Review

Edison investment research

24 July 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	6.0	9.0	3.0
03/09	30.1	8.7	36.7	8.5	5.4	4.3
03/10e	25.1	6.1	25.1	9.4	8.0	4.7
03/11e	26.2	6.4	26.3	10.3	7.6	5.2

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

Investment summary: Defensive growth

ACM offers defensive characteristics in a challenging trading environment with good medium-term prospects. The rating fails to recognise the defensive qualities of the energy sector. The physical movement of oil is more important than its price, although weak spot rates are undermining current profitability. The number of movements continues to rise and growth should be restored in 2010/11.

2009/10 challenging, but healthy recovery in 2010/11

2008/09 results were ahead of expectations. Solid organic growth, supplemented by the benefit of strategic acquisitions and currency movements, contributed to the increase of pre-tax profits. The immediate trading outlook is challenging, with lower spot rates and less favourable currency movements. Current year profits will be well down, but 2010/11 should see a recovery.

Growth driven by global oil demand movements

ACM is relatively highly exposed to wet cargo charter rates, which, while remaining low, offer less volatility relative to those for dry cargo rates. The underlying shift in global manufacturing capacity to low-cost territories has fundamentally changed the medium-term outlook for the shipping industry. Demand for oil transport remains firm, with slack in the developed countries made up in developing countries.

Still generating cash

The business is a net generator of cash. The group has a strong financial position with a £4.9m net cash position at March 2009. It has no debt and should remain cash generative in the current year despite the decline in earnings. An acquisition, in the dry bulk cargo market, is a possibility.

Compelling valuation with qualities not recognised

Each of the quoted shipbroking groups has seen share price volatility in recent months, reflecting the changing trading landscape. A modest premium to other shipbrokers reflects the group's involvement in the energy sector, but does not recognise the overall group potential.

Price	200p
Market Cap	£35m

Share price graph

Share details

Code	ACMG
Listing	AIM
Sector	Transportation
Shares in issue	17.5m

Price

52 week	High	Low
	235p	115p

Balance Sheet as at 31 March 2009

Debt/Equity (%)	N/A
NAV per share (p)	69.6
Net cash (£m)	4.9

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, purchase and demolition of ships.

Valuation

	2009	2010e	2011e
P/E Relative	51%	65%	73%
P/CF	3.9	7.8	5.5
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: Defensive growth

Company description: Specialist shipbroking

ACM Shipping Group is an 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, trading in second-hand tankers 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 businesses in Singapore, India and China.

Valuation

The share prices of all three quoted shipbroking businesses have seen much volatility over the last year in the face of the changing underlying trading conditions. We consider that these indiscriminate movements reflect a misunderstanding of the dynamics of the underlying businesses. ACM has the highest proportion of its income generated from charter arrangement (80% of revenues in the year to March 2009) and has a business geared almost entirely towards the energy sector. The quality of the group's earnings is not recognised by the adverse shift in the share price.

Sensitivities

The main immediate sensitivity relates to shifts in spot rates. Currency movements are also a key factor, with revenues generated in US dollars, while the cost base is largely in sterling; the group is a beneficiary of a strong dollar and weak 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, 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. 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 currently challenging and we expect this to remain so for most of the current financial year, but the group has a strong forward order book. We have adjusted our estimates largely reflecting a sharp fall in wet tanker spot rates. The group, though, has a healthy financial position with a £4.9m net cash position with no debt and should remain cash generative in the current year.

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	33.8	33.4	(1.5)	8.50	8.72	2.6	8.70	8.93	2.6
2010e	27.2	25.1	(7.7)	6.90	6.05	(12.3)	7.00	6.24	(10.9)
2011e	N/A	26.3	N/A	N/A	6.36	N/A	N/A	6.53	N/A

Source: Company announcements; Edison Investment Research estimates

Recent results/strategic developments

Results for the year ending March 2009 reflected the strong trading environment for most of 2008 with revenues up 29% and profit before amortisation and taxation up 59% to £8.7m. Underlying EPS was up 61% to 35.9p. The group was a beneficiary of US dollar strength in 2008/09 with revenues and profits before taxation enhanced by £4.8m and £2.1m, respectively. The final dividend was 6p per share making 8.5p for the year, up 42%. The group was strongly cash generative and at end of the year the group was in a net cash position of £4.9m with no debt.

The most significant strategic development was the acquisition of Harris and Dixon for £2.5m in June 2008. This acquisition has broadened ACM's offering into brokering services for smaller tankers and has also opened up a number of trading opportunities between Harris and Dixon and other desks within the group. This business has now been successfully integrated, contributing on a nine-month basis £2.5m to group revenue and £0.7m to profit.

