Xpediator plc

Free-cash flow yield high

29 April 2019

Xpediator has delivered a strong outcome for FY2018. Revenues and profitability on all measures grew strongly, reflecting a combination of organic and acquisition-led growth. The Group's net cash position strengthened further during the year. The outlook suggests another year of strong growth in FY2019, with an emphasis on cash generation. We anticipate Free Cash Flow of £6.6m in FY2019F, rising to £6.7m in FY2020F, suggesting FCF yields of above 10% in each of the forecast years. This high level highlights the extent to which the Brexit uncertainty has hit the shares. Our valuation models suggest a fair value of 78p/share, representing an uplift of 66.8% compared to current levels.

Although the valuation has succumbed to a hefty Brexit discount, **trading continued to be strong** throughout FY2018, indeed accelerating during H2. The FY2018 outcome was ahead of our revised expectations on all metrics but most significantly in terms of net cash, which rose to £3.2m and more than warranted the beat in terms of declared final dividend versus to expectation. Of particular note, delivering a strong uplift in revenues were the Baltic and Balkan based businesses and Pall-Ex Romania.

Both gross and operating margins showed y-o-y progress during H2, with the EBITA return at record levels during the period. The margin outcome was despite the difficulties experienced at Benfleet, the freight forwarding acquisition made in October 2017, owing to changes to the collection of customs duties by the EU on companies from the Far East. This is turn severely disrupted trading levels at the subsidiary, resulting in it reporting a small loss for the year and related exceptional costs as the holding value of the business was written down.

Two acquisitions were made during the year, ***Anglia Forwarding*** and ***Import Services***, both of which delivering strong growth following their integration into the group. We anticipate further M&A activity to occur in the current year, funded in part through cash flow and the group's cash balances.

The outlook for FY2019F remains optimistic, not least as management invests in the infrastructure and systems of the Group, while ensuring increasing benefits of cross-fertilisation of customers and services and, the introduction of new products/services across a wider geographical footprint. Xpediator's markets continue to improve, led by the global trend of home/office delivery of ecommerce-related purchases.

Our valuation models suggest a fair value/share of 78p, with a peer-based comparison of 91.6p and highlighting the marked discount Xpediator finds itself relative to peers. What we feel to be of greater interest to investors is the Group's free cash flow (FCF) yield.

With our estimates of FCF of £6.6m in FY2019F and £6.7m in FY2020F, this suggests an FCF yield of 10.6% in both years, thereby strongly highlighting the scale of the Brexit discount afforded the Group. Under normal circumstances, a FCF yield of such proportions tends to suggest significant undervaluation of a company's shares.

Company Data

EPIC	XPD
Price (last close)	47p
52 week Hi/Lo	88p/33p
Market cap	£63m
ED fair value/share	78p
Net cash	£3.2m

Share Price, p

Source: ADVFN

Description

Xpediator (XPD) is an integrated freight management business. The Group has three main business areas: freight forwarding services, logistics and warehousing and transport services. Revenues are derived from the UK (39.2% of Group revenue), CEE and Baltic states (60.8%).

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2018 Preliminary results

The 2018 preliminary results from Xpediator were ahead of revised expectations. We highlight this in the table below. The areas of note where the result beat expectations by the greatest margins were net cash (+39.4%), adj. EPS (+11.7%) and DPS (+5.0%). Growth y-o-y was the highest in terms of net cash (+118.5%), adj. PBT (+81.2%) and revenues (+54.1%).

Results vs expectations

£m	2018A	2018E	Variation	2017A	Growth
Revenue	179.2	179.0	0.1%	116.3	54.1%
Adj PBT	7.2	7.1	1.2%	4.0	81.2%
Adj EPS, p	4.8	4.3	11.7%	3.3	46.8%
DPS, p	1.3	1.2	5.0%	1.0	27.3%
Net Cash	3.2	2.3	39.4%	1.5	118.5%

Source: Equity Development

The year was an eventful one. The Group acquired two businesses, Anglia Forwarding ("Anglia") and Import Services Limited ("ISL") for a combined maximum consideration of £16.2m. Anglia is a freight forwarder and courier operating domestically and internationally, with bases in Essex, Birmingham, Felixstowe and Heathrow. The acquisition was particularly important in expanding the Group's air and sea freight capabilities. ISL is a third-party contract logistics and warehousing business operating within the port of Southampton, widening the scale of and customer relationships within the Logistics division.

