Review

Edison investment research

25 June 2008

# ACM Shipping Services

| Year End | Revenue (£m) | PBT* (£m) | EPS* (p) | DPS (p) | PE (x) | Yield (%) |
|---|---|---|---|---|---|---|
| 03/07 | 13.18 | 3.68 | 14.9 | 2.0 | 16.7 | 0.8 |
| 03/08 | 19.64 | 5.48 | 22.2 | 6.0 | 11.2 | 2.4 |
| 03/09e | 22.70 | 6.10 | 23.4 | 7.0 | 10.6 | 2.8 |
| 03/10e | 24.00 | 6.60 | 24.9 | 8.0 | 10.0 | 3.2 |

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

## Investment summary: Another good year

ACM is justifying its decision to float on AIM, with its second strategic deal in less than 12 months, which looks set to reinforce a positive earnings performance. The shares have performed well in recent months at a time when other AIM share prices have been struggling. The rating has improved steadily over the past year, to reflect the increasing quality of earnings and the group's links to the energy sector.

### In line with expectations

Results for 2007/08 were slightly ahead of our estimate as revised to reflect the April trading statement. After a quiet start to the year, the group experienced positive trading conditions during much of the second half, with the performance boosted by the timely acquisition of the remaining 70% of ACM Shipping Services. The current year has started well and we have edged our target higher.

### Earnings enhancing acquisition

ACM has announced the acquisition of specialist shipbroking business, Harris & Dixon for £2.5m. The business complements existing operations, managing movements in smaller tankers (up to 30,000 tonnes); an experienced team will be integrated into the group's London office and should quickly add to group earnings.

### Cash generative

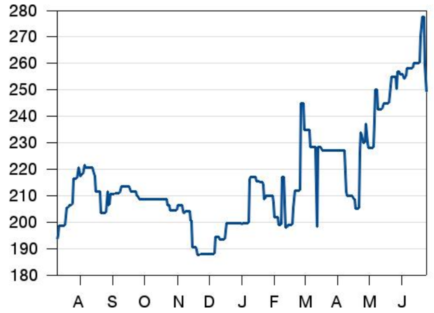
Net cash balances rose by £3.0m over the year to £3.6m. The underlying business is cash generative and despite acquisition expenditure of some £5.4m in the current year, the balance sheet should again be cash positive by the year end.

### Valuation: Premium rating justified

ACM shares stand on a very similar rating to Braemar (10.8x), the higher rated of the other two quoted shipbroking groups. This rating reflects the group's involvement with the more stable energy sector and the higher broking content to earnings. We believe that the quality of earnings warrants a higher rating across the sector.

| | |
|---|---|
| Price | 249.0p |
| Market Cap | £43m |

Share price graph




Share details

| | |
|---|---|
| Code | ACMG |
| Listing | AIM |
| Sector | Transportation |
| Shares in issue | 17.3m |

Price

| | High | Low |
|---|---|---|
| 52 week | 277.5p | 184.5p |

Balance Sheet as at 31 March 2008

| | |
|---|---|
| Debt/Equity (%) | N/A |
| NAV per share (p) | 51.3 |
| Net cash (£m) | 3.6 |

Business

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

Valuation

| | 2008 | 2009e | 2010e |
|---|---|---|---|
| P/E relative | 80% | 94% | 96% |
| P/CF | 8.5 | 9.9 | 8.1 |
| EV/Sales | 1.8 | 1.9 | 1.7 |
| ROE | 39% | 36% | 32% |

Revenues by geography

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


Analyst

Nigel Harrison 020 3077 5723

nharrison@edisoninvestmentresearch.co.uk


*ACM Shipping Services is a research client of Edison Investment Research Limited*

# Investment summary: Another good year

## Company description: Specialist shipbroking

ACM Shipping Group is a fully integrated shipbroking business focused on the global oil tanker market. The core business has historically been 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 two years, although there are deals 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

There are three quoted shipbroking groups, each of which has an impressive trading record which is hardly recognised in the rating. ACM's rating reflects the more focused nature of earnings and the group's involvement with the energy sector, balanced by fears about the shipping cycle.

