

**Begbies Traynor Group plc 85.5p**  
Potential 93% upside

8 February 2010

**Share Price: 85.5p**



**12m High:** 124.5p

**12m Low:** 85.5p

**Market Cap:** £77m

**Shares in Issue:** 89.4m

**Gearing:** 31%

**Interest Cover:** 17.4x (last 12 months)

**EPIC Code:** BEG.L

**Sector:** Support Services

**Market:** London AIM

**Nominated Adviser & Broker:**  
Shore Capital and Corporate

**PR:** Smithfield Group

**Website:** www.begbies-traynorgroup.com

**Description:** An independent corporate insolvency practitioner with national coverage in Great Britain. Also offers corporate finance, tax consultancy and forensic and investigative services.

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Begbies' interim results recorded growth of 21% in revenue, to £34.2m, and of 17% in operating profit, to £4.7m – the latter figure excluding amortisation, restructuring costs, share based payments, and the unwinding of deferred consideration discounts. With a sharply lower net interest charge, underlying pre-tax profit was up 36%, to £4.4m, giving adjusted EPS of 3.36p (+23%). The interim dividend was raised by 9%, to 1.2p.

Looking at the operating divisions, and splitting Corporate Finance out of Insolvency for comparability, we see a strong performance in three out of four areas:

	Revenue		Contribution <sup>1</sup>	
	£m	% change	£m	% change
Insolvency	28.2	+25.1	9.2	+21.2
C Finance	1.3	+170.2	(0.2)	-78.7
Other activities	2.2	+17.6	0.2	+0.0

<sup>1</sup> Contribution measured before allocation of shared service and central costs

It is, though, not surprising that one business unit was adversely impacted by the economic environment. Last year, Corporate Finance suffered from the lack of available bank finance to complete mandates. This year, recessionary pressures reduced activity, and increased fee pressure, in the Taxation division. As a result, divisional revenue fell by 26%, to £2.5m, and it reported an underlying loss, before restructuring costs, of £0.8m (profit £0.5m).

The market, however, was spooked not by the Taxation result but by the statement that full year results were likely to be "slightly below" consensus PBT estimates (of £12m), treating it as a profit warning – we do not believe that it was. The shares fell by a disproportionate 13% on the day, and subsequent weakness has increased the fall to 17%.

The comment was a prudent reaction to recognition that HMRC's "time to pay" initiative has reduced the number of company failures. However, many are expected only to have been delayed, extending the business cycle. Begbies' message was that, with a reversal unlikely this side of an election, flat H2 activity in its core business would make meeting forecasts of 22% PBT growth a challenge.

In response to this guidance, and the interim result from Taxation, we have reduced our FY 2010 and FY 2011 forecasts by c6%, to levels shown in the table below. We have a fair value price of 165p, giving upside of 93%.

Y/E	Group Sales	Declared Profit	Adjusted Profit	Adjusted EPS	P/E ratio	Dividend	Yield
April	£m	£m	£m	p	x	p	%
2008A	48.1	5.7	7.0	6.0	14.3	2.5	2.9
2009A	62.1	7.2	9.8	7.8	11.0	2.8	3.3
2010E	70.1	9.3	10.8	8.1	10.5	3.1	3.6
2011E	78.0	11.9	12.9	9.6	8.9	3.4	4.0

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External economic factors have impacted the interim results for both FY 2010 and FY 2009. Last year, it was the withdrawal of most bank finance availability that produced a hiatus in the activities of the Corporate Finance division. This time, it has been the Taxation division – where most activity is transactional, rather than on retention – that has suffered from the recession.

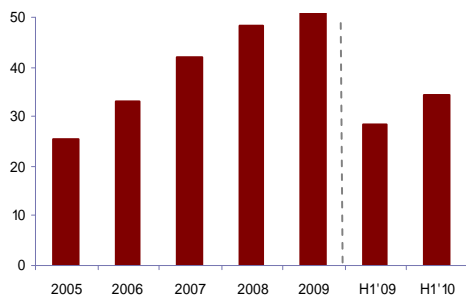
**Pressures on Taxation**

This, though, should not detract from the performance of the core business and its related forensic and intelligence activities, where revenues grew by 25% and contribution by 21%. Corporate Finance also achieved a significant recovery, with a £0.78m reduction in the interim loss being the result of both the restructuring undertaken last year (with further benefit to come in the second half) and a recovery in activity levels that saw revenue rise by 170%.

**Insolvency drives growth, progress elsewhere**

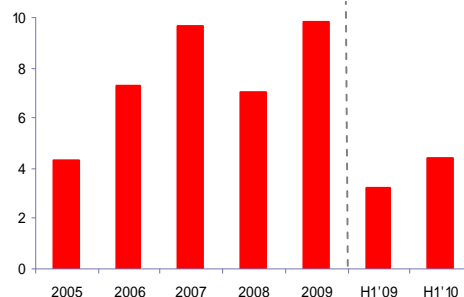
The overall position, showing the growth in revenue and in adjusted PBT – before charging amortisation of intangibles, share based remuneration, restructuring costs or the unwinding of deferred consideration discounting – are shown in the two charts below

**Chart 1: Revenue Profile (£m)**



Source: Hardman & Co

**Chart 2: Adjusted PBT Profile (£m)**



Source: Hardman & Co

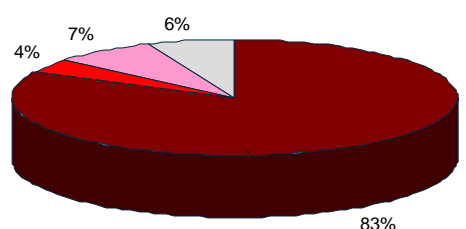
The 36% growth in adjusted PBT, to £4.43m, reflects

- a 15% rise in divisional contribution, to £8.38m;
- a 13% increase in shared service and central costs, to £3.72m – although the underlying increase was <7%, stripping out the impact of costs to establish the BTG Mesirrow joint venture and prepare for the launch of the Red Flag Alert subscription service (neither of which contributed to revenue); and
- a 67% reduction in the net interest charge, to £0.26m, resulting from a combination of falls of 496 percentage points (84%) in the average rate of 3-month LIBOR, and 443pp in Base Rate, partly offset by an estimated £2.65m increase in average net debt between the two periods and by a 125pp hike in the overdraft margin.

