Begbies Traynor Group

Look at what's right under your nose

1 April 2020

Who benefits from the death of businesses during the lock-down? Corporate undertakers, that's who. Maybe I should describe them as corporate 'upcyclers' since they recycle temporarily unusable assets and free any viable parts of the businesses from the bonds tying them to the moribund bits.

In every recession the rate of corporate insolvencies rises

And while Rishi Sunak's extraordinary emergency measures will do a lot to bail out sound businesses, they will not persuade commercial banks to throw £billions of loans to companies that have negligible chances of repaying them.

The Government Guarantee for business loans is a good scheme that will save many viable corporates yet leave most non-viable ones to go under. Why? Because the guarantee is only for 80% of the outstanding principal of the loan - so banks will take on more risk if they think that the odds are good enough when comparing the interest on 100% of the loan against the risk of loss on 20% of it.

However, with the Bank of England base rate at just 0.1% the interest rates on loans from commercial banks are too low for lending to unsound businesses to be worth the risk. We have already seen a raft of retail and hospitality companies give up in the face of the UK Government lockdown.

In just the last week BrightHouse (the UK's largest rent-to-own firm, already weighed down by claims for compensation on mis-selling) fell into administration because its chances of survival had become negligible – as did leading restaurant chains Carluccio's and Chiquito. They are joining many other household retail names there, such as Laura Ashley, Soak and Beales. The banks will continue to carry out their risk assessments as before with just one change in their formula for determining whether or not to make a loan.

So, just as the death rate from Covid-19 is highest among those with pre-existing medical conditions, the corporate death-rate will be highest among those companies with excessive debts and/or negative cash flow prior to the shut-down. It will also be higher among SMEs despite the array of government measures to help the smallest SMEs. A £25,000 grant plus rate relief plus 80% of the wage bill for employees, if any, should be just about enough for a corner shop to tide it over a couple of months when it can only serve one customer at a time.

Yet corporate giants can still borrow money from the market (e.g. Anglo American has just raised $1.5 billion by issuing medium-term notes to provide it with additional flexibility in managing its working capital).

We consider, therefore, that the recent decline in the share price of Begbies Traynor itself (LSE:BEG) as the leading corporate insolvency specialist for SMEs appears not merely overdone, but perverse.

Company Data

EPIC	BEG
Price (last close)	80p
52 weeks Hi/Lo	94p/59p
Market cap	£98m

Share Price, p

Source: ADVFN

Company Description

Begbies Traynor is the UK's leading Corporate Rescue and Recovery practice. It provides services via a nationwide network of over 70 offices, with clients ranging from small businesses and professional advisers to large corporations and financial institutions.

The company today forms part of Begbies Traynor Group plc, ('Begbies') an AIM-listed professional services consultancy delivering solutions for businesses, financial institutions and professional advisers in the areas of corporate recovery, restructuring and turnaround, corporate finance, forensic accounting, investigations and security risk.

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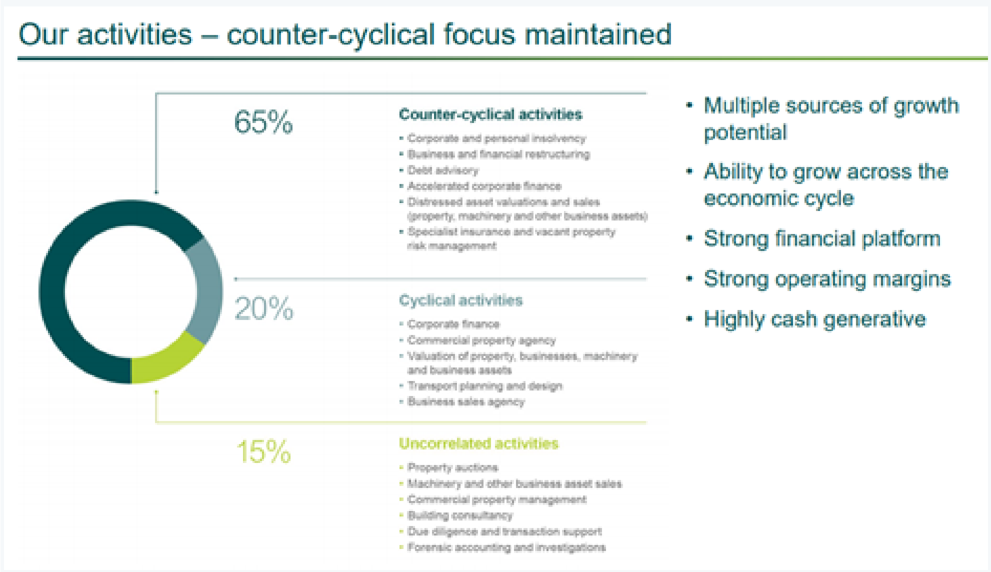
BEG already has strong momentum

Even before the Covid-19 outbreak, trading at Begbies was relatively encouraging with growing revenue, up 15%, in a rising market (corporate insolvencies in 2019 were 7% up on 2018) and adjusted profit before tax for the first half of 2019/20 up by one-third to £4.0m (IFRS PBT more than trebled in H1 to £1.9m); adjusted EPS rose more than 20% from 2.1p to 2.6p. The latest update on Q3, released on 3rd March, stated that they expect to meet current expectations for the current year (adjusted PBT of £9.4m and EPS of 5.8p). But in the current economic climate we would hope that they significantly exceed prevailing market forecasts for 2020/1 of £10.9m and 6.8p, assuming that Covid-19 does not significantly delay the work of administrators themselves.

As equity markets crashed in recent weeks, so Begbies' share price also slumped from 94p to 62p before a partial rebound to 80p, a level that puts them on a current year PER of c. 14x but one of around 10x, certainly <12x, for 2020/1. This seems too low for the leading company in its sector with a strong balance sheet (net debt of £2.3m at the half-year was less than 4% of shareholders' funds) and £30m of undrawn bank facilities. They have more than enough to fund the increased working capital that will be needed to take on the increased workload coming around the corner.

Begbies has strategically sought to broaden its range of service activities in order to be able to grow across an entire economic cycle. And it has been very successful in achieving that through organic growth and well-chosen acquisitions. Yet its weighting of activities still leaves the group excellently placed for strong performance in the very difficult months ahead:

Counter-cyclical weighting reduced, but still dominant



Source: Company H1 results 2019/20

Conclusion

In the Financial Crisis of 2009/10 a significantly smaller Begbies Traynor (it has since made a series of synergistic acquisitions) made PBT of £10.4m and EPS of 7.8p. Today's expanded group should easily beat that in the fall-out from the lockdown.

Investor Access

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