## Sensitivities

The main sensitivity relates to currency movements, with revenues generated in US$, while the cost base is largely in sterling. In addition, there is a vulnerability to the loss of key personnel, who manage the group's relationships with the oil majors and leading ship owners, while the Sale & Purchase business can be subject to an intermittent flow of business. The shipping cycle, which is frequently mentioned in the media, is also a factor, although it tends to be overstated as demonstrated by the consistent trading performance delivered over many years.

## Financials

- Results are in line with market expectations as adjusted to reflect the positive trading statement in April. The current year has started well, with encouraging trading in the early months; earnings are boosted by an earnings enhancing strategic acquisition.
- The balance sheet remains strong with net cash up by £3.0m to £3.6m. The current year will incur acquisition expenditure of £5.4m, but with trading operations continuing to generate cash, the group should still have net cash at March 2009.

Exhibit 1: Forecast changes

Note: Figures in £m except per share data.

| | EPS | | | PBT | | | EBITDA | | |
|---|---|---|---|---|---|---|---|---|---|
| | Old | New | % chg. | Old | New | % chg. | Old | New | % chg. |
| 2008 | 21.3 | 22.2 | 4 | 5.40 | 5.48 | 1 | 5.39 | 5.38 | 0 |
| 2009e | 21.4 | 23.4 | 12 | 5.70 | 6.10 | 7 | 5.64 | 6.14 | 9 |
| 2010e | N/A | 24.9 | N/A | N/A | 6.60 | N/A | N/A | 6.64 | N/A |

Source: Company announcements; Edison Investment Research estimates

# Ahead of expectations

Results for the year to March 2008 reinforced the positive trading statement issued in April, with a remarkably strong final quarter performance from the sale and purchase business, ACM Shipping Services (ACMSS), boosting the overall result. The latter was 30% owned until December 2007 when the group acquired the remaining 70% held by its management, for £9.6m.

Consolidating ACMSS for the final four months of the year helped the group boost total revenue by 54% from US$25.6m to US$39.4m (like-for-like growth was 22%). The impact of translation into sterling was less marked than at one time seemed likely, with reported turnover ahead by 45% to £19.64m, while pre-tax profits before goodwill amortisation rose similarly by 49% to £5.48m, comfortably beating our revised target of £5.40m.

Exhibit 2: Strong performance

Note: Figures before goodwill amortisation and exceptional items.

| | 2006/07 | 2007/08 | Change |
|---|---|---|---|
| | £m | £m | % |
| Revenue | | | |
| -Spot brokerage | 8.357 | 9.139 | +9 |
| -Time charter | 3.825 | 5.212 | +36 |
| -Demurrage | 0.571 | 0.565 | -1 |
| -Sale & purchase | 0.749 | 4.722 | +530 |
| | 13.502 | 19.638 | +45 |
| Operating profit | 1.981 | 3.929 | +98 |
| Associates/joint ventures | 1.480 | 1.308 | -12 |
| | 3.461 | 5.237 | +51 |
| Interest | 0.215 | 0.242 | +13 |
| Pre-tax profit | 3.676 | 5.479 | +49 |

Source: ACM Shipping Group

Trading conditions varied throughout the year and, after a relatively dull autumn of 2007, general levels of trade picked up sharply for the final four months. The weakness of the US$ had an adverse impact on margins, with income almost entirely dollar based and a majority of costs incurred in the UK.

