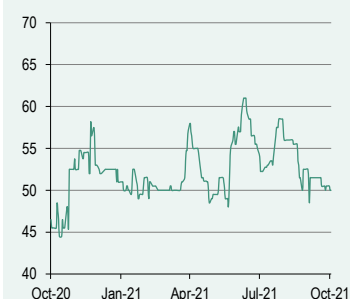
Valuation analysis suggests significant scope for re-rating

Comparing DRV to a combination of its peers and our relatively conservative DCF model, **we feel that the shares continue to be significantly undervalued, particularly in a consolidating market. Our fair value sits some 44% above the current share price, suggesting significant scope for a re-rating of DRV's shares.**

Company Data

EPIC	DRV
Price (last close)	50p
52 weeks Hi/Lo	62p/42p
Market cap £m	£27.1m
ED Fair Value	72p
Net cash (Mar '21)	£7.2m

Share Price, p



Source: ADVFN

Description

Driver Group is a multi-disciplinary consultancy group, providing clients with specialist commercial management, planning, programming and scheduling, and dispute resolution support services to the engineering and construction industry.

Driver Group has 31 offices in 18 countries, including eight in the UK, five in Europe, four in the Americas, six in APAC, and seven in the Middle East and Africa.

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

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Financials

We have introduced estimates for the year just ended, FY21, and the projected year, FY22. We demonstrate double-digit top-line growth in the EuAm region across both years, in addition to a significant expansion in EBIT margins as compared to the FY20 outcome.

We have projected relative stability in revenues from the Middle East during H2 21, combined with a return to top-line growth in FY22. We expect a reduced loss in the region during H2 21 (versus H1 21), with a modest loss conservatively anticipated in FY22.

The APAC region remains the 'problem child', although the combination of the appointment of the new head of the ME/APAC region and the recruitment of new fee earners in Singapore (following the team lost in late 2020) partially explains the lower cost base and the reduced loss we have pencilled in for FY22.

As with all operationally leveraged businesses, movements in the top-line often have a disproportionate impact on profitability. We remain encouraged by the positive start to the new financial year but believe it remains too early to get carried away - nevertheless, a FY22 adj. PBT estimate of £3.2m represents an uplift of £1.2m or 60% yoy.

The uplift in EBITDA also positively influences cash generation, which we expect to rise to a net cash position of £7.4m by the end of FY22, notwithstanding the sharp rise in the dividend versus FY20 levels.

Summary Profit & Loss					
Year to Dec	2018A	2019A	2020A	2021F	2022F
Europe & Americas	28.7	29.8	31.0	35.4	39.7
Middle East	22.9	19.6	14.4	11.0	11.5
APAC	11.0	9.1	7.7	3.4	2.0
Revenue	62.62	58.49	53.07	49.86	53.09
CoGS	-46.3	-45.0	-39.2	-36.8	-39.3
Gross profit	16.3	13.5	13.9	13.0	13.8
Gross margin (%)	26.0%	23.1%	26.2%	26.1%	26.0%
Op costs	-12.4	-11.0	-10.6	-11.1	-10.6
Other Op. income	0.1	0.2	0.1	0.1	0.1
Operating profit	4.0	2.7	3.4	2.1	3.3
Op margin (%)	6.3%	4.6%	6.4%	4.2%	6.2%
Net Interest	-0.1	-0.1	-0.1	-0.1	-0.1
PBT (Adjusted)	3.8	2.6	3.3	2.0	3.2
Exceptionals/Share-based payments	-1.1	0.6	-1.5	-0.2	0.0
PBT (Reported)	2.7	3.2	1.7	1.8	3.2
Tax	-0.6	-0.5	-0.4	-0.3	-0.5
Earnings	2.2	2.7	1.3	1.5	2.7
Ordinary Dividends	0.0	-0.7	0.0	-0.8	-0.9
Retained Profit	2.2	2.1	1.3	0.7	1.7
EPS (Adjusted) (p)	4.1	3.7	5.3	2.9	4.7
DPS (p)	0.0	0.8	0.8	1.5	1.75
Ave no of shares (FD) (m)	56.5	56.8	54.7	57.5	57.5