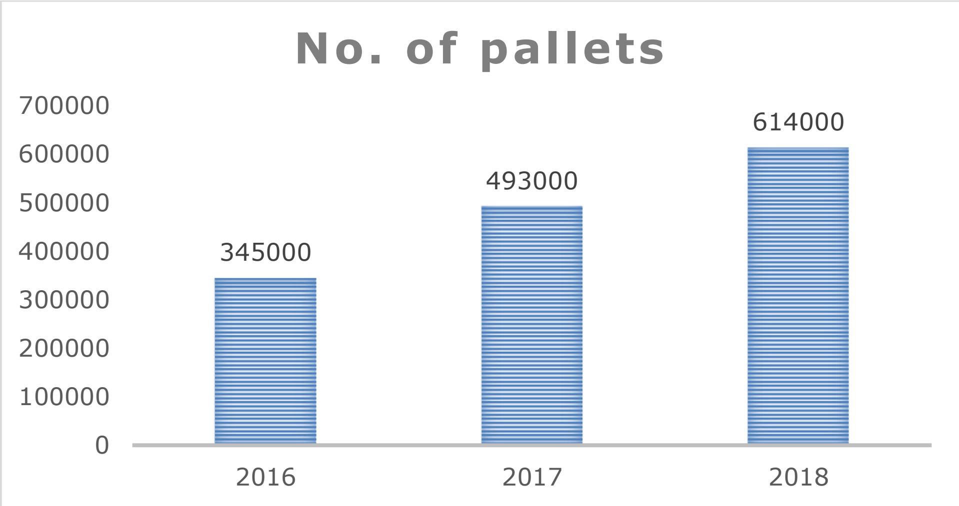
One of the Group's previous acquisitions, Benfleet, struggled during the year owing to the EU tightening customs security checks, in order to prevent lost duty. The level of trade from the Far East declined significantly, resulting in exceptional charges during the year. By diverting the trade via the Group's European network volumes have since recovered, albeit not to previous levels but nevertheless, providing optimism for the remainder of FY2019F.

Of the 54% y-o-y increase in revenues (+£62.9m), £25.5m is represented by organic growth (+21.8% y-o-y); £15.9m a result of a full-year impact of acquisitions made during 2017 and £21.5m due to the purchase of Anglia (+£8.7m) and ISL (+£12.8m). The organic growth arose from a combination of new client wins, an expansion of service offerings and an additional warehouse facility in Romania.

The Baltic and Balkan regions proved to be a key driver of organic growth once again, with revenues rising £11.1m and £4.2m, respectively. In the Baltics this reflected a combination of new client wins and an expansion in the number of services offered, including consolidation services to Italian customers from Lithuania. The Balkan operations and, Bulgaria, was driven by the increased levels of trade passing through Greece (in part reflecting the recovery of Benfleet's business with China). In addition, the Group's Freight Forwarding operation in Romania benefitted from the increase in the proportion of full-load trailers.

Pall-Ex Romania, the franchised operation, increased the number of pallets handled monthly by 25%+ to in excess of 50,000 (2017: 40,000). This progress translates to a near doubling of the growth rate y-o-y during H2, versus the 17% registered in H1. We highlight in the chart on page 3 the growth in pallet deliveries by Pall-Ex Romania from 2016 to the end of 2018, which represents an impressive CAGR of 33.4%.

Deliveries by Pall-Ex Romania



Source: Company

E-fulfilment remains a small but profitable segment of the business, that continues to grow rapidly. The new EshopWedrop franchises are up and running and are rapidly growing revenues, reflecting the global trend in favour of home delivery of e-commerce shopping activity. Several franchises were opened in 2018, including Albania, Cyprus and the US.

All top-line growth at Affinity was organic, with revenues rising 38.6% y-o-y to £6.4m. The number of fuel cards with customers increased 17%+ to over 14,000 (2017: 12,000), with a benefit from an 8% increase in bulk fuel prices and a higher proportion of tolls and ferry passes sold (rising 30% y-o-y). The spread of the business continues to widen, with Romania accounting for slightly less of the divisional revenues at 87.2% (2017: 89.5%).

Xpediator acquired Benfleet and Regional Express during Q4 2017, boosting its Freight Forwarding operations. We strongly suspect that Benfleet added very little in the full-year relative to its contribution during Q4 2017. We previously highlighted the £0.3m exceptional charge relating to the net effect of the issues at Benfleet. In addition, Benfleet moved into loss for 2018, of the order of £0.5m. That both prior year acquisitions accounted for c.25% of the Group's top-line growth reflects the strong performance during FY2018 of Regional Express (representing the bulk of the £15.4m contribution from prior year acquisitions), owing much to its close relationship with Amazon, combined with strong air and sea freight capabilities.