There were, nevertheless, impressive performances across the key businesses of the group:

- Spot brokerage – spot remains the core business, generating income of £9.14m, representing 46% of last year's revenues. There was a slight drop in the growth momentum, although a 12% rise in the number of deals (15% in 2006/07) suggests yet another rise in market share. Income per deal rose slightly in US$ terms, but the impact of exchange rate movement left the revenue advance at 9%. The improvement seen during the first half was relatively modest, but the business took full advantage of the improved trading climate during the final months of the trading year. The current year has started well, although it may be optimistic to expect a similar rate of growth in the number of trades.
- Time charter – the trend towards time charters continued throughout the year. Income rose by 45% in US$ terms (36% after conversion into sterling). Order books at March 2008 amounted to US$24.7m, representing a 27% increase over the previous year. The continuing uncertainty about global tanker capacity (there is considerable new tonnage on order, but the uncertainties in financial markets suggests that all construction may not

proceed to balance the medium term retirement of single hull ships) indicates to us that the trend toward time charters will continue for the foreseeable future. The current year is expected again to see material revenue growth.

- Sale & Purchase – the acquisition of Alchemy Trading in December 2007 materially strengthened the group's S&P operations, taking ACMSS from a 30% controlled associate to a wholly owned subsidiary. The timing was fortunate, with the company experiencing an unprecedented subsequent trading period, involving significantly increased sales and profits. The rise in the oil price and the uncertainty in markets suggest that the market may remain relatively buoyant in the immediate future, but it may be optimistic to project a similarly strong performance in the current year.
- Overseas – the group's operations in Singapore, India and China all delivered progress. The longest standing of these, in Singapore, continues to progress steadily, working closely with the teams in London. The new office in Mumbai, which began operations in December 2007, is benefiting from the earlier investment in the training of its key personnel in London and is reported to have started encouragingly. The Chinese operation is being restructured into a wholly owned business and shows considerable promise.

# Acquisition of Harris & Dixon

The acquisition of the business of Harris & Dixon (H&D) is the second strategic move since flotation. The business neatly complements the group's existing core operations, offers medium term cross-selling opportunities and should be immediately earnings enhancing.

## The business

H&D is a long established, London based shipbroking business, specialising in smaller oil tankers. It is a leading operator in its specialised field, with a similar split of spot and time charter business, working on behalf of major and independent oil companies, oil traders and ship owners. Whereas the ACM broking business is concentrated towards larger vessels used to transport oil from the production regions to major storage and refining facilities, the smaller tankers are more numerous and have a much larger number of relatively short trips between these facilities to a broad range of destinations for which the larger ships are not appropriate.

## Financials

The total consideration is £2.5m in cash, funded from the group's existing resources. Unaudited figures for the year to December 2007 show revenues of £2.1m and profits before interest and staff and director bonuses of £0.9m. We have made certain assumptions about the level of future bonuses and are assuming a 30% tax charge, which implies an exit rating of just under eight times earnings. On the basis of current interest rates, the deal should be immediately earnings enhancing.

## Integration benefits

The H&D business fits neatly alongside existing ACM broking operations and, although there are several common clients, there is virtually no overlap. The H&D team of 12 brokers and support staff will move into the ACM offices, leading to immediate cost savings from the closure of the firm's existing premises.

Over the medium term we would expect considerable cross-selling benefits, especially from the exposure of the H&D team to the group's more comprehensive client list. In addition, we expect ACM to respond to the fact that H&D has hitherto not been involved in the sale and purchase market.

# Finance

**While there is an element of seasonality to cash movements because of the timing of bonus payments, ACM should be cash generative on operations in virtually every year. The two acquisitions do involve a large element of cash consideration, but we expect the group to continue to show a clean balance sheet into the future.**

## Estimates raised

The chairman has reported an encouraging start to the current year, with freight rates continuing firm and a continuing rise in the number of deals. In addition, ACMSS will be consolidated for a full year (leading also to a reduced contribution from associates) and H&D for nine months.

In this context, both the Spot and Time Charter operations should deliver useful organic growth, supplemented by revenue from H&D of around £1.1m and £0.4m respectively. At this stage we have decided only to nudge the Sale & Purchase revenue target modestly higher, although as the year progresses, we are hopeful of taking a more optimistic line. With the deferred consideration payable on last year's deal plus the payment for H&D, interest receivable will be significantly reduced.