**Adjusted PBT benefited from lower interest rates**

**Divisional Performance**

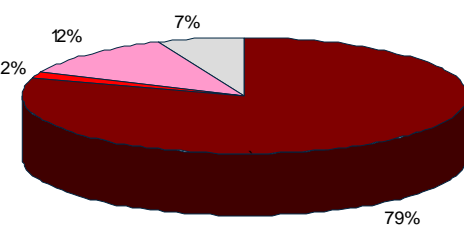
**Chart 3: Revenue Split H1 2010**



■ Insolvency ■ Corporate Finance ■ Taxation ■ Other

Source: Begbies Traynor Group plc

**Chart 4: Revenue Split H1 2009**



■ Insolvency ■ Corporate Finance ■ Taxation ■ Other

Source: Begbies Traynor Group plc

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These two charts illustrate the change in the composition of Group revenue between the two interim periods. In both, we have split out Corporate Finance from the enlarged Insolvency division in order to show both the advance from Insolvency itself, moving up from 79% of the total, to 83%, and the recovery in Corporate Finance, now accounting for 4%, against just 2%. The combined core Insolvency division, therefore, now accounts for 87%, up from 81%. With Other Activities little changed, at 7% (6%), the main casualty is, as expected, Taxation, which falls back to 7%, from 12%.

**Good recovery from Corporate Finance**

Figures for divisional performance are set out in Table 1, below. This shows clearly the progress achieved within both Insolvency and Corporate Finance, and the revenue growth in Other Activities. It also shows the impact on margins of investment for growth within Insolvency and Forensic and Investigations – as well as the significant progress achieved within Corporate Finance.

Within central costs, which include shared service costs, we understand that £0.2m of the increase in H1 '10 related – split equally between the two – to the costs of establishing the BTG Mesriow joint venture and to work to enhance the presentation of the Red Flag Alert database, ahead of the launch of its subscription service. Neither contributed to revenue or profitability during the period. If these costs are excluded, then the underlying increase in central costs was <7%

**Central costs increased by one-off items**

<b>Table 1: Divisional Performance</b>				
<b>(£m)</b>		<b>H1 '10</b>	<b>H1 '09</b>	<b>% change</b>
<b>Insolvency</b>	Revenue	28.22	22.55	+25.1
	Contribution	9.21	7.60	+21.2
	<i>Margin</i>	32.6%	33.7%	-3.1
<b>Corporate Finance</b>	Revenue	1.30	0.48	+170.3
	Contribution	(0.21)	(1.00)	-78.7
	<i>Margin</i>			
<b>Taxation</b>	Revenue	2.52	3.42	-26.4
	Contribution	(0.82)	0.50	
	<i>Margin</i>		14.6%	
<b>Other Activities</b>	Revenue	2.20	1.87	+17.6
	Contribution	0.20	0.20	+0.0
	<i>Margin</i>	9.1%	10.7%	-15.0
<b>Central Costs</b>		(3.72)	(3.30)	+12.8

In the sections below, we examine in greater detail the performance of the individual business units

**Insolvency**

Revenue growth of 25% should be seen against the background of figures from The Insolvency Service for Q2 and Q3, the nearest fit to Begbies' interim period, which show growth of 30% in new corporate insolvency cases – excluding compulsory liquidations, in which Begbies has limited involvement – in Great Britain. The growth figure is slightly lower, at 29%, if personal Protected Trust Deed cases in Scotland, an area of involvement for Begbies, are included. The national figure, though, takes in all instructions, including those large cases that have been to date the exclusive preserve of the Big Four and one or two other international firms.

**Insolvency case load continues to grow ...**

During the period, Begbies Traynor (BT) increased its headcount in this division by 8%, to 490. BT also expanded its presence in Birmingham, moving into larger premises, and established a new office in Cambridge, as well as opening in the Cayman Islands. Investment in the division, including establishing the BTG Mesriow joint venture (see below), was the reason for the 105pp (3%) reduction in the contribution margin.

**... and division expanded**

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The establishment of the BTG Mesiorow joint venture in early October was other significant event in the first half. While this did not introduce business in the period, we understand that it is beginning to bear fruit – in that Mesiorow now finds itself invited to tender for instructions with an international dimension where previously it had been excluded.

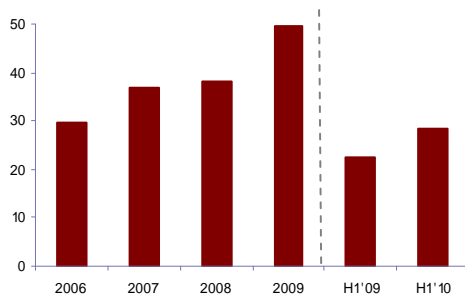
**BTG Mesiorow joint venture established**

The Begbies Global Network – a relationship between a number of overseas insolvency practices – continues to grow in importance to the Group. While it introduced fee income of c£1m in both interim periods, there was underlying growth between the two, given that the H1'09 revenue was weighted toward one large case, whereas H1'10 reflects a growing number of cases.

