Edison investment research

3 December 2009

ACM Shipping Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/08	19.6	5.5	22.2	6.00	9.3	2.9
03/09	30.1	8.7	36.7	8.50	5.6	4.1
03/10e	26.1	6.1	25.4	9.35	8.1	4.5
03/11e	27.3	6.4	26.9	10.30	7.7	5.0

Note: * PBT and EPS (fully diluted) are normalised, excluding goodwill amortisation and exceptional items.

Investment summary: Underlying progress

After the favourable trading conditions of last year, a profits downturn was always inevitable in 2009/10. However, the fundamentals of the first half show an increase in the number of movements managed by the group and further cash generation. The shares have recovered from their lowest levels, but continue to offer real value with an attractive and safe yield supported by a high-quality underlying business.

Interims ahead of expectations

In a tough market place, with average freight rates per spot fixture down by 64%, ACM emerged with real credit. Each of its other business segments delivered real progress, so that with a positive impact of currency movements the pre-tax reduction was quite modest. The second half downturn will be far more marked, because of the changes to the relative terms of trade, but we remain hopeful that, if the recent recovery in spot rates can be sustained, our full year target will prove conservative.

Strategy remains in place

ACM remains a broking/agency business. While profits will slip back in the current year, the group continues to grow the underlying business with an 11% increase in spot trades in a falling market. The international business is expanding on a controlled basis, while management continues to look for suitable teams to add to the main UK desk, broadening the overall business.

Still generating cash

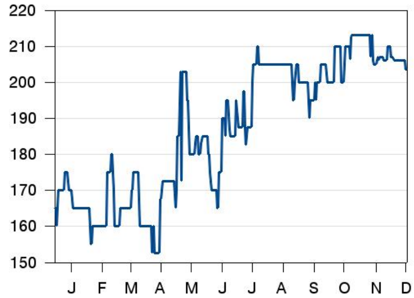
While profits will be down, the nature of the underlying business means that cash continues to be generated. Our 2009/10 target of a £2m inflow looks realistic.

Valuation: Best value in an undervalued sector

ACM's rating of 8.1 and 7.7 times prospective earnings for the next two years compares with an average of 9.4x and 8.6x for the other quoted shipbrokers. We find this hard to justify in the light of the more stable wet market led by ACM and the pure broking/agency nature of the business. The release of some of the tightly held equity may improve the liquidity of the shares and help the rating.

Price	206p
Market Cap	£36m

Share price graph



Share details

Code	ACMG
Listing	AIM
Sector	Transportation
Shares in issue	17.5m

Price

	High	Low
52 week	213p	151p

Balance Sheet as at September 2009

Debt/Equity (%)	N/A
NAV per share (p)	71
Net cash (£m)	6.4

Business

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

Valuation

	2009	2010e	2011e
P/E Relative	53%	66%	51%
P/CF	4.0	7.7	5.6
EV/Sales	1.0	1.1	0.9
ROE	48%	25%	21%

Revenues by geography

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

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ACM Shipping Group is a research client of Edison Investment Research Limited

Investment summary: Underlying progress

Company description: Specialist shipbroking

ACM Shipping Group is an integrated shipbroking business focused on the global oil tanker market. The core business arranges spot business, involving single voyage movements. There is a growing time charter business, for longer-term shipping movements typically for a period of six months to three years, but also of significantly longer duration. The group also operates a highly successful Sale & Purchase operation, bringing together parties for trading in new and second-hand vessels and demolition of outdated ships; 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 offices in India, Russia and the Far East.

Valuation

The prospective P/E ratio of ACM is around 10% below that of the other quoted shipbroking groups. We believe that the greater stability to earnings provided by the dependence on wet cargo rates, the continued increase in market share and the fact that ACM is wholly involved in broking/agency business justifies a premium rating. The sub-sector itself justifies a re-rating to reflect the quality of earnings – limited demand for capex and working capital leaves it highly cash generative.

Sensitivities

The main sensitivities relates to shifts in spot rates and the £/$ exchange rate. Volatile rates will lead to varying gross margins, although with a relatively high proportion of employee costs linked to profits, the impact is lessened. With revenues generated in US dollars and the cost base largely in sterling, the group is a beneficiary when the dollar strengthens and vice-versa. There is also a potential vulnerability to the loss of key personnel, who manage the group's relationships with the oil majors and leading ship owners; however, there are certain lock-in arrangements and the group has an impeccable record in terms of staff retention. The Sale & Purchase business can be subject to an intermittent flow of business.

