

ClearDebt Group

20 September 2010

Opportunist deal doubles size of company

ClearDebt offers debt resolution services, principally IVAs and DMPs but also PTDs in Scotland, 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.

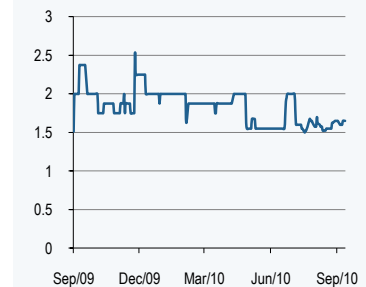
- ClearDebt's results for 2009/10 were more impressive than the IFRS figures that reported only modest pre-tax growth suggest and the market responded with a 3% lift to the share price but, in our view, it still remains seriously undervalued.
- Under IFRS ClearDebt can only report as profit the amount by which it earns more from the Relax assets than Relax would have done – the rest is swallowed in amortising the "Intangible asset" created by the acquisition.
- The two key features of ClearDebt's year were the strong growth in its core IVA business, which has more than doubled its market share in two years, and the acquisition of Relax's back book from the administrator of Relax Group plc, quadrupling its back book of IVAs and nearly doubling the DMP back book.

Company Details

Date:	20.09.10
Share price p	1.65
52 week High/Low p	2.9/1.5
Issued share cap m	308.3
Market cap £m	5.1
NAV p	1.4

Year to end-June	Pre-tax £m	EPS	PER
2007	(0.66)		
2008	(1.22)		
2009	0.46		
2010	0.47		
2011 est	1.9		
		EPS	PER
2007		(0.24)	
2008		(0.23)	n/a
2009		0.13	12.69
2010		0.11	15.00
2011 est		0.44	3.72

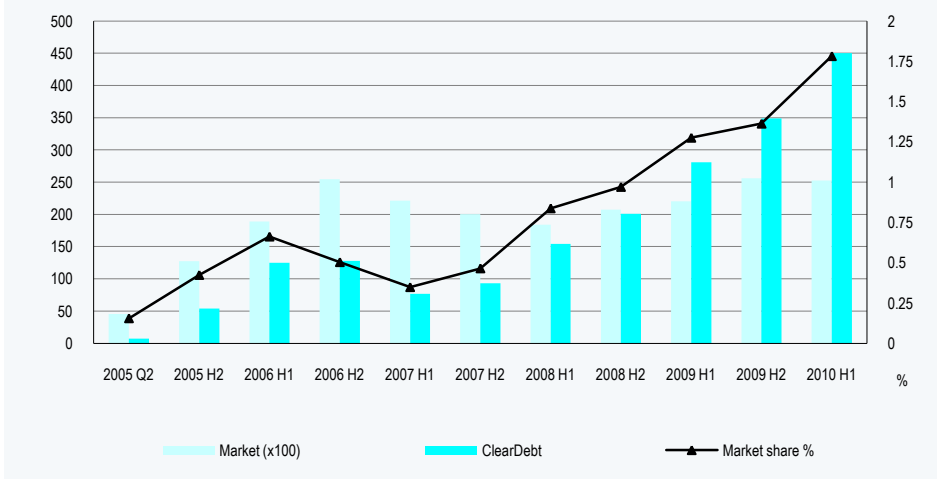
Share Price, p



Source: ADVFN

All our research is available at www.equitydevelopment.co.uk

Growth in new IVAs and ClearDebt's market share



Source: Insolvency Service and Company

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Revenue grew 96% and profit before abnormal items more than doubled from £0.38m to £0.78m, with most of that growth coming from the existing business.

The reported pre-tax figure of £0.47m (vs £0.46m) was disappointingly £0.23m below my forecast of £0.7m because the costs relating to the strategically important acquisition of Relax and post-acquisition restructuring costs were £0.53m, £0.23m higher than the £0.3m I had expected.

Under IFRS costs relating to acquisitions are charged against current year profits whereas under UK GAAP they would have been capitalised.

The IVA business actually did better than I had expected fully offsetting a slightly weaker than expected performance from the DMP side.

The new year has started well so I am marginally increasing my forecast for 2010-11 to £1.9m pre-tax, leading to eps of 0.44p: even after the shares have been marked up to 1.65p in response to the news, this puts the shares on a PFER of 3.7x, an extreme undervaluation.

