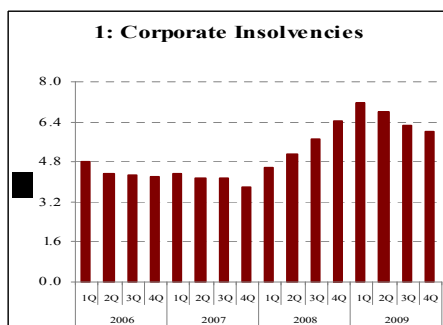


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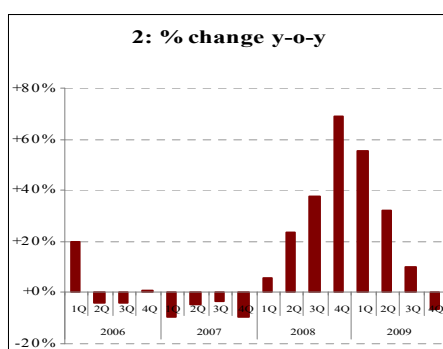
Support measure reducing company failures

22 February 2010



As part of our research coverage for client companies active in the insolvency sector, we are launching a quarterly insolvency market review, in which we will review the industry statistics published by The Insolvency Service on the first Friday of the month in February, May, August and November.

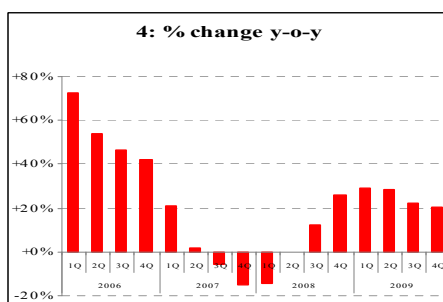
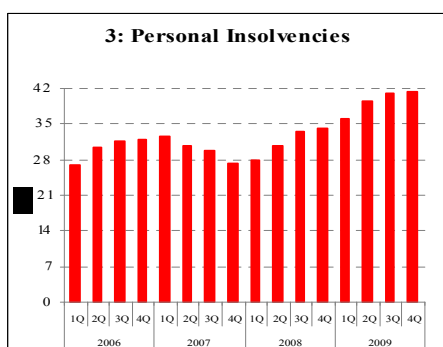
There are two distinct sections to the release, Corporate and Personal Insolvencies, which we address separately in this review. Quarterly data for the past four years – covering England, Scotland and Wales – are illustrated in the adjacent charts.



In the first and third charts, a comparison shows clearly the smaller number of corporate cases; the steeper rise through 2008 for corporate insolvencies; and the divergence of the trends between the two in 2009. The second and fourth charts show the y-o-y percentage changes, with the rises that started in 2008 being less steep, but more sustained, in personal cases than in the corporate arena.

Key points for corporate insolvencies from the February release:

- At 6,022 corporate insolvencies in Q4 2009 recorded their first y-o-y fall (-6.6%) in two years. Q4 was also the third period for which figures were down q-o-q (-3.9%). While this decline was little more than half that in Q3, it is too early to extrapolate a trend.
- Total corporate insolvencies in 2009 – in line with forecasts at almost 26,200 – were up by 19.9%, after a 33% rise in 2008. This represented 0.9% of the active company register, up from 0.6% at the end of 2007.
- Q4 was the tenth successive period with a more benign picture in compulsory liquidations than in CVLs, y-o-y, while the overall total of almost 4,530 represented a first y-o-y decline (-3.5%) after six periods of increases. (See Chart 6 on page 3).
- However, Q4 may represent a turning point. For the first time in 18 months there was a less benign picture q-o-q from compulsory liquidations (+5.4%) than from CVLs (-6.2%).



But what of the future? It is widely held that temporary support measures – employee co-operation (short-time working and pay restraint), HMRC’s “time to pay” initiative and a more lenient approach by creditors – have reduced the number of insolvencies in this recession. This has led R3, the insolvency practitioners’ body, to cut its expectations for 2010 from 30,000 cases to 28,000, but to forecast only a <4% decline in 2011, to 27,000 cases.

We remain to be convinced, though, that insolvencies will not pick up as the economy struggles to stay out of recession, and some temporary support measures come to an end. Public sector pay restraint and redundancies, deficit reduction after the election and the return of inflation, must risk depressing economic activity and increasing the risk of company failures.