Financials

- The profits shortfall in the first half of 2009/10 was slightly below expectations, but we are leaving our targets little changed; spot rates have firmed in recent months and if the improvement can be sustained our full year target could well prove conservative.
- ACM continues to generate cash despite the more volatile trading environment. Our current year target of a £2m inflow still looks realistic.

Exhibit 1: Estimate changes

Note: Figures in £m except per share data.

	EPS			PBT			EBITDA		
	Old	New	% chg	Old	New	% chg	Old	New	% chg
2009	36.7	36.7	N/A	8.72	8.72	N/A	8.93	8.93	N/A
2010e	25.1	25.4	+1	6.05	6.12	+1	6.24	5.85	-6
2011e	26.3	26.9	+2	6.36	6.43	+1	6.53	6.12	-6

Source: company announcements; Edison estimates

Encouraging statement despite slightly lower profits

While interim profits are down slightly compared with the first half of 2008/09, this was predictable in the light of sharply falling spot rates; indeed the shortfall would have been greater without the carry-over of some forward currency transactions from the previous year. Spot rates have recovered well in recent weeks, but it is too early to suggest that there will not be a somewhat larger shortfall in the second half. The fundamental points to take from these results, however, are that the number of spot deals has increased in a falling market and that the group continues to generate cash.

Interim figures

The quality of the underlying business at ACM was reinforced with the interim results for the current year. In a very difficult trading period for the group's core spot business, each of the group's other business segments showed material progress, enabling ACM to restrict the drop in turnover to just 1% in sterling terms; revenue in dollars fell by 19% from $24.4m to $19.8m. Because employee costs in the spot business are partially geared to the trading performance, the impact of operational gearing was reduced significantly. With the help of certain favourable forward currency contracts carried over from 2008/09, the impact on the group's bottom line was quite modest with pre-tax profits, before exceptional items and amortisation of intangibles, down by just 3% to £3.30m. This was slightly ahead of the target indicated in our October Update report. As an indication of the medium-term optimism of management, the interim dividend is to be raised by 10%.

Exhibit 2: Results to September

Note: Figures before exceptional items and amortisation of intangibles.

	2009/10 H1	2008/09 H1	Change	2008/09 Full year
	£m	£m	%	£m
Revenue				
– Spot brokerage	4,880	7,591	(36)	15,750
– Time charter	4,467	3,499	28	8,339
– Demurrage	950	435	118	1,103
– Sale and purchase	2,212	1,138	94	4,951
	12,509	12,663	(1)	30,143
Operating profit	2,497	2,798	(11)	7,236
Joint ventures	823	643	28	1,490
	3,320	3,441	(4)	8,726
Interest	(18)	(24)		(5)
Pre-tax profit	3,302	3.417	(3)	8,721

Source: ACM Shipping Group

There were no acquisitions during the period, but overseas offices were opened in Moscow and Beijing, raising the number of overseas operations to five. Currency movements were very favourable, with the £/$ rate averaging $1.53/£ over the period, compared with $1.93/£ in the corresponding half year to September 2008. This, in effect, added £2.2m to group revenues and £0.9m to operating profits.

- Spot market – as indicated above the spot market was very tough, with the average rate per fixture down by 64%. The market itself was also down by a few percentage points as indicted by the reduction in global oil consumption from around 86m barrels per day (bpd) to just over 83m bpd. The 36% drop in revenue from £7.6m to £4.9m was a clear indication of an increase in the number of movements managed by the group. ACM has undoubtedly raised its market share with an 11% rise in the number of fixtures, a rate of increase that has been relatively consistent throughout the period.

In looking to the second half, we are cautiously optimistic that returns will improve. Charter rates are well above their lowest levels, typically running at around $30,000 per day on a VLCC, compared with less than $20,000 at the lowest point. It is difficult at this stage to assess the extent to which this recovery is sustainable, but with more ship owners than previously avoiding time charters, the indications are positive. The International Energy Agency (IEA) is talking of demand going back above 86m bpd within two years, suggesting a steady recovery in demand for tankers.