**Importance of BGN increasing**

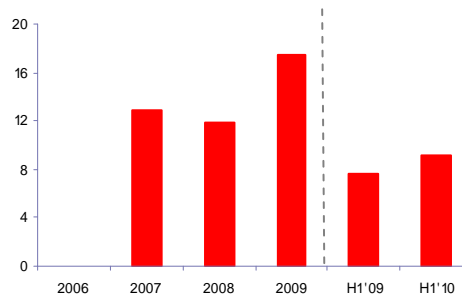
Progress, in terms of both revenue and contribution, is illustrated in Charts 5 and 6, below.

**Chart 5: Insolvency Revenue (£m)**



Source: Hardman & Co

**Chart 6: Insolvency EBITA (£m)**



Source: Hardman & Co

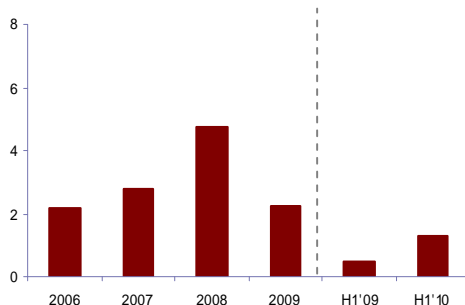
**Corporate Finance**

Now restructured, and integrated within Insolvency, Corporate Finance continued its recovery during the period. Revenues of £1.3m compared with <£0.5m in H1'09 and with £1.8m in H2'09 – although this period included an element of catch up from H1. Between the two interim periods, underlying losses were substantially reduced, to just £0.21m. This was a consequence of both the increased level of activity and the lower cost base, and greater flexibility resulting from the restructuring.

**Corporate Finance recovery on higher activity and lower costs**

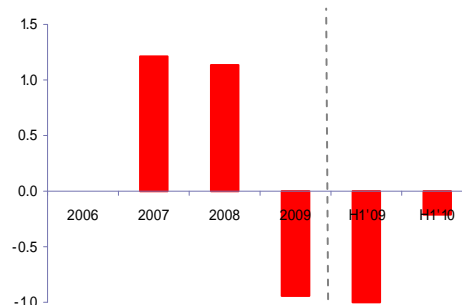
With the restructuring being carried out in H2'09, and integration continuing into H1'10, we expect further benefits to accrue during H2'10. The interim statement gives little information on the operation, with no data on the number of mandates completed, nor on the level of work ongoing into H2'10. What is clear, though, is that the margin improvement in the enlarged Insolvency division results from the reduced loss in Corporate Finance.

**Chart 7: C Finance Revenue (£m)**



Source: Hardman & Co

**Chart 8: C Finance EBITA (£m)**



Source: Hardman & Co

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**Taxation**

The performance of the Taxation division was significantly affected by a worse than expected decline in demand for specialist tax advice in the face of the recession. The impact on Begbies was exacerbated by the fact that much of its fee income relates to transactional advice, with less contribution from retained work, which would have been expected to provide a degree of protection. As firms targeted scarce instructions, so this gave rise to a degree of fee pressure, reducing both revenues and margins.

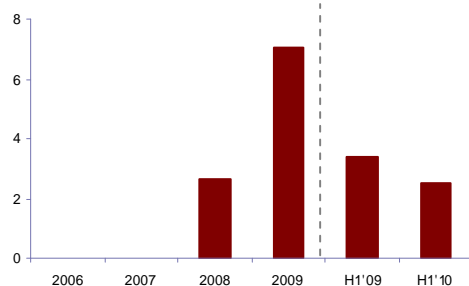
**Taxation suffers temporary reverse...**

Begbies had recruited staff to the division in FY 2009, raising the headcount from 63 to 75. The full cost of this expansion, and the fee pressure resulted in the £0.90m reduction in revenue, to £2.52m, giving rise to a £1.32m deterioration in underlying contribution, to a loss of £0.82m.

The division has now been restructured, at a cost of c£0.1m, which we have excluded from our analysis – although the Group does not identify it as exceptional. Ten staff left the business; five, with the skills appropriate to the new environment, have joined the division, taking the headcount to 70. This investment includes the opening of a tax office in Northern Ireland. This is the Group's first presence in the country, and one that has the potential to be converted into a full service presence adding an offering of insolvency, restructuring, forensic and intelligence services.

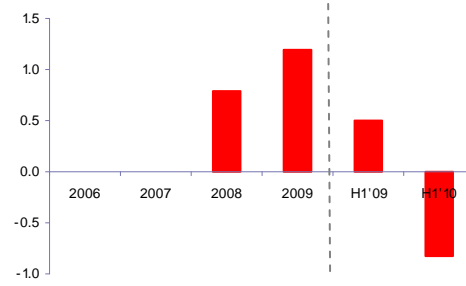
**... and has been restructured**

**Chart 9: Taxation Revenue (£m)**



Source: Hardman & Co

**Chart 10: Taxation EBITA (£m)**



Source: Hardman & Co

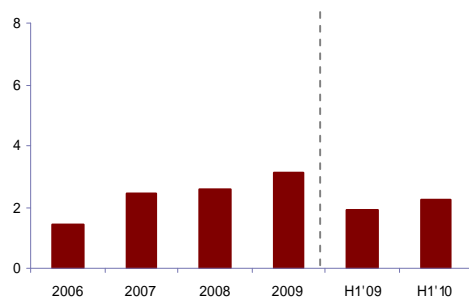
**Other Activities**

These, principally the Group's forensic accounting, financial investigation and corporate intelligence offering, delivered 18% growth in revenue, to £2.20m, but a broadly unchanged contribution, at £0.2m – largely due to investment that raised the headcount from 37 to 40.