Source: Company historics, Equity Development estimates

Summary Cash Flow

Year to Dec	2018A	2019A	2020A	2021F	2022F
Operating profit	4.0	2.7	3.4	2.1	3.3
Depn. & Amortn.	0.6	0.4	1.4	1.1	1.2
Working capital movement	1.6	-2.7	2.3	-2.8	-0.7
Other	0.0	0.0	0.0	0.0	0.0
Operating cash flow	6.2	0.4	7.1	0.3	3.7
Net Interest	-0.1	-0.1	-0.1	-0.1	-0.1
Taxation	-0.4	-0.6	-0.5	-0.4	-0.5
Net capex	1.3	-0.3	-0.3	-0.3	-0.4
Operating FCF	7.0	-0.7	6.1	-0.4	2.8
Net (Acquisitions)/Disposals	0.2	0.0	0.0	0.0	0.0
Dividends	0.0	-0.3	-0.7	-0.3	-0.9
Share Issues	0.0	-1.0	0.0	0.0	0.0
Minority payment	0.0	0.0	0.0	0.0	0.0
Other financial	-0.1	0.4	-2.6	-1.0	-1.0
Increase Cash/(Debt)	7.1	-1.5	2.8	-1.7	0.9
Opening Net Cash/(Debt)	-0.2	6.9	5.4	8.2	6.5
Closing Net Cash/(Debt)	6.9	5.4	8.2	6.5	7.4

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Dec	2018A	2019A	2020A	2021F	2022F
Intangible Assets	3.0	3.0	3.2	2.4	1.6
Tangible Assets	0.8	0.7	0.5	0.5	0.5
Investments/other	0.1	0.3	2.1	2.1	2.1
Net Working Capital	8.8	10.2	7.4	10.2	11.0
Capital Employed	12.6	14.1	13.2	15.3	15.2
Other	0.0	0.0	-1.0	-1.0	-1.0
Net Cash/(Debt)	6.9	5.4	8.2	6.5	7.4
Provisions Liabilities/Charges	0.0	0.0	0.0	0.0	0.0
Net Assets	19.5	19.5	20.4	20.8	21.6

Source: Company historics, Equity Development estimates

Valuation

Peer group comparative valuation

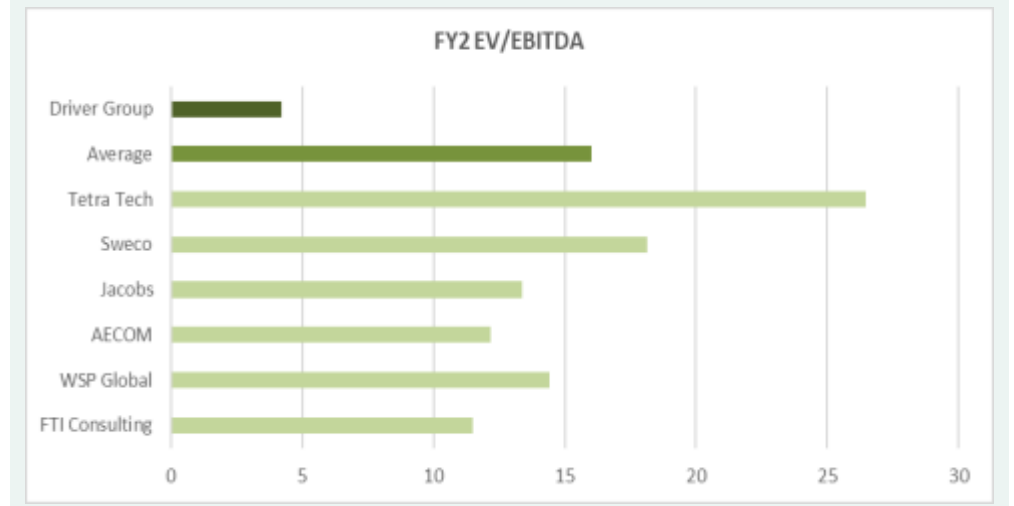
The introduction of estimates has enabled us to undertake a more detailed peer group comparative valuation model. Rather than using FY1 forecasts, we have taken the view that with FY21 completed, the focus now switches to FY22.

Driver Group is markedly smaller than its quoted international peers and, as such, we have applied more substantial discounts to ones that we would traditionally use, of 20% and 40%. **The Group is currently trading on a 72.6% discount to the average of its peers based on FY22 expectations.**

Applying a 20% discount suggests a fair value of 100p / share, representing a 100% premium to the current price.