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Insolvency Insights

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The main area of focus in this review is corporate insolvencies, because our client companies are primarily active in this market, with the personal sector representing a much smaller part of their business. We do, though, also consider the figures for personal insolvencies, because of the indicator that they give for the economy and the potential read-through to the trend of corporate failures.

Corporate Insolvencies

The most frequent corporate route into insolvency is liquidation, either compulsory or by Creditors' Voluntary Liquidation (CVL). In 2009, liquidations accounted for 75% of cases, split 69:31% between CVLs and compulsories. The other two procedures, Administration and Receivership, accounted for 16% and 6%, respectively, of new cases in 2009.

Liquidation most used form of insolvency ...

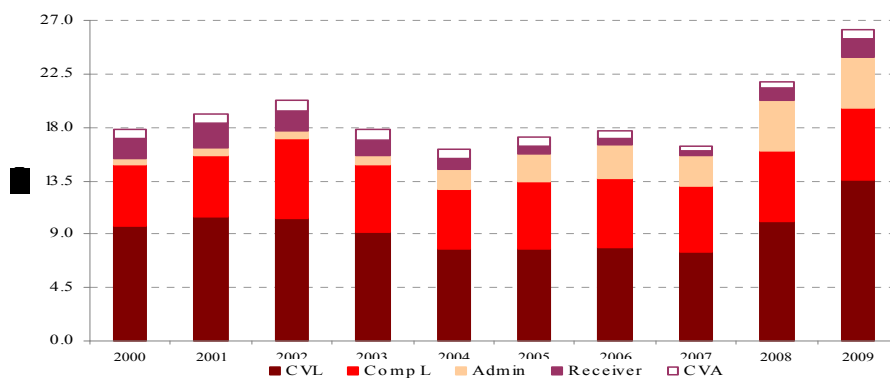
The one less formal route is a Company Voluntary Arrangement (CVA). These accounted for only 3% of cases in 2009, perhaps reflecting the difficulty of securing creditor agreement. There has been recent press comment that they are losing creditor support because they may not present a level playing field.

The relative contributions of the various procedures to the 2009 figures are illustrated in Chart 5. This shows the overall growth in 2008 and 2009, together with the changing relationship between the procedures. Over the past three years, for example,

- CVLs have increased to represent 52% of the total, up from 45% in 2007.
- Compulsory liquidations now account for 23%, down from 34%.
- It is the relatively static number of compulsories that is responsible for the overall percentage represented by liquidations falling to 75%, from 79%.
- Administrations and Receiverships have increased from 18% to 22%.
- CVAs have remained virtually unchanged, at 2.7% (2.6%).

CVL increasingly used; broadly flat trend in compulsories

Chart 5: Corporate Insolvencies



Source: The Insolvency Service

Our figures in tables 1,2 and 5 have been adjusted to count as only one administration each a number of multiple connected managed service companies placed in administration in Q4 2006 and in Q4 2008. Figures for CVLs are cases where a Liquidator was appointed as the first step in the insolvency process; cases where companies entered liquidation following an Administration – 1,470 cases in 2009 – are not included.

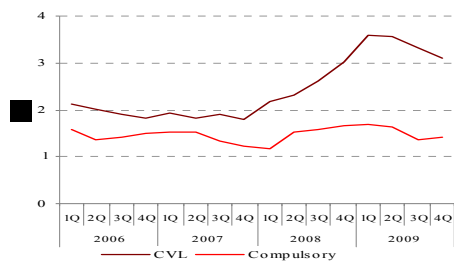
As referred to above, and on the front page, Q4 2009 saw a reversal of the recent trend in liquidations. In the five previous quarters movement in compulsory liquidations were more benign – either a lesser increase or a greater decrease – than for CVLs. In Q4 there was a reduction of 6% in CVLs, but an increase of 5% in compulsories. It is too early to declare a hardening attitude by creditors, but the figures bear watching in case a trend develops.

but with an upturn in Q4'09

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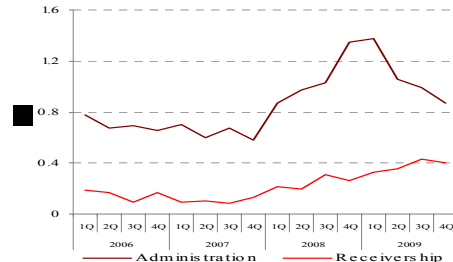
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Chart 6: Liquidations



