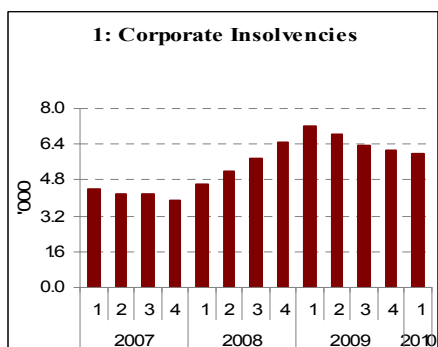


Insolvency Insights

Turning the corner, but recovery not yet robust

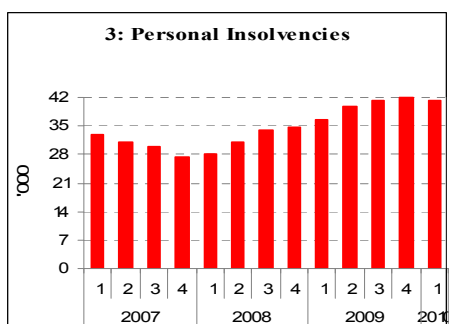
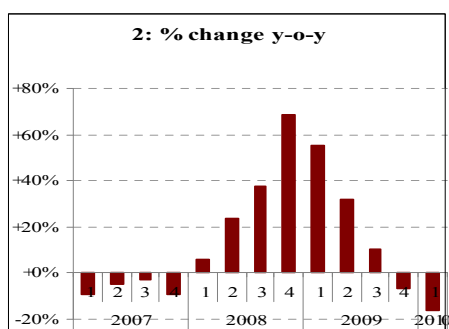
19 May 2010



In this, the second edition of our quarterly insolvency sector review, we focus on the statistics for corporate and personal insolvencies in Q1 '10 released recently by the Insolvency Service. These are illustrated, respectively in the adjacent Charts 1 and 3. Accompanying them, Charts 2 and 4 show the respective y-o-y quarterly change.

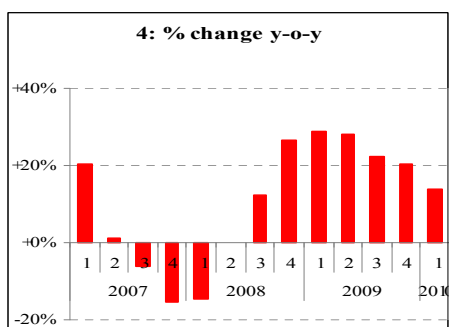
Key points for UK corporate insolvencies, including figures for Northern Ireland, from the May release are:

- Corporate insolvencies were down q-o-q for the fourth successive quarter, falling by 1.3% between Q4'09 and Q1'10, even though the rate of decline was only about a third of that seen between the two previous quarters.
- Because Q1'09 represented the peak of the current cycle, the Q1'10 figure represents a widening of the y-o-y decline in new cases to 16%.
- For the second successive quarter, compulsory liquidations increased (by 7%) while creditors' voluntary liquidations fell (by 4%). Some commentators see in this a more aggressive approach by creditors toward their debtors. Figures for other insolvencies – administrations, receiverships and creditors' voluntary arrangements – were also lower in Q1'10.
- Liquidations in the 12 months to end-March, with the peak Q1'09 falling out of the calculation, represented 0.8% of the active company register, down from 0.9% in calendar 2009.



Figures for personal insolvencies remained broadly flat for the second quarter in a row, showing a fall of 1% in Q1'10 after a similar rise in Q4'09.

- Figures for Scotland continued the recent decline.
- Elsewhere in the UK, bankruptcies and debt reduction orders continued their rising trend, but the number of individual voluntary arrangements turned down. It is perhaps too early, though, to see in this a tightening of approval criteria.



The outlook, we believe, remains fragile. On the one hand, Equifax has reported a further small fall in corporate failures in April, and sees in this a return of business confidence. On the other hand, Begbies Traynor's Q1'10 Red Flag Alert statistics see a 14% increase in companies with financial difficulties, and estimate that half of this increase is down to a hardening attitude by creditors.

What does seem to be agreed in the industry, though, is that the number of corporate insolvencies are likely to remain high in 2010 and 2011, and probably into 2012 as many companies face pressure to fund the increases in working capital that will be needed as activity recovers after the recession and to meet the costs of rising interest rates.

