Xpediator PLC

Cost of growth

7 October 2019

To us, there are three standout features within Xpediator's interim results: significant investment for growth, revenues broadly in-line with previous expectations and short-term difficulties across a few of the business areas.

Sales of £102.4m are in-line with prior expectations, given the H2 trading bias. However, whether facilities are filling capacity slower than initially expected, or due to temporary disruptions, margins were squeezed in some instances. The investment in management and IT has markedly increased the cost profile of the business, albeit it has cemented the foundation for future growth. The latter has arguably had the greatest impact on profitability and results in a further downward review of estimates.

Our valuation, based on the average of DCF, peer group comparison and dividend discount models, suggests a fair value of 53p / share. The updated fair value represents a premium of over 120% to the current share price.

It has been an eventful year to date. Management has looked to invest in the infrastructure of the business, to facilitate future growth and remove potential bottlenecks. While this approach is likely to pay dividends over the longer term, there have been short term cost implications. Also, disturbances within some businesses during H1, due to either temporary closures/disruptions or capacity filling at a slower than expected pace, had a knock-on effect on margins and adj. PBT/EPS. As a result, we have reduced our dividend estimate, with the new expectation covered 3.4x and equating to a forward yield of 3.5%.

The CFO/CEO designate resigned unexpectedly in September, and the search for his replacement is already quite advanced. The previous CFO, Richard Myson, has returned to the role on an interim basis.

Despite the disruption to some of the Group's operations, revenues are trending in-line with prior estimates. This is encouraging. That said, in the face of Brexit and the higher than anticipated cost base, we have reduced estimates for adj. PBT/EPS further. Management has guided on the adj. PBT outcome for FY2019F of £5.0m and because of the H1 result; a traditional H2 bias to sales, and temporary disruptions cleared, we believe this to be very achievable. Looking further forward, we prefer to take a very conservative stance and suggest 5% top-line growth into FY2020F and broadly static margins. We have assumed that dividend growth is likely to be progressive from here.

Valuation

We have built several valuation models for Xpediator, of which the peer group comparison is the most bullish. The average when including a three-stage dividend discount model and a DCF amounts to a fair value of 53p / share.

In addition, one should bear in mind that net cash amounts to 12.4% of the current market capitalisation, rising to 15.5% by the end of FY2020 on our forecasts.

Company Data

EPIC	XPD
Price	23.7p
52 week Hi/Lo	73p/22p
Market cap	£32.2m
ED valuation/share	53p
Net cash (Dec '18)	£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. The Group derives its revenues from the UK (41.8%), CEE and Baltic states (58.2%), as at June 2019.

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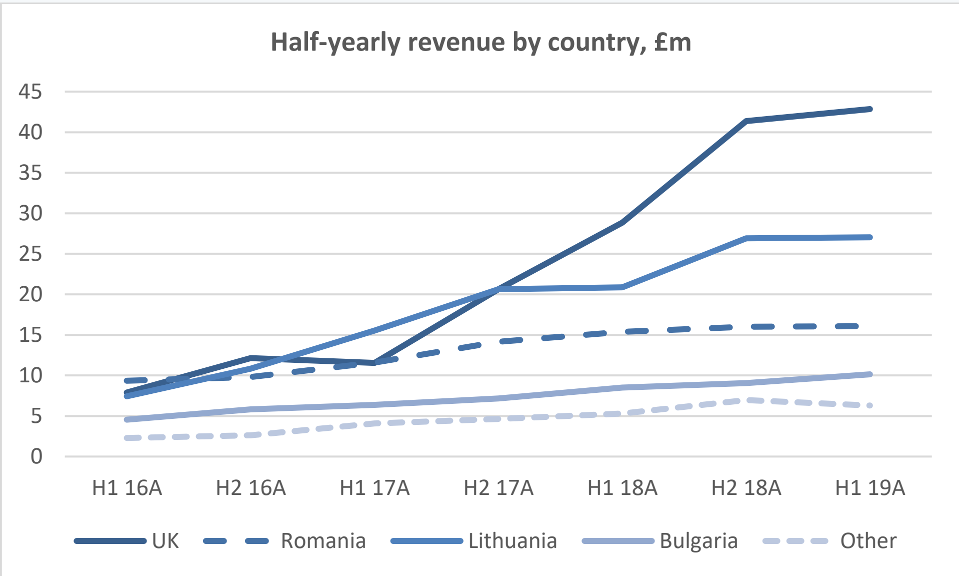
2019 interim results

Group revenues improved 29.8% to £102.4m, of which organic growth amounted to £8.5m (+11.0% y-o-y) and acquisitions made during 2018 contributing £15.0m. The Group purchased two UK-based businesses during FY2018: Anglia Forwarding in May and ISL in July.

