Progressive EQUITY RESEARCH

ANEXO GROUP

BUSINESS SUPPORT SERVICES

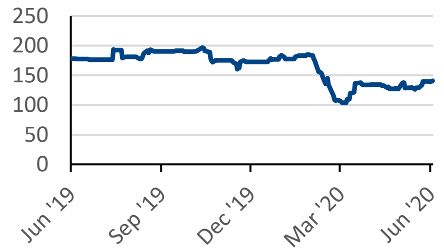
29 June 2020

ANX.L

141p

Market Cap: £163m

SHARE PRICE (p)



12m high/low	197p/104p

Source: LSE Data

KEY DATA

Net (Debt)/Cash	£(27.7)m *(at 31/12/19)*
Enterprise value	£198.8m
Index/market	AIM
Next news	Prelims, by end June
Shares in Issue (m)	116.0
Executive Chairman	Alan Sellers
CFO	Mark Bringloe
Bond Turner MD	Samantha Moss

COMPANY DESCRIPTION

Anexo is a specialist integrated credit hire and legal services group.

www.anexo-group.com

ANEXO GROUP IS A RESEARCH CLIENT OF PROGRESSIVE

ANALYSTS

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Solid foundations in place

Opportunities to grow in uncertain times

Anexo, the specialist integrated credit-hire and legal services business, has reported a record performance for FY 19 with numbers in line with previous guidance. The year saw good cash generation following the decision to focus on the Legal Services business while holding back growth of the Credit Hire business. A 0.5p final dividend strikes a balance between cash conservation and confidence in the outlook for the Group in uncertain times. Given the impact of COVID-19 on the wider operating environment, we think that the key focus should be on the Group's current positioning and its preparedness to operate in the evolving business environment. Although there is no update on guidance for estimates, we believe that the business is well-placed – particularly since the recent £7.5 million fundraise which underpinned the Group's options to accelerate growth without diminishing existing cash resources.

- Anexo, as well as having a significant book of business to mine, will accelerate the expansion of its advocacy and specialist litigation team and to continue recruitment within the Legal Services business. It will also proceed with the opening of a new office in Leeds and will look to expand its vehicle fleet to add further new business.
- With road traffic volumes continuing to recover as COVID-19 restrictions are lifted, Anexo's core business should continue to see plenty of new business opportunities in the UK credit hire market for EDGE and Bond Turner.
- The VW emissions case holds particular promise for Anexo and it has put in place further funding through which it can secure further cases while mitigating its exposure to ongoing expenses.
- All Anexo's businesses have remained fully operational during the lockdown period and the Group has started FY 20 well. It has seen high levels of cash collection and we expect the impact of new recruits into Bond Turner to continue to support growth in case settlements and cash collections as their case portfolios mature.
- Group revenues in FY 19 increased by 38.9% to £78.5 million (FY 18: £56.5 million) and adjusted profit before tax for the period increased by 43% to £23.1 million (FY 18: £16.1 million).

FYE DEC (£M)	2017	2018	2019
Revenue	45.3	56.5	78.5
Adj EBITDA	15.8	18.7	31.8
Fully Adj PBT	14.6	16.1	23.1
Fully Adj EPS (p)	11.1	11.8	16.6
EV/Sales (x)	4.4x	3.5x	2.5x
EV/EBITDA (x)	12.6x	10.6x	6.2x
PER (x)	12.6x	11.9x	8.5x

Source: Company Information and Progressive Equity Research estimates

Anexo’s business model

In the context of the opportunities available to the Group, it is worth reiterating some of the main points of Anexo’s business model:

The integrated approach which Anexo employs has proved to be an efficient one and it is also an area of differentiation. Anexo is an integrated credit-hire and legal services business which provides an end-to-end litigated claims service to predominantly impecunious non-fault motorists. While there are other credit hire and personal injury firms, there is no directly comparable UK competitor to Anexo’s integrated model.

Previous cases have tightened legal precedent in such a way that supports Anexo’s business model.

Anexo operates a direct capture model for finding customers. Following a road accident, individuals are put in touch with EDGE by recommendation through introduction by a network of local body shops and repairers. Claims are vetted and a replacement vehicle is delivered to the customer. Anexo does not source customers from insurers or brokers.

Anexo’s EDGE business hires out cars, vans and motorcycles to non-fault motorists who are mainly classed as impecunious and therefore able to claim credit hire rates rather than spot hire rates or GTA rates. The Group had around 1,730 vehicles available for hire at the end of April 2020 but is looking to grow the fleet size this year.