Exhibit 2: Results to March 2009

Note: Figures before exceptional items and amortisation of intangibles.

	2008/09 H1, £'000s	2008/09 H2, £'000s	Change % H2 YoY	2008/09 Full year, £'000s
Revenue				
– Spot brokerage	7,591	8,159	62.8	15,750
– Time charter	3,499	4,840	67.1	8,339
– Demurrage	435	668	125.0	1,103
– Sale and purchase	1,138	3,813	(16.0)	4,951
	12,663	17,480	38.1	30,143
Operating profit	2,798	4,438	N/A	7,236
Associates/joint ventures	0,643	0,847	N/A	1,490
Interest	(0.024)	0.019	N/A	(0.005)
Pre-tax profit	3,417	5,304	71.5	8,721

Source: ACM Shipping Group

Competitive position: Well placed

ACM is an integrated shipbroking business focused on the global oil tanker market with a strong fundamental business and a solid platform for future growth. In spot brokerage, ACM has one of the top ranked brokerage desks in the world. The group has a large and established client base including major oil companies, independent oil traders and ship owners and operators. Commission rates for broking deals between oil and shipping companies are normally 1.25%, which is expected to remain the status quo. ACM believes that its client base represents the leading players in the shipping sector, which helps underpin the sustainability of its forward book as well as limiting counterparty risk. The group's strategy is to gain market share by expanding its broker team into new shipping sectors and to penetrate new regional markets both organically and through acquisition. The group has negligible exposure to the dry bulk cargo market where rates, although higher, are more volatile.

We believe that growth will continue to focus on bolt-on acquisitions in the wet tanker market, LPG and LNG and other crude oil product markets. The group is also looking to enhance its global market presence especially in Asia, in China, India and Singapore where there is the strongest growth in oil consumption and trade. ACM will continue with its policy of operating these offices as satellite offices to avoid cannibalisation of business opportunities between offices.

Expansions into new areas such as the dry bulk market would normally be less likely in the current environment owing to the high risk involved in entering these markets. However, management has stated that the current time could be a very good entry point into this market segment, while asking prices are under pressure, reducing the potential measure of risk.

The group benefits from a degree of visibility of its operations from its forward order book. This consists of a range of shipbroking activities from time charter and Sales and Purchases businesses. It stretches out over 10 years to around $32m, of which $11.5m will be invoiced in 2009.

Competitor comparisons

ACM is smaller than its two principal listed competitors – Clarkson and Braemar Shipping – but the shipbroking industry is highly fragmented, with in excess of 30 small or specialist broking firms spread across the globe. Clarkson is the overall 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. Braemar Shipping is also significantly larger than ACM, again with a more broadly based business involving both broking and a number of shipping services having recently developed its diversification strategy. Braemar, though, is more focused on the dry cargo market. ACM Shipping is a global market leader in the wet cargo sector.

Trading outlook

The outlook for ACM's businesses remains challenging, reflecting the uncertainties about the state of the global economy and the reduction in world trade. However, we believe that ACM's business is well insulated and in a stronger position than many other brokers, in particular those involved in the dry cargo market where business activity and rates are much more volatile.

In the spot brokerage business, which is the hire of a ship for a single voyage, the fall in wet rates since the beginning of 2009 will lead to a material drop in revenues, despite a further rise in the number of movements managed by the group. In 2008/09, ACM concluded 1,350 spot deals, 19% up on the preceding year.. The group would be a beneficiary of any 'slow steaming' policies adopted by tanker operators; this would absorb tonnage, create a tighter supply/demand balance, helping to sustain rates.

ACM's tanker chartering business continued to grow its market share in 2008/09. However, since the start of the current calendar year tanker rates have fallen dramatically due to an adverse movement in the short-term balance between supply and demand. The Baltic Dirty Tanker index, the key indicator for freight rates for ACM cargoes, is currently standing at just over 700 compared with an average of around 1,400 in 2008. Our estimate assumptions are based on an index of around 700.

In the Time charter business – the involvement in long-term hire of tankers – the group has over one hundred tankers on charter from three months to 11 years. ACM has one of the largest forward books for tankers of any shipbroker – this currently stands at over $25m until 2018, with around $11.5m to be invoiced in the current financial year.

In the Sale and Purchase (S & P) brokerage business – the sale and purchase of new and older ships – activity is expected to see a sharp decline in the current year, but as yet ACM has not lost any deals and the forward order book remains healthy at $7.0m. Business in the demolition of ships should, however, remain healthy and show progress in the current year.

The overseas operation should continue to perform well, as the staff training initiatives continue to prove rewarding and the contribution from the GFI joint venture should continue to benefit from oil majors, oil traders and tanker owners' decisions to use the futures markets.