Revenues improved across all geographies, with the UK the stand-out performer, up 48.6% y-o-y to £42.8m. That said, excluding the effect of the previous year's acquisitions, l-f-l revenues were broadly flat at £27.4m. As no overseas acquisitions were completed during 2018, the healthy top-line growth of 19% was wholly organic and was driven by strong performances in Lithuania (+29.6% y-o-y, to £27.0m) and Bulgaria (+19.4% y-o-y, to £10.1m). The drivers of organic revenue included:

- Freight Forwarding in Lithuania and Bulgaria
- Logistics & Warehousing in Romania
- Transport Solutions outside of Romania

Half-yearly revenue progress by country



Source: Company, Equity Development

Freight Forwarding

By division, Freight Forwarding revenues improved by £11.4m (+17.4%) to £76.7m, comprising organic growth of £5.8m (+8.9%) and £5.6m due to the acquisition of Anglia. The strong growth in Lithuania and Bulgaria reflected a continuation of previous strong trends. By contrast, Freight Forwarding revenues in Romania declined 6.7% y-o-y reflecting a change in mix of business towards the more profitable groupage activity.

The investment required ahead of securing potentially significant new contracts at Regional Express disrupted top-line progress within the business. However, once such agreements are fully up and running, management believes that **Regional Express will deliver a healthy profit for the Group** from FY2020 onwards.

EshopWedrop, the Group's e-commerce business suffered some operational disruptions in Germany at the end of FY2018, resulting in a delay in servicing customer needs and resulting in a loss of customers. Subsequent tightening of the customer on-boarding process resulted in increased administration and systems development costs during H1. Costs increased further due to the higher marketing expenses to broaden the customer base, as the German operation was re-launched. This has since delivered an improvement in volumes. Also, the extension of the franchise into a further 14 new territories within Europe by Q1 2020, has also led to rising costs. The divisional COO, who also assumed the role of CIO, has since been tasked with focusing solely on the E-commerce division.

The combination of the move into losses at EshopWedrop (£0.4m turnaround), disruption at Regional Express, and slower than anticipated removal of previously identified cost savings, impacted the bottom-line. The net effect was a modest reduction versus earlier expectations. Nevertheless, divisional operating profits increased by 41.6% to £1.4m, representing margins of 1.8% (H1 2018: 1.5%). The inclusion of Anglia Forwarding accounted for approximately three-quarters of the increase in divisional EBIT during H1. Were we to exclude the losses within the E-commerce activity, the operating margins for the Freight Forwarding division increased from 1.5% in H1 2018 to 2.3% in H1 2019, highlighting the strong underlying performance of the business.

Warehouse & logistics

Revenue within the Warehouse & Logistics division (W&L) increased 115.5% y-o-y to £25.6m, combining strong organic growth from Pall-Ex Romania and acquisitions (ISL, delivering £9.5m of revenue during H1). Organic growth amounted to £2.6m or uplift of 24.9% y-o-y.

Pall-Ex saw the average number of pallets moved per month rise more than 31% y-o-y to over 60,000. The focus of Pall-Ex continues to be on manufacturers, retailers and importers. The business offers a very robust platform to develop logistics warehousing not only within the country, but also in the region, now that it has secured the franchise for both Hungary and Moldova. The new cross-dock facility, which recently opened in May, has since operated below anticipated capacity. There are signs of improvement at the facility in Sibu during Q3, reflecting the ability of customers to order later than previously for next day deliveries.

The July 2018 acquisition of ISL increased overall warehouse space by approximately 80% to 90,000 m², compared to 50,000 at the end of H1 2018. The performance of ISL, however, has been lagging that of its pre-acquisition period in H1 2018. There has been an improvement in ISL's trading since the half-year end. ISL is well-positioned for expansion in seaborne trade from its Southampton base.

Following the loss of a significant customer, the warehouse in Braintree has been reconfigured to cater for higher-margin e-fulfilment work, requiring a new layout and racking. The reconfiguration of the warehouse required its temporary closure, with higher-margin customers sought.

Following the acquisition of ISL, gross margins improved positively. Of the £0.8m divisional increase in operating profit, almost £0.5m resulted from the contribution of ISL and nearly £0.4m was organic. The organic element reflected strong performances at Pall-Ex Romania and EMT. The margin within the Warehouse & logistics division increased to 5.2% (H1 2018: 3.1%).

