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4 June 2020

RBG Holdings: Back a winning legal team

RBG published record annual results during the Covid-19 lockdown, and it's business as usual for its team of 46 fee-earning legal eagles at London law firm Rosenblatt. In fact, the firm has been winning new instructions, and is set to be a beneficiary of the economic crisis, too

RBG (RBGP)

Ticker	RBGP
Current price	68p
12-month target price	140p
Market cap	£58m
52-week high	127p
52-week low	48.5p
Net cash	£0.7m (31 March 2020)
Shares in issue	85.6m
Financial year-end	31 December
Next event	First-half trading update end-June 2020
Company website	www.rbgholdings.co.uk

RBG share price since IPO

Source: FactSet

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Simon Thompson's view:

RBG is not just a leading law firm in dispute resolution, the group boasts market-leading margins, testament to the pricing power of Rosenblatt's rainmakers who have an enviable success rate in winning legal cases. The group has also diversified its revenue streams, having purchased a highly profitable corporate finance boutique, with a bumper pipeline, last autumn. Add to that potential for shareholders to reap chunky cash returns from RBG's small portfolio of litigation investments, and a rating less than half that of its larger rivals, and the shares offer considerable upside trading on a forward price/earnings (PE) ratio of 7.5.

Bull points

- Long standing reputation attracts clients.
- Strong pricing power – highest cash profit margins in listed law firm sector.
- Consolidator of high margin professional services businesses.
- High payout ratio.
- Counter cyclical revenues – greater occurrence of litigation in economic downturns.
- High success rate in litigation cases.
- Convex Capital acquisition diversifies revenue stream, enhances cross referral opportunities and de-risks 2020 earnings forecasts.
- Prudent revenue recognition of contingent legal work offers forecast upside.
- Mergers & acquisition strategy supported by well capitalised balance sheet.
- Covid-19 – no impact on normal capacity and instructions. Rosenblatt law firm winning new instructions.
- Opportunity to boost market share in growth market.

Bear points

- Low free float.
- Final dividend lower than previous guidance.
- Litigation finance arm only two years old so yet to build full traction.
- Brexit uncertainty and market softness held back corporate legal work in 2019.
- Reliance on high earners creates greater earnings concentration risk.
- Negative sector sentiment following hedge fund short selling attack on Burford Capital.

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RBG Holdings (RBGP), a professional services group has evolved from being a pure play law firm, Rosenblatt, when the company raised £43m in an IPO two years ago. In fact, having established a nascent litigation funding arm, and made its first acquisition last autumn – specialist finance boutique Convex Capital – the group's growing diversified revenue stream offers scope to generate strong earnings growth in the coming years and reward shareholders with a high payout ratio, too. For good measure, RBG's businesses have performed well through the UK lockdown, and are ideally placed to benefit from the fall-out. For instance, Rosenblatt has received new instructions from clients in the areas of financial restructuring and employment-related issues.

Established more than 30 years ago, by 19.8 per cent shareholder Ian Rosenblatt, RBG makes money from three core activities.

RBG (RBGP)

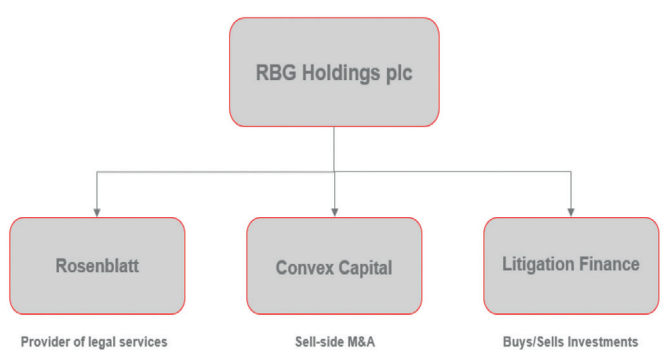
Ord Price: 68p
Touch: 67-69p
Dividend Yield: 7.4%
Net Asset Value: 49.5p*
*Includes intangible assets of £35.1m, or 41p a share

Market Value: £58.2m
12-Month High: 127p **Low:** 48.5p
PE Ratio: 7.5
Net Cash: £0.7m

Year to 31 Dec	Revenue and realised gains (£m)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2015	14.9	2.84	***	***
2016	14.1	0.50	***	***
2017	15.8	4.80	***	***
2018**	12.5	4.03	5.41	2.8
2019	23.7	7.65	7.56	3.0
2020^	30.6	9.30	8.50	5.1
2021^	32.4	10.30	9.20	5.5
2020-21 % change	6%	11%	8%	8%

Normal market size: 3,000 SETSqx
**Period from company incorporation on 6 Feb 2018 to 31 Dec 2018. Profits for 2018 exclude Aim Admission costs of £1m.
***Prior to IPO in May 2018
^N+1 Singer forecasts
Source: RBG Holdings annual report, London Stock Exchange

RBG Group Structure



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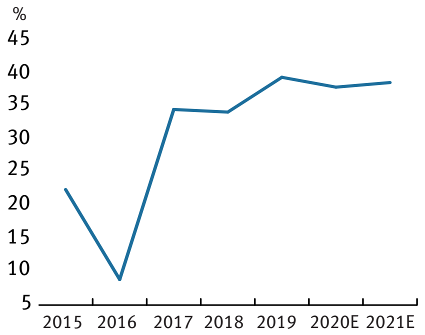
RBG's market leading profit margins

