MICROCAP COMPANY RESEARCH

companyREPORT

Cash Converters Intl.

4th September 2012

GICS: **Diversified Financials – Consumer Finance**

FY12 Results Overview…

RECENT NEWS

Cash Converters [ASX:CCV] recently announced its FY12 results. One-off expenses hit earnings with the underlying result boosted by continued growth of financial service products. The results were largely in line with forecasts.

UPDATE REPORT

Event

- **FY12 Results:** Underlying NPAT rose 9.8% to $32.6m on the back of a 25.7% jump in revenue to $234.3m. A final dividend of 1.75c was declared, taking full year dividend to 3.5c.
- **Financial Services:** Financial services were the main driver of underlying earnings growth in the half. Personal loans before tax profit was 37.1% higher and 10.8% higher for financial administration. Margins were squeezed due to continued deterioration in bad debts in the UK loan book.
- **Credit reforms legislation passed:** The cloud of uncertainty over the Australian Government's review on small amount credit has cleared with of parliament passing a watered down version of the reforms. The new fee caps will apply from July 2013 onwards and has less impact on revenue and margins than we had originally envisaged.

Our view

- **Upgrades to FY13 forecasts:** Our FY13 NPAT forecast is increased from $24.5m to $34.8m. We had originally forecast more severe impact from the credit reform and an earlier starting date. With the reforms now known, we think Cash Converters is well placed to deliver solid earnings growth in the near to medium term.

Valuation | Recommendation

We maintain a BUY recommendation and raise our price objective to $1.01 from $0.75. This represents a 27% premium over the last traded price of $0.795. Favourable outcomes from the regulatory review of the short term lending industry in Australia and our forecasts of solid earnings growth in the near to medium terms underpin our recommendation.

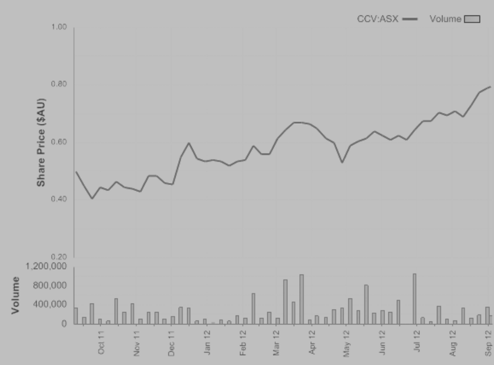
CCV | **BUY**

Price Objective: **$1.01**

Last traded	A$	$0.795
Market Cap	A$'m	306.4
Nº of Shares	m	385.4
2012A EPS	¢	7.6
2013F EPS	¢	9.0
2013F PE	x	8.8
2013F EV/EBITDA	x	5.8
2013F DPS	¢	3.75
2013F Div Yield	%	4.7
Sales 2012A	m	235.2
Sales 2013F	m	273.2
EBITDA 2012A	m	48.1
EBITDA 2013F	m	51.9
NPAT 2012A*	m	29.4
NPAT 2013F	m	34.8

*2012F NPAT is reported NPAT (inclusive of one-off items)

Share Price | 12month



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FY12 RESULTS OVERVIEW

Cash Converters reported strong revenue growth of 25.7% to $234.3m driven by continued growth in its financial services revenue, growth in its UK division and continued rollout of its corporate stores. Reported NPAT was 6.2% higher at $29.4m with diluted EPS of 7.63c, up 5.5% from pcp (FY12: 7.23c). Excluding one-offs, underlying NPAT was 9.8% higher at $32.6m, from $29.7m previously. One off expenses incurred during the period include store acquisition costs, IT review expenses, earn out payments, legal and professional fees and redundancy costs. In total, they had a $3.2m negative impact to NPAT.

Underlying NPAT was 9.8% higher on the back of a 25.7% rise in revenues. Strong growth in the financial services divisions drove this result.

The results were largely in line with forecasts with revenue 3.4% below our FY12 forecasts but beating our underlying NPAT forecast of $30.9m (actual: $32.6m). The board also declared a fully franked final dividend of 1.75c, bringing the total payout to 3.5c for the full year. This was slightly below our forecasts of 3.75c dividend for the full year.

