Eddie Stobart Logistics

FY results update

An attractive dividend yield with growth

General industrials

Recent strategic acquisitions have transformed Eddie Stobart Logistics (ESL) into a full end-to-end logistics provider. This strategy has resulted in strong FY18 revenue (+35% y-o-y, of which +18% y-o-y organic growth) and earnings growth (EBIT +14% and EPS +15%), reflecting the strength of its pay-as-you-go model and its ability to achieve synergies. We expect ESL to focus on margin improvement and cash flow generation in FY19, and now forecast a 13% EPS CAGR in FY18–20. Following recent share price weakness, the stock offers a 6.4% dividend yield for FY18 with a 5% CAGR in FY18–20, on our updated estimates. ESL continues to trade at a large discount to logistics companies in the UK and Europe on P/E multiples.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
11/17	623.9	37.8	9.8	5.8	10.1	5.9
11/18	843.1	49.2	11.4	6.3	8.7	6.4
11/19e	969.9	60.7	13.1	6.6	7.6	6.7
11/20e	1,034.9	67.9	14.7	6.9	6.7	7.0

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles, exceptional items and share-based payments.

Strong revenue and earnings growth progression

ESL reported strong revenue growth (35% y-o-y) and earnings progression (underlying EBIT +14%, underlying EPS +15%), boosted by both organic growth (+18% revenue y-o-y) and acquisitions (+17%). EBIT margin reduced from 7.8% in FY17 to 6.6% in FY18, reflecting the integration of the acquired companies coupled with strong organic growth and management's decision to invest in quality service and customers' loyalty. Margins improved in H218 (7.7% vs 5.0% in H1) and ESL expects further improvement in FY19. Its adjusted operating margins have consistently been well above competitors' levels for several years and we estimate they will be c 40% higher in FY19 (based on consensus).

We now expect a 13% EPS CAGR FY18–20

The trend for companies outsourcing logistics to achieve savings continues to support ESL's growth outlook, especially in the consumer and retail sectors, where there are revenue and cost pressures. Furthermore, the shift to e-commerce and the high market fragmentation offer medium-term growth opportunities. We now expect an improvement in EBIT margin in FY19 (6.8% vs 6.6% in FY18), driven by network optimisation (now largely completed), synergies from recent acquisitions and a focus on improving underperforming contracts. EBIT margin pick-up combined with revenue growth drives 14% EBIT and 13% EPS growth in FY18–20e on our revised forecasts. Even assuming slower dividend growth, we believe the dividend remains one of the key attractions of the stock, as we estimate a 6.4% yield in FY18 with growth of 5% pa in FY19–20e.

Valuation: Dividend support and P/E discount

In addition to an attractive dividend yield, ESL continues to trade at a large discount to the average P/E of UK (c 30% discount) and EU logistics companies (c 60% discount). While we have reduced our DCF valuation to 175p (from 190p) to reflect higher FY18 net debt than we previously assumed, our valuation still implies significant potential upside to the current share price.

29 March 2019

Price	**99p**
Market cap	**£376m**

Net debt (£m) at November 2018	159.7
Shares in issue	379.3m
Free float	74%
Code	ESL
Primary exchange	AIM

Share price performance

%	1m	3m	12m
Abs	(1.5)	1.0	(21.4)
Rel (local)	(3.1)	(6.0)	(22.7)

52-week high/low	145.5p	85.5p

Business description

Eddie Stobart Logistics is a market leader in end-to-end, multi-modal transport and logistics. Operations are primarily focused in the UK, with some activities in mainland Europe. Key customer segments include retail, consumer, industrials and increasingly, e-commerce.

Next events

Q1 results	xxx

Analyst

Dario Carradori +44 (0)20 3077 5700

industrials@edisongroup.com

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FY18 results overview: A year of strong growth

Strong revenue and earnings growth

Key highlights of the FY18 results were:

- Revenues grew by 35% y-o-y to £843m, driven roughly 50/50 by organic growth (£162m new contracts win) and acquisitions. On a sector basis, e-commerce continues to be the key growth driver (+65% y-o-y), but retail and consumer also continue to perform strongly (+43% and +26%, respectively).
- Underlying EBIT grew by 14% driven by the revenue growth and despite an EBIT margin reduction (6.6% vs 7.8% in FY17). The reduction reflected the task of integrating the acquired companies while at the same time experiencing very strong organic growth. The company has said it focused on offering quality service to new clients rather than on margin improvement, which will be the key focus for FY19. Hence lower margins also reflected a conscious decision by management to invest in a quality service for its customers. Margins already improved in the second half of FY18 (7.7% vs 5.0% in H1) and the company expects a further improvement in FY19.
- Net debt increased to £160m at the end of FY18, from £109 one year earlier. This reflects the impact of the increase in working capital to support new contract roll-outs as well as the impact of acquisitions (£24m for The Pallet Network, TPN). We calculate a net debt/EBITDA of 2.4x at the end of 2018 (based on pro-forma EBITDA, which includes the full-year impact of the TPN acquisition), which is above the 2.0x targeted by the company. ESL said it expects a return to historical levels of cash generation in FY19 and that it will move towards 2x net debt/EBITDA in FY19.
- The dividend grew 8.6% y-o-y to 6.3p/share. This implies a payout ratio of 55% based on adjusted EPS.
- Recent acquisitions (iForce, Speedy Freight, Logistics People and TPN) continue to trade in line with company expectations and have contributed to the strategic repositioning of the company on a full range of solutions for its customers as well as the addition of more innovative capabilities.