Anexo employs case screening and in-house databases to vet the case applications which it receives. The result is that it has a 98% success rate in cases where litigation is commenced. Importantly, the vast majority of cases settle before a court appearance.

Anexo’s litigation business, Bond Turner, looks to recover the costs associated with a case – including any repair costs, storage expenses and personal injury damages. The Group works on a no-win, no-fee basis so that there is no upfront cost to the customer.

Bond Turner’s involvement reflects its service to the customer throughout the process following the acceptance of the validity of the claim. It ensures compliance with court orders and collects cash once settlement has been agreed.

Anexo also operates an advocacy practice, with in-house barristers, headed up by Alan Sellers. That team has a significant role in the current litigation against Volkswagen and is set for expansion to further exploit this opportunity.

Opportunities and outlook

With road traffic volumes continuing to recover as COVID-19 restrictions are lifted, Anexo's core business should continue to see plenty of new business opportunities in the UK credit hire market for EDGE and Bond Turner. In addition, the VW emissions case holds particular promise – especially if the Group is successful in acquiring new clients to add to its existing base. All businesses have remained fully operational during the lockdown period.

Anexo stated that it had started FY 20 well in its recent trading update and that is reiterated in the results commentary. The Group started the year well with high levels of cash collection with the credit hire operation in a net cash positive position during the first four months of the year – a key positive for the business.

In particular, we expect the impact of new recruits into Bond Turner to continue to support growth in case settlements and cash collections as their case portfolios mature.

The Group retains a back book of around 20,000 cases of which some 12,000 have credit hire attached, the rest being predominantly personal injury cases. Clearly, the increased capacity within Bond Turner – including the opening of the Leeds office in Q3 2020 – will help reduce these existing case numbers even as the Group generates new business. That extra capacity means that the back book will represent around three years' worth of case load, down from four years previously.

We also note the opportunity for Anexo to purchase small books of business (say 400-600 cases) from firms wishing to exit the market. Management has said that it has received a number of approaches from willing sellers and would anticipate that it would pay around 20%-25% of the value of any books which were of sufficient quality.

During 2019 the Group secured a comprehensive protocol agreement with a major insurer, establishing parameters around specific settlement terms and timelines. Management has previously noted that Bond Turner tends to get maximum traction on case settlement between 12 and 24 months of a case timetable. Insurers could come to agreements such as this one with Anexo to settle cases (perhaps at lower rates) to enable more efficient and less costly settlement of cases. Executive Chairman Alan Sellers has said that this agreement accounts for around 1.5% of Anexo's debtor book. However, it has made a significant impact on the case book with this particular insurer with debtor days reducing from 550 days to around 110 to 120 days. Meanwhile, in general, we expect the longer timescale to continue to apply to the majority of Anexo's cases.

Commentary from the senior team remains encouraging:

"The Board remains confident of the Group's capacity for organic growth and, given the resilience of our business and our strong financial position, believes Anexo is well positioned to weather the current storm and deliver near-term profitable growth to our shareholders."

We also note the decision to pay a 0.5p final dividend (thus maintaining the annual payout at 1.5p) which, in the current circumstances, strikes a notable balance between cash conservation and confidence in the outlook for the Group in uncertain times.

Despite the positive news on performance, management feels that it is still too early to provide forward looking financial guidance at the moment so we are not including any estimates at present.

Divisional performance and opportunities

During FY 19, Anexo focused on the Legal Services business while holding back growth of the Credit Hire business. Investment in the number of senior fee earners saw their numbers increase from 89 at the end of 2018 to 127 at the end of 2019. This investment was reflected in the number of cases settled in the year as the new legal staff began to have an effect - cases settled rose from 2,066 in H1 19 to 2,872 in H2 19. In addition, there was a significant reduction in the level of cash absorbed by the Group in the second half compared to the first half of the year (£1.5 million versus £7.0 million). Despite that, the number of new claims increased from 3,392 in H1 19 to 3,567 in H2 19. Importantly, excluding the £1 million invested in engaging with prospective clients for the VW case, the core business moved from cash absorption to cash generation during the period.

Credit Hire division

Growth in the credit hire fleet was deliberately held back in FY 19 with the number of vehicles on hire reaching 1,308 at the end of 2019, down 14.6% on the prior year. This contributed to the business moving to net cash generation. Despite the reduction over the year, the average fleet size during FY 19 was still greater than that of the prior year and so Credit Hire revenue increased by 40.9% from £34.0 million to £48.0 million in FY 19. Profit before tax in the Credit Hire division rose by 64% to £17.9 million (FY 18: £10.9 million).