- Time charters – there was a 28% rise in time charter income over the period, which is a measure of the consistent investment in building this segment of the business in recent years. Income per fixture is obviously more stable, with most contracts on an agreed day rate negotiated before much of the recent volatility emerged.

  There is an ongoing demand for time charters from the major oil companies, but with many leading ship owners anticipating a further rise in freight rates there is little capacity available to the market at the current time. This factor is behind the modest drop in the forward order book by 7% from $25.3m to $23.6m. Nevertheless, the order pipeline seems to indicate another good result in the second half of the year and we are confident that ACM is better placed than most to react to any improvement in the market place.
- Demurrage – income from demurrage was more than doubled compared with the first half of 2008/09, rising from £0.44m to £0.95m. There is no specific comment in the trading statement about this improvement, but we suspect that the nature of the business, involving payments some time after the end of specific voyage, means that the income related to a time when spot rates were much higher than current levels. It may be optimistic to expect profits to be sustained in the immediate future.
- Sale and purchase – with activity in the oil tanker market having slowed down considerably and several new build contracts running behind schedule, the near doubling of revenue during the first half to £2.2m may have come as a bit of a surprise. However, we understand that much of the growth stems from dealing in dry cargo ships, where the more volatile market has thrown up a number of opportunities. With a healthy forward order book, valued at $7.4m, we are optimistic that the current rate of throughput can be sustained beyond the end of the current trading year.
- Joint ventures – the joint venture with GFI, which conducts derivative brokerage services, delivered another sound result, with income up from £0.64m to £0.82m. it is reported to have increased its customer base further and looks set to continue as a material contributor to group profits over the medium term.
- International offices – during the half-year the group opened new offices in Beijing and Moscow. When added to other recent developments in Singapore, Mumbai and Shanghai, the group now operates five overseas offices. No separate figures are disclosed to provide trading numbers, largely because of the style of management of the

brokerage desk. The overseas offices are manned by a combination of local and UK staff and on specific contracts, will work closely with the corresponding desk in the UK; indeed, virtually all of the key personnel will have been trained in the UK and developed close relationships with their UK counterparts. The group looks on these offices as an extension to the overall business, regardless of where they may be located; they fit into the overall team in the same way that a new UK team would do so when brought on to the main UK broking desk.

The overseas expansion strategy represents a natural forward move for the group. It is seen by management that having key personnel on the ground reinforces the relationships already developed from the UK and lays down strong foundations for future growth in these territories.

Second half outlook

It is already clear that ACM has very little chance of matching its 2008/09 result during the second half of the year. While spot rates are well off the bottom, the circumstances which led to last year's strong result are very unlikely to be repeated in the immediate future. Moreover, the forward currency transactions which contributed to the interim result are no longer in place. We are hopeful that our full-year target of £6.1m, before exceptional items and goodwill amortisation (implying £2.8m pre-tax against £5.3m in 2008/09), will be beaten, but any weakening of spot rates from present levels will make this difficult. We have decided to leave the estimate largely unchanged at this juncture, but we will review the matter again in early 2009, when hopefully we will have a clearer picture about how spot rates are moving.

In looking to the medium term, the feedback from the market place is quite positive. Ship owners are apparently avoiding time charters and holding back for higher rates in the future. Moreover, the IEA forecast of recovering demand for oil at a time when certain single hull vessels are being retired and new capacity is coming on stream more slowly than originally planned augurs well for the next two to three years. Again, we are optimistic that our estimates will prove conservative.

Finance

As anticipated the group financial position remains strong, with the balance sheet having net cash and the group continuing to generate cash. As a broking business, there are no inventories, while trade receivables usually exceed trade payables, even including accrued staff bonuses; moreover, capital expenditure demands relate to ensuring communications systems of the highest quality, but require little investment in the form of other tangible assets.

Over the half-year to September 2009, there was an adverse movement of £0.7m in working capital, to reflect the slowdown in revenue, but there was still a net cash inflow of £1.5m, lifting net cash balances to £6.4m. bearing in mind that the majority of bonus payments occur during the second half, our earlier target of cash balances at March 2010 of close to £7.0m still looks realistic.

Group strategy

Group strategy remains unchanged. Unlike the other quoted shipbroking groups, there are no plans to diversify into non-broking business in the foreseeable future. Management sees plenty of opportunity over the medium term in continuing to arrange spot and time charters, demurrage and the sales and purchase of ships.