Logistics outsourcing is key structural trend supporting growth

We believe the solid revenue growth shows that the trend for companies deciding to outsource logistics to achieve savings continues to support ESL's growth outlook, especially in the consumer and retail sectors, where there are revenue and cost pressures. In our view, the outsourcing opportunity is large, with 45–80% of logistics and supply chain services in the UK and Europe still performed in house (according to EU Commission estimates). ESL's pay-as-you-go model offers customers significant opportunities for cost savings and flexibility compared to running their own logistics networks. Furthermore, the shift to e-commerce provides another growth opportunity for ESL, thanks to its strong presence in the segment, which has led to strong growth historically (+65% in FY18).

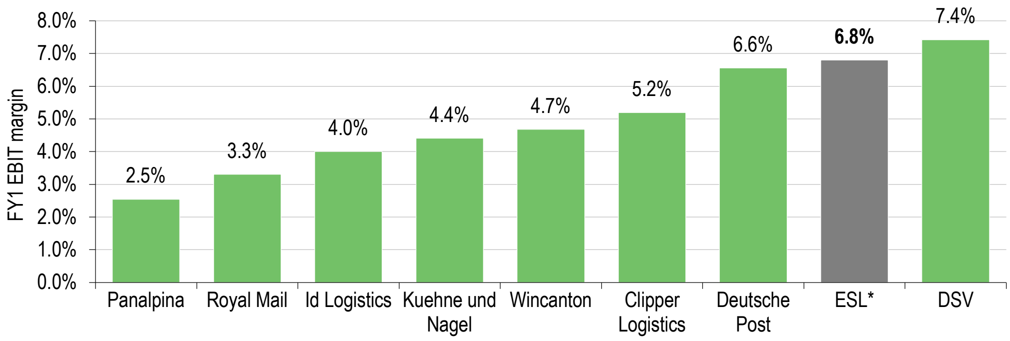
The UK logistics market remains very fragmented, with significant opportunities for consolidation. While in the short term we would expect ESL to focus on extracting synergies from recent acquisitions rather than targeting new ones, in the medium term, the opportunity remains large, especially considering the positive track record so far (with a weighted average EBIT acquisition multiple of 5.7x for iForce, Speedy Freight, Logistics People and TPN vs FY19 EV/EBIT for ESL of 7.6x).

Forecast changes

Strong EPS growth, healthy EBIT margins

Following a year of strong revenue growth (acquisitions and new contracts), we expect the key focus in FY19 will be on margin improvement and cash flow generation. In particular, we now model a 0.2 percentage point pick-up in FY19 adjusted EBIT margins to 6.8%, reflecting the efforts of the company on network optimisation (now largely completed) and synergies from recent deals, as well as the focus on improving underperforming contracts. We highlight that EBIT margins remain at very healthy levels and above competitors' margins. Our estimated adjusted EBIT margin of 6.8% (5.4% on the reported basis) for ESL in FY19 compares to a 4.8% average for other logistics companies, as shown in Exhibit 1.

Exhibit 1: FY1 EBIT margin for logistics companies



Source: Refinitiv, Edison Investment Research. Note: *Edison Investment Research forecast.

While we have made only small changes to our EPS forecasts for FY19–20, we reduced our DPS forecasts for FY19–20 by an average 9%, reflecting our expectations of lower growth as we believe continuous revenue progression requires further investment in working capital. We highlight, however, that the dividend remains one of the key attractions of the stock, as we calculate a 6.4% dividend yield in FY18, with growth of 5% a year in FY19–20 on our forecasts.

Exhibit 2: Forecasts revisions

£m		FY18	FY19e	FY20e
Revenue	New	843.1	969.9	1,034.9
	Old	817.9	911.2	973.1
	Change %	3%	6%	6%
EBITDA	New	62.9	74.7	81.7
	Old	66.3	77.3	84.7
	Change %	-5%	-3%	-4%
Adjusted EBIT	New	55.3	65.9	72.4
	Old	57.3	67.4	74.1
	Change %	-4%	-2%	-2%
Normalised EPS, p	New	11.4	13.1	14.7
	Old	11.5	13.4	15.0
	Change %	-1%	-2%	-2%
DPS, p	New	6.3	6.6	6.9
	Old	6.2	7.1	7.8
	Change %	2%	-7%	-11%

Source: Edison Investment Research. Note: FY18 new – reported, old – estimates.

Valuation

Large discount to peers' P/E, attractive dividend yield

ESL continues to trade at a P/E discount to UK (c 30% on FY1) and European competitors (c 60%). The dividend yield also stands out when compared to UK and EU logistics companies.