**Strong revenue growth in Other Activities**

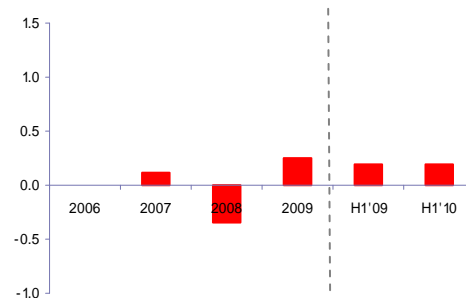
While only a small contributor to the Group result, the importance of the division is primarily the support that it gives to the core insolvency activity and the opportunities that it brings for cross referral to grow both businesses.

**Chart 11: Other Activities Revenue (£m)**



Source: Hardman & Co

**Chart 12: Other Activities EBITA (£m)**



Source: Hardman & Co

**Group Result**

Table 2 pulls together the divisional result into the revenue and EBITA lines, with EBITA representing the divisional result and the charge for shared services and central costs. As well as adding the gross profit line it then takes the underlying results down to attributable profit and earnings per share.

**Table 2: Underlying Profit & Loss Account**

(£m)	H1'10	H1'09	% change
Revenues	34.24	28.33	+20.9
Gross Profit	16.30	14.23	+14.5
<i>Gross Profit Margin</i>	47.6%	50.3%	-5.3
EBITA	4.69	4.02	+16.6
<i>EBITA Margin</i>	13.7%	14.2%	-3.5
Net interest	(0.26)	(0.77)	-66.7
<i>Interest cover</i>	18.3x	5.2x	+250
Pre-tax Profit	4.43	3.25	+36.3
Attributable Profit	3.00	2.27	+32.3
EPS	3.36p	2.73p	+23.1

Figures stated before amortisation, share based remuneration restructuring, unwinding of deferred consideration discounting and discontinued business

**Margins**

Investment in expansion saw margins in Insolvency and Other Activities reduced, and Taxation fell sharply into loss. Corporate Finance, though, delivered strong loss reduction in losses. As shown in Table 2, the overall impact on the Group was a contraction of the gross margin by 5.3%. At the EBITA level, this was narrowed to just 3.5%. Recent movements in margins are illustrated in Chart 13.

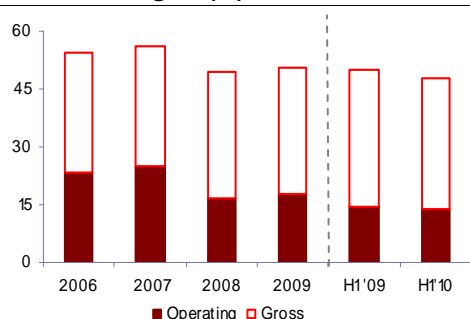
Margins under pressure ...

**Net interest**

The sharp reduction in the net interest charge is primarily the result of the falls seen in both bank Base Rate and 3-month Sterling Libor over the period. Base Rate was at 0.5% throughout H1'10; in H1'09 it average 4.9%. The average rate for Libor was 0.9% in H1'10, down substantially from the 5.9% for the comparable period. Monthly averages are shown in Chart 14.

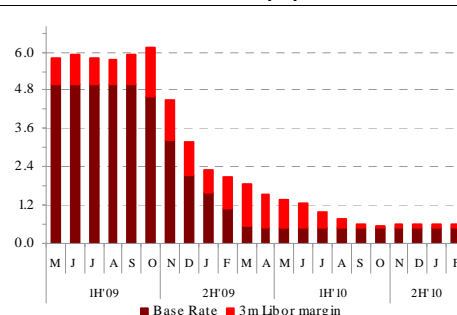
... but interest charge benefits from lower rates

**Chart 13: Margins (%)**



Source: Hardman & Co

**Chart 14: Interest rates (%)**



Source: Hardman & Co

The rate charged on Begbies' £5m overdraft facility is tied to Base Rate, with the benefit of lower rates partly offset by an increase in the margin charged from 1.5% to 2.75%. However, the net benefit was still 318 percentage points.

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The Group's £20m revolving credit facility is tied to Libor; here the margin was 1.4% in both periods, so that Begbies had the full benefit of the 495 percentage point reduction in the average rate. There was, though a further offset from an increase in average net debt, which we calculate at £2.65m (16%).

**Earnings and Dividend**

After allowing for tax credits on exceptionals, we calculate the H1'10 underlying tax charge at 32.3%, against 30.2% in H1'09, but similar to the 32.1% for FY 2009. When taken together with a 7.5% increase in WASC, a 36% rise in underlying PBT translates into a 23% increase in underlying EPS, to 3.36p.

The Board have proposed a 9% increase in the interim dividend, to 1.2p.

**Dividend increased 9%**

**Exceptional items**

In line with the Company's presentation of its results, we exclude from the underlying performance the charge for amortisation of intangibles (£0.52m) and the element of the net finance charge that relates to the discounting of deferred consideration (£0.2m). In addition, we have excluded share based payment expense (£0.03m) and the restructuring cost within the Taxation division (£0.1m).

This reconciles back to reported PBT of £3.58m and, together with the tax impact (credit £0.18m), to reported EPS of 2.61p.

**Cash Flow**

The Group's net cash outflow, excluding share issue proceeds, fell sharply, primarily as a result of the increase in operating cash flow – which benefited from improved profitability, lower interest payments and a net tax receipt – and a reduced working capital absorption. Of this, over 50% came from the absence of the £1.5m one-off impact in the comparative period of a change in the VAT regime for the Group.

**Underlying cash outflow reduced**

The major element in the working capital absorption in the current period was a £3.55m increase in w-i-p and fee debtors. We calculate that almost 70% of this resulted from the increase in the lock in period from 6.6 months to 7.1 months, with the balance being driven by organic growth. Elsewhere, there was an absorption from both an increase in sundry debtors and a reduction in creditors.

