Review

Edison investment research

3 December 2008

ACM Shipping Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/07	13.18	3.68	14.9	2.0	9.2	4.4
03/08	19.64	5.48	22.2	6.0	6.2	4.4
03/09e	25.00	6.80	26.9	7.5	5.1	5.5
03/10e	25.30	6.90	27.2	8.0	5.1	5.8

Note: *PBT and EPS (fully diluted) are normalised, excluding goodwill amortisation and exceptional items; 2007 dividend on pro rata basis equivalent to 6.0p.

Investment summary: Quality of earnings

Group interim results demonstrate the value of concentrating on the energy sector. Recent movements in the share price reflect a lack of understanding of the group; the movement of oil is more important than its price, while the volatility of dry cargo rates are not a factor. Trading will almost certainly become more challenging in the coming months, but the present rating fails to recognise the quality of earnings.

Strong interim results

Interim results are comfortably above expectations. Sound organic growth, supplemented by the early benefit of two strategic acquisitions, has contributed to a doubling of pre-tax profits. The immediate trading outlook remains sound, with a good start to the second half of the year. We are tempering our optimism because of medium-term economic uncertainties, but earlier full year estimates look too low.

Consistent growth

Each of the quoted shipbroking groups has seen its share price halved in recent months. While charter rates have come back, the underlying shift in manufacturing capacity to low-cost territories has fundamentally changed the long-term outlook for the shipping industry. The business is a net generator of cash, while demand for the transport of oil remains consistent, with any slack in the US made up elsewhere.

Still generating cash

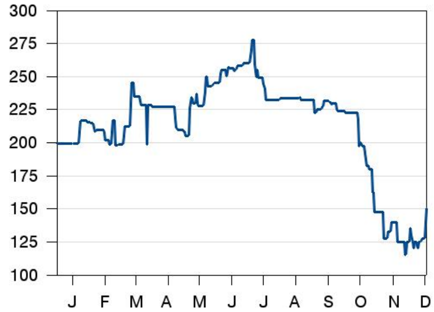
A £1.9m cash outflow over the half year was after acquisition expenditure of £5.5m. On the basis of our current estimates, there should be net cash in the balance sheet at March 2009, with over £2m likely to be generated in 2009/10.

Valuation: Quality in a misunderstood sector

ACM shares have halved over the past six months, yet trading is comfortably above market expectations. A modest premium to other shipbrokers reflects the group's involvement in the energy sector, but does not recognise the overall group potential.

Price	137.5p
Market Cap	£24m

Share price graph



Share details

Code	ACMG
Listing	AIM
Sector	Transportation
Shares in issue	17.5m

Price

	High	Low
52 week	277.5p	115.0p

Balance Sheet at 30 September 2008

Debt/Equity (%)	N/A
NAV per share (p)	48
Net cash (£m)	1.7

Business

ACM is a fully integrated shipbroking business, focused on the global oil tanker market. It arranges spot and time charters, also offering other services, including managing the sale and purchase of ships.

Valuation

	2008	2009e	2010e
P/E Relative	44%	67%	60%
P/CF	4.7	5.2	4.3
EV/Sales	0.9	0.9	0.8
ROE	39%	43%	34%

Revenues by geography

UK	Europe	US	Other
96%	0%	0%	4%

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Investment summary: Quality of earnings

Company description: Specialist shipbroking

ACM Shipping Group is a fully integrated shipbroking business focused on the global oil tanker market. The core business is the arrangement of spot business, involving single voyage movements. There is a growing time charter business, which arranges longer-term shipping movements typically for a period of six months to three years, but also including charters of significantly longer duration. The group also operates a highly successful Sale & Purchase business bringing together parties for the building of new vessels and trading in second-hand tankers; there is also a small demurrage business, which manages difficulties encountered when journeys are extended beyond the original contract period. Principal group operations are in London, with subsidiary businesses in Singapore, India and China.

Valuation

The share prices of all three quoted shipbroking businesses have performed badly during the second half 2008, losing more than half their value. We consider this movement reflects a misunderstanding of the dynamics of the underlying businesses. ACM has the highest proportion of its income generated from shipbroking and has a business geared almost entirely towards the energy sector. The quality of the group's earnings, which are still moving forward, is not recognised by the adverse shift in the share price.