	2015	2016	2017	2018	2019	2020E	2021E
Revenue	£14.9m	£14.1m	£15.8m	£12.5m	£23.7m	£30.6m	£32.4m
Ebitda	£3.4m	£1.3m	£5.5m	£4.3m	£9.4m	£11.7m	£12.6m
Operating profit	£3.3m	£1.2m	£5.4m	£3.0m	£7.9m	£9.6m	£10.6m
Ebitda margin	22.6%	8.9%	34.8%	34.4%	39.7%	38.2%	38.9%

Source: RBG annual report, N+1 Singer forecasts for 2020 and 2021

RBG's impressive Ebitda margins



Source: RBG annual report; N+1 Singer forecasts for 2020 & 2021

Profit from Rosenblatt's rainmakers

Rosenblatt, a top 200 UK law firm, is a high-margin business that made a £10.2m profit contribution (on revenue of £18.1m) in 2019, a performance that enabled RBG to post best-in-class cash profit margins of almost 40 per cent. The reason why Rosenblatt is so profitable is because its team of 46 fee-earning legal eagles specialise in litigious/contentious work that enables the firm to bill clients by the hour and control the level of fees it charges. Dispute resolution work accounts for two thirds of the business whereas listed peers have greater exposure to more commoditised general legal services work, which has lower pricing and where fixed fee structures are common.

Rosenblatt's diversified client base includes companies, banks, entrepreneurs and high net worth individuals and the firm has an increasingly international footprint, advising on complex cross-jurisdictional matters in China, Israel, America and India. Clients are loyal as Rosenblatt has established a number of longstanding relationships that generate recurring project work over time. The firm specialises in the business-to-business space and does not ordinarily undertake any form of consumer-facing legal services, such as personal injury claims, conveyancing or probate. Typically, it will act for the claimant litigant bringing a case rather than the defendant, and is a non-panel firm. A panel is a pre-determined list of legal service providers for large corporates (usually banks and established brand names). The directors consider that being a non-panel firm is strategically important as it helps Rosenblatt avoid potential conflicts of interest.

As a result, Rosenblatt is seen as a protagonist-led firm – taking on the big corporates and the Magic Circle of the top five legal fims in England – and has developed a reputation for handling complex cases. For instance, the firm helped logistics group **Stobart (STOB)** win a case against a dissident director last year. It's lawyers have also been quick off the mark to highlight the implications of Covid-19 rent defaults on the commerical property sector ('Coronavirus and Commercial Rent – Who Bears the Cost in a Time of Crisis?', 22 May 2020) and the changes proposed by the Corporate Governance and Insolvency Bill which had its first reading on 20 May 2020.

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Rosenblatt's areas of expertise

■ **Dispute resolution.** This segment mainly involves advising on fraud, pre-litigation investigations, professional negligence, insolvency and financial restructuring, and defamation work. By positioning itself away from institutional panels Rosenblatt remains free of conflict so can act on cases which other firms are unable to. Most cases are billed monthly with fees weighted towards the end of the case. The department often undertakes work on a conditional fee basis, which provides for a success fee.

■ **White collar fraud and crime.** Rosenblatt launched this division last autumn. It is likely to prove a boom area as historically there has been an increase in white collar crime during economic downturns. Financial crime is an increasing threat driven by the growth of cybercrimes such as identity theft and phishing, as well more traditional forms of financial crime such as money laundering, tax evasion and fraud. The UK financial regulator, the Financial Conduct Authority (FCA), estimates the financial services industry is spending over £650m annually in dedicated staff time to combat fraud, money laundering and other financial crimes.

■ **Corporate.** Instructions undertaken include work on private equity and venture capital deals, public and private mergers & acquisitions, corporate reorganisations, and real estate transactions. Corporate transaction fees are usually recognised towards the end of the transaction.

A differentiated structure

Average revenue per fee earner was £393,000 in 2019, little changed on the year earlier, but importantly remuneration is linked to profitable performance rather than billings. Fee earners receive a basic salary with bonuses arising from dividends paid on equity owned, rather than a percentage of billing.

In turn, this creates a culture of collaborative working, a commitment to controlling costs and a greater focus on targeting profitable work. It also means that senior partners can retire with dividends providing a future income, rather than 'blocking' the rise of junior lawyers, thus creating a progressive working structure. The other benefit of aligning remuneration with shareholder interests is that equity participation can be used to attract and retain talent, thus preventing Rosenblatt's rainmakers from being poached by other law firms.

