EDISON

Eddie Stobart Logistics

Trading update

Forecasts reduced, material value upside remains

General industrials

We prudently cut our FY19 and FY20 EBIT forecasts for Eddie Stobart Logistics (ESL) by 5% and 6% respectively post the H1 trading update highlighting solid revenue growth, but EBIT at the low end of management expectations and a 4% downward revision to the last reported adjusted EBIT. Despite this, our forecast FY19 EBIT margin remains at the top end of logistics peers and, even on our revised numbers, the stock is trading at a significant discount to peers, offering an attractive c 9% dividend yield.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
11/17	623.9	37.8	9.8	5.8	7.7	7.7
11/18	843.1	49.2	11.3	6.3	6.6	8.3
11/19e	969.9	57.5	12.3	6.6	6.1	8.8
11/20e	1,034.9	63.6	13.6	6.9	5.5	9.2

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

EBIT forecasts cut by 5–6% post H1 trading update

The H1 trading update shows that revenue growth continues to be sustained (+25% y-o-y, of which +8% organic), but pressure on margins persists, with H1 EBIT at the low end of management expectations due to slower productivity improvements in Contract Logistics and Warehousing and the short-term negative impact of exiting a problematic contract on the transport network's operational efficiency. In addition, a 4% negative revision to FY18 adjusted EBIT was announced. However, ESL expects to deliver full-year results in line with the board's expectations, not least because historically volumes have been weighted towards the second half. We have prudently reduced our FY19 and FY20 EBIT forecasts by 5% and 6% respectively on the assumption that EBIT margins will remain stable vs FY18 (we previously expected a small increase).

Top-line drivers continue to be solid

We believe that the market in which ESL operates continues to provide long-term growth opportunities. The trend for companies outsourcing their logistics is well-established and should continue to provide organic growth opportunities for the company. In addition, the shift to e-commerce provides strong growth opportunities for ESL, as it has developed a solid track record in reorganising the logistics of traditional retailers as a result of its e-commerce capabilities. We believe that H119 confirmed these trends, with 8% organic revenue growth.

Valuation: Attractive entry point

Even on our revised down forecasts, we believe the valuation is attractive. The FY19 P/E of c 6x is at a large discount to other logistics companies (11–21x for UK/EU companies). The dividend yield of c 9% stands out compared with other UK small-caps and logistics companies. The dividend is based on a payout ratio of c 50%, broadly in line with the levels of other UK and EU logistics companies. While the overhang risk related to the 22.89% stake of Woodford Investment Management may continue to weigh on the share price, we see room for a significant re-rating if/once this is removed. Our DCF-based valuation reduces to 154p/share (from 175p/share), still implying material upside.

15 July 2019

Price	**75p**
Market cap	**£286m**

Net debt (£m) at 31 May 2019	154
Shares in issue	379.3m
Free float	74%
Code	ESL
Primary exchange	AIM

Share price performance

%	1m	3m	12m
Abs	4.9	(23.5)	(46.6)
Rel (local)	3.1	(23.9)	(45.2)
52-week high/low		140.5p	67.5p

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

H1 results	29 August 2019

Analyst

Dario Carradori +44 (0)20 3077 5700

industrials@edisongroup.com

Edison profile page

Eddie Stobart Logistics is a research client of Edison Investment Research Limited

Margin forecasts cut, significant value upside remains

The recent H1 trading update highlighted solid revenue growth but profit margins under pressure due to slower productivity improvements in Contract Logistics and Warehousing and the negative impact of exiting a problematic contract in March on the transport network's operational efficiency. Despite this, ESL said it expects to deliver full-year results in line with the board's expectations, not least because volumes have been historically weighted towards the second half. We have prudently cut our FY19 and FY20 EBIT forecasts by 5% and 6% respectively based on broadly stable EBIT margins y-o-y (vs a small increase before). Despite our lower forecasts, we believe the recent share price drop provides an attractive entry point as the stock is trading at a significant discount to other logistics companies, as well as UK small-caps, on several valuation metrics. We see significant upside to the current share price, although the overhang risk from the 22.89% stake of Woodford Investment Management may continue to weigh in the short term (the fund is currently suspended and is selling several holdings). Increased visibility of the outlook for FY19 at the H1 results on 29 August may act as the next catalyst for the stock.