Sensitivities

The main sensitivity relates to currency movements, with revenues generated in US dollars, while the cost base is largely in sterling. There is a potential vulnerability to the loss of key personnel, who manage the group's relationships with the oil majors and leading ship owners; however, the group has an impeccable record in terms of staff retention. The Sale & Purchase business can be subject to an intermittent flow of business. The shipping cycle, which is frequently mentioned in the media, is a factor that tends to be overstated as demonstrated by the consistent trading performance delivered over many years.

Financials

- Trading is comfortably ahead of our expectations, despite the recent sharp weakness in the share price. Interim results for the six months to September 2008 show doubled pre-tax profits, prompting us to raise our estimates for the current year and 2009/10.
- There was a net outflow of £1.9m during the half year, entirely related to £5.5m of acquisition expenditure. We anticipate net cash in the March 2009 balance sheet.

Exhibit 1: Estimate changes

Note: Figures in £m except per share data

	EPS			PBT			EBITDA		
	Old	New	% chg.	Old	New	% chg.	Old	New	% chg.
2008	22.2	22.2	N/A	5.48	5.48	N/A	5.38	5.38	N/A
2009e	23.4	26.9	15	6.10	6.80	11	6.14	7.00	14
2010e	24.9	27.2	9	6.50	6.90	6	6.54	7.00	7

Source: Company announcements; Edison Investment Research estimates

Interim results

In an excellent half year, ACM has delivered growth in each of its revenue streams and is beginning to see the benefits of a strengthening US dollar. Results are comfortably above our estimates and we are raising our full year targets. Meanwhile the group forward order book is at record levels and ACM continues to generate cash.

Excellent figures

Interim figures show revenues ahead by 76% to $24.4m, benefiting from a combination of organic and acquisition based growth; benefits of the recent strength of the US dollar were relatively modest, with the sharpest movements having taken place since the end of the trading period. The group acquired the 70% of ACM Shipping Services (ACMSS) not already owned in December 2007 – it will have been consolidated as a wholly owned subsidiary in the half year under review, but as a 30% owned associated company in 2007. In addition, there will have been a maiden three months contribution from Harris & Dixon, which was acquired for cash in June 2008 and is reported to have performed ahead of management expectations.

Exhibit 2: Results to September

Note: figures before exceptional items and amortisation of intangibles.

	2007/08 H1	2008/09 H1	Change	2007/08 Full year
	£m	£m	%	£m
Revenue				
– Spot brokerage	4.128	7.591	84	9.139
– Time charter	2.316	3.499	51	5.212
– Demurrage	0.268	0.435	67	0.565
– Sale and purchase	0.184	1.138	N/A	4.722
	6.896	12.663	84	19.638
Operating profit	0.778	2.798	160	3.929
Associates/joint ventures	0.802	0.643	(20)	1.308
	1.580	3.441	+118	5.237
Interest	0.102	(0.024)		0.242
Pre-tax profit	1.682	3.417	+103	5.479

Source: ACM Shipping Group

There was material organic growth in both spot and time charter movements, as group management responded effectively to relatively favourable trading conditions, while revenues were also boosted by strong freight rates for most of the trading period.

Spot brokerage: The improved throughput from the group's core business was ahead of expectations, with a 23% increase in the number of movements. Wet charter rates remained relatively firm throughout the period. The new team from Harris & Dixon has already settled in well alongside a number of other newly recruited brokers.

There has been an easing of rates since September, but volumes are holding up well; demand for oil cannot be switched off to the same extent as that for dry cargoes, such as basic materials and consumer goods. We are hopeful that the improvement can be sustained further into the second half, but we would prefer to see how trading is in early 2009 before predicting a similar outcome for the second half.

Time charter: The recent trend towards time charters has continued, with business up by 32% over the period. Forward order books are reported to have risen (by some 25%) to record levels over the half year, which augurs well for the next 18 months.

Customers remain keen to ensure availability of capacity into the future while uncertainty persists. There is extensive new tonnage currently on order for delivery over the next four to five years, but some 20% of current capacity will be retired over the next two years as single-hull ships are taken out of usage. However, because of the credit crunch it is quite likely the several of the new ships on order may not be completed.

Sale and purchase: A fivefold increase in sale and purchase revenues largely reflects the change of status of ACMSS from associate to subsidiary. In fact, there was a substantial downturn in revenues compared with the £4.5m delivered in the very buoyant second half of 2007/08. Activity in the market was at a low ebb, with few tankers changing hands. On the other hand, several deals are in the pipeline, with management looking ahead with confidence to the second half outcome.