Financial Services

Financial services divisions showed strong operating performances, especially in personal loans. Personal loans division delivered revenue of $87.1m up 54% from FY11 and showed a 37.1% rise in EBIT to $33.5m. 2H12 revenue was circa $49.1m up from $38.0m in 1H12 as penetration into the UK market continued. Administration division (cash advance) revenue was 19.6% higher at $16.6m. 2H12 revenue was circa $8.8m, up from $8.0m in 1H12. EBIT for the division rose 10.8% to $13.65m.

Loan book in Australia and the UK grew strongly but lower margins was the result of higher bad debts in the UK book.

From a geographical split, personal loans and administration divisions in Australia delivered EBIT of $42.5m (+19.7%) and $4.6m in the UK (+285.7%).

Australia

The Australian personal loan book grew 28% pcp to $67.6m (FY11:$52.7m) and 8.9% half-on-half (1H12: $62.1m). Bad debt levels declined to 5.6% of the principal from 5.9% in pcp. We expect modest growth in the average size of the loans in FY13 with most of the growth driven by growth in loan volumes. We note that personal loans through its online lending program increased by 126.7% to $14.2m. We expect this to be a strong growth driver for the business in FY13. Our model assumes 12.1% growth in the Australian personal loan book to $75.8m.

Looking to FY13, we expect the Australian personal loan book to reach $75.8m. The cash advance division is forecast to grow funds lent in the low double digits.

The Australian cash advance business lent $229.8m in FY12 up 12.3% from pcp and 5.7% higher on a half-on-half basis (1H12: $111.7m was lent). Total customers grew 16.8% and average loan amount showed modest growth. Considering the slower half on half growth, we forecast 12.2% growth driven by 10% rise loan volumes and slight uptick in average loan size.

United Kingdom

The UK personal loan book rose 154% to £12.7m from £5.0m in FY11 and up from £8.5m at the end of 1H12 (+49.4%). The personal loan product is now rolled out in 170 out of the 220 stores in the UK, with rollout in a further 20 stores in the next 12 months. One area of concern is the high level of bad debts, rising to 11.3% of principal loaned up from 10.8% in FY11 and 11% in 1H12. Management commented in the 1H results that steps are being taken to improve this. We expect bad debt levels to trend downwards to around 7-8% in the next 3-5 years as increasing repeat customers improve Cash Converters ability to assess the credit worthiness of borrowers. Management have commented that repeat customers account for around 80% of the Australian loan book, whereas repeat business is only 10% in the UK. In FY13 we

In FY13, we expect the UK personal loan book to reach £20m. Bad debt levels if expected to improve over the next 3-5 years.

expect the UK personal loan book to grow by around 57% to circa £20m, driven by penetration into further franchise stores, new corporate stores and increased customer penetration.

UK cash advance business increases its amount loaned by 177.3% to £29.1m with a 136.8% rise in total customer numbers. Half-on-half growth was 23.8% with £16.1m lent in 2H12 compared to £13.0m in 1H12. We conservatively assume circa 33% growth in amount loaned in FY13 with 30% growth in loan volumes. We believe continued rollout of the cash advance product into UK franchise stores and increased penetration among Cash Converters customers will underpin growth going forward.

We also note management's commentary regarding looking at securitisation opportunities for its loan books. We believe this is a positive for the business and expect this to be finalised by the end of 1H13. This will release funds for continued expansion of the loan book and allow the company to speed up its acquisition of franchise stores.

Potential securitisation of its loan books provides funds necessary to drive loan growth and fund acquisition of franchise stores.

Corporate Owned Stores

Corporate owned stores recorded 21.8% revenue growth to $122.8m and EBIT of $5.6m (down 34.3% from FY11). This compares to 1H12 revenue of $60.8m and EBIT of $4.3m. The second half result continued to be adversely impacted by green-field store openings, earn out payments and stamp duty costs. In terms of retail sales, Australian and UK stores showed 4.5% and 4.1% like-for-like (LFL) sales growth respectively. This again highlights the defensive nature of the Cash Converter retail model, with weak retail sales figures experienced by most traditional retailers.

Cash Converters continued with the expansion of its corporate store network. Twelve green-field corporate stores were opened in FY12, taking corporate store numbers to 102 at the end of FY12 (59 in UK and 43 in Australia).

Franchise Operations…contribution now largely irrelevant

Franchise operations delivered EBIT of $6.05m down 7% from FY11. This was on the back of a 14% decline in divisional revenue to $23.5m. Further corporatisation of franchise stores was the main factor behind the fall in revenue and earnings.