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This would suggest that the prospects for, and defensive qualities of, the insolvency sector will remain attractive for some time to come.

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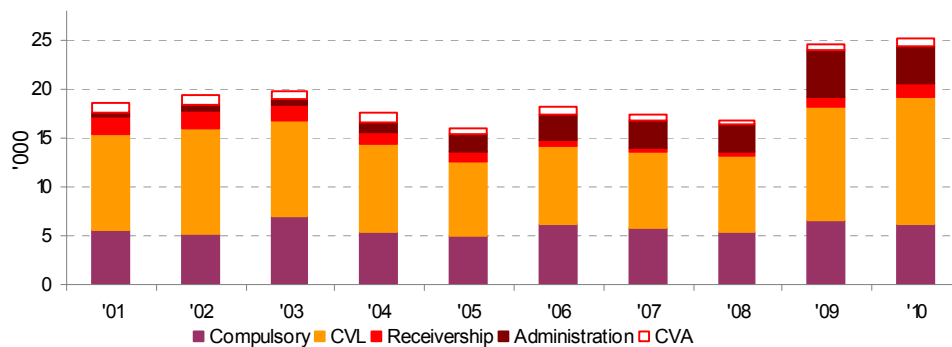
The main focus of this review is the corporate insolvency sector, because this the area in which our two client companies – Begbies Traynor and Vantis – are most active. However, we also consider the personal insolvency sector, recognising that RSM Tenon is the major instruction taker in this market place.

Corporate Insolvencies

As highlighted in the first edition of Insolvency Insights, in February, all our figures for corporate insolvencies are adjusted to count as one administration each the insolvency of a number of connected managed service companies in Q4 '06 and Q4 '08. They also exclude liquidations following an Administration.

The overall corporate insolvency picture, illustrated in Chart 1 on the front page, was little changed between Q4'09 and Q1'10, with total new cases falling by just 80 (1%). Because Q1'09 represented the peak of the cycle, four subsequent quarters of a fall in new cases has widened the y-o-y decline to 16%, as shown in Chart 2.

Chart 5: Corporate Insolvencies – 12 months to March

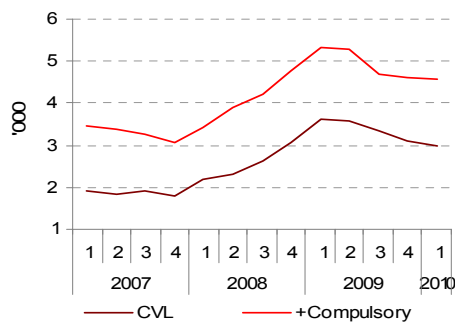


Source: The Insolvency Service

Chart 5 takes a longer term view, looking at the total number of corporate insolvencies in the 12 months to March 2010. This shows that the impact of the fall in new cases in the last four quarters has largely offset the rising trend in cases in the previous 12 months, leaving the overall total up by <3%, at 25,270. Liquidation continues to be the most frequent route into insolvency, accounting for 76% of total cases (2009: 73%). While compulsory liquidations fell y-o-y (-7%), the number of creditors' voluntary liquidations ("CVLs") increased by 12%, and they now account for 68% of all liquidations (2009: 64%). This may be indicative of a short-term reluctance on the part of creditors to force companies into insolvency, a trend that might now be reversing. Other routes into insolvency saw a 5% fall y-o-y, as increases in receiverships and creditors voluntary arrangements ("CVAs") failed to offset fully a decline in the number of administrations.

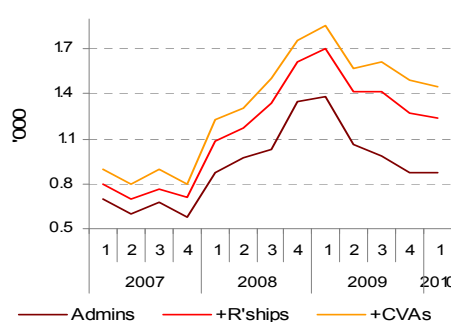
The quarterly trend in these figures is examined in greater detail in Charts 6 and 7.