Overseas operations: The performance of the group's overseas operations is slightly ahead of expectations, with management again signalling useful progress. The longest standing business, in Singapore, is now fully established in its region, is in profit and is moving ahead steadily. Progress in India has been remarkable; the strategy of bringing the personnel to London for training has enabled the business to be up and running quickly and the encouraging start reported with last year's 12 months figures has been extended impressively.

Associates: A 20% reduction in the contribution from joint venture/associates is slightly misleading because of the £0.4m contribution from ACMSS consolidated in the 2007 figures. The contribution from the GFI joint venture is up by 45%, as the business takes full advantage of the decision by increasing numbers of oil majors, oil traders and tanker owners to use the futures market to secure a measure of certainty in the potentially more volatile markets of the coming 12 months. Another sound result is expected during the second half.

Trading outlook

In formulating our trading targets, we are nervous about the state of the global economy. While wet freights are well short of their highest levels, the market has not seen the volatility experienced in dry cargo rates and is unlikely to do so in the immediate future. As mentioned above, demand for oil is much less elastic than for many commodities, largely because of the nature of its usage.

Many governments/people can withhold major capital projects if funds are in short supply, but much of the movement in a country's infrastructure is based on the flow of oil, regardless of the price. We expect the global credit crunch to have an impact on the demand for oil, but reductions will be of a limited nature and restricted to inessential uses. The chief executive's statement mentions global oil consumption at 86.2m barrels per day; we understand that despite a probable reduction in US consumption next year, the International Energy Agency is forecasting a rise to 86.5m barrels per day in 2009, with Far Eastern demand (notably from India and China) more than making up any shortfall. Moreover, incidents such as the hijacking of an oil tanker off the Horn of Africa add to tanker demand – the rerouting of charters round the Cape to pass to the east of Madagascar will add several days to journey times.

We have already mentioned the likely retirement of capacity over the next year or so and the uncertainty about slippage in the timetable for the introduction of replacement ships.

Our targets for the second half are considered conservative, especially if the recent weakness of sterling continues for some time. The average exchange rate over the six months to September was $1.93/£1; current rates are materially lower and we are assuming a $1.80 average in our calculations for the current year and $1.70/£1 for 2009/10. It should be remembered that shipping income is invariably negotiated in US dollars, despite the fact that the vast majority of group costs are incurred in the UK.

Exhibit 3: Profit estimates

Note: Figures before goodwill amortisation and exceptional items.

	2007/08		2008/09e		2009/10e
	£m	$	£m	$	£m
Revenue					
– Spot brokerage	9.1	24.0	13.3	22.0	12.9
– Time charter	5.2	12.5	7.0	14.5	8.6
– Demurrage	0.6	1.5	0.8	1.5	0.9
– Sale and purchase	4.7	7.0	3.9	5.0	2.9
	19.6	45.0	25.0	43.0	25.3
Operating profit	3.9		5.8		5.8
Associates/joint ventures	1.3		1.0		1.0
	5.2		6.8		6.8
Interest	0.2		0		0.1
Pre-tax profit	5.5		6.8		6.9

Source: Edison Investment Research estimates

Finance

The group continues to move firmly in the right direction, with a relatively high quality of earnings. There is a seasonal bias to cash movements with some 80% of the staff bonus (the largest individual item of expenditure) distributed during the second half of the year. Despite heavy acquisition expenditure, there was net cash in the balance sheet at the interim stage. We continue to expect the group to be cash generative on operations in each year.

Net cash at September 2008

The funds flow statement for the half year shows £4.4m generated from operations. The main features were operating cash flow of £2.9m and a £1.5m decrease in working capital (an increase in debtors related to the growth in the underlying business, less a seasonal increase in creditors related to the accrued, but unpaid bonus) making a total of £4.4m. Acquisition expenditure totalled £5.6m, comprising deferred payments to the vendors of ACMSS and £2.5m for Harris & Dixon. With tax paid amounting to £1.0m and other items (capex, income from joint ventures, interest payments) amounting to a net £0.3m, there was a net outflow of £1.9m, reducing cash balances from £3.6m at March 2008 to £1.7m the following September.

There is normally a cash outflow during the second half, largely as a result of the timing of the staff and directors' bonus. We are hopeful that income generated during that period will be sufficient to leave the group with net cash at March 2009. On the basis of our current estimates we expect the group to generate in excess of £2.8m in the following year to March 2010.