Source: The Insolvency Service

Chart 7: Other Insolvencies

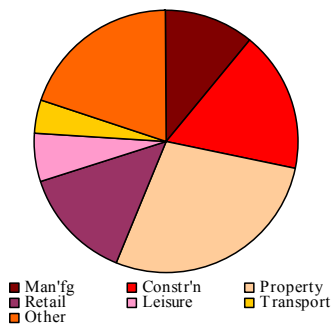


Source: The Insolvency Service

Chart 6 shows clearly the increase in liquidations through 2008, with the peak reached in Q1 2009 – before temporary support measures began to impact. A similar picture is given in Chart 7 so far as Administrations are concerned, with a peak in Q1 2009. It is notable, however, that Receiverships continued to increase through most of 2009, recording a fall, and one of only <6%, in Q4.

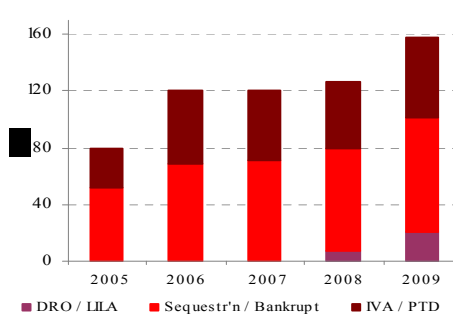
Chart 8 illustrates the approximate split of cases between various sectors. This shows Property to have been the most vulnerable, at 28% of cases, followed by Construction (17%), Retail & Wholesale – including motor dealerships – (14%) and Manufacturing (11%). Surprisingly, the Leisure sector (hotels, restaurants and bars) accounted for only 6%.

Chart 8: Sector Split 2009



Source: The Insolvency Service

Chart 9: Personal Insolvencies



Source: The Insolvency Service

Personal Insolvencies

Charts 2 and 4, on the front page, illustrate the continuing increase in personal insolvencies; in 2009 they rose by almost 25%. In Chart 9, we show the trend over the past five years. This shows the sharp increase in both 2006 and 2009, with three years of relative stability in between. The chart also indicates the initial impact of the low cost / minimal asset solutions introduced in Q2 '08 in Scotland – the low income low asset (LILA) route – and in Q2 '09 in England – Debt Reduction Orders (DRO).

Personal failures continue to grow

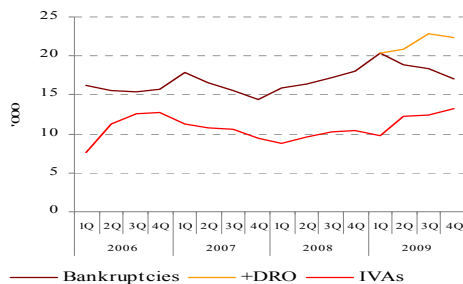
The number of Individual Voluntary Arrangements (IVA) in England and Protected Trust Deeds (PTD) in Scotland increased in 2009 after a two-year period in which their acceptance fell as creditors rejected the debt forgiveness and fee levels sought. However, their contribution to the total continues to fall – dropping from 43% in 2006 to 36% in 2009. More formal bankruptcy and sequestration proceedings continue to increase, to 64% in 2009, from 57% in 2008, but with DROs/LILAs taking 20% of the total.

The next two charts look at the relationship between bankruptcies and IVAs in England & Wales and between sequestrations and PTDs in Scotland. The two paint very different pictures.

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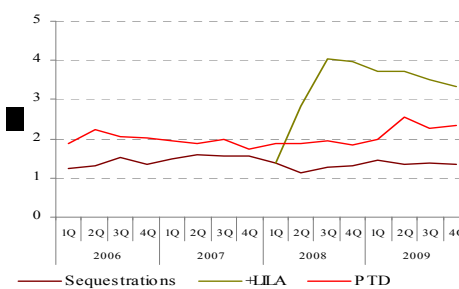
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Chart 10: Personal cases England & Wales



Source: The Insolvency Service

Chart 11: Personal cases Scotland



Source: The Insolvency Service

In England & Wales, we see a fall-off in the rate of bankruptcies from Q2'09 as DROs become available. As we would expect, there was then a continuing rise in the overall number, as low-value debtors took advantage of the new facility. Then, in 4Q'09, a decline in the number of bankruptcies more than outweighed the take-up of DROs, as the economic environment improved, so that the 22,850 cases in Q3'09 represented a peak.