**... despite lock-in extension**

The Group's overall position, therefore, was an increase in net debt of £2.92m – reflected in an increase of £0.75m in cash balances and a net drawdown of £3.67m on its finance facilities.

**Table 3: Interim Cash Flow Statement**

(£m)	H1 '10	H1 '09	% Change
Operating Cash Flow	5.38	3.10	+73.6
Working Cap Change	(4.24)	(7.03)	-39.6
Net Capital Expenditure	(1.38)	(1.27)	+7.9
Dividends	(1.52)	(1.22)	+24.7
<b>Net cash outflow</b>	<b>(1.76)</b>	<b>(6.42)</b>	<b>-72.6</b>
Acquisitions	(1.21)	(3.14)	-61.4
Share Issues	0.06	12.57	-99.5
<b>Change in Net Debt</b>	<b>(2.92)</b>	<b>3.01</b>	

The impact of these cash flow items can be seen clearly in the interim Balance Sheet.

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**Balance Sheet**

Begbies reported a £1.09m increase in shareholders' funds over H1'10, to £64.8m. The key figure within this is the £3.55m increase in fee debtors and w-i-p, to £42m, referred to above. The overall increase in working capital (from which we exclude deferred consideration – treating it as part of net debt) was £3.36m.

There was an offsetting £1.50m increase in adjusted net debt, to £25.41m, including deferred consideration – at which level adjusted net gearing is 39.2% (year-end 37.5%). Adjusted net debt comprises:

- drawn down bank facilities, net of £1m of cash balances, of £16m (year-end £13m), leaving Begbies with headroom of £9m (36%) on its £25m RBS facility;
- asset related finance of £4.4m (£4.5m); and
- deferred consideration of £5.01m (£6.42m), of which up to £2m is payable in H2'10.

**Net gearing up, but plenty of headroom**

Taken together, net bank debt and asset finance total £20.4m and represent basic net gearing of 31.5% (27.5%).

**Table 4: Balance Sheet**

(£m)	Oct '09	Apr '09	% Change
Fee Debtors & w-i-p	42.00	38.45	+9.2
Other Net Current Liabilities	(8.22)	(8.03)	+2.4
Goodwill & Intangibles	53.26	53.72	-0.9
Tangible Fixed Assets	7.15	7.01	+1.9
<b>Net Capital Employed</b>	<b>94.18</b>	<b>91.15</b>	<b>+3.3</b>
Net borrowings	(20.40)	(17.49)	+16.7
Deferred Consideration	(5.01)	(6.42)	-22.0
Deferred Tax	(3.96)	(3.52)	+12.6
<b>Shareholders' Funds</b>	<b>64.81</b>	<b>63.72</b>	<b>+1.7</b>
NAV per share	72.48p	71.46p	+1.4
Adjusted Net gearing	39.2%	37.5%	+4.5

We believe that this balance sheet position – and with bank facilities with 15 months to run, apart from the routine renewal of the overdraft facility this April (where we expect the only issue to be the potential for a further increase in margin) puts Begbies in a very strong position to grow the business.

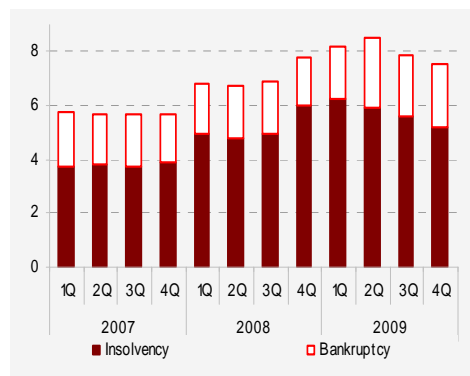
## Prospects and Forecasts

With core insolvency activity contributing >82% of Group revenue, prospects for this sector are key to its performance. Recent data is shown in Charts 15 and 16.

Q4'09 insolvency statistics have just been released. They show that corporate insolvencies were, again, down q-o-q (-4%) – but were also, for the first time, down y-o-y (-7%). This is a departure from behaviour seen in previous recessions. The difference appears to be that temporary support measures, principally HMRC's "time to pay" initiative and a more lenient approach by creditors, have helped companies, a significant proportion of which would otherwise have been declared insolvent. Total corporate insolvencies in 2009 were 26,200, which represents an increase of 20% over 2008. We understand that this figure was broadly in line with industry expectations.

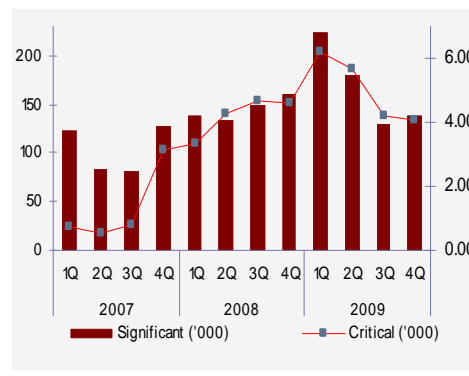
Easing of insolvency pressures ...

Chart 15: Insolvency Data



Source: The Insolvency Service

Chart 16: Red Flag Alert Statistics



Source: Begbies Traynor

The question for prospects in the sector, though, is the extent to which this is a structural change or simply a deferral of failure. If it is largely the latter, which we suspect, then the effect will be to prolong the insolvency cycle to peak later in the 1-2 years after the economy comes out of recession. Insolvencies over the past 12 months still represent 0.9% of the active company register; based on past cycles, we would expect the peak to be at least 1%, indicating a way to go yet. However, for now, a flatter insolvency trend is indicated, slowing growth in this sector of Begbies' business.