Earnings estimates increased

From the comments in our Trading Outlook paragraph, we are raising our ACM profit targets. We are lifting our current year target by 11% from £6.1m to £6.8m. As indicated, we are hopeful that these numbers will prove conservative, especially if trading continues at current levels and sterling remains weak. The interim dividend was raised by 0.5p to 2.5p; we now look for a final payment of 5.0p making a total of 7.5p, an increase of 25%.

We are taking a cautious view of the year to March 2010. On the assumption of a modest drop in income in US dollar terms, we expect to see nominally higher pre-tax profits. Market intelligence would imply somewhat stronger trading, but we have decided to await further evidence of growth before taking our estimates higher. In view of the cash generative nature of the underlying business, there would be ample scope for a modest rise in the dividend in the event of unchanged earnings.

Sensitivities

The main sensitivity relates to currency movements, with the vast majority of revenues generated in US dollars, while the cost base is largely in sterling. Other key factors are the key personnel, who control the group's relationships with the oil majors and leading ship owners, while certain aspects of the business (Sale & Purchase) do experience an intermittent flow of business. Ironically, the shipping cycle, which is frequently mentioned in the media, tends to be an overstated factor as demonstrated by the consistent trading performance delivered since the group's inception.

Currencies

ACM uses foreign exchange instruments to manage the risk in relation to the sterling/dollar situation; the board introduced a new policy during 2007/08 to have forward cover in place to manage this risk. At March 2008, there were forward exchange contracts in place to sell $6.4m.

The average effective exchange rate for the year to March 2008 was $2.00/£1, compared with $1.94/£1 in the previous year. During the current year, the average exchange rate was $1.93/£1 during the first half of the year; on the basis of subsequent sharp movements we are assuming an average rate of $1.80/£1 for the full year and $1.70/£1 for the year to March 2010.

The shipping cycle

The shipping cycle is seen in the City to be a major factor for shipbroking shares. However, experience over the years has shown that the impact on ACM has been far less marked than is generally assumed. This is particularly so in the current year, when dry cargo rates have continued to be highly volatile, while wet rates have proved much more stable.

Key personnel

The business has few tangible assets. Its strengths lie in the strong relationships that the group and certain key individuals have with the major oil companies and ship owners. The defection of specific individuals or teams to another broker could have an adverse impact on profits, especially in the short term. Management is fully aware of this risk and invests considerable time on staff motivation and retention.

ACM has a remarkable record in terms of retaining its key staff, the majority of whom are motivated by substantial share holdings and a generous bonus scheme. Obviously, the risks increase as the group becomes larger, but we believe that they should not be overstated.

Valuation

There are three quoted shipbroking groups, each of which has an impressive trading record that is hardly recognised in the rating. All three share prices are at less than half their 2008 highs, the adverse movement presumably reflecting fears about world trade and the recent weakness of dry cargo rates. The shipping cycle is obviously a factor, as was the expensive Russian litigation for Clarkson, but all three companies are highly cash generative, instantly recognisable in their sectors as respected global leaders and clearly misunderstood by the City.

Peer group comparison

All three companies have an impressive recent record, but there are distinct differences.

- Clarkson – is the market leader, having invested consistently in recent years to broaden the scope of the business. It is involved in all types of broking, from dry cargoes to oil tankers, augmented by specialist research facilities, port and agency services, plus financial services. The rating has yet to recover from the adverse impact on sentiment of litigation in conjunction with certain Russian clients.
- Braemar Shipping – is also significantly larger than ACM, again with a more broadly based business involving both broking and a number of shipping services. We sense that its rating reflects an element of concern about its diversification strategy and fears that dry cargo rates may have peaked.

Exhibit 4: Peer group comparison

Note: Figures before exceptional items. Priced as at 2 December 2008.

	Price	M Cap	Revenue	P/E	P/E 1	P/E 2
	p	£m	£m	x	x	x
ACM Shipping Group	135	24	24	6.1	5.0	5.0
Braemar Shipping Services	240	51	102	5.6	4.5	4.6
Clarkson	384	72	149	4.1	3.2	3.2

Source: Bloomberg; Edison Investment Research estimates

Sector undervalued

There is a natural fear in the City about the shipping cycle, but the shift in global manufacturing capacity to lower cost regions has effectively transformed a market that had been stagnating for many years. The credit crunch will slow down the rate of growth, but the fundamental shift in the market parameters appears irreversible and we sense that any slowdown in the global movement in goods will be largely matched by an enforced reduction in new shipping capacity coming on stream; the falling liquidity that affects trade will almost certainly also hit the shipyards.