Following the recent fundraise, one of the uses of proceeds mooted was a commitment to make further investment to reposition its fleet numbers towards the level that it had at the end of 2018 when it comprised 1,946 vehicles available for hire. By the interim stage of 2019, that had fallen to 1,904 and we believe that the number had declined further to around 1,730 by the end of April 2020.

Vehicles

	H1 18	FY 18	H1 19	FY 19
Vehicles on hire at period end	1,240	1,531	1,571	1,308
Average vehicles on hire for the period	912	1,155	1,496	1,454

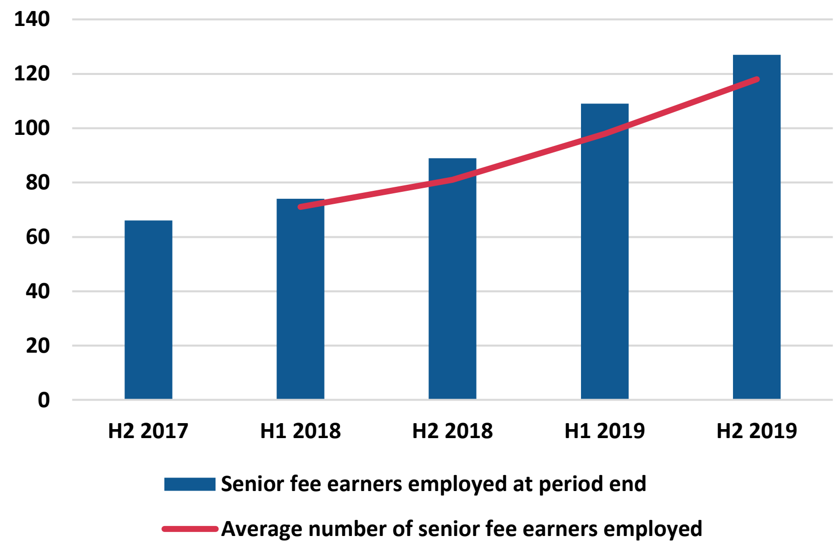
Source: Company information

On average, the fleet of vehicles had a utilisation rate of 73.8% in FY 19. With the new funding available, it makes sense to increase the number of vehicles available for new cases in conjunction with the increase in capacity within Bond Turner (see above and below).

Legal Services division

Revenues for the Legal Services division increased by 35.9% to £30.5 million in FY 19 from £22.5 million in FY 18 while PBT increased slightly to £5.92 million in FY 19 (FY 18: £5.88 million) despite the significant investment in expanding capacity during the year. The development of capacity within Bond Turner included the opening of the Bolton office in December 2018 and the fundraise means that Anexo will also proceed with the opening of a new office in Leeds, which was previously postponed earlier in the year while the effects of COVID-19 were assessed. The results announcement states that recruitment in Bolton 'has progressed better than expected, both in terms of the number and quality of the highly skilled and experienced litigators' to the extent that Bond Turner has taken a second floor in Bolton to allow continued investment in staff. As we note above, the number of fee earners in Bond Turner was 127 at 31 December 2019.

Senior fee earners



Source: Company information

VW Emissions Case

As well as its credit hire and related legal practice businesses, Anexo also operates an advocacy practice, with in-house barristers, which is headed by the Group's Executive Chairman, Alan Sellers. That team has a significant role in the group litigation against Volkswagen (VW). Anexo currently has around 8,000 clients and expects to gain more (while mitigating its exposure to the cost of acquiring new claimants). Although no specific revenue or profit numbers are mooted, we note the very positive impact that a case settlement would bring.

In the event of a settlement being agreed in the UK, Anexo would be entitled to claim a percentage of damages awarded to each of its clients, as well as legal costs. It is worth remembering that VW may yet appeal the High Court decision and that, in any event, any revenue from a settlement would be unlikely to accrue until FY-2021 at the earliest. So, at present, there is no certainty that a favourable settlement will be reached, nor that it would include financial compensation.

A number of Bond Turner's existing 8,000 clients were acquired through their status as past customers of the Group and others contacted Bond Turner following a limited marketing campaign which was predominantly conducted through social media channels. Following publicity around the ruling by the High Court, Anexo expects to add clients through a further targeted marketing campaign which it has previously noted 'would lead to a significantly larger return in the event of a successful settlement'.

Anexo has said that it will need additional staff to process new leads and the recent placing announcement stated that any further marketing and the processing of cases taken on by Bond Turner will be funded from a combination of June's placing proceeds and specialist financing rather than existing resources. Any case-related working capital funded by a third party at an agreed rate, while reducing Anexo's earnings, would insulate the Group from those further costs should the case eventually not succeed. The results announcement confirms that the Group has recently secured a £2.1 million lending facility from a litigation funder to support the proposed investment in obtaining new cases.