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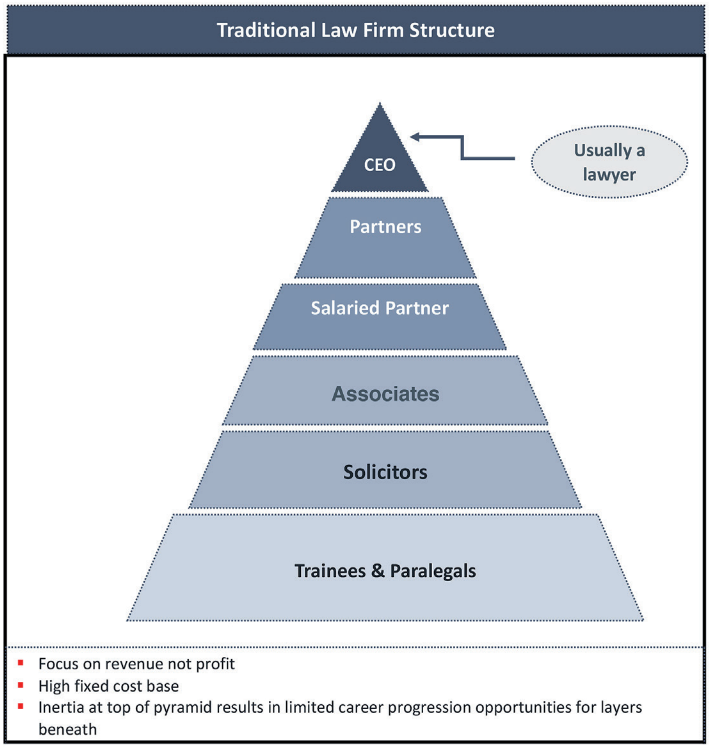
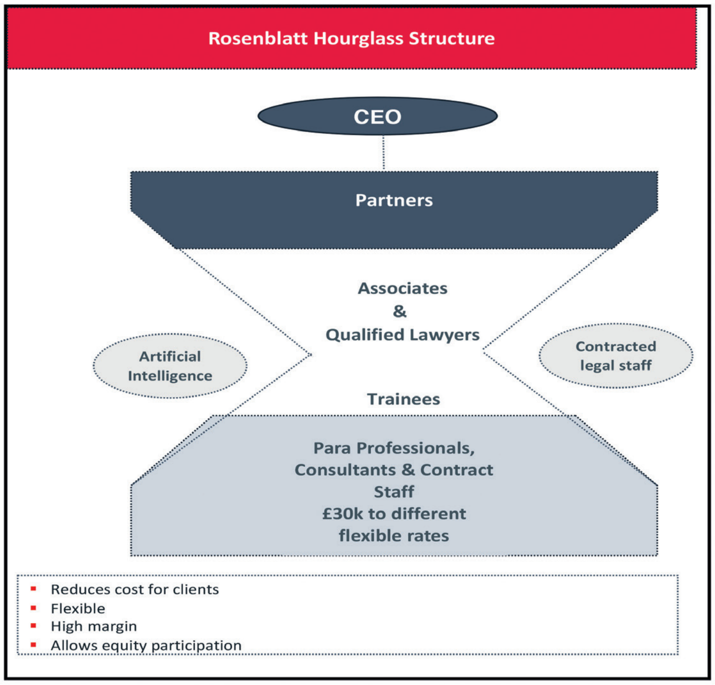
Rosenblatt's fee earner differentiation



Furthermore, Rosenblatt's flexible business model creates a lean cost base and removes the inefficiencies prevalent in the operating structure under the traditional partnership legal firm business model. In addition, Rosenblatt uses contractors, thus enabling the firm to manage its cost base in relation to changes in workload better than other law firms.



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“Rosenblatt is trading better than before the lockdown”

Another key feature of Rosenblatt’s business model is the focus on maintaining high margins on the work it does while ensuring the core business is cash-generative and efficient. Total lock up days, being the average debtor days plus average accrued income days, was 122 days in 2019 (of which 45 were debtor days and 77 were work in progress days). This is a measure of the time it takes to convert work done into cash. Importantly, the firm has a low level of bad debts. In fact, the total bad debt charge for last year was only £350, and debtor days have not extended since the Covid-19 outbreak, a sign of the quality of the client based.

Admittedly, corporate legal work was subdued in 2019 mainly due to Brexit uncertainty, but this was more than made up for by the dispute resolution business which performed strongly and has been taking on more contingent based work. Indeed, Ian Rosenblatt stepped up last year and brought in “new clients and millions of pounds of additional revenue”, according to chief executive Nicola Foulston, adding that “Rosenblatt is trading better than before the lockdown.....the pipeline [of work] is strong”. This highlights how Rosenblatt has successfully adapted its business approach to changes in the market and also to how litigation cases can be funded.

Alternative billing arrangements

The reforms of English commercial litigation, recommended by Lord Justice Jackson, came into force on 1 April 2013 and have promoted the use by clients of third-party litigation funding providers. The market has matured quickly since then, with numerous respected providers operating in the UK. Third party providers agree to fund all or part of a case on a contingent basis in return for a share of the litigation recoveries (being either a settlement or an award of damages) or an agreed multiple of the costs advanced. The basis on which funding is offered varies considerably depending on the facts of each case and the amounts in dispute.

Using third-party funding provides some certainty about the costs of litigation and ensures the cash flow required for the case is available. Where one party is in a much stronger financial position, third-party funding can help to create a more level playing field by removing the ability of one party to stifle the claim by deliberately increasing costs. In addition, engaging a third-party funder can assist settlement, and reduce pressure on court time, as an opponent knows that the counterparty has the means to pursue the case. There are two main types of litigation funding agreements.