Legislation passes…the outlook is bright

The legislation uncertainty has been resolved with both houses of parliament recently passing the Consumer Credit Legislation Amendment (Enhancement) Bill 2012. The final bill took into consideration the recommendations made by the Parliamentary Joint Committee to soften the impact of any potential changes on small amount credit providers.

Positive outcomes from the Australian Consumer Credit legislation means the impact on Cash Converters is likely to be much less than we had previously forecast.

Responsible lending requirements take effect from March 2013 with restrictions on fees and charged to come into effect in July 2013. The main changes include:

- Small amount credit contracts are those with a term of a minimum of 16 days but less than 1 year and for amounts of $2,000 or less
- Establishment fee capped at 20% of the loan lent to borrowers
- Monthly fee cap of 4% on the principal lent
- Total fees and charges cannot exceed the amount borrowed
- Centrelink dependent customers must have loan repayments capped at 20% of their income

The outlook for Cash Converters is much brighter and the government have finally recognised there is a place for legitimate and responsible small amount lending. We increase our FY13 and FY14 earnings expectations in light of these changes, as we had previously assumed negative outcomes from the legislation to impact in FY13. We also believe Cash Converters will offset most of the impacts from the new legislations from strong volume growth and strong loan book growth as a result of minor tweaks to its products.

CHANGES TO OUR FORECASTS

Our FY13 revenue, NPAT and dividend forecasts are upgraded as the impacts from the consumer credit legislation are not as severe as we had previously forecast.

Our FY13 revenue and NPAT forecasts are raised after the passing of the legislation and clarification of the caps on small amount credit contracts. We also introduce our FY14 forecasts of $294m in revenue, $55.8m EBIT and NPAT of $37.6m. Our FY13 dividend forecast is increased from 3.5c to 3.75c in light of our earnings upgrades. We also introduce our FY14 DPS forecast of 4.0c.

We had previously, albeit conservatively, forecast that regulatory changes would have a more negative affect and take effect from the start of calendar year 2013. We still expect margin impact on the financial services divisions in the medium to long term but we expect strong loan book growth in personal loans and volume growth in cash administration to offset most of this impact. The outlook for Cash Converters is a lot more clearer and we believe it is on track to deliver solid earnings growth.

Figure 1: **CCV – Changes to our forecasts**

Figures in A$'million unless stated	FY12Actual	FY13F (OLD)	FY13F (NEW)	FY14F (NEW)
Revenue	**234.4**	**257.6**	**274.2**	**294.2**
Operating Expenses	**-186.2**	**-213.1**	**-216.5**	**-231.0**
EBITDA	**48.1**	**44.5**	**57.8**	**63.2**
% Chg YoY	*15%*	*-14%*	*20%*	*9%*
EBITDA Margin	*21%*	*17%*	*21%*	*21%*
Depr & Amortisation	-4.3	-7.1	-5.9	-7.4
EBIT	**43.8**	**37.4**	**51.9**	**55.8**
EBIT Margin	*19%*	*15%*	*19%*	*19%*
Net Interest Expense	-2.4	-2.4	-2.2	-2.1
Profit Before Tax	**41.4**	**35.0**	**49.7**	**53.7**
Tax Benefit (Expense)	-12.0	-10.5	-14.9	-16.1
Reported NPAT	**29.4**	**24.5**	**34.8**	**37.6**
Add back: One-off items	3.2	0	0	0
Underlying NPAT	**32.6**	**24.5**	**34.8**	**37.6**

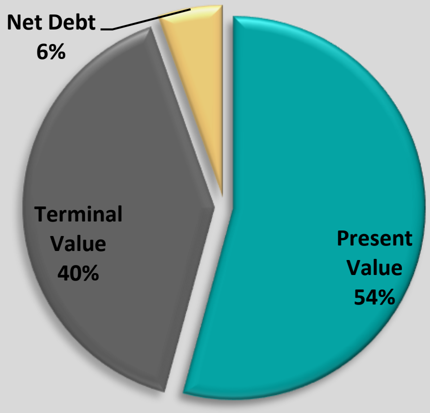
Source: Company data, Microequities estimates

VALUATION | RECOMMENDATION

DCF Valuation

Our DCF model provides us with a $1.13 valuation for CCV, representing a 42% premium to the last traded price. We have used a fundamental BETA of 1.11, a WACC of 10.7% and long-term growth rate of 1%.