Exhibit 3: P/E and dividend yield for a selection of UK and EU logistics companies

	Market cap (£m)	P/E (x)			Dividend yield		
		FY0	FY1	FY2	FY0	FY1	FY2
Clipper Logistics	269	17.7	15.8	13.9	3.2%	3.6%	4.2%
Royal Mail	2,341	5.2	8.7	9.3	10.0%	10.2%	10.1%
Wincanton	292	7.6	7.3	7.0	4.2%	4.6%	4.9%
UK average		**10.2**	**10.6**	**10.1**	**5.8%**	**6.1%**	**6.4%**
Deutsche Post	30,329	16.9	12.9	11.5	4.0%	4.3%	4.7%
DSV	11,776	24.7	23.0	21.0	0.4%	0.4%	0.5%
Kuehne und Nagel	12,288	20.9	19.8	18.3	4.5%	4.6%	4.8%
Panalpina Welttransport	2,973	50.0	35.1	28.2	2.3%	2.5%	2.7%
EU average		**28.1**	**22.7**	**19.8**	**2.8%**	**3.0%**	**3.2%**
Eddie Stobart Logistics	**372**	**8.6**	**7.5**	**6.7**	**6.4%**	**6.8%**	**7.1%**

Source: Refinitiv and Edison Investment Research. Priced as of 27 March 2018.

While we have reduced our DCF valuation to 175p (from 190p) to reflect higher net debt than we expected at the end of FY18 (£160m vs. £141m), our updated valuation still implies significant upside potential to the current share price. Our DCF valuation is based on an unchanged 6.9% WACC, implying an EV of £808m (11x FY20 EV/EBIT) and equity value of £663m (12x FY20 P/E).

Exhibit 4: Financial summary

£m	2016	2017	2018	2019e	2020e
November year-end	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	570.2	623.9	843.1	969.9	1,034.9
EBITDA	47.4	55.3	62.9	74.7	81.7
Operating Profit (before amort. and except.)	41.3	48.5	55.3	65.9	72.4
Intangible Amortisation	(9.5)	(11.1)	(13.8)	(13.8)	(13.8)
Exceptionals	(3.3)	(17.2)	(8.8)	0.0	0.0
Other	(1.2)	(0.6)	(1.1)	0.0	0.0
Operating Profit	27.2	19.6	31.6	52.1	58.6
Net Interest	(16.0)	(9.6)	(6.1)	(5.3)	(4.5)
Profit Before Tax (norm)	24.0	37.8	49.2	60.7	67.9
Profit Before Tax (FRS 3)	11.2	9.9	23.6	46.8	54.1
Tax	(1.3)	(5.0)	(7.4)	(10.9)	(12.2)
Profit After Tax (norm)	22.7	32.8	41.8	49.7	55.7
Profit After Tax (FRS 3)	9.9	4.9	16.2	35.9	41.9
Average Number of Shares Outstanding (m)	276.7	326.8	367.0	379.3	379.3
EPS - normalised (p)	7.9	9.8	11.4	13.1	14.7
EPS - normalised and fully diluted (p)	7.9	9.8	11.3	13.0	14.6
EPS - (IFRS) (p)	3.3	1.2	4.4	9.5	11.0
Dividend per share (p)	0.0	5.8	6.3	6.6	6.9
EBITDA Margin (%)	8.3	8.9	7.5	7.7	7.9
Operating Margin (before GW and except.) (%)	7.2	7.8	6.6	6.8	7.0
BALANCE SHEET					
Fixed Assets	259	339	386	380	374
Intangible Assets	219	272	312	298	285
Tangible Assets	38	60	66	74	82
Investments	2	7	7	7	7
Current Assets	150	163	240	275	293
Stocks	2	2	3	4	4
Debtors	134	149	231	266	284
Cash	14	12	5	5	5
Other	0	0	0	0	0
Current Liabilities	(119)	(142)	(216)	(241)	(255)
Creditors	(112)	(134)	(180)	(206)	(219)
Short term borrowings	(6)	(8)	(36)	(36)	(36)
Long Term Liabilities	(201)	(147)	(174)	(164)	(148)
Long term borrowings	(173)	(114)	(129)	(115)	(98)
Other long term liabilities	(28)	(34)	(45)	(49)	(50)
Net Assets	89	212	236	250	265
CASH FLOW					
Operating Cash Flow	30	30	8	67	73
Net Interest	(10)	(8)	(7)	(6)	(5)
Tax	(2)	(3)	(4)	(11)	(12)
Capex	(1)	(6)	(14)	(12)	(13)
Acquisitions/disposals	(2)	(48)	(22)	0	0
Financing	(5)	38	29	0	0
Dividends	0	(5)	(22)	(23)	(25)
Net Cash Flow	10.0	(2.4)	(32.3)	14.0	17.4
Opening net debt/(cash)	170	166	109	160	146
HP finance leases initiated	0	0	0	0	0
Other	(6)	58	(18)	0	0
Closing net debt/(cash)	166	109	160	146	128

Source: Company data, Edison Investment Research.

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