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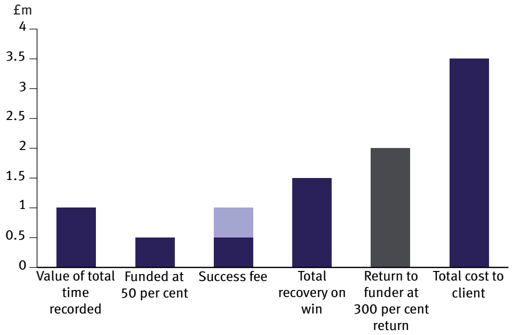
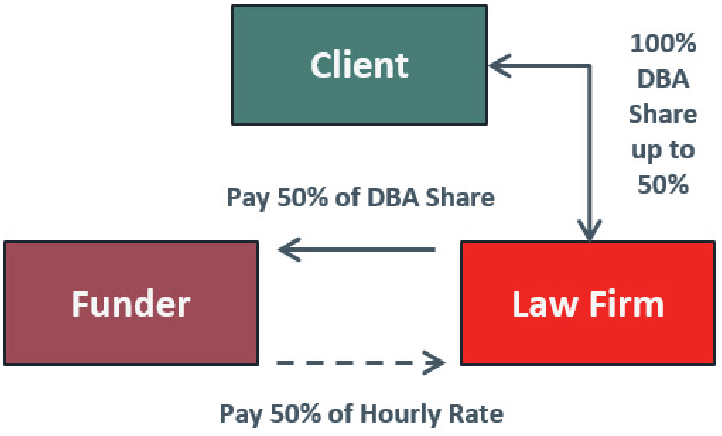
CFA with funding



Source: RBG investor presentation 20 April 2020

■ **Conditional Fee Agreement (CFA).** These are the most common form of 'no win, no fee' agreement. Under a CFA, lawyers share the risk of loss with the client. If the case is lost, the solicitors will not charge the client for the work done. However, if the case is won, the lawyers will charge an additional success fee on top of the normal fees. The additional success fee compensates the solicitors for taking on the risk of not being paid. The success fee is set as a percentage of base costs up to a maximum of 100 per cent.

■ **Damages-Based Agreement (DBA).** This is another type of 'no win, no fee' contingent fee agreement under which a solicitor can recover a percentage of the client's damages if the case is won. Previously, DBAs could not be used to fund litigation and could be used only in claims before tribunals or arbitrations (namely, proceedings adjudicated not in court). However, since 1 April 2013, DBAs can be used to fund proceedings in all civil litigation cases with limited exceptions. The DBAs Regulations 2013 caps the maximum payment that a solicitor can recover from the client's damages at 25 per cent of damages in personal injury cases, 35 per cent in employment tribunal cases and 50 per cent in all other cases.



Source: RBG plc investor presentation 20 April 2020

Rosenblatt has embraced the new legislation by increasing exposure to contingent cases in order to monetise its case flow and enhance the fee it earns from them, risking a proportion of the overall revenue to be earned from a case against its outcome for an increased return. Effectively, it enables the firm to retain the margin that would have been paid to an external funder. However, the directors take a prudent approach as no more than 25 per cent of annual revenue and 25 per cent of net assets can be committed or invested in contingent case work, and cash exposure to any one case is limited to 50 per cent of the liabilities.

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"The law firm has won 19 of the 22 cases that have concluded to date"

RBG uses external funders to fund the rest of the commitment, the benefit of which is that selling down participation rights in contingent cases contributes to one-off revenues, and means that cash can be recycled into additional cases to diversify the portfolio of contingent cases and mitigate investment risk. Rosenblatt has an enviable track record of success. Since taking on contingent work such as CFAs and DBAs in 2011, the law firm has won 19 of the 22 cases that have concluded to date.

Using expertise to move into Litigation Finance

In 2019, Rosenblatt made a cash investment of £2.2m in eight dispute resolution cases and accrued £1.9m of associated unrecognised investment of time. It has a further six cases under consideration. The law firm also realised £3.8m in profits from the sale of a percentage of its participation rights in two legal cases, Projects Shango and Mercury, which have total potential recoveries of £25m and £14.5m, respectively. Gains on participation rights were the primary reason why group adjusted pre-tax profits soared from £4m to £7.6m. RBG is anticipating booking a further of £2m from participation rights sales this year, a forecast that is viewed with "confidence" by the directors.

Rosenblatt has successfully concluded claims, too, having earlier this year announced the settlement of Project Blue Sky, a DBA for a shareholder dispute case. The claim was settled little over a year after being filed, and produced a 184 per cent return on the group's investment. There is a realistic chance of further hefty gains being realised in the future, too.

That's because in one of the cases, Project Neptune, which Rosenblatt has run on behalf of insolvency practitioners in a dispute with several leading UK financial institutions, judgment has been handed down in favour of the firm's clients. There is a consequential hearing to determine the costs to be awarded. The case remains ongoing as the defendant has applied for permission to appeal, which has not yet been granted but the hearing is likely to be heard in the fourth quarter if it does. The project is a CFA and was acquired during the IPO. Rosenblatt has work in progress, or time, of £2.1m invested which has not been billed. Should the judgment be upheld, the firm expects to charge total fees of £4.2m. Should the permission to appeal be granted, then Rosenblatt will be paid by the client in the usual way.

