Progressive EQUITY RESEARCH

ANEXO GROUP
BUSINESS SUPPORT SERVICES

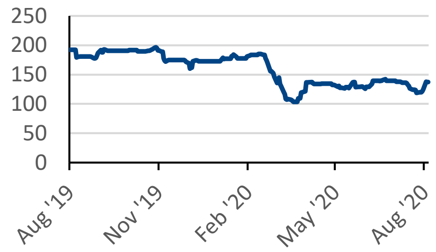
13 August 2020

ANX.L

138p

Market Cap: £159.5m

SHARE PRICE (p)



12m high/low	197p/104p

Source: LSE Data

KEY DATA	
Net (Debt)/Cash	£(19.6)m *(at 30/06/20)*
Enterprise value	£187.3m
Index/market	AIM
Next news	Trading update Jan 21
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

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Strong recovery in prospect

A resilient performance in H1 20

Anexo's interim results show a solid performance in a period affected by COVID-19, in our view. While revenue was flat versus H1 19, the Group continued to invest in future revenue opportunities and cash collection capacity. Adjusted operating profit consequently reduced by 33.9%. The second half is expected to see a strong recovery as vehicle numbers on the road return to higher levels and the investment in capacity in the Legal Services business bears fruit. The Group has proposed an interim dividend of 0.5p. Management has given guidance for the full year and we reintroduce estimates for this year and next which reflect the base from which the Group can now build. Clearly, there is considerable uncertainty as to what COVID-19 may yet bring. However, Anexo's management team takes a positive view on the Group's future performance.

- Management expects H2 20E underlying profit before tax (before investment in VW emissions case acquisition) to recover strongly. We are reintroducing estimates for FY 20E and FY 21E which reflect that outlook and the significantly increased investment in staff and marketing in relation to the VW emissions case of around £4.0 million for H2 20E.
- Our estimates for Adjusted EBITDA for the current financial year and FY21E are £24.8 million and £30.5 million respectively. Our estimates do not include any revenues for the VW emissions case but we look at some broad scenarios for revenue and PBT in this document.
- Cash collection is a key metric for Anexo and collections from settled cases reached £48.0 million in H1 20, an increase of 30.9% on H1 19 (£36.6 million) and a slight increase over £47.5 million in H2 19. We believe that is a good performance in the face of the operational headwinds created by COVID-19.
- Anexo ended the half year with net debt of £19.6 million compared to £27.7 million at the end of December 2019. Absent any acquisitions, we anticipate that this will reduce further by the end of FY 20E as management expects the core credit hire and legal services business to continue to be cash generative in H2 20E.

Overall, we view these results as a good indication of the adaptability and resilience of the Group's two businesses which have both dealt with headwinds from COVID-19 and are expected to recover strongly in H2 20E.

FYE DEC (£M)	2017	2018	2019	2020E	2021E
Revenue	45.3	56.5	78.5	81.5	90.6
Adj EBITDA	15.8	18.7	31.8	24.8	30.5
Fully Adj PBT	14.6	16.1	23.1	16.1	21.8
Fully Adj EPS (p)	11.1	11.8	16.6	11.1	14.7
EV/Sales (x)	4.1x	3.3x	2.4x	2.3x	2.1x
EV/EBITDA (x)	11.8x	10.0x	5.9x	7.5x	6.1x
PER (x)	12.4x	11.7x	8.3x	12.4x	9.3x

Source: Company Information and Progressive Equity Research estimates

Solid performance in a difficult operating environment

Anexo's first half performance was affected by COVID-19, resulting in a decline in activity levels and cash collections. Nonetheless, the Group still reported a solid set of numbers and recent activity levels bode well for the Credit Hire business during H2 20. The Legal Services business has continued to recruit and, although the level of cash collections is expected to improve somewhat more slower than the recovery in credit hire activity, management notes positive momentum in what is usually a slower period during the summer months.

Group revenues of £36.6 million, whilst being flat on H1 19, were 12.3% below H2 19's £41.8 million as the number of cases funded reduced and the investment in legal staff did not bring the anticipated short term increase in fee income and cash receipts.

Anexo has continued to invest in future revenue, however, supported by the fundraising and extended funding facilities. Profitability measures consequently show the impact of the increase in wages and salary costs within the Legal Services division from £6.0 million in H1 19 (and £8.0 million in H2 19) to £8.8 million in H1 20. In addition, the Group incurred £0.7 million of VW marketing costs, and £0.5 million of office and IT expenditure.