Chart 6: Liquidations



Source: The Insolvency Service

Chart 7: Other Insolvencies



Source: The Insolvency Service

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Chart 6 illustrates further falls, for the fourth successive quarter, in CVLs, down 4% q-o-q and now 17% below the peak of Q1'09. On the other hand, compulsory liquidations were up (+7%) for the second successive quarter, resulting in only a marginal fall, q-o-q, in the total number of liquidations, to 4,503.

Chart 7 picks up the position for administrations, virtually unchanged after two quarters of falls; receiverships, down by 10% after a 6% fall in the previous quarter; and CVAs, down 7% after four quarters of increases. In total, these classes of insolvencies peaked in Q1'09 and are now, at 1,440 new cases in Q1 '10, >22% below the peak.

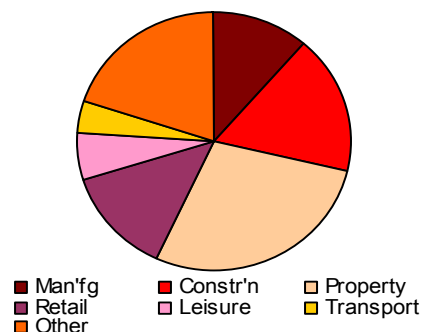
One encouraging statistic revealed in the Q1'10 release is that company liquidations in the 12 months to end March represented 0.8% of the active company register; this figure had been at 0.9% in Q3 and Q4'09.

Much has been written of the reasons for levels of insolvencies being lower than previously expected. We would highlight three particular factors:

- **Official support** HMRC's "time to pay" initiative has helped companies in the recession to remain in business.
- **Employee support** A number of companies have avoided insolvency with the help of short-time working and pay restraint by employees.
- **Creditor support** Some creditors have held off action. However, this may have more to do with a difficult asset realisation market than with any philanthropy.

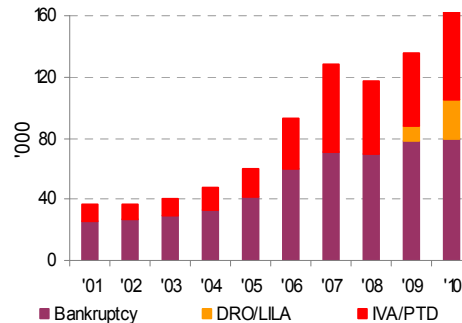
This, of course, raises a question as to how trends might change if this support is withdrawn as the recession ends and as the market for assets improves – but more of that later.

Chart 8: Sector Split 12m to March '10



Source: The Insolvency Service

Chart 9: Personal Cases – Year to March



Source: The Insolvency Service

Our final chart on the corporate sector, Chart 8, looks at the relative impact of insolvencies on different sectors of the economy. In the 12 month period, the Property sector accounted for 28% of cases, Construction for 18%, Manufacturing for 11% and Leisure for 6% – all little changed in the past three months – while Retail & Wholesale improved to 13%, from 14%.

Personal Insolvencies

The main message from the personal insolvency statistics, illustrated in Chart 3 on the front page, is that q-o-q growth in the UK may have peaked, at least for now. After growth of 1% between Q3 and Q4'09, the 41,410 new cases in Q1'10 represent a fall, albeit of only 1%. Y-o-y growth has also slowed, for the fourth successive quarter, and (Chart 4) is now <14%.

Chart 9 illustrates the outturn for the latest 12-month period. Bankruptcy figures were little changed (<1%). Growth of IVAs and PTDs was 23%, but only to a level <5% above the previous peak, in 2007. There was a strong take-up of DROs in their first year – they were introduced in 2Q'09 – but the number of LILA cases fell 11% in the second full year of availability.

More detail of the quarterly figures is illustrated in Charts 10 and 11. Outside Scotland, the number of bankruptcies rebounded (Chart 10), and was marginally ahead of Q3'09 levels. Growth q-o-q was almost 7%, to 18,570. The number of DROs – at 5,640 – continued to climb, but q-o-q growth slowed to <6%. The number of IVAs declined – by >10%, to 12,020 – after three quarters of increases. Given the increase in bankruptcies, this may indicate that it has become more difficult to secure creditor agreement to plans.

Personal cases in Scotland fell across the board between Q4'09 and Q1'10, with total cases down 9%, to 1,900. Within these figures, sequestrations were down by 9% to 1,240; there were 4% fewer LILA cases, at 1,900 new cases, continuing the quarterly decline that started shortly after their introduction; and new protected trust deed cases fell by 13%, to 2,030.