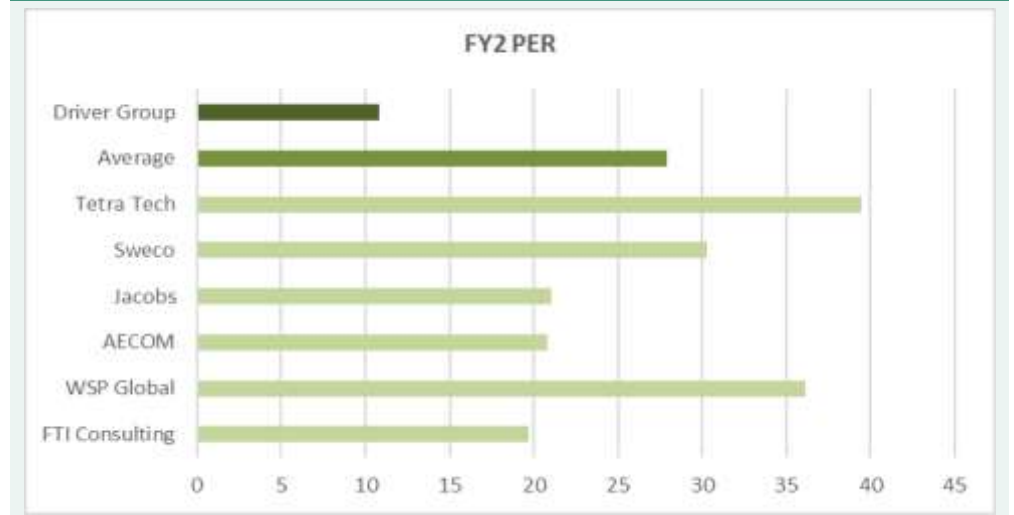
Increasing the discount to a substantial 40% still results in a fair value of 76p / share. We think that this highlights just how undervalued the current market capitalisation is in industry terms.

Peer group comparison: FY2 EV/EBITDA (x)

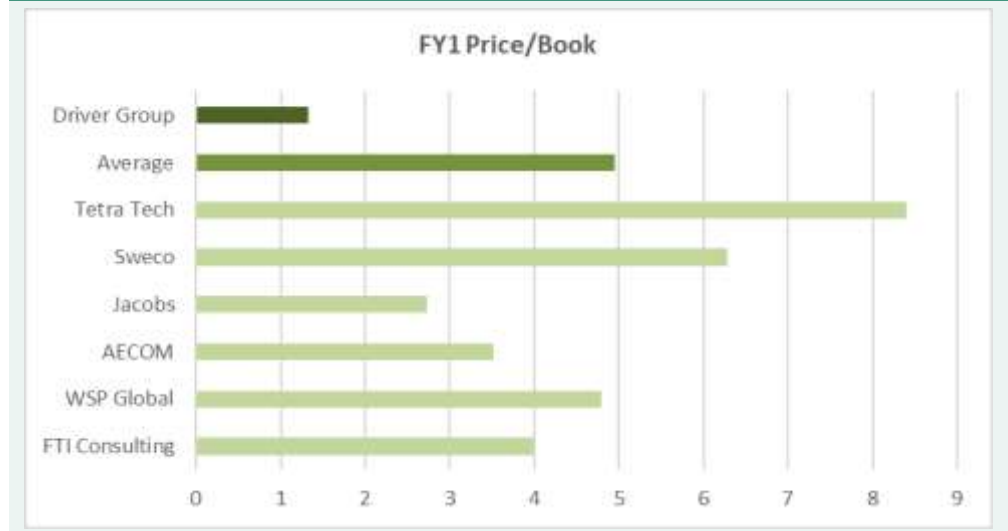


Source; MarketScreener

Peer group comparison: FY2 PER (x)



Source; MarketScreener

Peer group comparison: FY1 Price/Book (x)


Source: MarketScreener

DCF valuation

We have included a DCF valuation for Driver Group, utilising what we believe to be relatively conservative assumptions (terminal growth rate of 2.25% and a WACC of 8.25%). **The DCF suggests a fair value of 72.4p, representing a 44.8% premium to the existing share price.**

Driver Group DCF calculation

	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F
Free cash flow	-1.1	2.1	2.1	2.2	2.2	2.3	2.3	2.4	2.4	2.5
WACC (%)	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25	8.25
Timing factor	0.08	1.08	2.08	3.08	4.08	5.08	6.08	7.08	8.08	9.08
Discount rate	0.99	0.92	0.85	0.78	0.72	0.67	0.62	0.57	0.53	0.49
Present value	-1.1	1.9	1.8	1.7	1.6	1.5	1.4	1.3	1.3	1.2
Sum of discounted cash flows		12.6								
Terminal growth rate (%)		2.25								
Terminal value		20.0								
Net debt	6.5									
Equity value	39.1									
No. of shares (m)	54.0									
Value per share (p)	72.4									

Source: Equity Development



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