Exhibit 3: Profit estimates

Note: Figures before goodwill amortisation and exceptional items.

| | 2007/08 | 2008/09 | 2009/10 |
|---|---|---|---|
| | £m | £m | £m |
| Revenue | | | |
| -Spot brokerage | 9,139 | 10,700 | 11,200 |
| -Time charter | 5,212 | 6,400 | 6,900 |
| -Demurrage | 0.565 | 600 | 600 |
| -Sale & purchase | 4,722 | 5,000 | 5,300 |
| | 19,638 | 22,700 | 24,000 |
| Operating profit | 3,929 | 5,000 | 5,400 |
| Associates/joint ventures | 1,308 | 1,000 | 1,000 |
| | 5,237 | 6,000 | 6,400 |
| Interest | 0.242 | 100 | 100 |
| Pre-tax profit | 5.479 | 6,100 | 6,500 |

Source: Edison Investment Research estimates

While we are looking for a useful jump in pre-tax profits, the increased equity issued to help finance the ACMSS deal will lead to an element of dilution, limiting the rise in EPS.

## Balance sheet remains strong

Net cash balances increased £3.0m to £3.6m over the year to March 2008. As indicated previously, there are no inventories, while the quality of the vast majority of customers is such that debtors are well under control, while the largest item in creditors is accrued directors'/employees' bonuses – the net result is a highly cash generative business. There is a seasonal pattern to cash movements, related largely to the timing of bonus payments.

The large equity content of the initial consideration for Alchemy Trading (the holding company for the balance of ACMSS) meant that cash expended on acquisitions was relatively modest at just £0.2m, while the payment of a high dividend from ACMSS prior to the deal enhanced the inflow in an already cash positive trading period.

By contrast the current year will see significant acquisition expenditure. The deferred payment for Alchemy amounted to £2.9m and has already been paid; this will be followed by the current payment of £2.5m for H&D, making a total of £5.4m. In addition, the group will incur a full year's dividend payments.

Our current estimates suggest an outflow of up to £3.0m which should still leave the group with net cash at March 2009.

# Sensitivities

**The main sensitivity relates to currency movements, with the vast majority of revenues generated in US$, 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 US$6.4m.

The average effective exchange rate for the year to March 2008 was US$2.00, compared with US$1.94 in the previous year. The impact was relatively modest, equivalent to £0.5m of turnover.

## The shipping cycle

The shipping 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.

## Key personnel

The business has few tangible assets. Its strengths lie in the strong relationships which 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.

Experience has shown that ACM has a remarkable record in terms of retaining its key staff, many 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 which is hardly recognised in the rating. ACM and Braemar share the highest rating, which reflects short term problems specific to Clarkson, as much as it does their own trading prospects.

## Peer group comparison

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

- Clarkson – is the clear 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 is currently under a cloud because 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 25 June 2008.

| | Price | M Cap | PBT | PER H | PER 1 | PER 2 |
|---|---|---|---|---|---|---|
| | p | £m | £m | x | x | x |
| ACM Shipping Group | 253.5 | 43 | 6 | 11.5 | 10.6 | 10.2 |
| Braemar Shipping Services | 536 | 113 | 15 | 11.5 | 10.8 | 10.2 |
| Clarkson | 911 | 171 | 26 | 8.3 | 8.0 | 7.9 |

Source: Hemscott; Edison Investment Research estimates

## Sector undervalued

We sense that the troubles at Clarkson are currently undermining sector ratings. There is a fear in the City about the shipping cycle, which is running at close to peak levels. However, the shift in global manufacturing capacity to lower cost regions has effectively transformed a market which had been stagnating for many years. While the credit crunch may slow down the rate of growth, the fundamental shift in the market parameters and the cash generative nature of operations justify a somewhat higher rating for the sector.