Transport Solutions

Affinity, the Group's transport services division, a one-stop solution offering fuel cards, roadside assistance, toll passes, ferry bookings and financial services, expanded its service offering during H1. Revenues were flat at £3.1m, consisting of a 4.7% reduction in Romania, where most revenues are derived, and mitigated by a 26% improvement from the Balkan states. The database of users increased by approximately 4.3% to 14,600 from the 2018 year-end.

Operating profits improved 5.9% to £1.3m, representing an uplift of 1.6% y-o-y. The improvement reflects the improved mix in favour of fuel cards, compared to lower margin ferry crossings.

Cost base

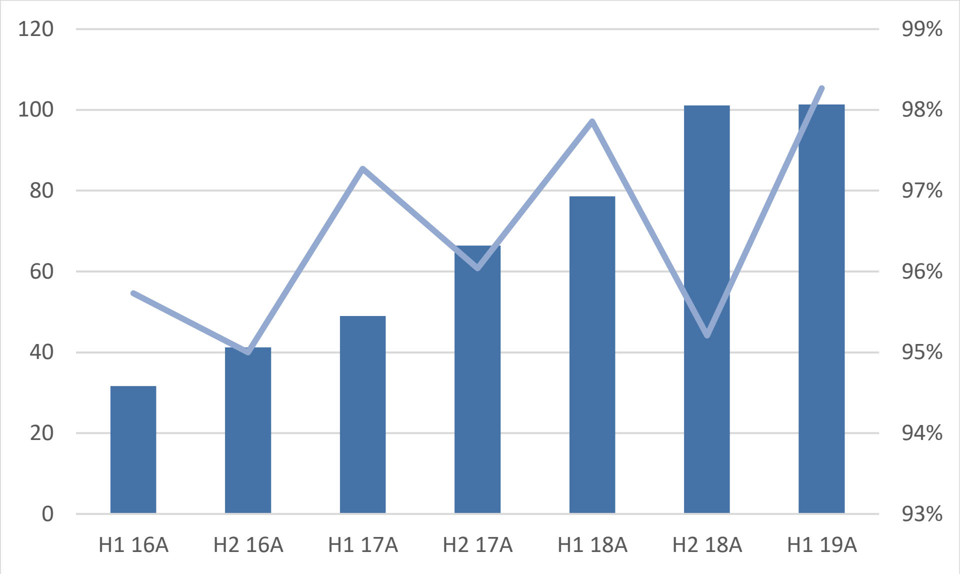
The Company has invested heavily in the business over the last 12 months, with five senior managers/Board members added during that time, including a Head of M&A/Integration and a Head of HR. The CEO designate/CFO recently resigned, with senior management in the process of replacing him. During the period the finance teams across the Group were also strengthened.

Investment in the IT infrastructure continued into H1, with management focused on centralising the IT support process across the Group. Further investment has been undertaken to improve data and systems security. The next step is a move to digitalisation, enabling smarter integration of the businesses and aiding a move towards group-wide automation of systems and processes (including customer enquiries/orders).

The investment in people/IT, however, has not come cheap. Central costs increased £1.2m y-o-y to £2.2m, the rise reducing operating margins by 1.2%. However, management is ultimately seeking to build a significant operation within freight and logistics markets across Europe. As a result, the infrastructure needs to be in place to ensure the business is scalable, removing potential bottlenecks to growth.

Overall costs (CoS and OpEx), increased 32.5% y-o-y to £100.6m (H1 2018: £76.0m). We think that management needs to look at this closely, while concurrently ensuring that any rationalisation of the cost base has no impact on existing and future growth.

Total costs (£m) and as a % of revenues (right axis)



Source: Company, Equity Development

EPS/dividends

Adj. PBT improved modestly (+5.7%) to £2.0m when adjusting for the exceptional item relating to Benfleet in H1 2018 (£0.7m) and adding back amortisation. Tax payable declined 79% to £0.1m (equating to a tax charge of 46%), and minority interests increased modestly.

Adj. EPS declined 25.7% to 1.24p (H1 18: 1.67p), mainly reflecting the increase in the weighted average number of shares to 135.6m (H1 2018: 119.6m).

The interim dividend fell 33.3% to 0.28p, which is covered 4.4x by earnings.