We expect the investment in legal staff to bring the expected improvement in fees and cash collections – but delayed from the initial timetable by COVID-19.

Given the above, there was a reduction of £4.0 million in adjusted operating profit to £7.8 million in H1 20 from £11.8 million in the comparable period last year and £13.4 million in H2 19.

Guidance for FY 20E and reintroduction of our estimates

Anexo has given guidance for the current financial year and expects H2 20 underlying profit before tax (before investment in VW emissions case acquisition) to recover strongly. The Group expects 'significantly increased' planned investment in staff and marketing in relation to the VW emissions case of around £4.0 million for H2 20E (compared to £0.7 million in H1 20) which will be funded from a portion of the funds raised in May 2020 and the newly agreed facility of £2.1 million from a litigation funder.

We are reintroducing estimates for FY 20E and FY 21E which reflect the guidance for the current financial year and anticipate an improvement over the FY20E outturn in next year's numbers. We would highlight that these numbers are subject to a high degree of uncertainty given the potential for further influences from COVID-19 on Anexo's operating environment. That said, they reflect the positive news on the two main business lines and the investment spend which the Group has already made.

The table below shows the half-yearly progression to help see where our estimates compare with the recent historical performance of the Group. In addition, we show some profitability measures to compare the performance of the Group without those costs associated with the VW emissions case. Our estimates do not include any revenues for the VW emissions case. We look at some scenario analysis towards the end of this document.

Half-year breakdown of actual and estimated numbers

£m	H1 19	H2 19	FY 19	H1 20	H2 20	FY 20	FY 21
Credit Hire	23.2	24.8	48.0	20.7	27.0	47.7	53.9
Legal Services	13.5	17.0	30.5	15.9	17.9	33.8	36.7
Revenue	36.7	41.8	78.5	36.6	44.9	81.5	90.6
Cost of sales	-7.2	-8.5	-15.7	-7.6	-8.5	-16.1	-18.1
Gross profit	29.5	33.3	62.8	29.1	36.4	65.4	72.5
Depreciation & gain on sale of fixed assets	-1.2	-1.1	-2.3	-1.1	-1.2	-2.3	-2.5
Depreciation on right of use assets	-2.8	-1.4	-4.2	-2.0	-2.1	-4.2	-4.2
Amortisation	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1
VW administration expenses	0.0	-0.9	-0.9	-0.7	-4.0	-4.7	-3.0
Non-VW administrative expenses	-13.6	-16.4	-30.0	-17.4	-18.6	-36.0	-38.9
Operating profit before exceptional items	11.8	13.4	25.3	7.8	10.4	18.2	23.7
Share based payment charges	-0.3	-0.3	-0.7	-0.3	-0.4	-0.7	-0.7
Non-recurring administrative expenses	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Operating profit	11.5	13.1	24.6	7.5	10.1	17.5	23.0
Finance costs	-0.8	-1.0	-1.8	-1.0	-1.0	-2.0	-2.0
Lease finance costs	-0.3	-0.1	-0.4	-0.2	0.0	-0.2	0.0
Total finance costs	-1.1	-1.1	-2.2	-1.1	-1.1	-2.2	-2.0
Profit before tax	10.4	12.0	22.4	6.3	9.0	15.3	21.1
Taxation	-2.0	-2.4	-4.4	-1.4	-1.7	-3.1	-4.2
Profit and total comprehensive income for the year attributable to the owners of the company	8.4	9.6	18.0	5.0	7.3	12.3	16.9
Adj EBITDA	15.9	16.0	31.8	11.0	13.8	24.8	30.5
Adj EBITDA (excluding VW costs)	15.9	16.9	32.8	11.7	17.8	29.5	33.5
Adjusted operating profit before tax	11.8	13.4	25.3	7.8	10.4	18.2	23.7
Adjusted operating profit before tax (exlcuding VW costs)	11.8	14.4	26.2	8.5	14.4	22.9	26.7
Reported PBT	10.4	12.0	22.4	6.3	9.0	15.3	21.1
Reported PBT (excluding VW costs)	10.4	12.9	23.3	7.0	13.0	20.0	24.1

Source: Company information, Progressive Equity Research estimates

Cash position

With good H1 20 cash collection, May's net £7.0 million fundraise, the £2.1 million from a litigation funder and £5.0 million drawn under the Government backed CBILS scheme in July, Anexo has improved its cash position. It will continue to prioritise cash generation while also investing in future revenue generating opportunities – the most obvious (and, at £4 million in H2 20E, costly) being the VW emissions case. Despite the mooted level of expenditure, the Board still expects the core credit hire and legal services business to be cash generative in H2 20.