Investment has been made in strengthening various teams by introducing skills from outside the group, often in the form of taking on carefully selected individuals or teams. The two acquisitions since flotation have developed the sales and purchase operation and extended the core broking business into smaller vessels operating between intermediate ports across Europe. Equally significantly, there has been a strategic move overseas, developing an international trade, blending local skills with those available in London. Central management is constantly looking to extend the overall business, building on the strategies already in place.

Management has made no secret of its medium-term strategy of extending the business into the dry cargo market. The key will be people; any team will need to be able to blend into the existing dealing desk and satisfy group management that it is capable of building a meaningful business over the medium term. We understand that several potential acquisitions have already been assessed, but the timetable for any move remains fairly fluid.

Sensitivities

The main immediate sensitivity relates to the fluctuation in spot rates and the £/$ exchange rate. While dry cargo rates have always proved more volatile, wet rates have moved much more widely than usual in recent months, with the intensity of the global recession. Similarly, with the vast majority of revenues generated in US dollars and the cost base largely in sterling, currency movements can also be fundamental. Other 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.

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 2009, there were forward exchange contracts in place to sell $9.0m at an average rate of $1.48/£. The average effective exchange rate for the year to March 2009 was $1.69/£, compared with $2.00/£ in the previous year. During the current year we are assuming an average rate of $1.60/£ for the full year and $1.60/£ for the year to March 2011.

The shipping cycle

The shipping cycle is seen by investors to be a major factor for shipbroking shares. However, experience has shown that the impact on ACM has been far less marked than is generally assumed, because dry cargo rates tend to be far more volatile than wet rates. Ironically, the past 12 months have seen extremes with rates for both sectors moving more sharply than for many years, reflecting the uncertainty about the depth and extent of the global trading downturn.

Nevertheless, with oil demand relatively stable and showing signs of recovering the small amount of ground lost in the past year, we expect the more stable conditions in the wet market to be quickly restored.

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, including share and bonus schemes and lock-in arrangements.

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 companies in the shipbroking sub-sector. Each has seen share price volatility in the face of uncertain trading conditions in the shipping market. We consider ACM to be unique within its sub-sector; which, itself, warrants a higher rating relative to the market.

Peer group comparison

Exhibit 3: Peer group comparison

Note: Figures before exceptional items. Priced as at 1 December 2009.

	Price	Market cap	Revenue	P/E Hist	P/E Pros 1	P/E Pros 2
	p	£m	£m	x	x	x
ACM Shipping Group	206	36	30	5.6	8.1	7.7
Braemar Shipping Services	447	94	127	4.3	8.9	8.3
Clarkson	804	153	250	2.8	9.8	8.8

Source: Thompson Reuters; Edison Investment Research estimates

ACM shares stand at a discount of just over 10% relative to the average of the other two groups on the basis of prospective earnings. We acknowledge that the heavy involvement of both Clarkson and Braemar in dry cargoes would suggest a greater recovery potential, but we prefer the greater stability available in the wet market. We also prefer the fact that ACM is entirely a broking/agency business, whereas each of the others has diversified into adjacent business areas such as port and shipping services; broking operations are highly cash generative, with employee costs varying to reduce the likely impact of fluctuating profits. Another factor is the tightly held equity; any response by management to feed market demand for shares could improve the liquidity in the shares and help to bridge the ratings gap.

Sector undervalued

There is natural concern from investors about the shipping cycle, but the shift in global manufacturing capacity to lower-cost regions transformed a market that had been stagnating for years. The global recession has interrupted growth, but the fundamental shift in market parameters appears irreversible. Moreover, any slowdown in the global movement in goods will be largely matched by a reduction in new shipping capacity coming on stream. The unique nature of shipbroking, involving cash generation, close involvement with the growth in world trade and stiff barriers to entry warrant a premium rating to the market, rather than the current large discount.

