

27 May 2011

ClearDebt Group plc

An uninformed reaction

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.

The market has clearly over-reacted to Fairpoint's trading statement on Monday, 23rd May. They issued a profits warning because the Coalition's "austerity" policies are resulting in fewer people declaring themselves insolvent than under the previous government and said that they expected profits to be "substantially lower" than previously forecast, but anticipated a significant recovery in 2012, with a doubling of its non-IVA revenues on top of a recovery in the IVA market.

- Fairpoint's share price subsequently fell by one-third and, as a side-effect, ClearDebt's share price fell by one-eighth before recovering a few percent, although the latter has not needed to issue a profits warning.
- Fairpoint mentioned two problems affecting it: the decline in the number of IVAs (when they had expected a small increase) and the smaller size of IVAs approved, and the income from them, relative to their business plan. It is probable that Fairpoint is also suffering from a downturn in the market for Debt Management Plans as DMPs are driven by the same economic sources as IVAs: other commentators also appear to think so, since the downgrade to forecasts exceed that attributable to the decline in IVAs.
- We think that Fairpoint's share price fall is over-done and, even if it was not, we should still consider that ClearDebt's decline is excessive and verges on the irrational.

For the sector as a whole the problems described by Fairpoint are 'temporary' and are expected to fade away towards the end of 2011 as cuts in public spending start to bite on unemployment levels and rises in interest rates make it harder/impossible for over-indebted consumers to keep up interest payments on their debt.

Company Details

EPIC	CLEA
Share price p	2.1
52 week High/Low p	3.4 / 1.5
Issued share cap m	308.3
Market cap £m	6.32

Share Price, p



Source: ADVFN

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

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ClearDebt market share in IVAs

	Total IVAs	ClearDebt IVAs	Share
2009 Q4	13219	173	1.31%
2010 Q1	11782	184	1.56%
2010 Q2	13466	266	1.98%
2010 Q3	12960	354	2.73%
2010 Q4	12508	407	3.25%

Company

Other factors that we think investors should note are that:

- ClearDebt is increasing volume and, as per the preceding table, gaining market share (it had more IVAs passed in the first seven months of 2010/11 than in any previous full year)
- We do not yet know how many ClearDebt IVAs were approved in the first quarter of 2011, but the January number (all January numbers are seasonally depressed as fewer are submitted over Christmas) was 77, a 285% increase on January 2010...
- ClearDebt already had a lower rating on a PFER basis than Fairpoint prior to the announcement and its share price had already fallen by one-third from its 2011 peak in the last three months
- Also, the decline in the number of IVAs approved and the lower average fee has a less geared impact on ClearDebt because it has low costs (both fixed and variable): the latest published data shows ClearDebt's EBITDA on IVAs as an attractive 39.6%. This is despite taking a larger proportion of the smaller IVAs that reduce fees and margins, although their conservative accounting policies reduce the difference reported at the pre-tax level.

Earlier this month ClearDebt was rated at 6.7x its broker's forecast of 2011 eps but now it is only 4x. Despite its impending year end, *it has seen no need to issue a warning in respect of those market expectations.*

Our opinion is that a slowdown in the market will merely slow ClearDebt's growth rather than cause an actual fall in its profits; also ClearDebt's reported profits will rise as the amortisation charge on the assets acquired from the administrator of "Relax" runs out. Even if earnings per share were to be 10% below the house broker's forecast, the current share price would be trading on less than five times eps for 2010-11.

Conclusion

Fairpoint has warned of a *temporary one-off drop in earnings per share of, say, 3p (probably less) and its share price has declined by 31p, which I can safely say is excessive; ClearDebt has issued no warning, but its share price fell by one-eighth, which I think is irrational.*

We think that ClearDebt's current share price should be at least 3.6p, and preferably 4.5p, which is double the current price.

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