

ClearDebt

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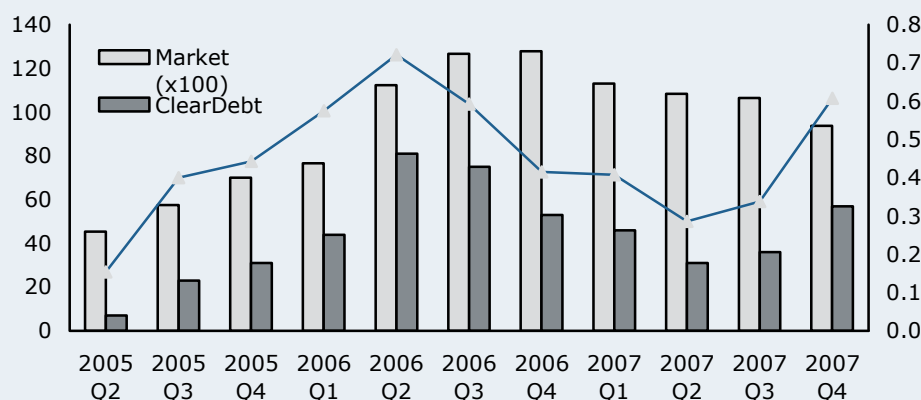
CLEA.L

Date:	31.03.08
Share price p	0.875
52 week High/Low p	2.125/0.875
Issued share cap	304.6m
Market cap £m	2.7
NAV p	1.3

Company Description: ClearDebt offers debt resolution services, primarily IVAs and DMPs, using a state-of-the-art web-based system for initial contact and individual supervision of all the later stages in the process, resulting in a higher success rate and lower overall costs than its competitors.

ClearDebt has started to recover from the impact of the "Creditors' strike" that led to a fall in IVAs approved when demand was rising sharply in early 2007. The number of ClearDebt IVAs is back onto a rising trend although the IVA market continued to shrink throughout 2007.

Figure 1: IVA market and ClearDebt / ClearDebt market share %



Company, ED

We can be very confident that Q1 of 2008 will show further improvement: ClearDebt had 17 IVAs passed in January and 30 in February, more in two months than in the first three months of 2007.

The "creditors' strike" was ended by an agreement brokered by the Insolvency Service and the British Bankers' Association that was finalised in February 2008. As with all strikes, both sides incurred painful losses: it increased the creditors' losses on the rejected cases by more than one-third and pushed most of the IVA producers, including ClearDebt, into loss. The impact was exacerbated by a sharp rise in advertising costs per case as DFD, the market leader, and several new entrants engaged in an expensive war for market share. The joint effect was to put several IVA producers out of business, including Debtmatters whom the creditors should have preferred and supported because it processed IVAs more cheaply than the other big IVA factories (although not as cheaply as ClearDebt) and so reduced their losses.

We expect that the number of IVAs will now resume its former growth as creditors accept the better returns that they receive from IVAs than bankruptcy - there is anecdotal evidence that this is the case.

Consequently the interim results shown below are more of a historical record than a guide to the future. Furthermore, they are inevitably distorted by the acquisition in July 2007 of Abacus which currently has more staff and a larger turnover than ClearDebt Ltd; they reflect the direct costs and disruption involved in moving both ClearDebt and Abacus to new premises in Timperley.

ClearDebt is quoted on AIM and investors should be aware that shares traded on AIM are subject to lighter due diligence than shares quoted on the main market and are therefore more likely to carry a higher degree of risk than main market companies.

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I should also point out that ClearDebt continues to account conservatively even after adopting IFRS and does not anticipate future income (unlike a larger rival that interprets IFRS to say it should match a portion of future supervisory fees against marketing and set-up costs). The business written in the period should generate profits in the future.