Chart 10: Personal cases UK (excl Scotland)

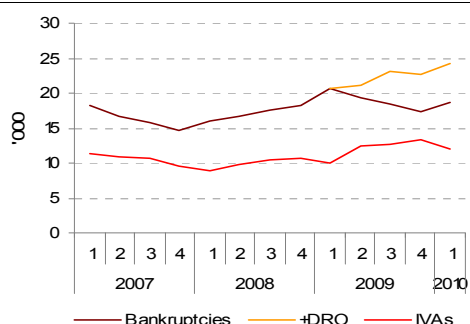
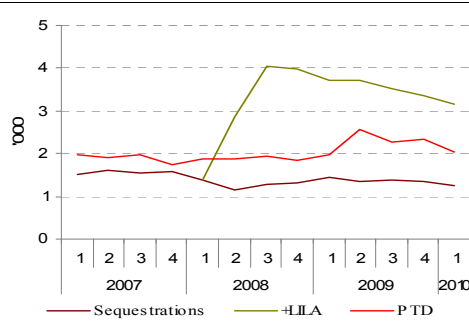


Chart 11: Personal cases Scotland



Source: The Insolvency Service

Source: The Insolvency Service

DRO = Debt Reduction Order IVA = Individual Voluntary Arrangement LILA = Low Income Low Assets PTD = Protected Trust Deed

Outlook

There is considerable uncertainty over the movement in the number of corporate insolvencies as the UK exits recession. The 2010 forecast from R3, the insolvency industry's professional body is for c28,000 new cases; this would represent a decline of 2% from its 2009 expectation, but an increase of 6% over the actual outturn for the year. We note, though, that Q1'09, the peak of the recent cycle, represented 27% of the full year outturn, whereas the Q1'10 result represents only 21% of the full year forecast. This implies that, unless there is to be another shortfall – the 2009 outturn was 8% below the forecast – figures for the next nine months will have to show a 14% y-o-y rise for the forecast figure to be reached. There are a number of factors which could influence this.

Probably top of the list is HMRC's attitude to its "time to pay" initiative. Amid anecdotal evidence that some companies that have used the scheme will not be able to restructure and survive even with this support, and that others who did not need support may have used it to augment cash flow, there are reports that HMRC is toughening its criteria for assistance, and is demanding an independent business review of applicants before granting it. Also, a recent report in the London Evening Standard stated that, of applications in respect of VAT, rejections were running at 11% in Q1'10, against 5.3% in 2009.

Next there is the attitude of creditors to outstanding balances. So far in the cycle, a poor market for asset realisations may have deterred creditors from making companies insolvent because it is more difficult to recover amounts owed. It is probable that attitudes will harden as asset markets improve. Indeed, as we discuss below, this may already be happening.

It is also notable that, in previous cycles, insolvencies have remained high as companies have experienced pressure on working capital as activity has recovered and borrowing availability has remained scarce. It is difficult to isolate the extent to which this is building up in the current cycle. The banks are saying that demand for borrowing is not there; companies are saying that facilities are not available. We suspect that the truth lies somewhere in the middle – many companies that are good banking risks are looking to reduce exposure to bank debt and to fund growth by other means; on the other hand, many companies that are seeking finance are either poor risks or balk at the high cost of it.

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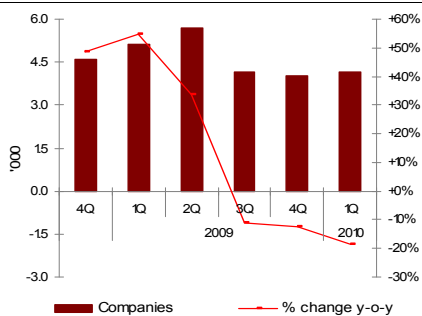
A recent report in the Financial Times quotes Equifax as saying that business failures were down 2.8% between March and April, but it is difficult to determine how this is calculated. The report does, though, suggest that there is a continuing positive trend, and that business confidence is growing.

The latest data from Begbies Traynor's Red Flag Alert statistical survey shows the number of companies with critical problems roughly flat over the last nine months (Chart 12), so that the y-o-y change continues to fall. This situation is likely to continue in the second quarter, seen against the sharp rise in 2009, but then to unwind in the second half. So far as companies with significant problems are concerned, numbers continued to rise in the first quarter (Chart 13), so that over 55% of the fall seen in Q3'09 has now been reversed.