Secondly, Rosenblatt has been successful in an interim hearing for the case known as Project Shango, a class

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"The board targets paying out 60 per cent of retained earnings"

action against a multinational company for the damage caused following an accident at one of its international sites. The project is a collaboration between Rosenblatt and an intermediary law firm under a DBA. The amount claimed is for over £1bn. To date, Rosenblatt has advanced £3m in cash and has contingent work in progress of a further £1.4m. The case will now be heard in the English Courts and is likely to run well into 2021. The total potential recovery is £25m, a significant sum in relation to RBG's own market capitalisation of £58m. Success could open the door for payment of a special dividend to shareholders, in addition to the normal dividend. The board targets paying out 60 per cent of retained earnings.

Industry back drop and consolidation opportunities

Part of RBG's strategy is to a take advantage of the highly fragmented legal market to engage in consolidation, but only at the right value, and with the right deal structure.

The UK has the largest legal market in Europe, with more than 10,000 law firms and partnerships making a direct economic contribution of 1.5 per cent of the country's GDP and accounting for 7 per cent of the global market for legal services. The sector is dominated by the traditional legal names with the top 15 law firms generating more than 40 per cent of aggregate revenue. However, the market is highly fragmented outside of the top 15 firms, with 85 per cent of all UK firms being classed as small, employing four or fewer partners. The firms ranked between 16 and 200 account for around 25 per cent of the market. Below this mid-market tier exists 1,000 further firms which have annual revenues of between £1m to £2m and account for 14 per cent of the market.

It's not difficult to understand why the UK has such a dominant position. That's because the UK legal services market is globally recognised as the most international due to the widespread use of English law as the framework for international contract and dispute resolution. As a result, London is the preferred location for settlement of disputes involving international companies. In fact, around two thirds of litigants in the Commercial Court are from overseas. If anything, the number of disputes to be settled by the legal profession will only increase in the coming years as the fallout of the Covid-19 pandemic on companies and their shareholders unfolds. That can only be good news for RBG.

Admittedly, the directors have yet to acquire another law firm, but they have been successfully diversifying revenue streams in other ways.

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Creating a broad, professional services group

Another key strategy is to diversify the group's activities beyond legal services to create a broad, professional services group focused on high-margin, specialist companies which create opportunities for cross-referrals.

With this in mind, last autumn RBG made the first acquisition post IPO, Convex Capital, a Manchester-based sell side M&A corporate finance boutique. Convex specialises in transacting owner managed and entrepreneurial buy-outs of smaller businesses across Europe for large corporations. Established in 2011 by its chairman Mike Driver, Convex completed over £1bn of transactions in the preceding four years, consistently delivering over £8m of annual revenue.

In the financial year to 30 June 2019, Convex completed 13 deals and generated pre-tax profit of £4.3m on revenue of £8.7m, a healthy 50 per cent profit margin. In the final three months of 2019, the first quarter post acquisition, Convex completed two transactions, generating £1.9m of revenue and making a pre-tax profit margin of £779,000. Convex has 30 potential transactions in its current pipeline which could generate upto £32m of fees. Historically, Convex has a 80 to 85 per cent conversion rate on its pipeline.

Prior to the acquisition, RBG had a business relationship with Convex, performing around a fifth of its legal work. Post acquisition, the group could potentially capture a further £1m of legal fees from the balance of Convex's business. Cross selling services to clients of both companies as well as creating a new hub in Manchester for Rosenblatt to expand its professional business services offering are the other main benefits of the acquisition.

Importantly, of the £13.6m initial consideration paid, almost half (£6.6m) was settled in shares at an issue price of 120p with the balance of £7m paid in cash. A deferred cash payment of £1.8m is payable to the vendors this autumn, and there is a contingent £6.6m earn-out to be settled in shares (minimum issue price of 140p), but only if Convex exceeds a cash profit (earnings before interest, taxation, depreciation and amortisation) of £6m for the 12 months to 16 September 2020. All the consideration shares have a lock in of three years.

The strategic rationale of the acquisition aside, the structure and pricing made it immediately earnings-enhancing to RBG's shareholders. Furthermore, the vendors of Convex are well incentivised for their former business to make a strong contribution to RBG's trading performance. That's because it would help push the share price back towards the level at which their own shares were issued, and they could also benefit from the deferred share consideration element.

There are no issues funding the deferred cash consideration as RBG had net cash of £0.7m at 31 March 2020, and the directors have access to an untapped £10m revolving credit

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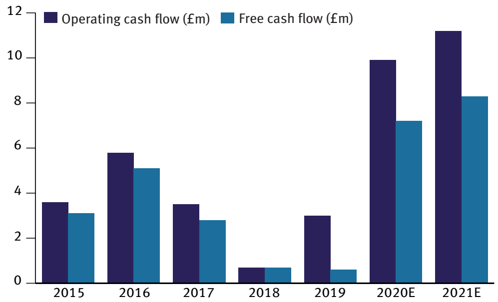
facility with HSBC priced at 1.75 to 2.25 per cent above Libor and expiring in October 2022. In any case, the deferred cash consideration should be self funding from Convex's profits.