FY 19 results

Group revenues in FY 19 increased by 38.9% to £78.5 million (FY 18: £56.5 million) and adjusted profit before tax for the period increased by 43% to £23.1 million (FY 18: £16.1 million). We outline the business segment contributions above.

Group performance (£m)

	FY 18	FY 19
Revenue	56.5	78.5
Cost of Sales	-16.2	-15.7
Gross profit	**40.3**	**62.8**
Administrative expenses before exceptional items	-21.6	-31.0
EBITDA	**18.7**	**31.8**
Depreciation, amortisation & loss on disposal	-1.6	-6.6
Operating profit	**17.2**	**25.3**
Share based payments & IPO costs	-1.8	-0.7
Finance costs (net)	-1.1	-2.2
Profit before tax	**14.3**	**22.4**

Source: Company information

Revenue

In 2019 Anexo successfully increased revenues across both its divisions, Credit Hire and Legal Services, resulting in Group revenues of £78.5 million, representing a 38.9% increase over the prior year (2018: £56.5 million). We have already touched on the changes to the size of the vehicle fleet that have taken place following the decision to focus on growing Bond Turner's capacity during FY 19. It is also worth noting the change in balance between cars and motorcycles within the total. In FY 19, the Credit Hire division provided vehicles to 7,182 individuals compared 5,215 in FY 18, an increase of 37.7%. However, the number of motorcycle claims increased by 53.0% from 2,923 in FY 18 to 4,475 in FY 19. There is a clear benefit to working capital consumption as, on average, the take-on cost of a motorcycle claim is significantly less than that of a car. As we highlight above, good revenue growth and flat PBT in the Legal Services business in FY 19 reflected the investment in capacity. Crucially, it was also key to improving cash settlements.

Gross Profit

Gross profit increased by 55.7% to £62.8 million although just under 9% of that was due to the adoption of IFRS 16 where vehicle fleet costs were replaced with a depreciation charge and interest cost in FY 19. Excluding that amount from the profit figure still leaves a good increase and a higher margin than was reported in FY 18 (75.5% versus 71.4%). At a business segment level, Bond Turner is essentially reported at a 100% gross margin while the Credit Hire division reported gross profit of £34.3 million in FY 19 at a margin of 71.4% (64.0% pre-IFRS 16) compared to respective figures of £19.9 million and 58.5% for FY 18.

Operating Costs

The 43.2% increase in administrative expenses to £31.0 million in FY 19 reflects the investment in staff capacity in Bond Turner. Staff costs rose to £13.5 million from £8.7 million in FY 18 with the rest of the increase coming from investment in marketing, staff and infrastructure.

Adjusted EBITDA

Adjusted EBITDA on a pre-IFRS 16 basis was a touch ahead of our estimate at £27.6 million in FY 19. The reported number of £31.9 million after the adoption of that accounting standard in FY 19 was up from £18.7 million in FY 18.

Cash, net debt and facilities

As noted previously, Anexo's cash collections saw a strong improvement in FY 19 increasing by 44.8% from £58.1 million in FY 18 to £84.1 million in FY 19. That countered a £5.5 million increase in net investment in new cases during the year to £26.3 million. Two further impacts on cash flow were seen in the investments in hire claims and recruitment of staff into Bond Turner. The chart below shows the half yearly progression of collections and cases funded over FY 18 and FY 19.

Case data

	H1 18	H2 18	H1 19	H2 19
Cash Collections from Settled Cases (£'000s)	28,230	29,870	36,628	47,512
New Cases Funded	2,588	3,342	3,392	3,567

Source: Company information

The Group had a cash balance of £2.3 million as at 31 December 2019 from £5.5 million at the end of 2018 following the aforementioned investment spend. Anexo secured an increase in facilities for both divisions during 2019 with a balance of £29.9 million at the end of 2019 (its facilities include a revolving credit facility of £8.0 million with HSBC Bank plc and an invoice discounting facility of £18.5 million with Secure Trust Bank). At the end of May 2020, Anexo undertook a successful placing which raised £7.5 million before expenses. The Group has also secured a £2.1 million lending facility from a litigation funder and has received confirmation of approval of a term loan from Secure Trust Bank plc of £5.0 million under the government backed CBILS scheme, which Anexo expects to be available to draw in July 2020.

At the end of FY 19, Anexo's net debt stood at £27.7 million.

In summary

In all, Anexo significantly improved cash collections during FY 19 and has continued in that vein during the first four months of 2020. We expect that to continue during the rest of the year in conjunction with the growth plans which the Group is undertaking from its secure financial position. There are plenty of opportunities for further longer term growth alongside the significant potential of the VW emissions case. The Group's investment in the latter should complement the impact of additional capacity in Bond Turner and the build-up of the fleet size over the coming year.

