

Strategic focus on strong growth

21 July 2016

The two key messages from the H116 trading update were (a) **strong progress by Legal Services**, in line with expectations and (b) the decision to **pursue an orderly wind-down of the debt management plan services (DMP)**, prompted by new FCA regulation which increased costs and made that business appear unviable. Fairpoint also confirmed the appointment of David Broadbent as new CFO from 1 August.

This will continue the group's focus on core Legal Services which contributed 75% of H1'16 revenues. That was 20% up y-o-y, but the current run rate is **closer to twice last year** driven by the acquisition of Colemans completed in August 2015, near fully integrated. This division already represented 100% of medium term growth potential. DMP income pivoted on a steadily shrinking client portfolio, management of which has become more complex and time-consuming, resulting in higher potential churn.

We have adjusted forecasts for divisional closure costs and no further DMP contribution i.e. declines of £1.3m in forecast adjusted pre-tax profit this year (2016e) and £1.5m in 2017e. These are in line with the indicated, flat y-o-y profit performance in H2. Interims are announced on 15 September 2016.

Accelerated focus on Legal Services

The transition to predominantly legal services is ahead of schedule, but was already well underway. There were no operational synergies between the two operations and no plans to rescale debt solutions. Legal Services reported a positive H1'16 and continues to seek acquisitions to complement its service portfolio. In H1 it added a small, market leading practice which specialises in child abuse actions (£0.3m costs included in our forecasts).

There was also a more sanguine view regarding the impact of one previously reported area of possible concern, related to small claims limits on whiplash claims (9% of first half revenues). As this consultation is still yet to get underway any changes are unlikely to be implemented before Autumn 2017.

Valuation: strategic change can take time to absorb but, costs aside, the news fits our expectations. Fairpoint won't extract quite as much value from its shrinking debt management book, but we had already assumed very soft IVA volumes. Legal Services revenues are growing even without new acquisitions, long term facilities are available to fund organic growth and acquisitions, and even after this adjustment the dividend is very well covered. Share price weakness post small claims uncertainty and this latest news puts them on an attractive prospective **FY16 PER of 6.5x and 7.1% yield**.

Summary forecasts

Year end 31 Dec	2013A	2014A	2015A	2016E	2017E
Adj Pre-tax, £'000s	8,051	9,255	10,464	8,800	9,800
EPS, p	15.0	17.2	19.3	15.6	16.6
PER	6.7	5.9	5.2	6.5	6.1
Div, p	6.0	6.4	6.8	7.2	7.6
Yield, %	5.9	6.3	6.7	7.1	7.5

Source: Group report & accounts and ED estimates

Company Data

EPIC	FRP
Price	101p
52 week Hi/Lo	195p / 97.5p
Market cap	£42.8m

Share Price, p



Source: ADVFN

Description

Fairpoint Group provides a range of retail consumer targeted professional services. The group's core business is a consumer legal operation, supported by legacy IVA services.

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Refocus on legal services gathers pace

Overall the group traded in line with expectations in H1'16, with Debt Solutions and Claims businesses continuing their anticipated declines in tough markets. Fairpoint's profile is in transition from **low growth, higher margin** debt solutions towards **higher growth, lower margin** Legal Services businesses.

Legal Services

The group's legal service operations continued to take share in the first half. The strategic focus has been successful integration of recent acquisitions, notably Colemans (August 2015). The update confirmed that 80% of divisional revenues are now administered on a common IT platform and that early results of a new marketing approach have been encouraging. Conveyancing experienced a quieter period (as reported in the AGM in May). It contributed 6% of first half revenues, but its slower performance was compensated by growth elsewhere within this division.

Debt Solutions and Claims – restructuring costs

For the purposes of our outlook and valuation we already regarded this division as in de facto run-off, although the DMP closure happened ahead of schedule. Taking that business first, management drew attention to the more rigorous FCA regulatory agenda when it reported its final results in March 2016, and that was behind last year's decision to refrain from further acquisitions. The impact of new regulation on the industry and on the commercial viability of Fairpoint's operations is reflected in lower DMP profitability in H116.

The group's experience to date suggests that the new regulatory regime will give the **charitable** DMP sector material competitive advantages over its **commercial** operation and make its business model unsustainable. Management thus decided to complete the orderly wind down of the group's DMP operations in H2 2016, with an inevitable negative impact on operational revenues and profitability. This restructuring will result in c £2m of exceptional charges in H216, (£1m cash costs in FY16), and a £5m non-cash impairment of debt management intangibles.

IVA – tough markets, focus on profit and cash generation

The strategy here is unchanged. The group will focus on margins, cash generation and avoidance of uneconomic business. Fairpoint has put segment related marketing activity on hold, with lower prospects of the upwards movements in interest rates which typically prompt customer demand for debt solutions.

New CFO – David Broadbent joins on 1 August

Fairpoint also announced the appointment of **David Broadbent** as CFO from 1 August 2016. He has over 20 years' experience of professional and financial services and previously served on the board of International Personal Finance plc from its 2007 listing to 2016, as FD and more recently as Chief Commercial Officer. He replaces John Gittins, who has previously announced his desire to step down and pursue a portfolio career.



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