In terms of the acquisitions made either side of the half-year, Anglia in early June and ISL in July, we believe that significant growth (comfortably in double-digits) was experienced within both businesses under the ownership of Xpediator. Anglia delivered revenues of £8.7m, with ISL, £12.8m. The strong performances largely reflected a cross-fertilisation of customers across the Group, as a wider range of services were offered to clients.

Gross margins declined modestly to 23.3% (2017: 24.2%), owing to a combination of:

- A move to full-load shipments
- The sharp rise in lower margin ferry crossings at Affinity

However, what gives us encouragement is that the traditional improvement in gross margins in H2 continued into FY2018, with the outcome of 24.8% 33 bp's higher than H2 2017.

Strategic planning

We believe that the management team, led by CEO, Stephen Blyth, highlighted its quality and forward thinking during the year, as it invested ahead of and to facilitate growth in the Company. Three new senior managers/Board members were added (with a further two in Q1 2019). There are several IT initiatives under way, not least to increase the level of automation across the business. The finance team was also strengthened during FY2018.

New facilities were added during H2 2018, not least an additional warehouse in Romania (with a further cross-dock terminal to open during early Q2 in Sibiu, Romania), benefiting both the Pall-Ex franchise and the Delamode Freight Forwarding operation in the country.

Operating costs increased £11.3m y-o-y, with approximately 46% of this due to the 31% increase in the average number of staff to 902 (2017: 687) and the average salary increasing 5.8% to £20.6k (in part due to skills shortages in the CEE region). Rents payable rose 161% to £5.9m due to the expansion of warehousing facilities and the acquisitions made. A further £0.4m increase in operating costs was a result of the increase in the vehicle fleet (reflecting driver shortages across Europe).

Despite the strengthening of both infrastructure and personnel from H2 2018 onwards, operating margins improved to 4.2% (2017: 3.8%) and encouragingly, the EBIT margins reached record levels of 4.8% during H2. EBITA of £7.6m was £0.1m ahead of our expectations.

With the rise in net cash it comes as no surprise that the level of net interest declined to £0.5m (2017: £0.7m), aided by improvements in debtor collection. Adjusted PBT increased 115% to £7.2m, with adjusted and diluted EPS rising 43% y-o-y, despite the 34.5m increase in the number of shares (on a weighted average basis, which included the full effect of the IPO and the acquisitions made post-IPO), aided slightly by the reduction in the blended tax charge to 12.3% (2017: 19.4%).

The 2018 dividend of 1.26p was 5% ahead of expectations, the payment rising 27.3% y-o-y. Dividend cover amounts to 3.7x, relative to EPS and in terms of cash cover, 2.6x, compared to free cash flow. Dependent upon the level of capex and M&A activity going forward, we believe that management has the scope to further increase the dividend pay-out ratio, particularly as the level of net cash increases throughout the period of our estimates.

Looking forward

The outlook for the business appears positive, notwithstanding concerns over Brexit. Management has put in place a Brexit team to co-ordinate the Group's response, whatever the outcome. Measures are already in place, with a plan identifying how to mitigate or seize opportunities thrown up by the ultimate Brexit outcome. Management is utilising Anglia's expertise in customs clearance in the UK to manage said activity for the Group. The Group continues to work closely with leading transport associations and port authorities, which has helped it to formulate its Brexit strategy.

In addition, the group has obtained Authorised Economic Operator (AEO) certification, which is an internationally recognised quality mark, which indicates that one's role in the international supply chain is secure and that the operator's customs controls and procedures are efficient and compliant.

The current waiting scheme for approval to the scheme is up to 12 months via HMRC, highlighting the forward planning of the Xpediator management team.

We think the Group's status is likely to see it secure additional business ahead of and following Brexit, as it steals a march on its smaller, less well-prepared competitors.

Management desire further acquisitions, with a key focus on two areas:

- Geographic expansion, particularly an increase in exposure to the CEE region
- Product diversification, including greater air and sea freight capability

The Group announced ahead of the results that it is no longer in discussions with the shareholders of the Slovenian logistics company, Intereuropa d.d. Xpediator has targeted a good pipeline of other opportunities, which are at a variety of stages of consideration and evaluation. One can comfortably suppose that FY2019 is likely to witness further M&A activity from Xpediator.

The comforting factor is that the level of cash generation, coupled with the existing cash balance is likely to mean that much of the consideration can be funded internally.