Financial Summary: Anexo Group

Year end: December (£m unless shown)

PROFIT & LOSS	**2017**	**2018**	**2019**
Revenue	45.3	56.5	78.5
Adj EBITDA	15.8	18.7	31.8
Adj EBIT	15.1	17.2	25.3
Reported PBT	14.6	14.3	22.4
Fully Adj PBT	14.6	16.1	23.1
NOPAT	15.1	17.2	20.7
Reported EPS (p)	11.1	10.2	16.0
Fully Adj EPS (p)	11.1	11.8	16.6
Dividend per share (p)	0.0	1.5	1.5
CASH FLOW & BALANCE SHEET	**2017**	**2018**	**2019**
Operating cash flow	3.1	(2.1)	6.2
Free Cash flow	(4.0)	(13.5)	(6.5)
FCF per share (p)	(3.7)	(12.3)	(5.9)
Acquisitions	0.0	0.0	0.0
Disposals	0.0	0.0	0.0
Shares issued	0.0	9.2	0.0
Net cash flow	(3.8)	(2.2)	(6.5)
Overdrafts / borrowings	(15.2)	(22.8)	(29.9)
Cash & equivalents	0.2	5.5	2.3
Net (Debt)/Cash	(15.0)	(17.3)	(27.7)
NAV AND RETURNS	**2017**	**2018**	**2019**
Net asset value	55.6	75.8	91.7
NAV/share (p)	50.6	68.9	83.4
Net Tangible Asset Value	1.5	3.3	11.5
NTAV/share (p)	1.4	3.0	10.4
Average equity	27.8	65.7	83.7
Post-tax ROE (%)	57.8%	35.1%	30.9%
METRICS	**2017**	**2018**	**2019**
Revenue growth		24.7%	38.9%
Adj EBITDA growth		18.4%	69.8%
Adj EBIT growth		14.0%	47.2%
Adj PBT growth		10.3%	43.3%
Adj EPS growth		5.7%	41.3%
Dividend growth		N/A	0.0%
Adj EBIT margins		30.4%	32.2%
VALUATION	**2017**	**2018**	**2019**
EV/Sales (x)	4.4	3.5	2.5
EV/EBITDA (x)	12.6	10.6	6.2
EV/NOPAT (x)	13.2	11.6	9.6
PER (x)	12.6	11.9	8.5
Dividend yield	N/A	1.1%	1.1%
FCF yield	(2.6%)	(8.7%)	(4.2%)

Source: Company information and Progressive Equity Research estimates

29 June 2020

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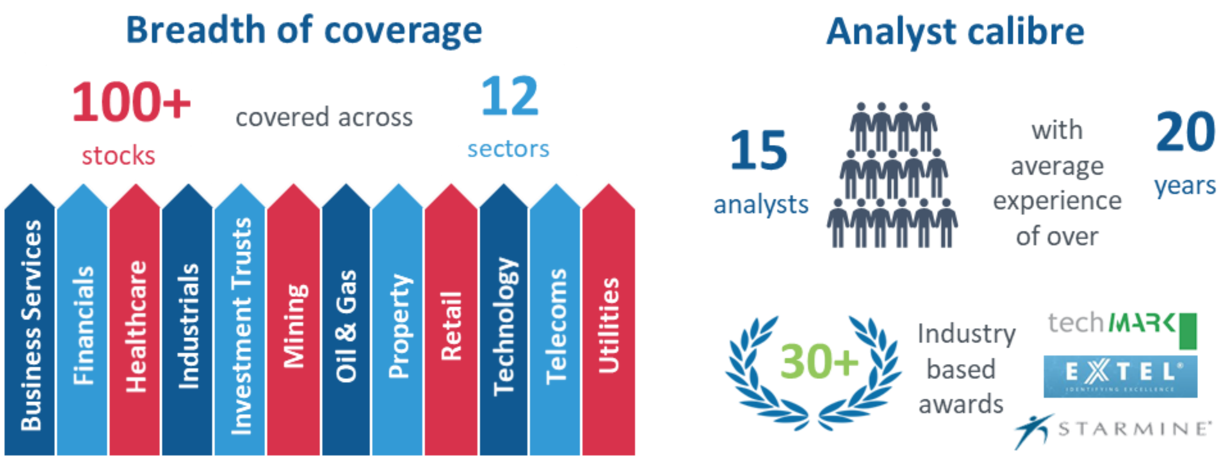

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