Exhibit 3: Profit estimates

Note: Figures before goodwill amortisation and exceptional items.

	2008/09	2009/10e	2010/11e
	£'000s	£'000s	£'000s
Revenue			
– Spot brokerage	15,750	11,813	12,403
– Time charter	8,339	7,672	8,055
– Demurrage	1,103	1,015	1,065
– Sale and purchase	4,951	4,555	4,692
Operating profit	7,236	4,886	5,112
Associates/joint ventures	1,490	1,118	1,173
Interest	(0.005)	0.050	0.070
Pre-tax profit	8,721	6,053	6,355

Source: Edison Investment Research estimates

Medium- and long-term projections reflect a continuing increase in world demand for traded oil products. We continue to see a shift in demand for imported oil from the US towards the Far East.

Trade flows and demand for oil and oil products are much less sensitive to economic activity than for many other commodities primarily due to its differing usage patterns. Governments and corporates can withhold and delay major capital projects – using dry cargoes such as iron ore and coal – if credit and funds are in short supply, but oil is more essential for everyday usage especially in the transport and power sectors.

The world consumption of oil is approximately 83.3m barrels a day. The latest report from the International Energy Agency suggests that global oil demand will move ahead in 2010 as the world economy emerges from its slump. The IEA estimates that global consumption should increase by 1.7% in 2010 driven by growth in emerging economies.

Consequently, the medium/long-term drivers for the shipping market continue to apply despite the volatility seen in spot market rates. The vast majority of world trade is still carried by ship, with seaborne trade accounting for 95% of world trade. The long-term demand for raw materials from the Far East will continue to grow, with industrialisation and urbanisation in developing economies like China and India being the key drivers. Demand for oil and energy products will rise steadily as the economic outlook improves.

Financials: Net cash position should prevail

Despite heavy acquisition expenditure, there was net cash in the balance sheet at the end of March 2009. Earnings will decline in 2009/10, but should rebound strongly in 2010/11. We continue to expect the group to be cash generative on operations in each year.

For 2009/10 we expect group revenues to fall substantially, led by a decline in the spot brokerage/freight revenue (53% of group revenues) reflecting lower freight rates and lower spot deals. The group will benefit from any appreciation of the US dollar as the bulk of the group's income is denominated in dollars. The average effective exchange rate for 2008/09 was $1.69/£. Our current assumption is for a $1.60/£ rate.

In 2009/10, we expect administration charges to return to the 2007/08 level of c 80% of sales from c 76% in 2008/09 as the exceptionally high freight rates unwind. The fact this has not increased further on the sharp rate correction is testament to the success of cost controls at the company.

Administrative expenses will decline sharply, reflecting the high bonus element of salary compensations. 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.

At the end of March 2009 the group was in a net cash position of £4.9m with no debt. Our estimates assume capital expenditure of £200k, with no acquisition spend. Interest on cash is assumed to be 1% and the group's tax rate is expected to rise slightly to 30%.

The group has a progressive dividend policy with an historic dividend cover at just under four times. This policy will be maintained even if earnings decline – we are suggesting a 10% increase for the current year. On our estimates dividend cover is still comfortable at 2.6 times.

Earnings estimates lowered for year to March 2010

We are taking a cautious view of the year to March 2010. We are hopeful that these numbers will prove conservative, especially if trading improves from current levels in the second half and sterling remains weak. In view of the cash generative nature of the underlying business, as stated above, there would be ample scope for a rise in the dividend, even in the event of lower earnings.

Sensitivities

The main immediate sensitivity relates to the fluctuation in spot rates. However, with the vast majority of revenues generated in US dollars, while the cost base is largely in sterling, currency movements are also fundamental. 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 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 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, 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 which has seen much share price volatility in the face of the change in underlying trading conditions in the shipping market. In common with shares of the other leading shipbrokers in its sub-sector, ACM's share price fell from an all-time high in July 2008 of 280p to touch a low of 108p in November 2008 before recovering, amid volatility to stand currently at 200p. The sub-sector of quoted shipbroking companies currently trade on a range of PER of 7.6 to 9.0 times, with a yield range of 4.7 to 7.1 times.

Peer group comparison: Majors in cash position as well

All three companies have had a resilient trading performance over the last 12 months and are in net cash positions, but each is expected to show a decline in underlying earnings for 2009. Clarkson, the largest and most diverse shipbroker, could see earnings decline by as much as 35%, most adversely affected by the decline in dry bulk chartering. Braemar Shipping is also significantly larger than ACM and more exposed to the dry cargo market and could see earnings decline by as much as 30%. We are currently estimating a similar earnings decline for 2009/10 for ACM compared with 2008/09. ACM merits the small premium rating compared with its peers and its yield, although not compelling in relation to its peers, does provide some support relative to the market.