Cash generation to underpin progressive dividend policy

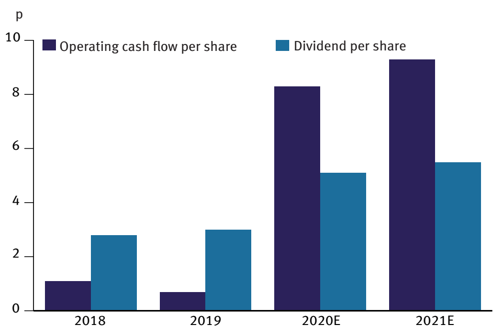
With the addition of Convex Capital, RBG has created a further additional stream that will underpin free cash flow generation and enable the board to pursue its IPO policy of paying out 60 per cent of retained earnings as dividends to shareholders.

RBG free cash flow generation set to improve



Source: Company data; N+1 Singer estimates

RBG dividend covered by forecast free cash flow in 2020 and 2021



Source: Company data; N+1 Singer estimates Jan 2020

RBG free cash flow set to improve

Financial year to 31 Dec	Operating cash flow	Free cash flow
2015	£3.6m	£3.1m
2016	£5.8m	£5.1m
2017	£3.5m	£2.8m
2018	£0.7m	£0.7m
2019	£3.0m	£0.6m
2020E	£9.9m	£7.2m
2021E	£11.2m	£8.3m

...which feeds through to a well-covered dividend

Financial year to 31 Dec	Free cash flow per share	Dividend per share
2018	1.1p	2.8p
2019	0.7p	3.0p
2020E	8.3p	5.1p
2021E	9.3p	5.5p

Source: Company data; and N+1 Singer estimates

As noted, RBG also offers investors the opportunity to benefit from further cash inflows from the sale of participation rights on litigation funded cases, as was the case in 2019 when Rosenblatt realised gains of £3.8m, while retaining an economic interest in the outcome of the cases. If Rosenblatt can maintain its enviable track record – 86 per cent success rate on concluded cases since 2011 – then there is even scope to recycle surplus cash back to shareholders through special dividends.

Admittedly, the board have taken a cautious approach to the 2019 payout in light of the ongoing Covid-19 pandemic. Instead of making a 5p a share payout as first planned the directors declared a total payout of 3p a share. However, if trading across the group remains largely unimpacted as has been the case to date, then it's reasonable to expect a significant uplift in the 2020 dividend.

Indeed, one would expect the ongoing fall out from Covid-19 to create additional revenue opportunities for Rosenblatt's team of lawyers, specifically in dispute resolution. It's also reasonable to assume that well capitalised larger companies will try and take advantage of the current situation by making opportunistic

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approaches to smaller indebted rivals, thus boosting fee work from M&A transactions. The private equity industry is also awash with cash to deploy in a zero interest rate environment, both factors being positive for Convex's deal flow and its cash generation.

Peer group comparison

Although RBG is the smallest company by market capitalisation amongst its listed law firm peers, there is obvious value in the shares on any metric.

Peer group comparisons

Company	Year-end	Share price	Market capitalisation	Enterprise valuation
RBG	31 Dec 19	£0.68	£58.6m	£58m
DWF	30 Apr 20	£0.70	£227m	£292m
Gateley	30 Apr 20	£1.46	£167m	£168m
Keystone Law	31 Jan 20	£4.55	£142m	£138m
Knights	30 Apr 20	£3.84	£315m	£331m

Source: London Stock Exchange. Net cash or net debt figures taken from: RBG and Knights Group annual accounts; DWF based on trading update on 29 May 2020; Gateley based on trading update on 26 May 2020; and Knights Group based on year-end trading update on 21 May 2020.

For starters, its 46 fee earners are by far the most profitable, generating almost double the peer group average amount of revenue and efficiently so, as they need almost half the average number of back up staff to support them.

Fee earners in 2019 financial year

Company	Revenue per fee earner	Ratio of fee earner to admin staff
RBG	£393k	2.1
DWF	£168k	1.5
Gateley	£170k	2.1
Keystone Law	£133k	8.7
Knights	£101k	4.2
Average	£226k	3.7

Source: 2019 company annual accounts, RBG investor presentation April 2020

The pricing power of RBG's lawyers is reflected in market leading levels of profitability. In fact, RBG's cash profit margins are almost double those of **Knights Group (KGH)** and **Gateley (GTLY)**, the next most profitable law firms.

Peer group profitability

Company	Year-end	Revenue	Ebitda	Margin
RBG	31 Dec 19	£23.7m	£9.4m	39.7%
DWF	30 Apr 20	£301m	£34m	11.3%
Gateley	30 Apr 20	£108m	£24.7m	22.9%
Keystone Law	31 Jan 20	£49.6m	£6.1m	12.3%
Knights	30 Apr 20	£73.9m	£17.7m	23.9%
Average				27.5%

Source: London Stock Exchange RNS; RBG and Knights Group annual accounts; DWF based on trading update on 29 May 2020 and Zeus Capital forecasts; Gateley based on trading update on 26 May 2020 and Panmure Gordon forecasts; Knights Group based on year-end trading update on 21 May 2020 and Numis Securities forecasts.