Overall, the report states that there was a 14% increase in companies experiencing financial distress between Q4'09 and Q1'10. While about half of this increase is thought to be down to normal seasonal trends, the report estimates that the other 50% results from a shift in trade creditor behaviour, with an increase in court actions seen as evidence of a growing willingness to take action.

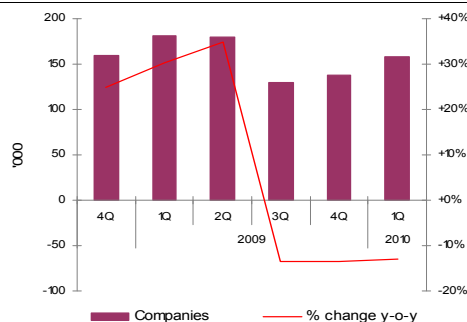
The report suggests that, while the economy has turned the corner, these figures indicate that the recovery remains fragile. It also points to expectations of an increase in interest rates later in the year – which would be supported by 12-month Sterling LIBOR at 1.40% against the overnight rate of 0.55%, and the 20% increase in the monthly average 3-month rate since it bottomed last October – and the potential risk that this represents to indebted companies.

Chart 12: Red Flag Alert Critical cases



Source: Begbies Traynor

Chart 13: Red Flag Alert Significant cases

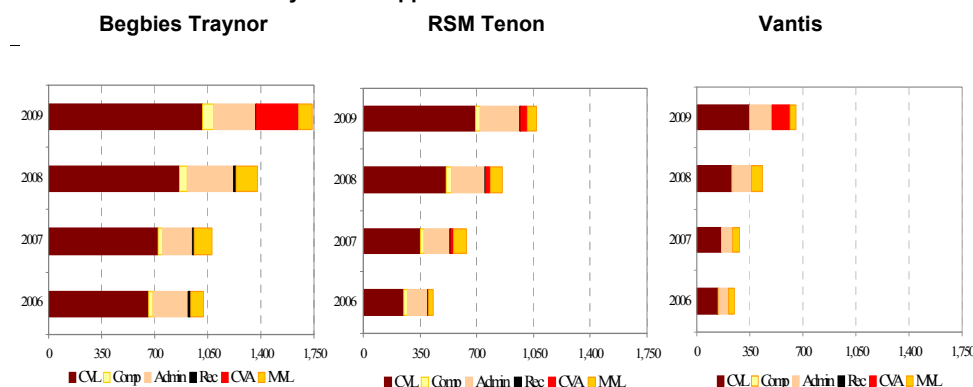


Source: ONS

Company Comments

Chart 14 shows the growth in, and relative numbers of, new appointments for the three quoted companies over the past four years.

Chart 14: Relative calendar year new appointments



Source: Hardman & Co

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With the exception of those for CVAs the figures in these charts have been sourced from the London and Edinburgh Gazettes as analysed by Begbies Traynor. CVA figures for 2009 have been assumed to be the difference between these Gazette figures and those provided by RSM Tenon in a recent presentation. RSM Tenon has also supplied its CVA appointment figures for the earlier years.

Begbies Traynor

Excluding CVAs, because we do not have figures for the comparative periods, new corporate insolvency appointments for Begbies in 2009 were up by 11%, to c1,370 cases. Adding in CVAs and MVLs, Begbies was appointed in a total of 1,740 corporate cases in 2009.

Begbies remains the largest instruction taker in the corporate sector, estimated in a recent OFT draft report to be worth £1bn in annual fee income. In terms of the number of new appointments taken, Begbies had a share almost 5.9% of cases according to statistics from the Insolvency Service. Its share of corporate cases excluding CVAs, however, fell slightly between 2008 and 2009, from 5.2% to 5.0%. This, though, takes no account of fee income, and we believe that the average size of Begbies' appointments has been rising. In the personal sector, Begbies was the largest instruction taker in Scotland for Protected Trust Deeds, with 970 appointments.

Begbies Traynor Group is a research client of Hardman & Co. The Company recently announced the renewal and enlargement of its banking facilities, and this is covered in our research note of 6 May 2010.