Financials

We are encouraged by the outlook for the Group, with our assumptions for growth based on the following likely outcomes:

- Expansion of Regional Express in support of its relationship with Amazon
- Further cross-selling opportunities, both within divisions and across the Group, with a team with responsibility for this established
- Opening of new cross-dock facility in Sibiu, Romania in April 2019
- Improved utilisation of warehouse facilities across the group
- Continued strong growth at Pall-Ex, Romania
- Introduction of new products/services, such as truck leasing and insurance
- Franchise openings at EshopWedrop
- Recovery of Benfleet, with Q1 2019 signs encouraging
- Full-year impact of FY2018 acquisitions
- Further M&A likely

In terms of our estimates, we have adjusted FY2019F expectations modestly and introduced initial estimates for FY2020F. The largest change is in the outlook for the dividend, rising 22.1% compared to our previous expectation and by 21.1% y-o-y. This reflects a combination of the Group's progressive dividend policy; strong levels of cover, both cash and earnings and; the strong cash generative nature of the business.

Change in Estimates

	Old	New	Change
FY2019F revenue (£m)	207.83	207.92	0.0%
FY2020F revenue (£m)		225.60	
FY2019F EBIT (£m)	8.53	8.50	-0.4%
FY2020F EBIT (£m)		9.62	
FY2019F EPS (p)	4.63	4.83	4.4%
FY2020F EPS (p)		5.70	
FY2019F DPS (p)	1.25	1.53	22.1%
FY2020F DPS (p)		1.81	

Source: Equity Development

Summary Profit & Loss

Year to Dec, £m	2016A	2017A	2018A	2019F	2020F
Freight Forwarding	58.9	93.1	136.9	153.9	166.2
Logistics	10.3	18.4	35.9	47.1	51.9
Transport Services	3.5	4.9	6.4	6.9	7.5
Revenue	72.7	116.3	179.17	207.92	225.60
CoGS	-55.6	-88.2	-137.5	-159.7	-172.9
Gross profit	17.2	28.1	41.7	48.2	52.7
Gross margin (%)	23.6%	24.2%	23.3%	23.2%	23.4%
Op costs	15.2	24.3	35.0	40.7	44.1
Other operating income	0.6	0.7	0.9	1.0	1.1
EBITA	2.5	4.4	7.6	8.5	9.6
Op margin (%)	3.5%	3.8%	4.2%	4.1%	4.3%
Associates			-0.1	0.0	0.3
Net Interest	-0.3	-0.7	-0.5	-0.3	-0.2
FRS13, non-cash interest		-0.3	-0.2	-0.3	-0.3
PBT (Adjusted)	2.2	4.1	7.2	8.4	9.9
Amortisn. of acqd. intangibles		-0.4	-1.1	-1.2	-1.4
Exceptionals	-0.7	-0.9	-0.3	0.0	0.0
PBT (Reported)	1.5	2.4	5.6	6.9	8.3
Tax	-0.2	-0.7	-0.9	-1.2	-1.5
PAT	1.3	1.8	4.7	5.7	6.8
Profit from discontinued items	-0.2	0.0	0.0	0.0	0.0
Minority interests	-0.5	-0.2	-0.3	-0.3	-0.4
Earnings	0.6	1.5	4.4	5.3	6.4
Ordinary Dividends	-3.6	-1.1	-1.7	-2.0	-2.4
Retained Profit	-3.0	0.4	2.7	3.3	3.9
EPS (Adjusted) (p)	1.5	3.3	4.7	4.8	5.7
DPS (p)	0.0	1.0	1.3	1.5	1.8
Ave no of shares (FD) (m)	80.0	94.3	128.8	135.9	135.9

Source: Company historics, Equity Development estimates

We note the strong cash generation, which we expect to result in FCF amounting to a combined £13.3m over FY2019 and FY2020. As a result, we anticipate that net cash should rise to c. £12.9m by the end of FY2020F.

This should underpin the strong dividend progression and can fund much of the likely M&A activity to arise during the current year.

Summary Cash Flow

Year to Dec, £m	2016A	2017A	2018A	2019F	2020F
EBITA	2.5	4.0	6.5	7.3	8.3
Depn. & Amortn.	0.3	0.8	1.8	2.0	2.2
Working capital movement	2.6	-1.2	-3.7	-0.5	-1.4
Other	-0.2	-0.9	1.5	0.0	0.0
Operating cash flow	5.1	2.8	6.2	8.8	9.1
Net Interest	-0.3	-0.4	-0.3	-0.3	-0.2
Taxation	-0.7	-0.8	-1.1	-1.1	-1.4
Net capex	-0.5	-0.7	-0.5	-0.7	-0.8
Pref. dividends			-0.1		
Operating FCF	3.6	0.9	4.2	6.6	6.7
Net (Acquisitions)/Disposals	-1.9	-5.8	-6.9	-1.1	1.3
Dividends	-3.4	-0.4	-1.3	-1.8	-2.2
Share Issues	0.0	7.2	6.6	0.8	0.0
Minority payment	-0.3	-0.3	-0.3	-0.3	-0.4
Other financial	-0.8	-0.1	-0.6	0.0	0.0
Increase Cash/(Debt)	-2.7	1.5	1.8	4.2	5.4
Opening Net Cash/(Debt)	2.7	0.0	1.5	3.2	7.4
Closing Net Cash/(Debt)	0.0	1.5	3.2	7.4	12.9