Cash flow

The level of net cash increased to £3.7m, before the impact of IFRS 16, an improvement of £0.5m y-o-y. IFRS 16 added £31.8m to net debt, resulting from capitalising the Group's operating leases. The net interest expense of £0.8m (H1 2018: £0.2m) included £0.4m relating to the adoption of IFRS 16. The remainder of the non-cash interest charge relates to the nominal interest of £0.2m on the outstanding deferred consideration (ISL and Anglia).

The level of depreciation increased from £0.2m in H1 2018 to £3.8m in the period up until June and reflects the adoption of IFRS 16, given the increase in the asset base. The remaining key features of the cash flow statement were a £0.7m working capital outflow, capex of £1.2m (including intangibles) and tax of £0.4m.

Because of the very fragmented nature of the European freight management market, Xpediator has sought to add bolt-on acquisitions that further its strategy of becoming a full-service, one-stop-shop. Mindful of the current share valuation, we think the short-term focus has shifted in favour of greater integration of the prior acquisitions, including improved cross-fertilisation of the Group. The management and M&A teams have built a pipeline of acquisition opportunities. However, any M&A is likely to be at the smaller end, utilising the strength of the balance sheet.

Brexit

We believe that the Group is well prepared for Brexit. In the short term, it has been a distraction for management but also an additional cost on the business, not least due to the delay from 29 March to 31 October. Management believes that post-Brexit there is a substantial opportunity in providing customs clearance for customers. Indeed, the Group's strong coverage of ports and airports in the South of England strengthens this view.

Financials

Interim results			
£m	**H1 18A**	**H1 19A**	**% change**
FF	65.36	76.71	17.4%
L&W	10.46	22.55	115.5%
Affinity	3.06	3.11	1.8%
Revenue	**78.88**	**102.38**	**29.8%**
CoS	-62.05	-77.61	25.1%
Gross profit	**16.83**	**24.77**	**47.2%**
GP%	*21.3%*	*24.2%*	
Other operating income	0.15	0.44	
Impairment loss on receivables	-0.63	-0.42	
Admin expenses	-13.92	-23.02	65.4%
FF	0.99	1.40	41.6%
L&W	0.32	1.16	263.4%
Affinity	1.19	1.26	5.9%
Central costs	-0.81	-2.05	153.2%
Operating profit	**1.69**	**1.77**	**5.0%**
Operating margin, %	*2.1%*	*1.7%*	
Associates		-0.074	
Cash finance costs	-0.167	-0.385	
Non-cash finance costs	-0.017	-0.382	
Exceptional items	0.656	-0.705	
Adj. PBT	**1.883**	**1.99**	**5.7%**
PBT	2.161	0.227	-89.5%
Taxation	-0.506	-0.105	-79.2%
Tax %	*23.4%*	*46.3%*	
Minorities	-0.13	-0.18	
Earnings	**1.52**	**-0.06**	
Adj. EPS (p)	**1.67**	**1.24**	**-25.7%**
Dps (p)	0.42	0.28	-33.3%

Source: Company

Management has provided guidance for adj. PBT for FY2019 of £5.0m. Given Brexit and the requirement to carefully consider the cost base, we prefer to take a conservative view on the outlook for revenue and profitability. Moving into FY2020F, we have assumed 5% top-line growth, some way below anything the Group has delivered to date and broadly static margins.

In terms of dividend, we estimate that based on the approximate one-thirds/two-thirds, H1/H2 split, that the full-year dividend is likely to amount to 0.84p. At the current share price, this represents a yield of 3.5%. Based on our revised estimates, the dividend is likely to be covered 3.5x by adj. EPS.

Change in Estimates

	Old	New	Change
FY2019F revenue (£m)	203.15	207.03	1.9%
FY2020F revenue (£m)	218.76	217.38	-0.6%
FY2019F EBIT (£m)	6.46	5.80	-10.2%
FY2020F EBIT (£m)	8.48	6.16	-27.3%
FY2019F EPS (p)	3.56	3.00	-15.7%
FY2020F EPS (p)	4.88	3.17	-35.0%
FY2019F DPS (p)	1.26	0.84	-33.3%
FY2020F DPS (p)	1.52	0.89	-41.5%