RSM Tenon

New corporate appointments for Tenon Recovery, including CVAs and MVLs, increased by 24% in 2009, to 1,070 cases. This figure does not include the 85 cases (2008: 44) in which RSM Bentley Jennison, acquired in December 2009, was appointed.

Tenon Recovery remains the second largest instruction taker in the corporate sector. In terms of the number of new appointments taken, Tenon had a share of almost 3.6% of cases according to the Insolvency Service statistics. Its share has, we calculate, risen from 3.2% in 2008. RSM Tenon's recent presentation revealed that it had a share of 3.5% of the OFT's estimate of fee income. The presentation also revealed that RSM Tenon is, apart from the Official Receiver, the largest instruction taker in respect of bankruptcies, and the second largest overall, in the personal sector – in an analysis that excluded the larger debt management companies such as those included below.

Since our previous issue, RSM Tenon has announced interim results, showing 20% growth in first half revenues from the Business Recovery division, to £23.2m, at which level it contributed 32% of the Group total, up from 26%. The company has also announced that it is to move from Aim to the Main Market on 27 May 2010.

Vantis

Excluding CVAs – as, again, we do not have the comparator figures – Vantis saw corporate insolvency appointments increase by 36% in 2009, to almost 500. Overall Vantis was appointed in almost 660 corporate cases, including CVAs and MVLs, during the year.

In the corporate sector, Vantis is, again, ranked third in terms of the number of new appointments, with a share of >1.8% of cases, per the Insolvency Service statistics. It, too, has seen this percentage increase, rising from c1.6% in 2008.

Since our previous issue, Vantis has updated the market on:

- 1) The Court of Appeal hearings on issues arising in the Stanford International Bank liquidation.

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The Court upheld the 2009 High Court decision that the Centre of Main Interest of SIB was Antigua and that the Joint Liquidators should be recognised as the office holder to be entrusted with the UK assets of SIB. The Court of Appeal, however, kept in place the Criminal Restraint Order obtained by the SFO, meaning that funds are not yet available for distribution to depositors and creditors. This decision is being appealed to the Supreme Court.

2) Prospects for the Business Recovery Division.

In the end-March announcement, it was stated that activity levels in the department were expected to be below previous expectations. Given, the ongoing litigation, above, the two announcements are likely to be connected.

3) The successful extension of its debt facility to 15 May 2011, from the earlier 31 January 2011 maturity.

At the same time the total size of the facility has been increased by a further £3.5m, to £53.6m, having been raised by £6.65m earlier in the current financial year. The early-May announcement makes no mention of rates – under the earlier agreement the RCF facility (now £34.6m) was at 4% over LIBOR and the £19m term loan at LIBOR +5% – or arrangement fees.

Vantis is a research client of Hardman & Co.

The Personal Insolvency Sector

There are three quoted companies, all listed on Aim, that are active in this space. While none is a client of Hardman & Co, we provide below a brief summary of announcements since our February edition

<p>Fairpoint (Mkt Cap: £34.0m)</p>	<p>Fairpoint has reported a positive performance for 2009.</p> <ul style="list-style-type: none"> Revenue growth was 9%, to £28.9m. New case volumes for IVAs and debt management fell 7%, but lower costs (from improved conversion and lower marketing spend) resulted in a £1m (160%) increase in operating profit. Strong cash flow resulted in a £4.1m reduction in net debt, reducing net gearing to 13% (2008: 27%). <p>The share price has appreciated by almost 9% since our last issue, in February.</p>
<p>ClearDebt (Mkt Cap: £5.2m)</p>	<p>Since our last issue, ClearDebt has successfully raised £2.3m by an issue of loan notes. The funds have been used</p> <ul style="list-style-type: none"> to repay a loan used for a further interim payment for the acquisition of the business and assets of four subsidiaries of Relax Group (in administration), to pay the final sum due to the Administrator, and to repay an earlier loan. <p>An EGM has been called for later this month for the purpose of granting the loan notes conversion rights and for approving a capital reorganisation to eliminate the P&L deficit.</p> <p>A sharp fall in response to the posting of the Circular for the EGM wiped out earlier gains, leaving the share price down by almost 11% over the period.</p>
<p>Invocas (Mkt Cap: £4.3m)</p>	<p>There have been no announcements from Invocas since our previous issue. The Company has seen its share price fall by over 33% over the period.</p>

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