The focus on cash collections is particularly evident in the interim results announcement. It is important because the ability to generate cash is a key focus for the Group – to the extent that management has been able to demonstrate that it can deliver the level of control necessary to grow cash collections while also growing the business. Of course, COVID-19 has impacted Anexo's operating environment. Therefore, the success in increasing cash collections in a turbulent economic situation is also a useful indicator of how well the Group's business model has coped, in our view.

Net cash inflow from operating activities in the first half of 2020 totalled £6.2 million (H1 2019: net cash inflow £2.5 million). Overall net cash inflow (excluding the recent fundraise of a net £7.0 million at the beginning of June) was £2.4 million compared to a net cash outflow of £7.0 million in the first half of 2019. Within those numbers was a significant reduction in cash absorbed into working capital from £13.0 million in H1 2019 and £11.9 million in H2 2019 to £4.5 million in H1 2020.

Importantly, cash collections from settled cases reached £48.0 million in H1 20, an increase of 30.9% on H1 19 (£36.6 million) and a slight increase over £47.5 million in H2 19 – a good performance bearing in mind the operational headwinds created by COVID-19.

Anexo ended the half year with net debt of £19.6 million compared to £27.7 million at the end of December 2019. We currently expect this to improve further to around £16.7 million by the end of FY 20E assuming that the Group makes no acquisitions (the Group has previously alluded to the opportunity to consider acquisitions of Work in Progress books of small legal and credit hire firms that the fundraise has afforded).

The effects of COVID-19 on divisional operations

Credit hire

The result of the credit hire business in H1 20 reflects the sharp fall in the number of vehicles on roads as the UK went into lockdown – the announcement states that, at the lowest point, Anexo's weekly levels of new business fell to around 25% of its normal expected volumes. In addition, its average number of vehicles on the road fell 14% to 1,286 (H1 2019: 1,496), obviously affecting revenues. There was some mitigation of that from improvements in the value of each claim taken on, which also made for a more efficient deployment of working capital.

The Group was already managing the growth in the Credit Hire division while it was increasing settlement capacity in the Legal Services division. The combination of that and COVID-19 meant that the number of completed vehicle hires reduced from 3,363 in H1 19 and 3,819 in H2 19 to 2,953 in H1 20.

Activity levels have subsequently recovered reasonably quickly, reflecting the significant proportion of its business which comes from the courier market, reaching 1,380 vehicles on the road at the end of H1 20. The current number of 1,575 vehicles is ahead of management expectations with management noting 'a number of our competitors reducing or ceasing activity in the sector'.

Vehicle hires

	H1 18	FY 18	H1 19	FY 19	H1 20
Vehicles on hire at period end	1,240	1,531	1,571	1,308	1,380
Average vehicles on hire for the period	912	1,155	1,496	1,454	1,286

Source: Company information

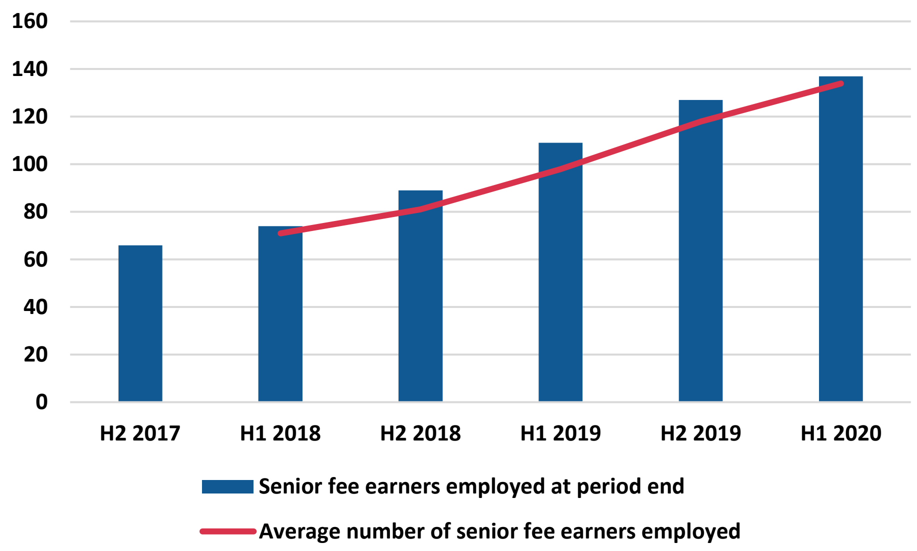
This decline in activity impacted the trading performance of the division with revenues declining to £20.7 million in H1 20 (H1 19: £23.2 million), and profit before tax declining by £1.5 million to £6.8 million in H1 20.