... but is it only temporary?

The latest central forecast from the insolvency body R3 is that cases will peak at 28,000 (+23%) in 2010, but then decline only marginally to 27,000 (-<4%) in 2011. We believe that these projections could be revised upwards if creditors become more aggressive as asset realisation prospects improve or if HMRC comes under pressure to improve the rate of tax collection.

## Profit Forecasts

So far as our forecast for FY 2010 is concerned, we have reduced our expectations for underlying PBT by c6%. The detailed adjustments we have made are discussed below.

Forecasts adjusted and rebalanced

- We had already taken a cautious view of insolvency prospects. As a result, with guidance for a flat performance in H2'10, we have been able to raise our revenue forecast. Even with a margin reduction, contribution is still expected to be within 5% of our earlier estimate.
- Both Corporate Finance and Other Activities have performed ahead of our expectations. With guidance for increased activity in H2'10, we have raised forecasts for revenue and contribution from both divisions.
- Tax has, of course, been downgraded – although we have taken note of guidance of a second half weighting in activity and a return to profitability in the period, but not for the year as a whole.

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- Guidance is for shared service and central costs to be flat in H2. This allows us to reduce our estimate by 7% to recognise the tight control achieved.
- Finally, expected net debt levels, and a likely further 30+pp reduction in Libor between H1 and H2 has enabled us to cut our forecast for the net interest charge by almost 40%.

We have made a similar c6% overall reduction in our PBT forecast for FY 2011. This may be over-cautious, given the potential we see for economic recovery to stall, giving added impetus to prospects for a rise in the level of insolvencies. The details of our changes are shown below.

... for both years

- In Insolvency, we have, again, raised revenue expectations but trimmed margins. This leaves forecast contribution only <4% below our earlier estimate.
- We have, again, raised forecasts for revenue and contribution from both Corporate Finance and Other Activities to reflect the progress achieved.
- The cut in expectations for Taxation in FY 2010 feeds through to reduced forecasts for FY 2011, but we are anticipating y-o-y revenue growth, and a return to profitability.
- Similarly, our FY 2010 reduction in central costs in FY 2010 feeds through to a 6% fall in expectations for FY 2011.
- The net interest charge is the one area which we have left broadly unchanged, so that it reflects a y-o-y increase. There are several elements to this:
  - While bank debt is expected to be broadly unchanged y-o-y, we calculate that this represents a c6% increase in the average figure.
  - Base rate is expected to increase over the next year, and Libor will follow.
  - With past experience on the overdraft margin, we believe that it is prudent to allow for a further increase in margin on the bank facility.

Cautious approach to interest rates

Our revised figures, in which we apply a 33% tax charge in both years, similar to H1'10, are shown in Table 5, below, and in the table on page 14.

Table 5: Profit Forecasts					
(£m)		FY 2010	% change	FY 2011	% change
Insolvency	Revenue	56.90	+14.5	63.70	+12.0
	Contribution	18.47	+5.7	20.70	+12.1
	Margin	32.5%	-7.6	32.5%	+0.1
Corporate Finance	Revenue	3.30	+45.5	3.50	+6.1
	Contribution	0.00		0.10	
	Margin			2.8%	
Taxation	Revenue	5.40	-23.2	5.90	+9.3
	Contribution	(0.10)		0.50	
	Margin			8.5%	
Other Activities	Revenue	4.50	+43.7	4.90	+8.9
	Contribution	0.50	+103.3	0.60	+20.0
	Margin	11.1%	+41.5	12.2%	+10.2
Central Costs		(7.44)	+6.8	(8.07)	+8.5
Revenue		70.10	+12.8	78.0	+11.3
<b>Adjusted EBITA</b>		<b>11.43</b>	<b>+2.7</b>	<b>13.83</b>	<b>+21.0</b>
Net interest		(0.59)	-50.2	(0.96)	+62.7
<b>Adjusted Pre-tax profit</b>		<b>10.84</b>	<b>+10.1</b>	<b>12.87</b>	<b>+18.7</b>
Adjusted EPS		8.12p	+4.5	9.64p	+18.6
Dividend		3.1p	+10.7	3.4p	+9.7

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**Dividend**

Given an interim dividend in line with our expectations, we are leaving unchanged our full year forecasts, at 3.1p for FY 2010 and 3.4p for FY 2011. Dividend cover would be 2.6x and 2.8x, respectively – so consistent with the 2.8x in FY 2009.

**Cash Flow and Balance Sheet**

We expect there to be a small net cash outflow in H2'10. Adjusted EBITDA is forecast to be some £1.6m higher, given the anticipated improvement in Corporate Finance, Taxation and Other Activities. This will be offset by tax payments of c£1.5m. However, the major impact comes from a significant reduction in working capital absorption, to £1.5m, as a result of the relatively flat performance expected from Insolvency and the stabilisation of the length of lock-in. After similar levels of capital expenditure to H1'10, the reduced cost of the interim dividend relative to the FY 2009 final in H1, and an increase in deferred consideration payments to c£2m, we are forecasting a net outflow of about £0.73m.

**Substantially improved cash flow in H2'10 ...**

We anticipate that this will leave the FY 2010 year-end balance sheet with net capital employed of £95.8m (interim £94.2m), with net finance debt of £21.1m (£20.4m) and with deferred consideration liabilities of £3m (£5m) – giving shareholders' funds of £67.0m (£64.8m). Assuming asset related finance of c£4m, net bank debt would be £17.1m (£16m). At this level, headroom within the RBS facility would still be £7.9m (or 32%), and basic gearing would be 31.5%, virtually unchanged from the H1'10 level.