The other feature of Chart 10 is the decline in IVAs into 2008, after bankruptcy levels had started to turn up. This, we believe, related to creditor unwillingness to accept the low levels of recovery proposed by debt management practitioners and the high fees charged. After a relatively flat period through to Q4'08, the number of IVAs only started to rise in Q2'09.

Acceptability of IVAs returning

In Scotland, by contrast, the PTD process is more regulated, with practitioners appointed by creditors from approved lists, and charging agreed fees, so there were not the same reasons for resistance, and numbers of cases remained fairly constant around the 2,000 case level until a pick-up in Q2'09. It is also notable that, throughout the period covered by the chart, sequestrations have been running below the level of PTDs – the reverse of the bankruptcy / IVA position in England & Wales. The other striking feature of Chart 11 is the strong initial take-up under the LILA scheme, and the, only gradual, tail-off through 2009.

Outlook

We appear to be in new territory coming out of this recession, at least for insolvency expectations. But then, never before, it seems, have we had the same level of temporary support aimed at helping companies, or the same corporate resolve, to avoid failure.

Pressures on temporary support to grow

- In the workplace, employers and employees have been willing to consider short-time working, pay freezes or cuts and restructuring as alternatives to closure.
- HMRC, often the biggest creditor, has introduced its “time to pay” initiative, which has helped a significant number of companies, at least some of which would otherwise have been declared insolvent.
- Other creditors have been prepared to take a more lenient approach to the recovery of outstanding debt, but this may also have had something to do with the difficulty of realising assets.
- A Barclays Bank spokesman (FT 6 Feb) did refer to there being “greater and more sophisticated efforts”, more than in any previous recession, to keep companies trading, and acknowledged that this had reduced the level of corporate insolvencies.

It is, though, difficult to know the longevity of much of this support.

It seems inevitable that HMRC will withdraw its “time to pay” initiative and return to a normal regime at some point after the election, especially if it comes under pressure to increase tax revenues. Also, as other creditors see asset markets improving, and their own finances under pressure, there may be added pressure on debt recovery.

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Looking at the wider economy, we have the Bank of England Governor saying that the exit from recession will be bumpy and slow and we are beginning to see the impact of pressure on the public sector. This was responsible for a fall in the CIPD index to -5% for Q1 2010. Birmingham, for example, has announced 5% job losses, and there are warnings of more to come. There is also the upturn in inflation, and forecasts of increasing home repossessions. None of this augurs well for the outlook for consumer confidence. On inflation, though, it is notable that, while the balance between items may be different, what we are seeing is, largely, a reversal of the sharp fall in the RPI, which reached its low in January 2009. The January 2010 index is still slightly below the September 2008 peak.

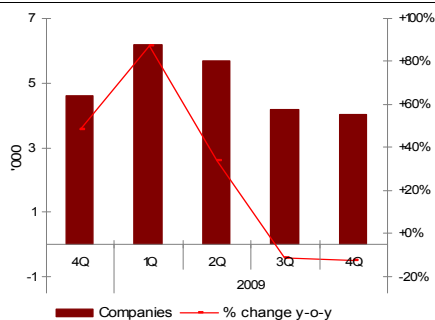
Economic recovery not strong

In the media, we have reports that KPMG are warning of an upturn in CVAs from retailers as the lagged impact of the recession takes effect (FT 10 Feb) and companies face pressure to restock and to pay down debt. The same Barclays spokesman was also quoted (FT 6 Feb) as saying that “the number of business failures in 2010 is likely to remain high” but that the focus on keeping companies trading would “continue well into the recovery”.

As an indication of corporate health, and potential insolvency activity, the two charts below show the position reported by Begbies Traynor’s Red Flag Alert bulletin for Q4’09. In cases with both “critical” problems (Chart 12) and “significant” problems (Chart 13) the position improved through to the end of 2009. However, there were still 4,000+ companies on the “critical” list in Q4, while the 3% downturn here was offset by a 6% upturn on the less severe “significant” problem list.