DCF Valuation Breakup

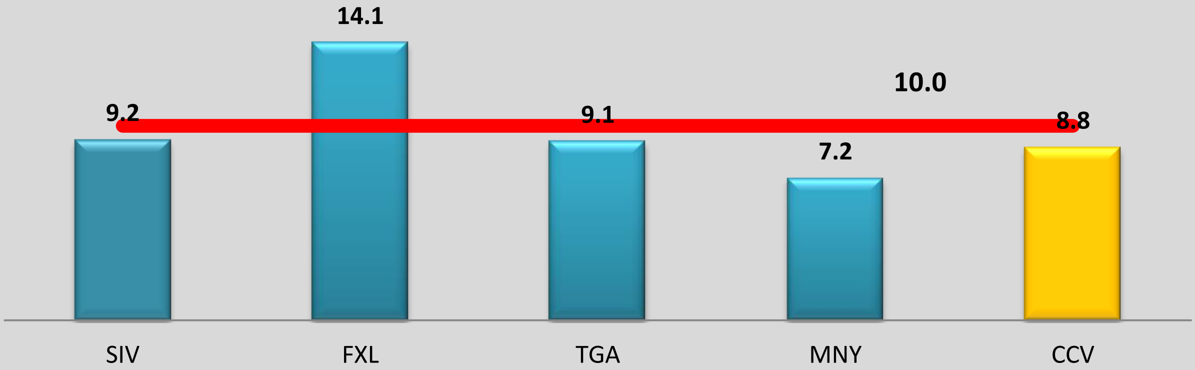


Key Assumptions			
Equity Beta:	**1.11**	**Debt:**	**$42.6m**
Risk free rate:	**3.02%**	**K_d:**	**6.3%**
Return on Equity:	**11.31%**	**WACC:**	**10.70%**
LT Growth Rate:	**1.00%**		

Relative EV/EBITDA Valuation

We have undertaken a relative valuation using the most appropriate peer comparisons in the consumer financials sector. Using a forecast FY13 PE multiple of 10x, we have derived a relative valuation of $0.90 per share, representing a 13% premium to the last traded price.

Peer group financial summary (*as at 03/09/2012*)



Investment Opinion

We maintain to a BUY recommendation and increase our price objective to $1.01 from $0.75. The price objective is based on a combination of our DCF valuation of $1.13 and our relative peer valuation of $0.90 which we have applied a peer group average forward PE of 10x.

The full year result was largely in line with our expectations. Looking to FY13, recent positive outcomes from the regulatory review removes the cloud of uncertainty over fee caps on personal loans and cash advances. As a result we upgrade our near term revenue and NPAT forecasts. We now believe the outlook for Cash Converters is now much brighter with a resumption of solid earnings growth in FY13 and FY14.

PRICE OBJECTIVE & RECOMMENDATION HISTORY

Changes to recommendations and/or price objectives

Date	Recommendation	Price at time of Rec	Price Objective
04/09/2012	BUY	$0.795	$1.01
02/03/2012	BUY	$0.60	$0.75
18/01/2012	STRONG BUY	$0.52	$0.78

FINANCIAL SUMMARY

PROFIT & LOSS SUMMARY ($m)			
Year Ending June	**2012A**	**2013F**	**2014F**
Revenue	**234.4**	**274.2**	**294.2**
Op. Expense	**-186.2**	**-216.5**	**-231.0**
EBITDA	**48.1**	**57.8**	**63.2**
% Chg YoY	*15%*	*20%*	*9%*
% Margin	*21%*	*21%*	*21%*
Depreciation & Amortisation	-4.3	-5.9	-7.4
EBIT	**43.8**	**51.9**	**55.8**
% Margin	*19%*	*19%*	*19%*
Net Interest Expense	-2.4	-2.2	-2.1
PBT	**41.4**	**49.7**	**53.7**
Tax	-12.0	-14.9	-16.1
NPAT	**29.4**	**34.8**	**37.6**