**... should reduce gearing**

For FY 2011, adjusted EBITDA is forecast to grow, and an increase in interest and tax payments will be largely offset by a reduced working capital requirement, as the length of lock-in stabilises. We expect the Group to be able to bring its movement in net cash back to be broadly neutral, despite the settling of a further £2.8m of deferred consideration and the increased cost of the dividend. We calculate that this would see both conventional and net gearing reduce, to just under 30% – and would leave almost £8m (32%) of headroom within the current bank facility. Our full year forecasts are set out in Table 6, below.

<b>Table 6: Forecast Cash Flow &amp; Balance Sheet</b>					
<b>(£m)</b>		<b>FY 2010</b>	<b>% change</b>	<b>FY 2011</b>	<b>% change</b>
Adjusted EBITDA		12.73	+11.2	15.28	+20.0
Interest & tax		(2.05)	-6.5	(3.31)	+61.5
Working capital		(5.76)	-49.8	(4.44)	-22.9
Capital expenditure		(2.88)	+11.5	(2.00)	-30.6
Dividend		(2.59)	+17.8	(2.87)	+10.8
Acquisitions		(3.20)	-39.8	(2.82)	-11.9
Share issues		0.10		0.00	
<b>Movement in Net debt</b>		<b>(3.65)</b>		<b>(0.16)</b>	
Working capital		35.30	+16.0	39.74	+17.7
Non current assets	Tangible	7.25	+3.4	7.15	-1.4
	Intangible	53.25	-0.9	52.95	-0.6
Net finance debt		(21.14)	+20.9	(21.30)	+10.4
Deferred consideration		(3.02)	-53.0	(0.20)	-93.4
Deferred tax		(4.60)	+30.7	6.12	+33.0
<b>Shareholders' funds</b>		<b>67.04</b>	<b>+5.2</b>	<b>72.22</b>	<b>+7.7</b>
Net gearing	Basic	31.5%	+14.9	29.5%	-6.5
	Adjusted	36.0%	-4.0	29.8%	-17.4

This leaves the Group in a strong position to fund the organic growth expected to come through in the next 2-3 years, within the current cycle, and to look at further bolt-on acquisitions.

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Begbies has stated that it is looking to expand overseas, both by opening new offices and by acquisition, and that it hopes to complete an acquisition by the end of calendar 2010. Longer term, we would expect the Group to consider broadening its range of professional services into related areas – but only when appropriate given market conditions and availability of any necessary funding.

**Growth by  
acquisition to  
continue**

## Valuation

We continue to value Begbies on a PER-based SOTP model that looks at applying a consultancy multiple to the Taxation and Other Activities divisions and then looks at a premium rating for Insolvency/Corporate Finance to reflect the market-leading position and strong growth prospects of this part of the business. Finally, we apply a Support Services multiple to unallocated costs, including interest.

**Fair Value Price  
165p**

These give us a Fair Value Price of 165p, for upside of 93% from the current price, based on our forecasts for calendar 2010.

By way of comparison, we have reviewed our Fair Value Price with reference to the relative growth forecast for Begbies and – using consensus estimates – for Tenon and with reference to the different composition of the two businesses. This gives a similar Fair Value Price.

## Conclusion

So did Begbies' interim results, and its statement on trading prospects, deserve the 19% drop in the share price that has followed? We think not.

- Begbies was not issuing a profit warning, which would imply that results were likely to be materially (>10%) below expectations, but alerting the market that, given the flat short-term outlook for insolvency cases, meeting the earlier forecast could be a challenge, and that it anticipated that results would be below the (£12m) consensus.
- The downward re-rating ignores the progress that has been made by the other areas of the business.
  - Losses in Corporate Finance have been sharply reduced. This results from an increase in levels of activity as well as lower costs. As last year, the second half is expected to be profitable, locking in the reduction in losses for the full year.
  - Other Activities – Intelligence and Forensic – continue to grow strongly. While investment has put pressure on margins, this is expected to be only short-term, with a recovery as new capacity become fully productive.
  - The restructuring of Taxation is anticipated to return the division to profitability, so that H1 losses should be reduced by the year-end. Further, we expect the demand for tax advice and services to pick up as the recession ends and attention is turned to the increase in taxation that is either in place or will be required to reduce the national deficit.
  - Central or shared-services costs are held under tight control, while the Group is also a beneficiary of low/stable interest rates, which seem unlikely to be raised in the short-term
- It also appears to underplay the potential benefit to Insolvency from its recent expansion, and the potential for this to continue:
  - the growing ability of the BGN to deliver new instructions,
  - the prospects for new business wins by the new BTG Mesirow joint venture,
  - the recent expansion into Northern Ireland and the Cayman Islands and the opening of other new offices, and
  - the prospects for further acquisitions.
- We believe that the correct level for the consensus forecast is at c£11m. This involves a reduction of c8%. True, there is probably an element of the pendulum here, in that those who were exposed at the top of the range are likely to compensate by cutting too far, but.... As, in our case, the reduction is just 6%, we believe the reaction to be overdone.
- Our revised forecast still represents y-o-y growth of c10%, which respectable in the current environment.
- We anticipate that the impact of the R3 reduction in the 2010 forecast peak in insolvencies from 30,000 to 28,000 (-6.7%) to an extent represents a deferral, rather than a loss, of cases – so that the business cycle will be extended.
- Also, given that, in previous recessions, insolvencies have peaked at 1% of active companies, we believe that there is scope for the R3 consensus forecast to be exceeded.

As a result, we continue to rate the attraction of the shares and believe that their downgrading will be reversed as the market recognises the Group's robust underlying position and its financial strength.