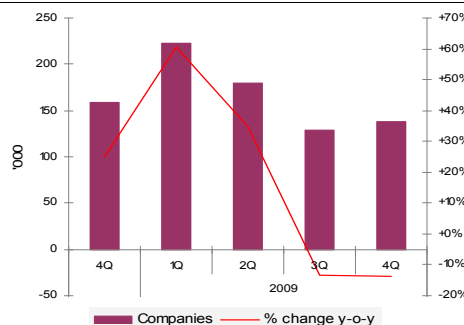
Company problems remain

Chart 12: Red Flag Alert Critical cases



Source: Begbies Traynor

Chart 13: Red Flag Alert Significant cases



Source: ONS

R3, the insolvency practitioners’ body, has recently forecast 28,000 corporate insolvencies in 2010, falling only slightly in 2011, to 27,000. The 2010 forecast represents a 7% increase over 2009. R3’s forecast for personal insolvencies is 154,000 in 2010, a 2% fall against 2009, and to fall to 151,000 in 2011. Research into previous recessions by R3 shows the extent of the lag between the economy coming out of recession and the peak in insolvencies, particularly in the 1990s.

Insolvencies peak after end of recession

Recession
Q3’90 – Q3’91
(five quarters)

Corporate insolvencies

Liquidations peaked in Q4’92, fifteen months after the recession ended, and took four years to return to pre-recession levels. Other insolvencies, including rescued companies, peaked in Q1’92, two quarters after the recession end.

Personal insolvencies

Continued rising through to Q1’93, eighteen months after the end of the recession. Never returned to pre-recession levels.

Company Comments

There are three quoted companies active primarily in the corporate insolvency sector. These are, by order of insolvency revenue, Begbies Traynor, RSM Tenon and Vantis. The three companies, though, have very different profiles.

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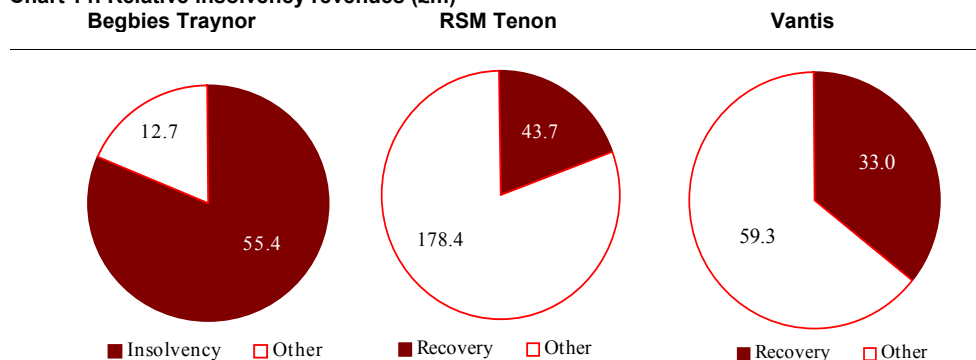
<p>Begbies Traynor (Mkt Cap: £77m)</p>	<p>Its Insolvency division is Begbies' core activity. Its £55.4m revenue over the twelve months to October 2009 accounted for 81% of the Group total. Of its other activities, corporate finance, corporate intelligence, forensic accounting and financial investigation are all closely related to the core division's rescue and recovery focus.</p>
<p>RSM Tenon (Mkt Cap: £150m)</p>	<p>Tenon's annual report for the year to June 2009 discloses that its Recovery division's revenue of £43.7m contributed 29% of the Group total. The December acquisition of RSM Bentley Jennison, though, will reduce this to c20%. The core business is focused on accountancy and advisory services in the entrepreneurial market.</p>
<p>Vantis (Mkt Cap: £12.9m)</p>	<p>Vantis' Business Recovery division reported revenue of £33m for the twelve months to October 2009, representing over 35% of the Group total. Its other accountancy and advisory businesses are grouped together within its Business Advisory & Taxation division.</p>

Begbies Traynor the most focused play

Tenon the largest company

The relative contribution of the insolvency / recovery divisions of the three companies is set out in Chart 14.