Preliminary results for the year to end-June 2010			
Year to end-June	2009	2010	Change
	£000	£000	%
Insolvency revenue	941	3,408	262.0%
Debt Management revenue	2,445	3,226	31.9%
Total revenue	3,387	6,634	95.9%
Cost of sales	(1,951)	(3,333)	70.9%
Gross profit (pre-exceptionals)	1,436	3,301	129.8%
Operating expenses	(938)	(2,390)	154.9%
Operating profit/(loss)	499	910	82.6%
Net interest received/(paid)	(115)	(127)	10.5%
Profit before abnormal items	383	783	104.3%
Abnormal items	78	(317)	-509.6%
IFRS Profit/(loss) before tax	461	466	1.0%
Tax	(54)	(123)	129.2%
IFRS Profit/(loss) after tax	407	342	-15.9%
Earnings/(loss) per share (p)	0.13	0.11	-16.5%
No of IVAs passed	483	799	65.4%

Source: Company

Second half revenue was nearly double that in the first half thanks to the acquisition of the Relax assets which contributed £2.3m, a majority of H2 revenues, against less than £0.3m in the first half. ClearDebt Ltd continued its strong growth with revenue 24% higher than in the first half and more than double that in the second half of 2008-9; Abacus revenue dipped as fewer new clients chose/were recommended to take out DMPs but its back book continued to grow so profits improved.

The rise in the cost of sales is partly due to an increase in advertising spend that has contributed to the 65% growth in new IVAs but mostly due to the Relax acquisition which has more than doubled the size of the workforce.

The largest item in operating expenses is the £0.94m amortisation of the £2.7m value placed on the Relax assets in line with their anticipated useful life. The Relax deal involved adding a second office, from which they have moved to a smaller one, also in Staveley; the balance of the increase is made up of a variety of smaller items.

The cash flow from the Relax assets has been better than anticipated and they reported a profit from them of £0.12m after amortisation but before "Gain on acquisition": at this rate ClearDebt should have recouped all the costs associated by the end of 2010/11. Profit before abnormal items rose 104%; over two-thirds of the improvement from the pre-existing group and 30% from the acquisition.

The abnormal items comprise the costs (including legal costs) associated with the acquisition of the Relax assets, the "Gain on acquisition" which is the difference between the valuation placed on the assets and the purchase price (excluding costs), restructuring costs (including redundancies, relocating the newly-acquired staff in Staveley to a more suitable smaller office and transferring all the client records onto ClearDebt's systems) and interest on a bridging loan from the time of the acquisition in December 2009 to the fund-raising in March 2010. That in 2008-9 comprised the recovery of legal costs incurred in 2007-8.

Consequently pre-tax profit reported under IFRS pre-tax rose a mere 1% and after a higher (26.5%) tax charge, reported earnings declined 16%, in sharp contrast to the 193% rise in operating cash flow.

Current Trading and Prospects

The new year has started well with further strong growth in new IVAs passed – 216 in the two summer months, which are usually quiet periods. This is a rise on 74% on the comparative period and any extrapolation would imply further growth of more than 50% for the year as a whole. The flow of new DMPs has slowed but good retention rates should mean that the back book, will continue to grow: this, combined with the inclusion of the Relax DMPs for a full year will lead to useful growth in profits from this division. Interest costs will be higher reflecting the debt taken on to finance the acquisition and naturally the costs of the Staveley staff and office will also be included for a full year.

I have marginally increased my forecast for 2010/11 since the faster growth in IVAs is more significant than the switch from modest growth to modest decline in Abacus' new business to £1.9m pre-tax, leading after a normal 28% tax charge to eps of 0.44p (we don't expect the group to actually pay that much tax as it has accumulated losses to shelter much of its profits). At the current price of 1.65p, the shares are on a PFER of 3.72x

The group has now clearly established itself as a profitable growing business and is the only quoted competitor to the larger and longer-established Fairpoint, the market leader in personal insolvency solutions. We think that Fairpoint is undervalued as some investors take a jaundiced view after it briefly fell into loss under the previous management, so its PFER of c.6x is an unflattering basis for comparison. **However, even against this yardstick ClearDebt looks undervalued on a PFER of less than 4x and we think the share should be at least 2.5p; in the medium to long-term, it should more than double.**

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