Legal Services

Despite the strong cash collections performance, the Legal Services division felt the impact of the various restrictions which lockdown brought. The Legal Services division remained operational during lockdown and the court system remained open for hearings via video conference or telephone. However, the various challenges that faced Anexo's litigators, the insurers and the court system hindered cash collections. Staff have returned to normal working practices following the end of formal lockdown.

Investment in increasing Bond Turner's claim settlement capacity resulted in the number of senior fee earners rising from 127 at the end of FY 19 to 137 at the end of H1 20 meaning that the average number of fee earners operating during the first half of 2020 was around 134 as the Group added to its team of specialist litigators. The Leeds office is still expected to be open and operational in FY 20.

Senior fee earners



Source: Company information

As we note elsewhere, case settlements and cash collections were still strong during the first half, albeit below levels that management had originally expected from the growing team thanks to some of the logistical hurdles thrown up by COVID-19. Management expects a return to previous efficiencies and increases in settlements and cash collections into H2 20E.

Cash collections and new cases

	H1 18	H2 18	H1 19	H2 19	H1 20
Cash Collections from Settled Cases (£'000s)	28,230	29,870	36,628	47,512	47,961
New Cases Funded	2,588	3,342	3,392	3,567	3025

Source: Company information

Revenues in the Legal Services business increased by 17.8% in H1 20 to £15.9 million (H1 19: £13.5 million). Given the significant level of investment, profit before taxation in the Legal Services business declined to £0.6 million from £2.3 million in H1 19. The full effect of the investment should now start to come through following the relaxation of lockdown restrictions with an experienced litigator generally reaching capacity on settlements and cash collection after at least nine to twelve months.

The VW emissions case

Anexo's advocacy practice is headed by Executive Chairman, Alan Sellers. That team was involved in the high-profile Aston Hall abuse case and also has a significant role in the group litigation against Volkswagen (VW). In the latter case, in the event of a settlement being agreed, Anexo would be entitled to claim a percentage of damages awarded to each of its clients, as well as legal costs. Given the wide range of possible outcomes, understandably there is no guidance on the quantum from management other than to refer to 'a significant positive impact'.

Anexo has around 10,700 clients and expects to gain more while mitigating its exposure to the cost of acquiring new claimants. Litigation is ongoing so there is no guarantee of success, but a case settlement could have a very positive impact on profits and cash flow. So far, the Group has spent around £0.9 million in FY 19 and £0.7 million in H1 20 gathering cases and expects to invest a further £4 million during H2 20E. It does, of course, have access to £2.1 million of funds from a litigation funder with which to help fund the acquisition of further cases. Although this will reduce Anexo's earnings from some of the cases, it will also reduce the call on the Group's cash resources while insulating it from those further costs should the case eventually not succeed.

There are about 91,000 claimants involved in the Group Litigation Order (to which Anexo is not a party) against Volkswagen in the High Court. Following publicity around the ruling by the High Court, Anexo expects to add to those 10,700 clients through a further marketing campaign.

In April, in the preliminary finding by Mr Justice Waksman, he wrote that he found that "the software function in the vehicles here did indeed amount to a prohibited 'defeat device'" and concluded that VW's "attempt to relitigate the issue here was an abuse of the process." VW maintains that the claimants did not suffer any loss and might appeal, emphasising that the case was not yet decided.

However, this week, the Court of Appeal has refused VW permission to appeal the decision on the basis that Mr Justice Waksman's decision on a key preliminary issue was clearly correct and an appeal would not have a real prospect of success. The legal action against VW can now proceed. VW has stressed that the Court decisions did not determine the questions of loss, liability and causation, which will be decided at a trial, not before March 2022.