Chart 14: Relative insolvency revenues (£m)



Source: Hardman & Co

Begbies Traynor

Begbies Traynor offers the most focused exposure to the insolvency sector. It is an independent corporate insolvency practitioner with national coverage in Great Britain. Its Taxation division has recently opened an office in Northern Ireland which has the potential to add an insolvency presence. The Begbies Global Network, an affiliation with overseas insolvency practices, is introducing a growing level of business, and the recently announced BTG Mesirov joint venture has potential to add significant work referral from the USA. Research by the Company indicated Begbies' market share in 2008 was c8%, ranking it 7th in the UK marketplace by estimated fee income.

Begbies saw its insolvency business grow by 27% in the 12 months to October 2009. The operational efficiency that the increased level of business brought added 178pp to margins, at 34.5%, before allocation of shared-service and central costs. This gave a contribution of £19.1m, an increase of 34%. This was achieved despite continued investment in the business, including the launch of the BTG Mesirov joint venture, the opening of new offices and preparation for the launch of the subscription service to its Red Flag Alert statistics.

For FY 2010, we are currently forecasting 14% revenue growth within Insolvency, to £56.9m, and a contribution of £18.5m (+6%). This represents a c5% revenue reduction, and a lower margin, from our earlier forecast, to reflect the cut in expectations for the number of insolvencies.

Begbies Traynor Group is a research client of Hardman & Co. Please see our research note of 8 February 2010 for more detailed analysis of the recent interim figures.

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RSM Tenon

RSM Tenon is the largest of the quoted companies in the sector in terms of both its market capitalisation and its overall revenue and profitability, which have been significantly enhanced by the RSM Bentley Jennison acquisition, announced last December.

The Group's Recovery division reported 41% growth in revenues, to £43.7m, in FY 2009. This added 416pp to the contribution margin, to 21.5%, raising contribution, before central and regional costs, by 75%, to £9.4m. Bank panel accreditation was increased last year

RSM Bentley Jennison had little, if any, exposure to insolvency, so that the merger dilutes the contribution of recovery to the enlarged group. It also represents a significant growth opportunity, by establishing an insolvency practice in many of the Bentley Jennison offices. The RSM international element in the acquisition will, too, bring more cross border work.

Vantis

Vantis reported growth of almost 50% in revenues from its Business Recovery division in the 12 months to October 2009, to £33.0m. We do not, though, have available the H1 split of contribution between the divisions to comment on the 12-month performance in this respect. The latest information available, for FY 2009, shows contribution – after the allocation of central costs – more than doubling, to £6.9m, on a 45% growth in revenue, to £27.7m. Margins were raised by over 700pp, to almost 25%. This compares with a post-allocation margin of 22.8% within Begbies – reflecting its level of investment in growth.

Vantis is a research client of Hardman & Co. We are preparing a report to initiate coverage.

The Personal Insolvency Sector

There are three quoted companies, all listed on Aim, that are active in this space.

Fairpoint (Mkt Cap: £31.2m) Fairpoint's personal insolvency business, delivered 98% of revenue in the 12 months to June 2009. Revenues declined by 3% in that period, to £25.9m.

Insolvency is focused on the IVA market in England & Wales, with a 19% market share in Q2 2009. IVA revenues, at £22.8m for the 12 month period, were down by c12% on the prior period. Fees have been reduced, resulting in an increase in the level of IVAs approved.

The Group has a growing debt management business, where revenues rose from £0.9m to £3.1m, to account for 12% of the total. Fairpoint has introduced its own fair share plan, branded ClearStart.

**Three companies
focused on the
personal market**

Invocas (Mkt Cap: £6.4m) Invocas saw its insolvency revenues fall by 7% in the 12 months to September 2009, to £8.7m, as it moved from time-based billing to a fixed-fee model.

We believe that the business is primarily focused on the personal insolvency sector. The group broadened its distribution channels and, in its interim results, to September 2009, reported that 64% of business was won from B2B partners.

Invocas is also active in corporate business recovery and insolvency, but it does not split this out in its segmental reporting.

ClearDebt (Mkt Cap: £5.8m) ClearDebt's business is focused on debt management plans, which accounted for 72% of revenues in the year to June 2009. The other element of its business is personal insolvency. The group reported strong revenue growth in the year, with debt plans up 77%, to £2.4m, and insolvency up 93%, to £0.9m.

In December the group announced that it was purchasing c6,500 cases from the administrator of the Relax Group. These comprise a mix of PTD, IVAs and DMPs, and represent a near trebling of fee generating cases at June 2008.

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