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Despite having market leading margins, RBG is by far the lowest rated company amongst its peers, trading on a less than half the average enterprise valuation to cash profit multiple.

Peer group ratings

Company	Enterprise valuation	Ebitda	EV/Ebitda
RBG	£58m	£9.4m	6.2
DWF	£292m	£34m	8.6
Gateley	£168m	£24.7m	6.8
Keystone Law	£138m	£6.1m	22.6
Knights	£331m	£15.8m	20.9
Average			13.0

Source: London Stock Exchange RNS; company annual accounts; DWF based on trading update on 29 May 2020 and Zeus Capital forecasts; Gateley based on trading update on 26 May 2020 and Panmure Gordon forecasts.

RBG is also undervalued when you compare the company to listed litigation-only funders.

Litigation funders peer group

Company	Year-end	Share price	Market capitalisation	Enterprise valuation
RBG	31 Dec 19	£0.68	£58.6m	£58m
Manolete Partners	31 Mar 20	£5.35	£233m	£226m
Litigation Capital Mgmt	30 Jun 20	£0.62	£71m	£56m
Burford Capital	31 Dec 19	£4.45	£995m	£1,445m

Source: London Stock Exchange RNS; RBG and Burford Capital 2019 annual accounts; Manolete closing net cash of £6.7m at 31 March 2020 based on Arden forecasts; Litigation Capital Management closing net cash of A$28m (£15.1m) at 30 June 2020 based on Arden forecasts.

The closest comparable is Sydney-based **Litigation Capital Management (LIT)**, a constituent of my 2019 Bargain Shares Portfolio and a company I continue to view in a positive light. RBG is rated on an unwarranted 10 per cent ratings discount (enterprise valuation to cash profit multiple) to Litigation Capital, even though its profit margins are more than double those of Litigation Capital and RBG has a more diversified revenue base which reduces earnings risk.

Litigation funders ratings

Company	Revenue	Ebitda	Margin	EV/Ebitda
RBG	£23.7m	£9.4m	39.7%	6.2
Manolete Partners	£23m	£10.9m	47.4%	20.7
Litigation Capital Mgmt	A$77.3m	A$14.8m	19.1%	7.0
Burford Capital	£356m	£279m	78.4%	5.2
Average			46.2%	9.8

Source: London Stock Exchange RNS; RBG and Burford Capital 2019 annual accounts; Manolete EBITDA and revenue estimates for 12 months to 31 March 2020 based on Arden forecasts; Litigation Capital Management EBITDA and revenue estimates for 12 months to 30 June 2020 based on Arden forecasts.

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Meet the management

RBG's directors believe that many law firms are being managed by senior partners, who often have little or no commercial management experience. As a result, these firms forego work on fee earning transactions because their team of lawyers are managing the business. Rosenblatt has addressed this issue through the appointment of a professional, experienced and specialist management team, which sets the company apart from many of its competitors.

■ Key to this differentiated approach was the appointment of 13.45 per cent shareholder and **chief executive Nicola Foulston** in September 2016, in order to commercialise Rosenblatt's management and enable the partners to focus more on fee earning work.

The entrepreneurial approach adopted by Rosenblatt's lawyers fits well with that of Ms Foulston who, in 1996, was the youngest ever recipient of the Veuve Cliquot 'Business Woman of The Year Award'. Having been appointed chief executive to Brands Hatch Leisure at the age of 22 in 1990, under her leadership the value of the business increased 30-fold by the time Interpublic, one of the world's largest advertising and marketing groups, acquired the company for £195m in 1999. She subsequently ran a family office with private equity investments in the USA and Europe.

■ **Finance director Robert Parker** has been with the company since the summer of 2018. The 54-year old boasts over 20 years' experience with international businesses, having worked extensively with public funds, private equity and venture capital investors. He previously held management positions at software company Ubisense and Immedia Broadcasting.

■ The small board is led by **chairman Keith Hamill**. His previous roles include chairman of interdealer broker Tullett Prebon, high street retailer Moss Bros (MOSB), budget hotel chain Travelodge, food group Premier Foods (PFD) and insurance broker Heath Lambert. He has also been appointed to act as chairman leading a number of businesses through financial and operational reconstruction. Earlier in his career Mr Hamill was a partner in accountancy firm PWC and finance director of WH Smith (SMWH). There are two **non-executive directors** who bring a wealth of experience: **Victoria Hull** and **Marianne Ismail**.

■ Victoria Hull is a former executive director and general counsel of former FTSE 100 groups Invensys and Telewest Communications. She started her legal career at Clifford Chance LLP in 1985 where she trained and qualified into the corporate finance discipline, before joining industrial group Invensys as General Counsel in 2001 where she gained global experience across a wide variety of legal matters in diverse industries including litigation, contracting, and Intellectual Property.