In 2017, VW agreed to pay $4.3bn in civil and criminal penalties in the US. Compensation varied with the age and model of vehicles involved, with the sums ranging from $5,100 (£4,150) to over $40,000 (£32,520). Anexo has previously noted lower ranges of compensation in Germany and Australia where sums ranged from €1,350 to €6,257 (£1,190 to £5,540) plus a payment of €190 (£170) towards legal costs in the former. In Australia, the settlement sums varied from AU$1,589 to AU$6,554 (£800 to £3,290).

Clearly, there is no guidance on the revenue or profit that might accrue to Anexo from the case. However, given the level of investment which it intends to make, we have included some high level scenario analysis in this table to show a range of possible outcomes.

Our base assumptions are as follows:

- Number of Anexo claimants 11,000
- Average claim size (£) 3,000
- Anexo commission 20%
- Anexo revenue per case (£m) 600
- Total revenue (£m) 6.6
- Margin 75%
- PBT (£m) 5.0

We have aimed to be conservative in these base assumptions in respect of the number of Anexo cases, which we expect to rise; the average claim size and the commission percentage, both of which we think are likely to be greater than our base numbers.

The table below shows the sensitivity of resulting revenue and PBT to changes in the average value of claims and the number of claimants. Obviously, if Anexo's commission rate is higher, the numbers will rise accordingly as well. The numbers highlighted in pink represent what we consider to be a low base case outcome in the event of a settlement.

Given the uncertainty of timing and the outcome of the case, we have not included any revenues in our estimates for the VW case – although the costs associated with building claimant numbers are included.

VW emissions case revenue and profit sensitivity analysis

Revenue (£m)		Number of claimants						
		11000	**15000**	**20000**	**25000**	**30000**	**35000**	**40000**
Value of claim	**2000**	4.4	6.0	8.0	10.0	12.0	14.0	16.0
	3000	6.6	9.0	12.0	15.0	18.0	21.0	24.0
	4000	8.8	12.0	16.0	20.0	24.0	28.0	32.0
	5000	11.0	15.0	20.0	25.0	30.0	35.0	40.0
	6000	13.2	18.0	24.0	30.0	36.0	42.0	48.0
	7000	15.4	21.0	28.0	35.0	42.0	49.0	56.0
	8000	17.6	24.0	32.0	40.0	48.0	56.0	64.0

PBT (£m)		Number of claimants						
		11000	**15000**	**20000**	**25000**	**30000**	**35000**	**40000**
Value of claim	**2000**	3.3	4.5	6.0	7.5	9.0	10.5	12.0
	3000	5.0	6.8	9.0	11.3	13.5	15.8	18.0
	4000	6.6	9.0	12.0	15.0	18.0	21.0	24.0
	5000	8.3	11.3	15.0	18.8	22.5	26.3	30.0
	6000	9.9	13.5	18.0	22.5	27.0	31.5	36.0
	7000	11.6	15.8	21.0	26.3	31.5	36.8	42.0
	8000	13.2	18.0	24.0	30.0	36.0	42.0	48.0

Source: Progressive Equity Research estimates

Financial Summary: Anexo Group

Year end: December (£m unless shown)