Source: Equity Development

Summary Profit & Loss

Year to Dec, £m	**2016A**	**2017A**	**2018A**	**2019F**	**2020F**
Freight Forwarding	58.9	93.1	136.9	152.3	159.9
Logistics	10.3	18.4	35.9	48.2	50.6
Transport Services	3.5	4.9	6.4	6.6	6.9
Revenue	**72.7**	**116.3**	**179.17**	**207.03**	**217.38**
CoGS	-55.6	-88.2	-137.5	-160.4	-168.5
Gross profit	**17.2**	**28.1**	**41.7**	**46.6**	**48.9**
Gross margin (%)	*23.6%*	*24.2%*	*23.3%*	*22.5%*	*22.5%*
Op costs	15.2	24.3	35.0	41.7	43.7
Other operating income	0.6	0.7	0.9	0.9	0.9
EBITA	**2.5**	**4.4**	**7.6**	**5.8**	**6.2**
Op margin (%)	*3.5%*	*3.8%*	*4.2%*	*2.8%*	*2.8%*
Associates			-0.1	-0.1	0.1
Net Interest	-0.3	-0.7	-0.5	-0.3	-0.4
IFRS 16 charge		-0.3	-0.2	-1.2	-1.1
PBT (Adjusted)	**2.2**	**4.1**	**7.2**	**5.0**	**5.4**
Non-cash deferred consideration					
Amortisation of acqd. intangibles		-0.4	-1.1	-1.3	-1.2
Exceptionals	-0.7	-0.9	-0.3	-0.7	0.0
PBT (Reported)	1.5	2.1	5.4	2.2	3.5
Tax	-0.2	-0.7	-0.9	-0.3	-0.6
PAT	1.3	1.5	4.5	1.9	2.9
Profit from discontinued items	-0.2	0.0	0.0	0.0	0.0
Minority interests	-0.5	-0.2	-0.3	-0.1	-0.2
Earnings	**0.6**	**1.2**	**4.2**	**1.8**	**2.8**
EPS (Adjusted) (p)	**1.5**	**3.3**	**4.7**	**3.0**	**3.2**
DPS (p)	**0.0**	**1.0**	**1.3**	**0.8**	**0.9**
Ave no of shares (FDil) (m)	80.0	94.3	128.8	135.9	136.0

Source: Company historics, Equity Development estimates

We have assumed a modest outflow of net cash during H2 (from £4.1m to £3.5m), reflecting the payment of a dividend and deferred consideration. Our expectation is that the level of net cash rises to £5.0m by the end of FY2020F, with the latter reflecting a combination of deferred consideration net of the refunded part-consideration for Benfleet.

On the current valuation, net cash accounts for 12.4% of the market capitalisation.

Summary Cash Flow

Year to Dec, £m	2016A	2017A	2018A	2019F	2020F
EBITA	2.5	4.0	6.5	4.5	4.9
Depn. & Amortn.	0.3	0.8	1.8	2.0	2.1
Working capital movement	2.6	-1.2	-3.7	-1.4	-0.5
Other	-0.2	-0.9	1.5	0.0	0.0
Operating cash flow	5.1	2.8	6.2	5.1	6.5
Net Interest	-0.3	-0.4	-0.3	-0.3	-0.4
Taxation	-0.7	-0.8	-1.1	-0.5	-0.5
Net capex	-0.5	-0.7	-0.5	-1.2	-1.0
Pref. dividends			-0.1		
Operating FCF	3.6	0.9	4.2	3.1	4.6
Net (Acquisitions)/Disposals	-1.9	-5.8	-6.9	-1.9	-1.8
Dividends	-3.4	-0.4	-1.3	-1.5	-1.2
Share Issues	0.0	7.2	6.6	0.8	0.0
Minority payment	-0.3	-0.3	-0.3	-0.2	-0.1
Other financial	-0.8	-0.1	-0.6	0.0	0.0
Increase Cash/(Debt)	-2.7	1.5	1.8	0.3	1.5
Opening Net Cash/(Debt)	2.7	0.0	1.5	3.2	3.5
Closing Net Cash/(Debt)	**0.0**	**1.5**	**3.2**	**3.5**	**5.0**

Source: Company historics, Equity Development estimates

Movement on Net Assets

Year to Dec, £m	2016A	2017A	2018A	2019F	2020F
Opening Net Assets	**8.3**	**3.5**	**14.5**	**28.5**	**30.2**
Earnings	1.0	1.5	4.5	1.9	2.9
Dividends paid	-3.6	-0.5	-1.7	-1.0	-1.1
Share Issues	0.0	10.0	6.6	0.8	0.0
Goodwill	0.0	0.0	0.0	0.0	0.0
Other	-2.1		4.6		
Closing net assets	**3.5**	**14.5**	**28.5**	**30.2**	**32.0**
Movement on Net Assets	*-4.7*	*11.0*	*14.0*	*1.6*	*1.8*

Source: Company historic data, Equity Development estimates

Investor Access

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