

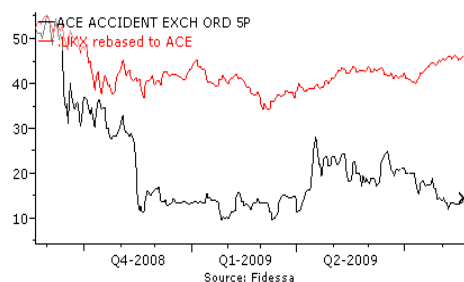
Accident Exchange

Targeting cashflows, not growth

15p

27 August 2009

Share Price: 15p



12m High: 55p

12m Low: 10p

Market Cap: £20.6m fully diluted

Shares in Issue: 71.1m undiluted, 137.4m fully diluted

NAV/Share: 40p/share (April 2009)

Gearing: 531% on undiluted capital (April 2009)

Interest Cover: 1.8X (Full Year to April 2009)

EPIC Code: ACE

Sector: General Financial

Market: London Full List

Broker: Singers Capital Markets

PR: Bankside Consultants

Website: www.accidentexchange.com

Description: Provides replacement vehicles to drivers in motor accidents and reclaims the costs from the at fault party.

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2009 was a challenging year for Accident Exchange but the company has downsized and against a more benign trading backdrop (hire days were stable in Q1, the accident rate and utilisation rates were both up) is now firmly focused on converting its substantial debtor book into cash. Key points are:

- The FY09 results showed a declared loss of £55m after £68.8m of exceptional debtor impairment, fleet impairment, commission and restructuring charges. Excluding the exceptional items, pre-tax profit was down 4%, a much better result than we were expecting.
- Of the total £44.2m debtor book write-down, £16.3m was conceded in Q4. The balance is a provision for future lower settlements on outstanding debtors at end April 2009. Importantly, this exceptional debtor write-off has not set a precedent for the recovery rate on future sales.
- Overall trade and other receivables – before the exceptional debtor book write-down - were up £14m to £124.6m while debtor days were higher, at 269 days vs. 227 at end April 2008.
- Year end net debt was virtually unchanged at £149.8m. Banking headroom has decreased, however, from £37m at end April 2008, to £17.2m at the year-end and c. £10m at end July 2009.

Looking ahead, the strategy over the next two years is to chase cash, not growth. To this end, the cost base has been cut by £6m, the fleet size has reduced by 18% and forward commitments to purchase new vehicles have been reduced by £40m saving £10m in future depreciation, maintenance and interest charges. In addition, low margin credit repair activity is to be curtailed, reducing revenues by c.20% (in our best estimate) but improving working capital by c. £10-12m. The impacts of these initiatives are reflected in our forecasts below.

In-house processes are now geared to speeding up the rate of cash collections and the litigation process is gaining traction both in terms of the number of claims with solicitors (currently a record £94m) and the higher values being achieved once these claims get to Court. Together with a fall in the daily cash break-even rate from £600k in FY09 to £550k in H1'10 and £450k in H2'10, we estimate Accident Exchange will be operating at cash-flow break-even towards the end of the current second half.

Y/E	Group Sales	Declared Profit/(Loss)	Adjusted Profit	Adjusted Diluted EPS	P/E ratio	Divi	Yield
April	£m	£m	£m	p.		p.	%
2008A	161.9	9.9	13.9	12.1	1.2	2.5	16
2009A	132.0	(55.4)	13.3	9.6	1.6	0	-
2010E	120.1	6.9	8.3	7.3	2.1	0	-
2011E	120.5	8.2	8.3	7.3	2.1	0	-

*2009A sales have been adjusted for the debtor impairment write-down.

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The Full Year Results

The £55m declared loss for the year to end April 2009 was heavily dominated by exceptional items. These included:

- A £44.2m write-down to the debtor book, equivalent to 35% of gross trade receivables. £16.3m of this write-down was conceded in Q4 as insurers held on to their cash in response to their own severe liquidity constraints. The balance is a provision for future lower settlement levels on the outstanding debtor book at end April 2009 so there *may* be some recovery over time. Significantly, our discussions with management indicate that the recovery rate on current sales is more in line with historical settlement discounts (c.10%).
- A £19.6m fleet impairment charge, taken against the H1 results. Encouragingly, the used car market has picked up since December 2008 and recent fleet disposals have taken place at better than expected rates.
- £4m in one-off commission charges. These reflect the amounts paid to the group's main garage chain referrers to exit forward vehicle purchase commitments totalling £40m thus saving c. £10m in future fleet, depreciation and maintenance charges. Our forecasts look for a 1-2% increase in commission rates going forward but unlike previously, Accident Exchange will have the option to offset future purchasing, swapping fixed costs for variable costs. This is a major improvement in the business model, in our view.
- £0.8m in other restructuring costs, primarily headcount, salary and pension cuts.

Last year was a challenging year but Accident Exchange has downsized and the business model has improved.

Excluding these exceptional items, the adjusted results were much better than we were expecting. Revenues rose 3% to £167m whilst pre-tax profit was down just 4.3% to £13.3m. The decline in adjusted EPS was significantly greater, at 21%, on account of a full 12 months dilution from the Convertible Loan Notes.