**Consolidated Financial Statements – Year End April**

£'000	2007A	2008A	2009A	2010E	2011E
<b>Profit &amp; Loss</b>					
<b>Revenue</b>	<b>41,910</b>	<b>48,108</b>	<b>62,143</b>	<b>70,100</b>	<b>78,000</b>
<i>sales change</i>	+26.1%	+14.8%	+29.2%	+12.8%	+11.3%
<b>Gross profit</b>	<b>23,583</b>	<b>23,838</b>	<b>31,478</b>	<b>33,370</b>	<b>37,130</b>
<i>Gross profit margin</i>	56.3%	49.6%	50.7%	47.6%	47.6%
<b>Operating profit</b>	<b>10,472</b>	<b>8,122</b>	<b>11,032</b>	<b>11,430</b>	<b>13,830</b>
<i>operating margin</i>	25.0%	16.9%	17.8%	16.3%	17.7%
Net interest payable	(792)	(1,085)	(1,184)	(590)	(960)
<i>interest cover</i>	13.2x	7.5x	9.3x	19.4x	14.4x
<b>Adjusted profit before tax</b>	<b>9,680</b>	<b>7,037</b>	<b>9,848</b>	<b>10,840</b>	<b>12,870</b>
Exceptionals	(655)	(235)	(1,396)	(500)	(250)
Amortisation of intangibles	(520)	(1,125)	(1,176)	(1,030)	(700)
<b>Reported profit before tax</b>	<b>8,495</b>	<b>5,677</b>	<b>7,249</b>	<b>9,250</b>	<b>11,860</b>
Underlying taxation	(3,281)	(2,188)	(3,155)	(3,580)	(4,250)
Tax on exceptionals	306	315	538	310	220
<i>effective tax rate %</i>	33.9%	31.1%	32.0%	33.0%	33.0%
<b>Continuing profit after tax</b>	<b>5,520</b>	<b>3,804</b>	<b>4,632</b>	<b>5,980</b>	<b>7,830</b>
<b>Adjusted earnings per share</b>	<b>8.49p</b>	<b>5.98p</b>	<b>7.77p</b>	<b>8.12p</b>	<b>9.64p</b>
<b>Dividend per share</b>	<b>2.5p</b>	<b>2.5p</b>	<b>2.8p</b>	<b>3.1p</b>	<b>3.4p</b>
<i>Dividend cover</i>	3.4x	2.4x	2.8x	2.6x	2.8x
<b>Cash Flow</b>					
Adjusted EBITDA	10,455	9,080	11,420	12,730	15,280
Interest	(700)	(1,085)	(1,184)	(590)	(960)
Taxation	(1,981)	(1,835)	(1,008)	(1,460)	(2,350)
Working capital	(2,401)	(3,249)	(11,470)	(5,760)	(4,440)
Net Capital Expenditure	(1,641)	(3,794)	(2,582)	(2,880)	(2,000)
Dividends	(1,505)	(2,026)	(2,199)	(2,590)	(2,870)
Acquisitions & disposals	(6,672)	(9,085)	(5,313)	(3,200)	(2,820)
Share issues	7,787	478	12,626	100	
<b>Move in Net Debt</b>	<b>3,342</b>	<b>(11,516)</b>	<b>290</b>	<b>(3,650)</b>	<b>(160)</b>
<b>Balance Sheet</b>					
Fee debtors & w-i-p	23,246	27,972	38,450	43,300	47,740
Other net current liabilities	(8,691)	(7,933)	(8,027)	(8,000)	(8,000)
Goodwill & Intangibles	42,432	50,399	53,716	53,250	52,950
Tangible non-current assets	4,277	6,843	7,012	7,250	7,150
<b>Net capital employed</b>	<b>61,264</b>	<b>77,281</b>	<b>91,152</b>	<b>95,800</b>	<b>99,840</b>
Net debt	(5,271)	(17,803)	(17,488)	(21,140)	(21,300)
Deferred consideration	(5,168)	(7,718)	(6,423)	(3,020)	(200)
Deferred tax	(1,000)	(2,311)	(3,519)	(4,600)	(6,120)
<b>Shareholders' funds</b>	<b>49,825</b>	<b>49,449</b>	<b>63,722</b>	<b>67,040</b>	<b>72,220</b>
<i>Net Gearing</i>	10.6%	36.0%	27.4%	31.5%	29.5%

## Begbies Traynor Group

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Management	Major Shareholders
<b>Executive Chairman:</b> Ric Traynor	Ric Traynor 29.5%
<b>Chief Operating Officer:</b> Andrew Dick	Andrew Dick 7.2%
<b>Chief Financial Officer:</b> John Gittins	Other Directors 1.0%
<b>Corp Development Director:</b> Graham McInnes	Caledonia Investments 10.8%
<b>Executive Director:</b> Geoffrey Hill	Baillie Gifford 4.2%
<b>Non-executive Director:</b> John May	Isis Equity Partners 3.6%
	Goldman Sachs 3.5%
	Octopus Asset Management 3.1%
Key Dates	Key Milestones
<b>4 June 2009:</b> Trading update	<b>30 January 2008:</b> Acquisition of Shaw Tax BTG Tax established
<b>9 July 2009:</b> Preliminary results	<b>22 February 2008:</b> Acquisition of CoyleClarke
<b>2 October 2009:</b> AGM	<b>13 May 2008:</b> Acquisition of Fanshawe Lofts Acquisition of Cardiff team
<b>10 December 2009:</b> Trading update	<b>12 September 2008:</b> Placing at 165p raises £12.5m net
<b>21 January 2010:</b> Interim Results	<b>8 October 2009:</b> Announcement of BTG Mesirov joint venture
	<b>7 December 2009:</b> Launch of <i>Red Flag Alert</i> subscription service

## Begbies Traynor Group

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