■ Marianne Ismail has worked in financial services for over 30 years in a variety of small and large regulated entities. She was a managing director of investment bank Morgan Stanley for 10 years, working in New York and internationally, and has held senior positions in Citigroup and Standard Chartered Bank. Until January 2019, she was chief executive of Aim-traded Kingswood Holdings (KWG), a private wealth management business.

In 2019, the board of five directors received total remuneration of £831,808, a reasonable sum in relation to the £7.9m operating profit reported by RBG and less than a third of the £2.56m received by shareholders in cash dividends.

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Major shareholders and liquidity

Around two thirds of RBG's shares are not in public hands which reduces liquidity and means that share price moves can be accentuted. That said, the shares are readily tradable on a tight bid-offer spread of 2p and it's even possible to deal within the spread and in bargains well above the London Stock Exchange normal market size of 3,000 shares.

RBG significant shareholders

Name	Percentage of issued share capital
Mr Ian Rosenblatt	19.8%
Premier Miton	17.0%
Nicola Foulston (CEO)	13.5%
Blackrock	7.7%
Fidelity Investments	5.7%
Total	63.7%

Source: RBG Holdings 2019 annual report and accounts

It's also worth noting that investors backing the IPO, at 95p, in May 2018 are under water, so there is a possibility that some stale bulls may appear when the share price revisits that level. However, the IPO price is still 38 per cent above the current offer price, so there is significant short-term upside. Also, there is a catalyst for even stronger gains as RBG's forecast earnings progression should drive the rating back up towards that of the group's listed law firm peers.

Target price

On any measure, RBG shares are too lowly rated, priced on a historic price/earnings (PE) ratio of nine, even though 2020 results will benefit from a maiden 12-month profit contribution from last autumn's acquisition of Convex Capital. The shares trade on a modest 1.4 times premium to book value, too, a harsh rating given the earnings power of Rosenblatt's legal eagles as highlighted by RBG's post tax return on equity, of 16 per cent in 2019.

True, the short raiding attack by hedge fund Muddy Waters on market leader Burford Capital (BUR) has undermined sector sentiment. However, investors have overeacted as only £2.2m of RBG's net asset value of £42.4m is held in litigation investments, and these investments are prudently valued. In fact, the legal fee from Project Neptune could be worth double the value of the litigation portfolio.

When investors cotton on that RBG is actually a beneficiary of the Covid-19 crisis – expect a pick up in dispute resolution, white collar crime and employment related law suits – the shares should re-rate towards the average enterprise valuation to cash profit multiple of 13.5 times for its law firm peers. On a 12-month basis, my target price is 140p to value the equity at £120m. Offering potential to make a 100 per cent gain, the shares rate a **buy**.

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Risk assessment

■ **Litigation investments and fair value IFRS 9.** Where RBG enters DBAs that include both provision of services and litigation finance, it must apportion the total expected settlement between that arising as conditional revenue for services and that arising as a return on participation. Establishing the value that will eventually be recovered on contracts involves estimation.

Management use the expected outcomes at the year-end to establish the estimated value and compare it to historic outcomes to ensure it is reasonable. Estimates are updated as work progresses, and any changes in revenue recognition (because of a change in circumstances) is recognised in the income statement for that year.

In relation to any contingent fee arrangements, revenue is constrained to the amount for which it is considered highly probable that there will be no significant reversal. The approach adopted by management is prudent and minimises the risk of overstatement of income resulting in future revenue write-offs.

■ **Covid-19.** All RBG's 96 staff and directors have been remote working from home during the UK lockdown period. Rosenblatt has always encouraged flexible working as part of its business model, which has smoothed the switch to remote working and enabled the law firm to operate at normal capacity. Rosenblatt's workflows since the UK general election in December 2019 have been strong, but like all businesses, the board has been conducting regular stress tests and reducing all non-essential costs.

The corporate finance business, Convex Capital, has a strong pipeline of transactions, including those that were ongoing at the time of the UK government lockdown, albeit the lockdown has potential to delay the completion of certain transactions. That said, Convex's management is well incentivised through a lucrative deferred share earn-out to get the deals done.

■ **Economic risk.** Historically, there has been an increase in white collar crime during economic downturns and Rosenblatt is well placed to take advantage, having established a division last autumn. Expect the firm to also benefit from dispute resolution and employment related law suits resulting from the pandamic-induced economic downturn. Both factors should mitigate any potential softening of volumes in Rosenblatt's corporate legal work.

■ **Earnings concentration risk.** Rosenblatt's earnings

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are generated by 46 fee earners who brought in revenues of £18.1m in 2019. Therefore, it's critical to maintain staff loyalty. By aligning remuneration with shareholder interests, the equity participation offered to fee earners in their pay packages not only attracts talent, but acts as a disincentive for them to leave, too.

■ **Dividend.** RBG retains a cash rich balance sheet, and the board are targeting a 60 per cent payout ratio. However, the directors adopted a conservative approach with the 2019 dividend. Expectations of the dividend meeting analyst expectations of 5.1p a share this year will be dependent on the group continuing to trade well through the Covid-19 crisis to generate the free cash flow to cover the cash cost of the pay-out. It's possible that the directors may decide to retain higher cash levels, but even if they do, the 4.4 per cent historic dividend yield is still attractive.

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