During the period hire starts reduced from 41,000 to 38,500 although overall rental days were unchanged at 1.1m helped by longer rental lengths in H1. A further shift in the revenue mix towards lower margin mainstream vehicles is apparent. Mainstream vehicle hire accounted for 55% of revenues in 2009, up from 45% in the previous year and we expect this trend to continue in FY 2010. Fleet utilisation (excluding the non-rental fleet) was lower, falling from 60.5% to 58.5% but post the year end has moved up to 66.7% following an 18% reduction in the total fleet to 4,865 vehicles.

Cash Flow and Balance Sheet

Cash collections increased by 18% to £157m during the year. Of this total, cash collected through the litigation process was up 125% to £31.8m equivalent to c.20% of the total outstanding debtor book.

Despite the progress made on cash collections, Accident Exchange was forced to concede larger discounts and wait longer for the cheques to arrive, particularly in Q4. Hence the exceptional write-down to the debtor book and the increase in the invoiced trade debtor collection period, which ran at 269 days vs. 227 days at end April 2008.

Net debt including vehicle finance lease obligations at end April 2009 was virtually unchanged at £149.8m, but below the £174m reported at 31 October 2008 as a result of the fleet disposal programme.

Cash in hand was lower, however, at £17.2m vs. £27m at end April 2008, and working capital headroom has also reduced, from £37m at end April 2008 to £17.2m at end April 2009, after full draw down of the £10m revolver. Given that the group continues to be cash flow negative, working capital headroom will have reduced further since the year end, possibly to £10m. Accident Exchange continues to operate within its banking covenants at the present time but there can be little doubt that cash collections must improve if this is to continue to be the case.

Cash collections improved during the year but not by as much as hoped

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Strategy

The FY results release states that the group's "primary objective and biggest challenge continues to be the improvement in cash collections and the achievement of cash flow break even as soon as possible." Several indicators suggest an improving settlement trend is likely in the current year. These include:

- The litigation process is continuing to gain momentum. As at end July 2009, a record £94m of outstanding claims were in the hands of the group's 18-strong solicitor panel. Over half of these (£55.9m) have had proceedings issued i.e. are near to closing. A further 15% have been allocated a hearing date.
- A number of improvements to in-house processes have been implemented to increase the number of claims settling within 90 days at standard discounts (under the GTA). Early results have been 'encouraging'.
- At least four major insurers are known to have outsourced their claims management functions in recent months. In the past, limited back office capability has been a key obstacle to the settlement process. Outsourcing should go some way towards overcoming this problem, and it is worth re-iterating that it continues to be in the interests of *both* parties to settle without resorting to litigation.
- Following the £6m reduction in the cost base, daily cash break-even costs are set to fall from £600k in March to £550k in H1'10, and £450k in H2'10.

In our best estimate, Accident Exchange will be operating at cash flow break-even in H2 of the current financial year, strongly cash generative thereafter.

Near term Outlook

Both the accident rate and hire lengths have stabilised in the current financial year. Also, utilisation rates have picked up following the fleet disposal programme and rental day activity is said to be 'holding up well' on account of the two new account wins secured during the year. No specific details have been released on these wins except to say that both are mainstream accounts and one is with a high volume provider. The high volume account win was secured in late Q4 so did not contribute to the 2009 numbers.

In spite of these positive developments we expect the full year results to April 2010 to show a 28% decline in adjusted revenues to £120m, a 37% decline in adjusted pre-tax profit to £8.34m and a 24% decline in fully diluted adjusted eps to 7.3p (assuming the Morgan Stanley Convertible Loan Notes convert in full). There are three main reasons for the decline in revenue and profits we expect to see this year. Firstly, the size of the revenue generating fleet has reduced. Secondly, the depreciation charge will inevitably increase in FY10 as the 'impaired' fleet is gradually replaced with new fleet. And finally, low margin (c.4%) credit repair activity is to be scaled back and the offering restructured. From now on Accident Exchange will only pay its bodyshop referrers for credit repair work once it has received the cash as opposed to paying upfront and then waiting for the cheques to come in. This decision to scale back credit repair will, in our best estimate, reduce turnover by c. £40m (or 20%). The flipside is that the profit impact is minimal and the move is forecast to improve working capital by c. £10-£12m.

The 2010 prospective PER of 2.1X reflects the challenge of bringing cash collections up to cash break-even and beyond. Until this objective is achieved, the shares are unlikely to enjoy a re-rating.

Several indicators suggest an improving settlement trend is likely in the current year

Daily cash break-even costs are set to fall from £660k in FY09 to £450k in H2'10.

Delivering on cash collection targets will be key if the shares are to enjoy a re-rating.

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Management	Major Shareholders
<p>Chairman: David Galloway</p> <p>Managing Director: Stephen Evans</p> <p>Finance Director: Martin Andrews</p>	<p>Stephen Evans 44.7%</p> <p>Sanlam & Rembrandt 9.4%</p> <p>M S Bramwell 5.6%</p> <p>Lord Young of Grafham 4.4%</p> <p>R H Seel 4.3%</p> <p>Morgan Stanley will potentially become a significant shareholder on conversion of its Loan Stock.</p>
Key Dates	Key Milestones
<p>Annual General Meeting: 17 September 2009</p>	<p>2004: Accident Exchange arrived on AIM via a reverse.</p> <p>2007: Moved from AIM to Full London Stock Exchange Listing.</p> <p>2008: Additional finance raised via a Morgan Stanley Convertible Loan Note.</p> <p>2008: Victory in a series of legal actions that had been holding back payments by some insurance companies and restricting cash flow.</p>

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