Table 1: Interim results

Six months to end-December	2006	2007	Change
	£000	£000	%
Turnover	226.78	794.84	250.5%
Cost of sales	(344.18)	(808.22)	134.8%
Gross profit	(117.40)	(13.38)	-88.6%
Other operating expenses	(180.54)	(444.03)	145.9%
Operating profit/(loss)	(297.94)	(457.41)	53.5%
Net interest received/(paid)	8.91	(37.77)	-524.0%
Loss before tax	(289.03)	(495.18)	71.3%
Headline loss per share (p)	(0.11)	(0.16)	46.1%

Company Data

After these caveats, they remain mildly disappointing. We, and many others, had expected the protocol between creditors and the IVA Factories to have been agreed and come into force during 2007 so the number of IVAs passed and hence ClearDebt Ltd's income was less than expected. Abacus had been expected to be immediately profitable but the disruption had a greater than expected impact on turnover so gross profit failed to cover overheads and it lost £0.1m pre-tax, although it was cashflow positive.

The obstruction of IVA proposals by a minority of creditors in 2007 resulted in a drop in revenue and an almost equal rise in loss for ClearDebt Ltd; this was most marked in the second and third calendar quarters. The year-on-year growth in the October-December quarter achieved despite this would have been far greater if those creditors had behaved rationally.

The swing from net interest received to net paid is due to the group borrowing £1.6m to cover the purchase of Abacus (including associated costs), of which £0.4m had been repaid by end-December.

Trading has improved in the new calendar year/second half in both divisions: Abacus is not yet back in line with projections but is rapidly approaching them and has moved back into profit. ClearDebt has a pipeline of 70+ IVAs being processed which suggests the number completed in the second quarter of 2008 will be more than twice in Q2 2007 although still less than half the level anticipated in the original business plan. We expect the group to be operating at a profit by its June year-end although it will still report a loss for 2007-8 as a whole.

There are several reasons to be more optimistic about prospects: some arise from improvements in the market environment and some from management action.

The headlines may over-dramatise the drying-up of credit but the fact remains that many more borrowers will be forced more quickly to face reality in the form of debt resolution. The regrettable demise of Debtmatters has increased the share of the market in which only ClearDebt and MDC can reasonably compete (and MDC recognises that ClearDebt is the only one that can handle the smallest cases); and, of course, the change in creditor behaviour will reduce wastage.

It appears that the new management at Northern Rock are taking a more pragmatic attitude, seeking to minimise actual losses from bad debts in preference to flattering reported profits – this may (at least in part) be due to the esoteric IFRS rules on accounting for bad debts which requires a bank to recognise a loan as impaired and make a provision if interest ceases to accrue under a DMP.

The largest single plus will come from synergies between ClearDebt Ltd and Abacus, both cost-savings and cross-referral of leads to the most appropriate solution. Next, ClearDebt has massively increased the number of IFAs etc who will refer to it clients who are unable to (and/or clearly should not) obtain more credit. 1,100 mortgage brokers and IFAs have been signed up as ClearDebt introducers since June and a recent deal made ClearDebt's partner programme available online to another 24,000.

The failure rate for Abacus clients will be reduced by ClearDebt providing insurance against loss of income due to illness or involuntary redundancy to DMP clients as it already does for IVA clients. In another attempt to help clients ClearDebt is launching a prepaid Debit card under the "ClearCash" name so that they can have the convenience of using a plastic card without breaching the rules on credit.

For both divisions, the growth in the "book" of business will gradually lead to substantially higher profits as marketing costs are entirely, and administrative costs are heavily, front-end loaded; continuing cases generate profits out of which these initial costs can be recouped

I am not making a forecast more precise than "loss for 2007-8 as a whole, profit for 2008-9" at this point because the future behaviour of creditors and of TIX, which claims to represent them, is still a critical unknown. If, however, there should be an outbreak of commonsense, then 2008-9 profits could be, and 2009-10 profits should be, well over £1m, which would make the current price look extraordinarily cheap.

I certify that this report represents my own opinions
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