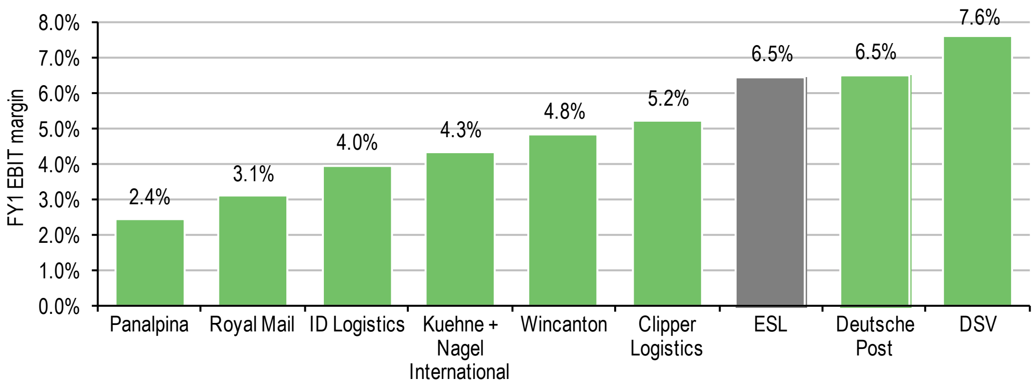
H1 trading update: Revenue growth but pressure on margins

Revenue progression: H1 revenues increased 25% y-o-y (including a full first-half contribution from recently acquired The Pallet Network (TPN); like-for like revenues were up 8%) and the growth trend appears consistent with our FY19 forecast of +15% y-o-y revenue growth.

EBIT margin development: H1 adjusted EBIT is expected to be towards the lower end of management expectations, due to slower productivity improvements in Contract Logistics and Warehousing and the negative impact on the operational efficiency of the transport network of exiting a problematic contract in March. In addition, following the appointment of Anoop Kang as the new CFO, the company announced some adjustments to historical financial statements, including a £2m reduction in FY18 adjusted EBIT (4%) and a £1.6m negative impact on FY19 adjusted EBIT (2% of our current forecast). Despite the level of H1 margins and the adjustment to historical EBIT, ESL expects to deliver full-year results in line with the board's expectations, not least because volumes have been historically weighted towards the second half.

The pressure on margins is disappointing as these were a key focus for investors following a significant EBIT margin reduction in FY18 (from 7.8% in FY17 to 6.6% in FY18, which the company explained reflected the integration of the acquired companies, coupled with strong organic growth and management's decision to invest in quality service and customer loyalty). However, even on our new forecasts, we show that ESL's EBIT margins continue to be well above the average level of international logistics companies (Exhibit 1). Further, the gradual implementation of an optimised transport solution starting from mid-2019 may be supportive of profit margins (mostly in FY20). The system will automate transport planning and improve utilisation rates by reducing empty vehicle miles, as well as provide enhanced visibility to customers.

Exhibit 1: FY1 EBIT margins for selected companies operating in logistics business



Source: Refinitiv, Edison Investment Research

Cash flow generation: net debt reduced to £154m in H119 from £160m at the end of FY18. We have increased our net debt forecast for FY19 to £154m (from £146m). Our forecast requires an acceleration in cash flow generation in the second half of the year, as dividends are paid in H2. We believe this is realistic considering that results are usually weighted to the second half. Net debt/EBITDA was 2.4x at the end of 2018 (based on pro forma EBITDA, which includes the full-year impact of the TPN acquisition), which was above the 2.0x targeted by the company. ESL previously 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. On our updated forecasts, net debt/EBITDA will reduce to 2.1x in FY19 and 1.8x in FY20.

Forecasts changes: FY19 and FY20 EBIT forecasts cut 5% & 6%

Following the trading update, we have maintained our top-line estimates but cut our FY19 and FY20 EBIT forecasts by 5% and 6% respectively based on the assumption that the EBIT margin will remain broadly in line with FY18 (6.5% and 6.6% vs 6.6% in FY18). As results are usually weighted to the second half of the year (we expect H1 EBIT to represent c 30% of FY19), analysing the development of the business over the summer will be key. We expect ESL to provide more visibility on the outlook for FY19 at the H1 results on 29 August. We maintain our dividend forecasts (implying c 5% CAGR in FY18–20e) and have marginally increased net debt.