PROFIT & LOSS	**2017**	**2018**	**2019**	**2020E**	**2021E**
Revenue	45.3	56.5	78.5	81.5	90.6
Adj EBITDA	15.8	18.7	31.8	24.8	30.5
Adj EBIT	15.1	17.2	25.3	18.3	23.8
Reported PBT	14.6	14.3	22.4	15.3	21.1
Fully Adj PBT	14.6	16.1	23.1	16.1	21.8
NOPAT	15.1	17.2	20.7	14.6	19.0
Reported EPS (p)	11.1	10.2	16.0	10.6	14.3
Fully Adj EPS (p)	11.1	11.8	16.6	11.1	14.7
Dividend per share (p)	0.0	1.5	1.5	1.5	1.7
CASH FLOW & BALANCE SHEET	**2017**	**2018**	**2019**	**2020E**	**2021E**
Operating cash flow	3.1	(2.1)	6.2	15.8	18.8
Free Cash flow	(4.0)	(13.5)	(6.5)	3.4	4.3
FCF per share (p)	(3.7)	(12.3)	(5.9)	3.0	3.7
Acquisitions	0.0	0.0	0.0	0.0	0.0
Disposals	0.0	0.0	0.0	0.0	0.0
Shares issued	0.0	9.2	0.0	7.5	0.0
Net cash flow	(3.8)	(2.2)	(6.5)	10.9	4.2
Overdrafts / borrowings	(15.2)	(22.8)	(29.9)	(34.9)	(34.9)
Cash & equivalents	0.2	5.5	2.3	18.2	22.4
Net (Debt)/Cash	(15.0)	(17.3)	(27.7)	(16.7)	(12.5)
NAV AND RETURNS	**2017**	**2018**	**2019**	**2020E**	**2021E**
Net asset value	55.6	75.8	91.7	110.4	125.3
NAV/share (p)	50.6	68.9	83.4	95.1	108.0
Net Tangible Asset Value	1.5	3.3	11.5	11.0	10.8
NTAV/share (p)	1.4	3.0	10.4	9.5	9.3
Average equity	27.8	65.7	83.7	101.0	117.9
Post-tax ROE (%)	57.8%	35.1%	19.2%	21.6%	0.0%
METRICS	**2017**	**2018**	**2019**	**2020E**	**2021E**
Revenue growth		24.7%	38.9%	3.9%	11.1%
Adj EBITDA growth		18.4%	69.8%	(22.0%)	23.0%
Adj EBIT growth		14.0%	47.2%	(27.5%)	29.9%
Adj PBT growth		10.3%	43.3%	(30.4%)	35.6%
Adj EPS growth		5.7%	41.3%	(33.2%)	32.8%
Dividend growth		N/A	0.0%	0.0%	13.3%
Adj EBIT margins		30.4%	32.2%	22.5%	26.3%
VALUATION	**2017**	**2018**	**2019**	**2020E**	**2021E**
EV/Sales (x)	4.1	3.3	2.4	2.3	2.1
EV/EBITDA (x)	11.8	10.0	5.9	7.5	6.1
EV/NOPAT (x)	12.4	10.9	9.0	12.8	9.9
PER (x)	12.4	11.7	8.3	12.4	9.3
Dividend yield	N/A	1.1%	1.1%	1.1%	1.2%
FCF yield	(2.7%)	(8.9%)	(4.3%)	2.2%	2.7%

Source: Company information and Progressive Equity Research estimates

Progressive EQUITY RESEARCH

13 August 2020

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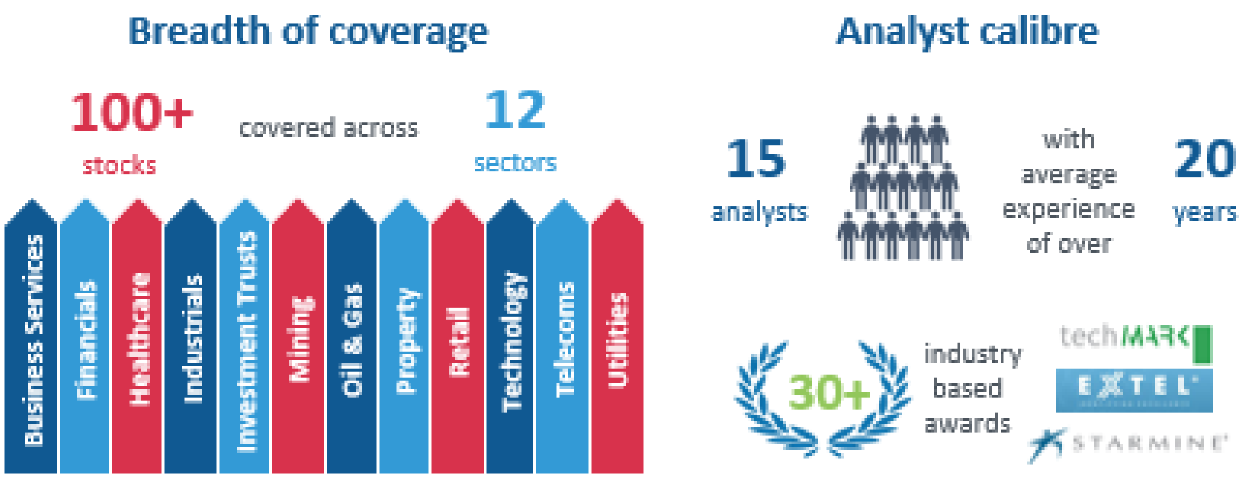

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