Exhibit 4: Peer group comparison

Note: Figures before exceptional items. Priced as at 24 July.

	Price	Market Cap	P/E 1	P/E 2	Yield
	p	£m	x	x	%
ACM Shipping Group	200	35	8.0	7.6	4.7
Braemar Shipping Services	345	73	9.0	7.8	7.0
Clarkson	595	112	7.6	7.0	7.1

Source: Bloomberg; Edison Investment Research estimates

Sector undervalued

There is natural concern from investors 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 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 relative 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	2007	2008	2009	2010e	2011e
Year end 31 March	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	13,180	19,638	30,143	25,054	26,216
Cost of Sales	(3,954)	(5,891)	(9,043)	(8,268)	(7,865)
Gross Profit	9,226	13,747	21,100	16,786	18,351
EBITDA	3,604	5,377	8,926	6,238	6,527
Operating Profit (before GW and pre bonus)	3,461	5,237	8,726	6,003	6,285
Goodwill Amortisation	0	(664)	(606)	(630)	(600)
Exceptionals	0	0	0	0	0
Other	0	0	0	0	0
Operating Profit	3,461	4,573	8,120	5,373	5,685
Net Interest	215	242	(5)	50	70
Profit Before Tax (norm)	3,676	5,479	8,721	6,053	6,355
Profit Before Tax (FRS 3)	3,676	4,815	8,115	5,423	5,755
Tax	(1,432)	(1,744)	(2,275)	(1,627)	(1,727)
Profit After Tax (norm)	2,244	3,549	6,446	4,426	4,629
Profit After Tax (FRS3)	2,244	3,071	5,840	3,796	4,029
Average Number of Shares Outstanding (m)	15.1	15.9	17.5	17.5	17.5
EPS - normalised fully diluted (p)	14.9	22.2	36.7	25.1	26.3
EPS - normalised (p)	14.9	22.3	36.9	25.3	26.5
EPS - FRS 3 (p)	14.9	19.3	33.4	21.7	23.0
Dividend per share (p)	2.0	6.0	8.5	9.4	10.3
Gross Margin (%)	70.0%	70.0%	70.0%	67.0%	70.0%
EBITDA Margin (%)	27.3%	27.4%	29.6%	24.9%	24.9%
Operating Margin (before GW and except.) (%)	26.3%	26.7%	28.9%	24.0%	24.0%
BALANCE SHEET					
Fixed Assets	2,883	10,988	13,000	12,335	11,693
Intangible Assets	0	8,702	10,619	9,989	9,389
Tangible Assets	445	484	550	515	473
Investment in associates	1,981	1,509	1,493	1,493	1,493
Unquoted investments	457	293	338	338	338
Current Assets	3,373	7,544	10,932	11,856	15,844
Stocks	0	0	0	0	0
Debtors	2,807	3,979	5,997	4,985	5,216
Cash	566	3,565	4,935	6,871	10,628
Other	0	0	0	0	0
Current Liabilities	(3,240)	(9,228)	(10,331)	(7,647)	(7,973)
Creditors	(2,669)	(8,097)	(9,014)	(6,492)	(6,793)
Other creditors	(571)	(1,131)	(1,317)	(1,155)	(1,180)
Short term borrowings	0	0	0	0	0
Minority interests	0	0	0	0	0
Long Term Liabilities	(1,556)	(1,439)	(1,414)	(1,114)	(814)
Long term borrowings	0	0	0	0	0
Other long term liabilities	(1,556)	(1,439)	(1,414)	(1,114)	(814)
Net Assets	1,460	7,865	12,187	15,430	18,750
CASH FLOW					
Operating Cash Flow	283	4,675	8,988	4,494	6,355
Net Interest	110	125	(29)	(50)	(70)
Tax	(1,007)	(2,063)	(2,137)	(1,789)	(1,702)
Capex	(64)	(195)	(267)	(200)	(200)
Acquisitions/disposals	(1,006)	(6,700)	(5,599)	0	0
Financing	3	4,000	0	0	0
Dividends	(500)	(652)	(1,139)	(1,636)	(1,800)
Other	1,421	3,809	1,553	1,118	1,173
Net Cash Flow	(760)	2,999	1,370	1,936	3,757
Opening net debt/(cash)	(1,326)	(566)	(3,565)	(4,935)	(6,871)
HP finance leases initiated	0	0	0	0	0
Other	0	0	0	0	0
Closing net debt/(cash)	(566)	(3,565)	(4,935)	(6,871)	(10,628)

Source: Company accounts/Edison Investment Research

Edison Investment Research

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