PROFITABILITY RATIOS			
Year Ending June	**2012A**	**2013F**	**2014F**
Sales	**235.2**	**273.2**	**293.1**
% Chg YoY	*26%*	*16%*	*7%*
Price/Sales	1.3x	1.1x	1.0x
EPS (cents)	**7.6**	**9.0**	**9.8**
% Chg YoY	*6%*	*18%*	*8%*
P/E	**10.4x**	**8.8x**	**8.2x**
Enterprise Value	332.6	332.6	332.6
EV/EBIT	**7.6x**	**6.4x**	**6.0x**
EV/EBITDA	**6.9x**	**5.8x**	**5.3x**
DPS	3.50¢	3.75¢	4.00¢
Dividend Yield	4.4%	4.7%	5.0%
ROE	*16%*	*15%*	*14%*
Debt to Assets	*16%*	*14%*	*12%*
Debt to Equity	*23%*	*18%*	*16%*

BALANCE SHEET SUMMARY ($m)			
Year Ending June	**2012A**	**2013F**	**2014F**
Cash & cash equivalents	16.4	21.2	32.5
Trade and other receivables	10.9	12.5	14.4
Inventories	17.1	19.6	21.2
Other Current Assets	91.1	113.8	131.0
Total Current Assets	**135.5**	**167.2**	**199.0**
Other financial assets	4.0	4.0	4.0
Trade and other receivables	6.1	6.1	6.1
Property, Plant & Equipment	19.6	28.1	31.7
Intangible assets	15.5	28.3	30.6
Deferred tax assets	4.8	4.8	4.8
Other Non-Current Assets	77.2	77.2	77.2
Total Non-Current Assets	**127.3**	**148.6**	**154.4**
TOTAL ASSETS	**262.7**	**315.7**	**353.5**
Trade and other payables	19.6	20.8	22.0
Borrowings	11.3	11.3	11.3
Current tax liabilities	7.1	7.5	8.1
Deferred establishment fee	4.1	4.1	4.1
Provisions	2.7	2.7	2.7
Total Current Liabilities	**44.7**	**43.6**	**45.4**
Borrowings	31.4	32.8	32.9
Provisions	.1	.1	.1
Total Non-Current Liabilities	**31.4**	**32.9**	**32.9**
TOTAL LIABILITIES	**76.1**	**76.4**	**78.3**
NET ASSETS	**186.6**	**239.3**	**275.1**

CASH FLOW SUMMARY ($m)			
Year Ending June	**2012A**	**2013F**	**2014F**
EBITDA	$48.1	$57.8	$63.2
Decre./(Incr.) in work. Cap	-$5.0	-$3.0	-$2.2
Net Int. (Paid)/Rec	-$1.7	-$2.2	-$2.1
TaxesPaid	-$15.3	-$14.9	-$16.1
Incr/(decr) in provisions	$0.6	$0.0	$0.0
Other Op. Cash items	-$3.7	$0.0	$0.0
Cash from Operations	**$23.1**	**$37.7**	**$42.7**
CAPEX	-$11.9	-$19.8	-$16.1
Disposals/(Acquisitions)	-$6.1	$0.0	$0.0
Other Inv. Cash Flows	-$1.4	$0.0	$0.0
Loans to/from other ent.	$0.6	$0.0	$0.0
Cash Flow From Invst.	**-$18.8**	**-$19.8**	**-$16.1**
Incr/(Decr) in Equity	$0.0	$0.0	$0.0
Incr/(Decr) in Debt	$20.4	$1.4	$0.1
Ord, Dividend paid	-$11.1	-$14.5	-$15.4
Preferred dividends	$0.0	$0.0	$0.0
Other Fin. Cash Flow	-$0.3	$0.0	$0.0
Cash Flow From Fin	**$9.0**	**-$13.0**	**-$15.3**
Net Incr/(Dcr) in cash	**$13.2**	**$4.8**	**$11.3**
Forx & Disc. Op.	-$0.6	$0.0	$0.0
Net Inc/(Decr) Cash	**$12.6**	**$4.8**	**$11.3**
Equity FCF	$11.1	$10.6	$25.2

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RECOMMENDATION GUIDE

Recommendation	Market Price undervalued/overvalued to Microequities price objective
Strong Buy	**Above 40%**
Buy	**20 to 40%**
Hold	**0 to 20%**
Sell	**0 to -20%**
Strong Sell	**Greater than 20%**

ADDITIONAL VOLUNTARY DISCLOSURE BY MICROEQUITIES*

Investment Banking	Staff Interest	Analyst personal Interest	Equity Stake By Microequities	Disclosure to Company	Business Relationship
NO	NO	NO	NO	NO	✓

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