Exhibit 4: Financials

£'000s Year end 31 March	2006	2007 IFRS	2008 IFRS	2009 IFRS	2010e IFRS	2011e IFRS
PROFIT & LOSS						
Revenue	13,552	13,180	19,638	30,143	26,075	27,278
Cost of Sales	(4,116)	(3,954)	(5,891)	(9,043)	(8,605)	(8,183)
Gross Profit	9,436	9,226	13,747	21,100	17,470	19,095
EBITDA	618	3,604	5,377	8,926	5,847	6,124
Operating Profit (before GW and pre bonus)	474	3,461	5,237	8,726	6,072	6,356
Goodwill Amortisation	0	0	(664)	(606)	(420)	(600)
Exceptionals	0	0	0	0	0	0
Other	0	0	0	0	0	0
Operating Profit	474	3,461	4,573	8,120	5,652	5,756
Net Interest	(2)	215	242	(5)	50	70
Profit Before Tax (norm)	472	3,676	5,479	8,721	6,122	6,426
Profit Before Tax (FRS 3)	472	3,676	4,815	8,115	5,702	5,826
Tax	(453)	(1,432)	(1,744)	(2,275)	(1,654)	(1,690)
Profit After Tax (norm)	19	2,244	3,549	6,446	4,468	4,737
Profit After Tax (FRS3)	19	2,244	3,071	5,840	4,048	4,137
Average Number of Shares Outstanding (m)	N/A	15.1	15.9	17.5	17.5	17.5
EPS - normalised fully diluted (p)	N/A	14.9	22.2	36.7	25.4	26.9
EPS - normalised (p)	N/A	14.9	22.3	36.9	25.5	27.1
EPS - FRS 3 (p)	N/A	14.9	19.3	33.4	23.1	23.6
Dividend per share (p)	0.0	2.0	6.0	8.5	9.4	10.3
Gross Margin (%)	69.6%	70.0%	70.0%	70.0%	67.0%	70.0%
EBITDA Margin (%)	4.6%	27.3%	27.4%	29.6%	22.4%	22.5%
Operating Margin (before GW and except.) (%)	3.5%	26.3%	26.7%	28.9%	23.3%	23.3%
BALANCE SHEET						
Fixed Assets	944	2,883	10,988	13,000	13,005	12,837
Intangible Assets	0	0	8,702	10,619	10,199	9,599
Tangible Assets	524	445	484	550	975	1,407
Investment in associates	420	1,981	1,509	1,493	1,493	1,493
Unquoted investments	0	457	293	338	338	338
Current Assets	4,418	3,373	7,544	10,932	12,210	16,302
Stocks	0	0	0	0	0	0
Debtors	3,092	2,807	3,979	5,997	5,188	5,427
Cash	1,326	566	3,565	4,935	7,022	10,875
Other	0	0	0	0	0	0
Current Liabilities	(4,453)	(3,240)	(9,228)	(10,331)	(7,959)	(8,282)
Creditors	(4,453)	(2,669)	(8,097)	(9,014)	(6,798)	(7,111)
Other creditors	0	(571)	(1,131)	(1,317)	(1,162)	(1,171)
Short term borrowings	0	0	0	0	0	0
Minority interests	0	0	0	0	0	0
Long Term Liabilities	(1,421)	(1,556)	(1,439)	(1,414)	(1,114)	(814)
Long term borrowings	0	0	0	0	0	0
Other long term liabilities	(1,421)	(1,556)	(1,439)	(1,414)	(1,114)	(814)
Net Assets	(512)	1,460	7,865	12,187	16,142	20,043
CASH FLOW						
Operating Cash Flow	(1,842)	283	4,675	8,988	4,665	6,430
Net Interest	61	110	125	(29)	(50)	(70)
Tax	(42)	(1,007)	(2,063)	(2,137)	(1,809)	(1,681)
Capex	(65)	(64)	(195)	(267)	(200)	(200)
Acquisitions/disposals	0	(1,006)	(6,700)	(5,599)	0	0
Financing	0	3	4,000	0	0	0
Dividends	0	(500)	(652)	(1,139)	(1,636)	(1,800)
Other	2,389	1,421	3,809	1,553	1,118	1,173
Net Cash Flow	501	(760)	2,999	1,370	2,087	3,853
Opening net debt/(cash)	(825)	(1,326)	(566)	(3,565)	(4,935)	(7,022)
HP finance leases initiated	0	0	0	0	0	0
Other	0	0	0	0	0	(0)
Closing net debt/(cash)	(1,326)	(566)	(3,565)	(4,935)	(7,022)	(10,875)

Source: ACM Shipping Group, Edison Investment Research