## Exhibit 5: Financials

| £'000s Year end 31 March | 2006 UK GAAP | 2007 UK GAAP | 2008 UK GAAP | 2009e UK GAAP | 2010e UK GAAP |
|---|---|---|---|---|---|
| PROFIT & LOSS | | | | | |
| Revenue | 13,552 | 13,180 | 19,638 | 22,700 | 24,000 |
| Cost of Sales | (4,116) | (3,954) | (5,891) | (6,810) | (7,200) |
| Gross Profit | 9,436 | 9,226 | 13,747 | 15,890 | 16,800 |
| EBITDA | 618 | 3,604 | 5,377 | 6,140 | 6,540 |
| Operating Profit (before GW and pre bonus) | 474 | 3,461 | 5,237 | 6,000 | 6,400 |
| 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 | 5,500 | 6,001 |
| Net Interest | (2) | 215 | 242 | 100 | 100 |
| Profit Before Tax (norm) | 472 | 3,676 | 5,479 | 6,100 | 6,500 |
| Profit Before Tax (FRS 3) | 472 | 3,676 | 4,815 | 5,600 | 6,101 |
| Tax | (453) | (1,432) | (1,744) | (2,013) | (2,145) |
| Profit After Tax (norm) | 19 | 2,244 | 3,549 | 4,087 | 4,355 |
| Profit After Tax (FRS3) | 19 | 2,244 | 3,071 | 3,587 | 3,956 |
| | | | | | |
| 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 | 23.4 | 24.9 |
| EPS - normalised (p) | N/A | 14.9 | 22.3 | 23.7 | 25.2 |
| EPS - FRS 3 (p) | N/A | 14.9 | 19.3 | 20.8 | 22.9 |
| Dividend per share (p) | 0.0 | 2.0 | 6.0 | 7.0 | 8.0 |
| Gross Margin (%) | 69.6% | 70.0% | 70.0% | 70.0% | 70.0% |
| EBITDA Margin (%) | 4.6% | 27.3% | 27.4% | 27.0% | 27.3% |
| Operating Margin (before GW and except.) (%) | 3.5% | 26.3% | 26.7% | 26.4% | 26.7% |
| | | | | | |
| BALANCE SHEET | | | | | |
| Fixed Assets | 944 | 2,883 | 10,988 | 12,948 | 12,508 |
| Intangible Assets | 0 | 0 | 8,702 | 10,702 | 10,302 |
| Tangible Assets | 524 | 445 | 484 | 444 | 404 |
| 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 | 4,737 | 7,868 |
| Stocks | 0 | 0 | 0 | 0 | 0 |
| Debtors | 3,092 | 2,807 | 3,979 | 4,599 | 5,099 |
| Cash | 1,326 | 566 | 3,565 | 138 | 2,768 |
| Other | 0 | 0 | 0 | 0 | 0 |
| Current Liabilities | (4,453) | (3,240) | (9,228) | (6,206) | (6,525) |
| Creditors | (4,453) | (2,669) | (8,097) | (5,007) | (5,294) |
| Other creditors | 0 | (571) | (1,131) | (1,198) | (1,231) |
| 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 | 10,041 | 12,411 |
| | | | | | |
| CASH FLOW | | | | | |
| Operating Cash Flow | (1,842) | 283 | 4,675 | 4,330 | 5,326 |
| Net Interest | 61 | 110 | 125 | (100) | (100) |
| Tax | (42) | (1,007) | (2,063) | (1,946) | (2,112) |
| 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) | (1,211) | (1,384) |
| Other | 2,389 | 1,421 | 3,809 | 1,000 | 1,000 |
| Net Cash Flow | 501 | (760) | 2,999 | (3,427) | 2,630 |
| Opening net debt/(cash) | (825) | (1,326) | (566) | (3,565) | (138) |
| HP finance leases initiated | 0 | 0 | 0 | 0 | 0 |
| Other | 0 | 0 | 0 | 0 | 0 |
| Closing net debt/(cash) | (1,326) | (566) | (3,565) | (138) | (2,768) |

Source: Company accounts/Edison Investment Research



Edison Investment Research

Lincoln House, 296-302 High Holborn, London, WC1V 7JH ■ tel: +44 (0)20 3077 5700 ■ fax: +44 (0)20 3077 5750 ■ www.edisoninvestmentresearch.co.uk
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