Exhibit 2: Forecasts changes: FY19–20e EBIT cut 5–6%

		FY18	FY19e	FY20e
Revenue	**New**	**843**	**970**	**1,035**
	Old		970	1,035
	Change (%)		0%	0%
EBITDA	**New**	**62.9**	**71.5**	**77.4**
	Old		74.7	81.7
	Change (%)		-4%	-5%
EBIT	**New**	**55.3**	**62.8**	**68.1**
	Old		65.9	72.4
	Change (%)		-5%	-6%
EPS	**New**	**11.4**	**12.4**	**13.7**
	Old		13.1	14.7
	Change %		-5%	-6%
DPS	**New**	**6.3**	**6.6**	**6.9**
	Old		6.6	6.9
	Change (%)		0%	0%
Net debt	**New**	**160**	**154**	**140**
	Old		146	128
	Change (%)		5%	9%

Source: Company data, Edison Investment Research

Valuation attractive following recent share price decline

We believe the recent share price decline provides an attractive entry point into the stock. In our view the recent trading update, concerns over shareholder structure and overhang risks (Woodford Investment Management owns a 22.89% stake as of 8 July 2019) as well as Brexit have pushed the share price down to excessively low levels. We note the following:

1. The FY19 P/E of c 6x is at a significant discount to UK small-caps and other logistics companies (see Exhibit 3).

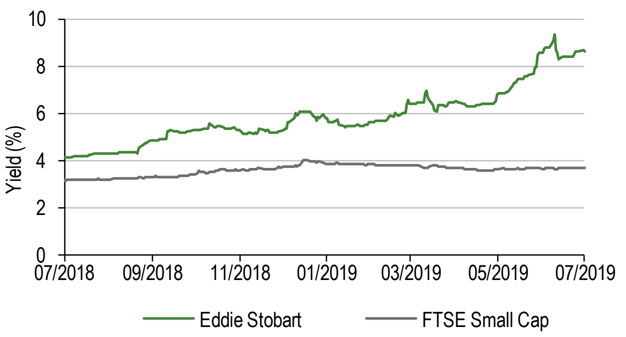
Exhibit 3: Valuation multiples for Eddie Stobart Logistics and UK/EU companies operating in logistics business

	Market cap (£m)	P/E (x)			Dividend yield (%)			EV/EBITDA (x)			EV/EBIT (x)		
		FY0	FY1	FY2	FY0	FY1	FY2	FY0	FY1	FY2	FY0	FY1	FY2
Clipper Logistics	298	19.6	17.6	15.4	2.9	3.2	3.7	12.1	10.5	9.3	18.4	14.9	13.2
Royal Mail	2,128	7.0	8.8	8.4	11.4	8.2	8.0	2.6	3.1	3.0	4.7	7.4	7.2
Wincanton	336	8.2	7.9	7.6	4.0	4.3	4.6	5.4	5.3	5.1	6.5	6.3	6.1
UK average		**11.6**	**11.4**	**10.5**	**6.1**	**5.3**	**5.5**	**6.7**	**6.3**	**5.8**	**9.9**	**9.6**	**8.8**
Deutsche Post	32,716	17.4	13.8	11.8	3.9	4.1	4.5	7.5	6.5	5.9	14.7	11.9	10.3
DSV	14,183	28.7	26.5	23.9	0.4	0.4	0.4	21.6	13.8	13.2	24.6	21.3	20.1
Kuehne und Nagel	13,864	22.3	21.8	19.9	4.2	4.3	4.5	16.1	10.8	10.8	19.9	18.0	16.5
European average		**22.8**	**20.7**	**18.5**	**2.8**	**2.9**	**3.1**	**15.0**	**10.4**	**10.0**	**19.8**	**17.1**	**15.6**
ESL	**286**	**6.6**	**6.1**	**5.5**	**8.3**	**8.8**	**9.2**	**6.9**	**6.2**	**5.5**	**7.9**	**7.0**	**6.3**

Source: Refinitiv, Edison Investment Research. Note: Prices as at 12 July 2019.