We believe that the unique nature of the sector warrants a materially higher rating, even in current market conditions; the defensive nature of the wet market justifies a premium rating for ACM, relative to the remainder of the sector, at the current time.

Exhibit 5: Financials

£'000s	2006	2007	2008	2009e	2010e
Year end 31 March	UK GAAP	UK GAAP	UK GAAP	UK GAAP	UK GAAP
PROFIT & LOSS					
Revenue	13,552	13,180	19,638	25,000	25,300
Cost of Sales	(4,116)	(3,954)	(5,891)	(7,500)	(7,000)
Gross Profit	9,436	9,226	13,747	17,500	18,300
EBITDA	618	3,604	5,377	7,000	7,000
Operating Profit (before GW and pre bonus)	474	3,461	5,237	6,800	6,800
Goodwill Amortisation	0	0	(664)	(500)	(400)
Exceptionals	0	0	0	0	0
Other	0	0	0	0	1
Operating Profit	474	3,461	4,573	6,300	6,401
Net Interest	(2)	215	242	0	100
Profit Before Tax (norm)	472	3,676	5,479	6,800	6,900
Profit Before Tax (FRS 3)	472	3,676	4,815	6,300	6,501
Tax	(453)	(1,432)	(1,744)	(2,100)	(2,150)
Profit After Tax (norm)	19	2,244	3,549	4,700	4,750
Profit After Tax (FRS3)	19	2,244	3,071	4,200	4,351
Average Number of Shares Outstanding (m)	N/A	15.1	15.9	17.3	17.3
EPS - normalised fully diluted (p)	N/A	14.9	22.2	26.9	27.2
EPS - normalised (p)	N/A	14.9	22.3	27.2	27.5
EPS - FRS 3 (p)	N/A	14.9	19.3	24.3	25.2
Dividend per share (p)	0.0	2.0	6.0	7.5	8.0
Gross Margin (%)	69.6%	70.0%	70.0%	70.0%	72.3%
EBITDA Margin (%)	4.6%	27.3%	27.4%	28.0%	27.7%
Operating Margin (before GW and except.) (%)	3.5%	26.3%	26.7%	27.2%	26.9%
BALANCE SHEET					
Fixed Assets	944	2,883	10,988	12,888	12,388
Intangible Assets	0	0	8,702	10,702	10,302
Tangible Assets	524	445	484	384	284
Investment in associates	420	1,981	1,509	1,509	1,509
Unquoted investments	0	457	293	293	293
Current Assets	4,418	3,373	7,544	5,254	8,600
Stocks	0	0	0	0	0
Debtors	3,092	2,807	3,979	5,065	5,565
Cash	1,326	566	3,565	189	3,034
Other	0	0	0	0	0
Current Liabilities	(4,453)	(3,240)	(9,228)	(6,836)	(6,916)
Creditors	(4,453)	(2,669)	(8,097)	(5,616)	(5,683)
Other creditors	0	(571)	(1,131)	(1,220)	(1,233)
Short term borrowings	0	0	0	0	0
Minority interests	0	0	0	0	0
Long Term Liabilities	(1,421)	(1,556)	(1,439)	(1,439)	(1,439)
Long term borrowings	0	0	0	0	0
Other long term liabilities	(1,421)	(1,556)	(1,439)	(1,439)	(1,439)
Net Assets	(512)	1,460	7,865	9,867	12,633
CASH FLOW					
Operating Cash Flow	(1,842)	283	4,675	4,532	5,567
Net Interest	61	110	125	(100)	(100)
Tax	(42)	(1,007)	(2,063)	(2,011)	(2,138)
Capex	(65)	(64)	(195)	(100)	(100)
Acquisitions/disposals	0	(1,006)	(6,700)	(5,400)	0
Financing	0	3	4,000	0	0
Dividends	0	(500)	(652)	(1,298)	(1,384)
Other	2,389	1,421	3,809	1,000	1,000
Net Cash Flow	501	(760)	2,999	(3,376)	2,846
Opening net debt/(cash)	(825)	(1,326)	(566)	(3,565)	(189)
HP finance leases initiated	0	0	0	0	0
Other	0	0	0	0	0
Closing net debt/(cash)	(1,326)	(566)	(3,565)	(189)	(3,034)

Source: Company accounts/Edison Investment Research

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