Source: Company historics, Equity Development estimates

Abbreviated Balance Sheet

Year to Dec, £m	2016A	2017A	2018A	2019F	2020F
Intangible Assets	2.9	15.2	24.9	23.7	22.3
Tangible Assets	1.2	1.6	2.4	2.3	2.3
Investments/other	0.3	0.3	1.5	0.0	0.0
Net Working Capital	-0.5	-1.0	2.9	2.4	1.0
Capital Employed	3.9	16.2	31.6	28.4	25.6
Deferred tax	0.3	1.2	2.2	2.2	2.2
Deferred consideration		1.7	2.1	1.0	
Net Cash/(Debt)	0.0	1.5	3.2	7.4	12.9
Provisions	0.0	0.0	1.5	1.5	1.5
Net Assets	3.6	14.8	29.1	31.1	34.7

Source: Company historics, Equity Development estimates

Valuation

Two of the three valuation models we choose to use suggest a 12-month share price expectation of 70p (Gordon's Growth Model) or modestly above (73.7p, DCF), with the third, the peer group valuation model, a much higher valuation. Using the latter, we have utilised a 15% (size related) discount to its peer group average multiple to suggest a weighted average 12-month price expectation of 91.6p.

The average of the three suggest a fair value of 78.4p per share.

Discounted Cash Flow valuation

£m, unless otherwise stated	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F
Free cash flow	5.7	5.5	5.6	5.7	5.9	6.0	6.1	6.3	6.4	6.5
WACC (%)	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0	8.0
Timing factor	0.6	1.6	2.6	3.6	4.6	5.6	6.6	7.6	8.6	9.6
Discount rate	1.0	0.9	0.8	0.8	0.7	0.7	0.6	0.6	0.5	0.5
Present value	5.4	4.8	4.6	4.3	4.1	3.9	3.7	3.5	3.3	3.1
Sum of discounted cash flows	40.8									
Terminal growth rate (%)	2.25									
Terminal value	54.4									
Net debt	3.2									
Equity value	98.5									
Number of shares	133.7									
Value per share (p)	**73.7**									

Source: Equity Development

Three-stage Dividend Discount model, £m

D0 =	1.26						
g1 =	19.9%	for first two years					
g2 =	12.0%	for next four years					
gp =	6.00%	thereafter					
Req. Return =	9%						
Time	0	1	2	3	4	5	6
Dividend	1.26	1.51	1.81	2.03	2.27	2.55	2.85
Terminal Value							100.76
Total Cash Flow		1.51	1.81	2.03	2.27	2.55	103.61
Present Value		1.39	1.53	1.57	1.61	1.65	61.78
Intrinsic Value/share	70.0p						

Source: Equity Development

Peer Group valuation		
Y/e to end Dec	**FY 2018E PER**	**FY 2018E Yield**
DSV	24.80	0.39%
Kuehne & Nagel	22.00	4.20%
Clipper	16.04	3.26%
Aramex	10.72	3.58%
Palletways	11.30	8.26%
DHL Express	13.61	3.70%
Fedex	12.27	1.32%
UPS	14.81	3.47%
Wincanton	7.59	4.33%
XPO Logistics	20.07	0.00%
Panalpina Welttransport	50.50	0.00%
Average	**21.05**	**1.82%**
Xpediator	9.74	3.24%
Prem/(disc) to average	***-53.7%***	***77.8%***

Source: Bloomberg, ED

Conclusion

We believe that Xpediator's shares are markedly undervalued, currently reflecting a hefty Brexit-related risk discount. Moreover, with a FCF of a combined £13.3m over FY2019F and FY2020F, the dividend is amply covered by 3.7x and 3.1x respectively. Lastly, we anticipate that the level of net cash is likely to rise £9.7m to £12.9m by the end of FY2020F, excluding further acquisitions, representing 20.5% of the current market capitalisation.

We have calculated the free cash flow yield to be 10.0% in FY2019F, rising to 10.6% in FY2020F. We think this represents a clear indication of undervaluation at current levels.

Investor Access

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