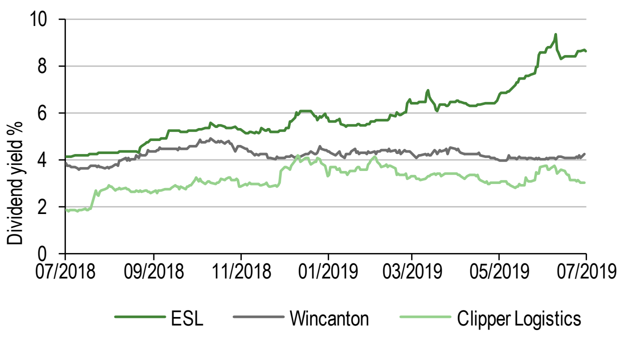
2. The dividend yield of c 9% stands out compared with other UK small-caps and logistics companies like Wincanton and Clipper Logistics.

Exhibit 4: Dividend yield for ESL and FTSE SmallCap



Source: Refinitiv. Note: Based on consensus data.

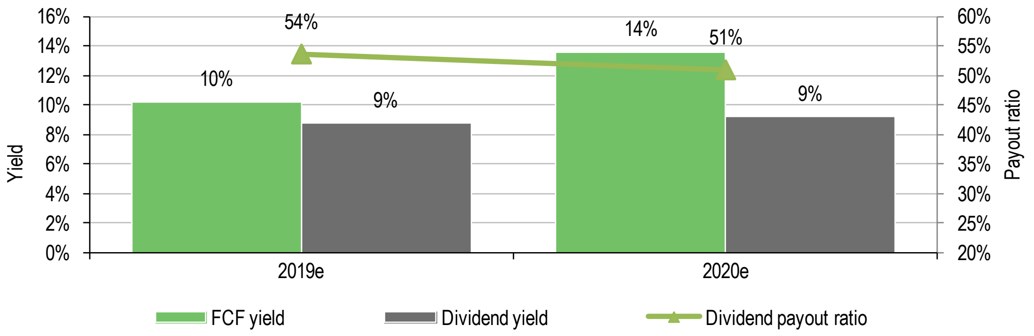
Exhibit 5: Dividend yield for logistics companies



Source: Refinitiv

3. The dividend is based on a payout ratio of c 50%, broadly in line with the levels of other UK and EU logistics companies. On our forecasts, the dividend is covered by cash flow (we estimate an FCF yield of c 10–14% in FY19–20). However, we recognise that cash flow generation needs to accelerate in H2 to achieve our forecast (£29m/£39m free cash flow post capex in FY19/FY20).

Exhibit 6: FCF yield vs dividend yield and payout ratio



Source: Edison Investment Research

4. Despite its low valuation multiples, ESL has a strong growth track record (22%/20% revenue/EPS CAGR for FY16–18) and, in our view, further growth prospects (we estimate 11%/10% revenue/EPS CAGR in FY18–20).

Looking at the discount at which ESL had been trading vs other UK logistics companies ahead of the trading update, specific concerns about overhang risks (rather than Brexit) appeared to be the main driver of the recent share price drop, hence we would expect the removal of this risk to drive significant share price appreciation.

As a result of the lower estimates, our DCF valuation is reduced to 154p (from 175p previously), still implying significant upside to the current share price. Our DCF valuation is based on an unchanged 6.9% WACC, implying an EV of £737m (10.8x FY20e EV/EBIT) and an equity value of £583m (11.2x FY20e P/E). While the upside to our DCF valuation is significant, the share price may not recover completely until the overhang risk disappears (we apply no discount to reflect this). Apart from a potential resolution to the shareholder situation, we believe the main short-term catalyst is visibility on the outlook for FY19, which the company may provide at the H1 results.

Growth driven by outsourcing, e-commerce and consolidation

Logistics outsourcing supports medium-term growth outlook

The trend for companies 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 and companies are refocusing on their in-store and online operations. 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. Clients can transform internal logistics fixed costs to variable costs and cope more easily with seasonal demand, as well as expansion projects.

The positive impact of the logistics outsourcing trend was clear for ESL in FY18 when group revenues grew organically 18% y-o-y, thanks to growth from existing contracts and £162m from new contracts (full-year impact). In retail, 2018 revenues grew by double digits in organic terms, even though UK retail conditions were difficult. The trend continued in H119, with top-line organic growth of 8% y-o-y. ESL is supporting top-line growth with investment in expanded capacity, with a company plan to open a 644,000 sq ft warehouse at Appleton, next to the operational headquarters, in Q420 (this would increase the company's warehousing capacity by 7% vs 8.8m sq ft at the end of FY18).

E-commerce progress sustains ESL's growth

The shift to e-commerce provides strong growth opportunities for ESL, as it has developed a solid track record in reorganising the logistics of traditional retailers as a result of its e-commerce capabilities. It has a full service offering across multiple customers and sectors (not final mile), which it has recently strengthened with the acquisition of iForce, which provides a full end-to-end logistics service.

Over the last few years, growth in the e-commerce market has been supported by both traditional retailers looking to further develop their online offering and new e-commerce entrants. This has led to strong growth for e-commerce historically and most recent statistics show this trend is continuing. Internet sales have risen as a proportion of UK retail sales from 3.1% in 2007 to 19.3% in May 2019 with online UK retail sales up 8.3% y-o-y in May 2019, according to data from the Office of National Statistics. These dynamics have historically driven strong growth for ESL, as we estimate that e-commerce services represent c 20% of FY18 revenues vs 7% in FY15.

Market fragmentation offers growth opportunities beyond 2019

While we do not believe that acquisitions will be a priority for the company in the near term (we expect ESL to focus on improving cash flow and leverage over the course of FY19), we see room for further external growth opportunities in the medium term due to high market fragmentation. We also believe that acquisitions in logistics create a high level of cost synergies as duplicate transport routes and warehousing can be eliminated. ESL has acquired four companies since its IPO and in our view has built a positive track record through its ability to buy companies at attractive multiples. It acquired iForce, Speedy Freight, Logistics People and TPN at a weighted average EBIT multiple of 5.7x vs the current FY19e EV/EBIT for ESL of 7.0x.

Exhibit 7: 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	71.5	77.4
Operating Profit (before amort. and except.)	41.3	48.5	55.3	62.8	68.1
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	49.0	54.3
Net Interest	(16.0)	(9.6)	(6.1)	(5.3)	(4.5)
Profit Before Tax (norm)	24.0	37.8	49.2	57.5	63.6
Profit Before Tax (FRS 3)	11.2	9.9	23.6	43.7	49.8
Tax	(1.3)	(5.0)	(7.4)	(10.4)	(11.4)
Profit After Tax (norm)	22.7	32.8	41.8	47.2	52.1
Profit After Tax (FRS 3)	9.9	4.9	16.2	33.4	38.3
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	12.4	13.7
EPS - normalised and fully diluted (p)	7.9	9.8	11.3	12.3	13.6
EPS - (IFRS) (p)	3.3	1.2	4.4	8.8	10.1
Dividend per share (p)	0.0	5.8	6.3	6.6	6.9
EBITDA Margin (%)	8.3	8.9	7.5	7.4	7.5
Operating Margin (before GW and except.) (%)	7.2	7.8	6.6	6.5	6.6
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)	(171)	(160)
Long term borrowings	(173)	(114)	(129)	(123)	(109)
Other long term liabilities	(28)	(34)	(45)	(49)	(50)
Net Assets	89	212	236	242	253
CASH FLOW					
Operating Cash Flow	30	30	8	58	69
Net Interest	(10)	(8)	(7)	(6)	(5)
Tax	(2)	(3)	(4)	(10)	(11)
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)	6.1	13.8
Opening net debt/(cash)	170	166	109	160	154
HP finance leases initiated	0	0	0	0	0
Other	(6)	58	(18)	0	0
Closing net debt/(cash)	166	109	160	154	140

Source: Company data, Edison Investment Research. Note: We will incorporate adjustments to historical financial statements following the release of full accounts.

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Australia

New Zealand

United Kingdom

United States

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1,185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia