ORD MINNETT

Company Review

Ord Minnett Research Tuesday, 23rd February, 2010

CCV A$0.69

Recommendation
Accumulate

Risk Assessment
High

Consumer discretionary - retail

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Cash Converters

1H10 results review

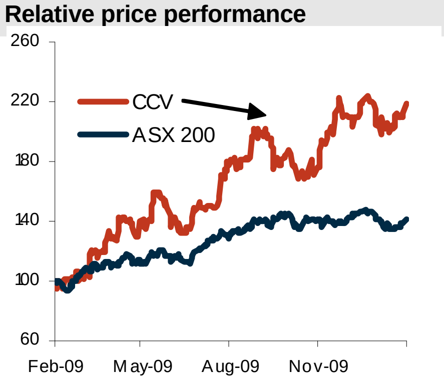
- CCV reported sound 1H10 results. Revenues were up 33% to $59.3m, EBITDA up 26% to $15.9m, NPAT up 27% to $10.0m and EPS up 6.1% to 3.5cps. EPS was held back by the large issue of equity in November via the EZCORP placement (30% diluted capital).
- Corporate store operations reported a strong improvement with OPBT up 83% to $3.6m. This was offset by franchise operations being down 10% - with a degree of self cannibalisation occurring as franchises are bought out by CCV.
- Financial services – particularly the personal loan business performed strongly with OPBT up 49% to $7.0m driven by an expanding loan book. Bad debt as % of assets remained stable and showed signs of improvement in December.
- Guidance was retained with NPAT expected to track between $20.5m and $21m for FY10 – with CCV "well positioned to meet or improve on this".
- OM is upgrading forecasts on the back of improved revenues from the financial services division. The rapid pace of corporate store expansion and acquisitions including up to 13 more (under negotiation), continued product expansion and geographic expansion all position the business strongly into FY2011. Minimal competition exits in alternative finance and this helps margins and reduces credit quality issues (by being selective).
- We believe that the valuation is attractive with a FY10 P/E of 10.3X and a DCF valuation of $0.83. A material risk around regulation remains present - this restrains OM from moving the stock to a Buy. Retain Accumulate.

Key Financials Year-end June (A$)	FY08A	FY09A	FY10E	FY11E
Revenue ($m)	74.3	94.4	118.0	140.5
EBITDA ($m)	23.4	25.6	31.7	35.7
Net profit after tax ($m)	15.2	16.1	21.8	25.4
EPS (¢)	6.1	6.6	6.7	7.0
P/E (x)	11.2	10.4	10.3	9.9
EV/EBITDA	6.9	6.9	6.5	5.9
Dividend (¢)	3.0	3.0	3.7	4.2
Net Yield (%)	4.3%	4.3%	5.4%	6.1%
Franking (%)	100%	100%	100%	100%
Normalised NPAT ($m)	15.2	16.1	21.8	25.4
Normalised EPS (¢)	6.1	6.6	6.7	7.0
EPS Growth (%)	26.7%	8.0%	1.3%	4.1%
Normalised P/E (x)	11.2	10.4	10.3	9.9
Relative P/E (%)	75.7%	70.1%	69.2%	66.5%
Normalised ROE (%)	20.6%	19.6%	14.5%	15.8%

Source: Iress, Company Data, Ord Minnett Est. Share price: $ 0.69 Feb 22, 2010

Cash Converters	
ASX code	CCV
52 week range	A$0.3 - A$ 0.71
Market Cap	250.6
Shares Outstanding	363.2
Av Daily Turnover	254,200
ASX All Ordinaries	4,733
ASX200 Industrials	3,939
NTA FY09 (¢ per share)	9.17
Net Debt FY09	9.8

Relative price performance



Source: Iress

Consensus earnings

	FY10F	FY11F
NPAT (C)*	$20.5-$21.0	n/a
NPAT (OM)	21.8	
EPS (C)	n/a	n/a
EPS (OM)	6.7	

Source: CCV guidance

Results summary

Strong result, driven by financial services and corporate store profitability

NPAT was up 26.8% to $10.1m from $7.9m previously driven by strong results from store operations and financial services (personal loans). Store operations (CCV 100% corporately owned) have been helped by the continued store acquisition and opening program with 4 franchisee stores acquired and 3 greenfield sites opened taking the total corporately owned stores to 44. Corporate stores has also been the initial area to pilot and then rollout financial service products – which have performed strongly.

The Safrock (personal loans business) had strong loan growth, with the loan book moving from $15.5m (30 June 09) to $31.9m at Dec 2009. The combined lending business had EBIT growth of 23%. The cash advance business segment of the business had negative revenue growth partially due to a change in software licensing arrangements, where franchisees were offered a new contract which offers lower fees and a new incentive for volume.

Bad debts remains stable as % of assets and tracked down in December to 6.4% of loans outstanding compared to 7.2% in Dec 08. This looks high but it is important to remember loans are priced for risk and the risk/reward remains favourable.

EPS held back by share issuance

Table 1. Summary CCV 1H10 result

	1H09A	1H10A	% change
Revenue	44.5	59.3	+33%
EBITDA	12.7	15.9	+26%
EBIT	12.1	15.3	+26%
NPAT	7.9	10.1	+27%
EPS reported	3.3	3.5	+6%
DPS Interim	1.5	1.5	n.c

Source: Company data, Ord Minnett

Management identified a further 3 stores in the UK and 10 in Queensland – as well advanced in terms of being acquired

The loan book business and increasingly the cash advance was also assisted by:-

1. The cash advance and personal loan business has also been launched in NSW and the ACT with an additional 13 stores in NSW and ACT participating in this product line.
2. And in the UK - initially 1 corporate store and now 2 more corporate stores were trialled in October 2009 with financial products. The payment history has matched the Australian experience and a further 5 corporate stores are to receive the product with further acceleration into corporate and franchisee stores possible.

Initial volumes from these new initiatives appear strong.

Importantly management made mention that they are well advanced in the acquisition of 10 stores in Queensland and 3 in the UK. Depending on the timing of the acquisitions – this helps underpin FY11 results for the business.

Interestingly the 2 greenfield sites in the UK are trading well and management expect that more high street sites will become available – helped by the recession over in the UK.

Importantly Cash Converters traded well during the UK downturn – strengthening OM's conviction that this is a countercyclical business.

Divisional snapshot

Table 2.divisional summary CCV 1H10 result

	1H09A	1H10A	% change	Comment
Revenues				
Franchise operations	12.6	11.4	-9.5%	Self cannibalisation
Store operations	19.3	30.8	+57.9%	Acquisitions, better sales, financial products
Fin. Admin – cash advance	5.4	4.7	-12.9%	New fees arrangement + incentive for vol.
Fin Serv. – personal loan	10.0	15.6	+56%	Rollout into new stores
Elimination	(2.9)	(3.2)		
Total	44.4	59.3	+33.5%	
PBT				
Franchise operations	5.0	4.5	-10%	
Store operations	2.0	3.6	+80%	More stores acquired
Fin. Admin – cash advance	4.4	4.1	-6.8%	
Fin Serv. – personal loan	4.7	7.1	+51%	Rollout of product
Eliminations	(3.6)	(4.5)		
Total	11.6	14.8	+27%	

Source – CCV and OM

Store operation

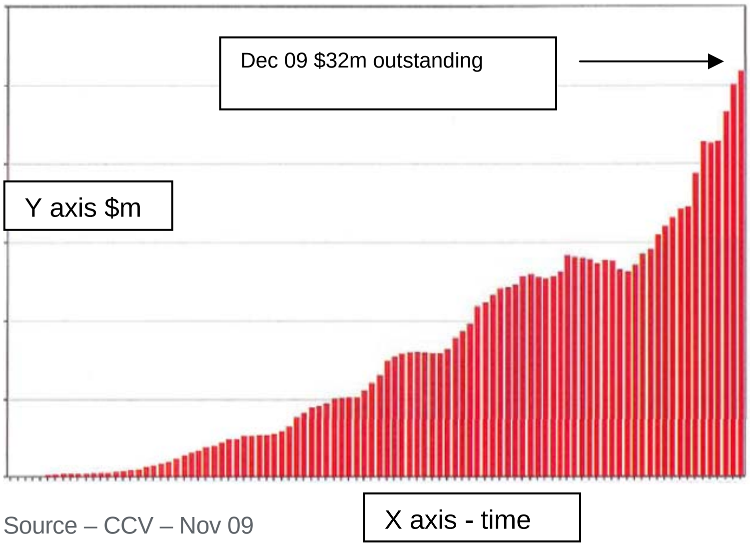
Within the **Corporate store** division – CCV owns over 44 now (plus 13 under acquisition). Management noted that in Australia, Christmas trading was soft post the stimulus – but that the division hit budgets for the entire period. The UK was slightly behind due to some new stores being opened and consuming some profit in the short term. Management believe the UK has a potential for further store rollouts and that the credit rating system (both negative and positive) is more helpful in assessing risk for clients when approving (or declining) personal loans. In terms of profit Australia delivered PBT of $2.2m and the UK $1.4m.

Interestingly **franchised stores** also continue to grow with 7 opened in the UK and 2 stores in Australia. The total number of franchised stores stands at 473 with 121 in the UK and 121 in Australia. **This gives CCV a great deal of optionality in acquisition of these businesses into the future**. There is no outstanding litigation in Australian or the UK which is a positive.

Financial Services

The chart below demonstrates the rapid growth of the personal lending book. It has grown by $10.5m in the half to over $31.9m. Bad debts as % of assets have remained steady and are showing signs of improving with the Dec 09 moving down to 6.4% of asset written off (vs 7.4% in Dec 08).

Chart 1.total loan book growth since 2001



Source – CCV – Nov 09

This chart is hard to read. The X axis is about 4-5 years in time and the Y axis is $m- clearly the growth of this product has been strong. The personal loan product is being rolled out in corporate stores in the UK and in Australia with good early results encouraging in terms of volumes and behaviour of the loans.

Cashflow to earnings

EBITDA did not convert as easily to cashflow during the period.

Table 3 – revisions to forecasts

Item - A$m	1H09	1H10
EBITDA	12.7	15.9
Operating cashflow	+8.4	9.2
Add back tax paid	+3.6	3.6
Add back interest	+0.2	20k
Operating cashflow	12.2	12.8
Cashflow to earnings	96%	80%

Source – OM - CCV

Store acquisition and the associated drain on working capital may have hindered this result. In addition the rapid growth of the loan book (and the fees that CCV charges) may have also caused some timing differences during the period – drained circa ~$6m according to management.

The balance sheet remains strong with net $43.5m in cash available.

Changes to estimates

OM has lifted the revenue forecasts for the financial services part of the business and this has lead to some upgrades in our forecasts.

Table 4 – revisions to forecasts

A$m June	FY10F	FY10F	%Δ	FY11F	FY11F	%Δ
Profit and loss	Previous	Current		previous	current	
Sales	115.1	118.0	+2.5%	137.4	140.5	+2.2%
EBITDA	30.1	31.7	+5.3%	33.9	35.7	+5.3%
EBIT	29.1	30.7	+5.5%	32.7	34.4	+5.2%
NPAT	20.7	21.8	+5.3%	24.2	25.4	+5%
EPS	6.4	6.7	+4.7%	6.7	7.0	+4.4%
DPS	3.5	3.5	n.c	4.0	4.2	+5.0%

source - OM

We have made circa 5% upgrades to our earnings forecasts driven from an improved contribution from the financial services business.

Stock catalysts

- ✓ Continued store expansion and acquisitions – appears in place given the large bank of franchised stores available and the current slate of acquisition opportunities. News around store acquisitions is a positive for the business.
- ✓ Product rollout of financial services – loan books have strong momentum, products being piloted and rollout in new geographies.
- ✓ Renewing the stalled growth rate in the cash advance lending business – helped via new store pilots and ongoing growth of the corporate store business. The new contracts with volume incentives should assist in this process over time, despite some cuts to initial fee rates.

Risk factors

- × OM believes that the largest outstanding risk is an adverse resolution of the attempt by the federal government to regulate the interest rates that the Australian industry can charge. We are expecting a decision by June 30 – 2010.
- × Management of the bad debt cycle of the loan books – given CCV's recent growth also remains important. The loans turn over fairly rapidly reducing the risk of underestimation of bad debts

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Business Description

CCV is one the largest corporate pawn broker and providers of alternative credit in the world (albeit in a highly fragmented industry) with over 517 outlets (473 franchisee and 44 corporate stores). It has 4 divisions.

1. Australia – including growing corporate store presence.
2. UK – including a growing corporate store presence.
3. Finance – alternative finance and/or micro credit.
4. Franchisee operations (rest of world) – tiny % of revenue despite large footprint.

Financial Statements

Cash Converters Int

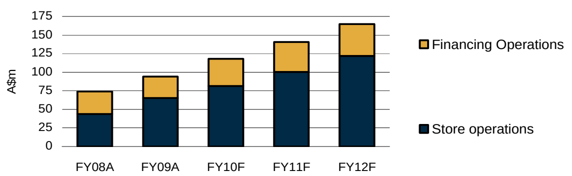
Accumulate

Profit & Loss Statement (A$m)	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	74.3	94.4	118.0	140.5	164.7
Operating Costs	-51.0	-68.8	-86.3	-104.8	-125.6
EBITDA	**23.4**	**25.6**	**31.7**	**35.7**	**39.1**
Depreciation & amortisation	-0.8	-1.1	-1.0	-1.3	-1.5
EBIT	**22.6**	**24.5**	**30.7**	**34.4**	**37.6**
Net Interest	-1.0	-1.3	0.5	1.9	1.7
PBT pre-unusual items	**21.6**	**23.2**	**31.2**	**36.3**	**39.3**
Unusual non-operating items	0.0	0.0	0.0	0.0	0.0
NPBT	**21.6**	**23.2**	**31.2**	**36.3**	**39.3**
Income Tax Expense	-6.4	-7.1	-9.4	-10.9	-11.8
NPAT pre-OEI	**15.2**	**16.1**	**21.8**	**25.4**	**27.5**
Minority interest	0.0	0.0	0.0	0.0	0.0
NPAT	15.2	16.1	21.8	25.4	27.5
Abnormals / convertible dist.	0.0	0.0	0.0	0.0	0.0
Reported NPAT	**15.2**	**16.1**	**21.8**	**25.4**	**27.5**
Normalised NPAT	**15.2**	**16.1**	**21.8**	**25.4**	**27.5**
Effective Tax Rate	29.6%	30.6%	30.0%	30.0%	30.0%
Reported - diluted EPS	6.1	6.6	6.7	7.0	7.6
Normalised (diluted) EPS	6.1	6.6	6.7	7.0	7.6
DPS (cps)	3.0	3.0	3.7	4.2	4.5
Dividend Yield (%)	4.3%	4.3%	5.4%	6.1%	6.6%
Payout Ratio	48%	44%	55%	60%	60%
Franking	100%	100%	100%	100%	100%
Free cash flow (cps)	7.0	5.6	3.4	4.3	4.7
FCF Yield (%)	10.1%	8.2%	4.9%	6.3%	6.8%

Cash Flow Statement (A$m)	FY08A	FY09A	FY10F	FY11F	FY12F
Gross cashflow	15.5	8.6	23.0	26.7	29.0
Net Interest (paid)/received	-0.2	-0.6	0.5	1.9	1.7
Tax Paid	-7.2	-6.6	-9.4	-10.9	-11.8
Other Operating Items	10.5	13.9	0.0	0.0	0.0
Operating Cash Flow	**18.6**	**15.3**	**14.2**	**17.7**	**18.9**
Capex	-0.8	-1.5	-2.0	-2.0	-2.0
Net Acquisitions and Investments	-18.5	-18.5	-5.0	-5.0	-5.0
Other investing items	0.3	0.3	0.0	0.0	0.0
Investing Cash Flow	**-19.0**	**-19.7**	**-7.0**	**-7.0**	**-7.0**
Inc/(Dec) in Equity	0.0	0.0	60.0	0.0	0.0
Inc/(Dec) in Borrowings	10.2	4.0	-10.0	0.0	0.0
Dividends Paid	-7.3	-7.3	-13.4	-15.2	-16.5
Other Financing Items	-1.2	-0.5	0.0	0.0	0.0
Financing Cash Flow	**1.7**	**-3.8**	**36.6**	**-15.2**	**-16.5**
Net Inc/(Dec) in Cash (ex-FX)	**1.3**	**-8.2**	**43.7**	**-4.6**	**-4.6**

Balance Sheet (A$m)	FY08A	FY09A	FY10F	FY11F	FY12F
Cash and Cash Equivalents	16.3	7.0	50.7	46.2	41.6
Current Receivables	19.4	31.8	40.7	50.0	60.5
Other Current Assets -Inv	3.6	7.7	9.7	11.3	13.2
PP & E	2.6	4.6	8.1	11.4	14.4
Intangibles	53.4	60.3	62.8	65.3	67.8
Other Non Current Assets	3.7	3.2	3.2	3.2	3.2
Total Assets	**99.0**	**114.6**	**175.2**	**187.4**	**200.6**
Short term Debt	4.6	3.9	3.9	3.9	3.9
Current Payables	6.7	8.4	10.6	12.6	14.8
Other Current Liabilities	5.0	5.8	5.8	5.8	5.8
Long term Debt	7.7	12.9	2.9	2.9	2.9
Other Non Current Liabilities	1.3	1.3	1.3	1.3	1.3
Total Liabilities	**25.3**	**32.3**	**24.5**	**26.5**	**28.7**
Total Equity	**73.7**	**82.3**	**150.7**	**160.9**	**171.9**
Net Debt	-4.0	9.8	-43.9	-39.4	-34.8

FY09A Revenue



Source: Ord Minnett, Company Data.

Divisions (A$m)	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue					
Store operations	43.9	65.3	81.4	100.3	122.1
Financing Operations	30.4	28.7	36.6	40.3	42.7
Total	**74.3**	**94.0**	**118.0**	**140.5**	**164.7**
Drivers					
Corporate stores	22	38	46	55	65
Comp sales		3.0%	3.0%	3.0%	2.0%
Financing book Y/E $m	8.5	21.4			

Operational Metrics (%)	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue growth	61.9%	27.1%	25.0%	19.1%	17.2%
EBITDA margin	31.5%	27.1%	26.8%	25.4%	23.7%
EBITDA growth	39.3%	9.4%	23.7%	12.6%	9.6%
EBIT margin	30.4%	26.0%	26.0%	24.5%	22.8%
EBIT growth	40.4%	8.4%	25.2%	12.2%	9.3%
Normalised EPS growth	26.7%	8.0%	1.3%	4.1%	8.2%
Return on asset	16.1%	14.8%	12.3%	12.9%	13.1%
Normalised ROE	20.6%	19.6%	14.5%	15.8%	16.0%

Valuation Ratios (x)	FY08A	FY09A	FY10F	FY11F	FY12F
Reported P/E	11.2	10.4	10.3	9.9	9.1
Normalised P/E	11.2	10.4	10.3	9.9	9.1
Price To Free Cash Flow	9.9	12.3	20.6	16.0	14.8
EV / EBITDA	6.9	6.9	6.5	5.9	5.5
EV / EBIT	7.1	7.2	6.7	6.1	5.7

Leverage	FY08A	FY09A	FY10F	FY11F	FY12F
Net Debt / Equity	-5%	12%	-29%	-24%	-20%
Net Debt / (ND + Equity)	-6%	11%	-41%	-32%	-25%
Net Debt / Total Assets	-4%	9%	-25%	-21%	-17%
EBITDA Interest Cover (x)	23.4	19.7	-63.4	-19.0	-23.7
EBIT Interest Cover (x)	22.6	18.8	-61.4	-18.3	-22.8

Substantial Shareholders	m	%
Ezcorp	108.2	29.8%
Staff	21.0	5.8%
Rand Holdings	14.9	4.1%

Valuation	A$m	A$	
WACC (%)			10.9%
Fully Diluted Number of shares (m)			363.2
Cost of Equity			12.0%
D/EV			20.0%
Risk Free Rate			5.5%
Operational NPV (5 year Forecast)	75.1	0.21	
Terminal Value	171.5	0.47	
Less Net Debt	43.9	0.12	
Franking Credits Value (50% weight)	11.3	0.03	
Group NPV	290.5	**0.83**	
Current Share Price		0.69	
NPV Discount to Share Price			**20.3%**

Sensitivity Analysis

		WACC				
		9.9%	10.4%	10.9%	11.4%	11.9%
	1.6%	$0.89	$0.85	$0.81	$0.77	$0.74
Terminal	1.8%	$0.91	$0.86	$0.82	$0.78	$0.75
Growth	2.0%	$0.92	$0.87	$0.83	$0.79	$0.76
Rate	2.2%	$0.94	$0.89	$0.84	$0.80	$0.77
	2.4%	$0.95	$0.90	$0.86	$0.81	$0.78

		β				
		0.9	1.0	1.0	1.1	1.1
Equity	5.2%	$0.97	$0.95	$0.93	$0.91	$0.89
Risk	5.9%	$0.92	$0.90	$0.88	$0.86	$0.84
Premium	6.5%	$0.88	$0.85	$0.83	$0.81	$0.79
	7.2%	$0.84	$0.81	$0.79	$0.77	$0.75
	7.8%	$0.80	$0.78	$0.76	$0.74	$0.72

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Guide to Ord Minnett Recommendations

BUY	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over 12 months.
ACCUMULATE	The stock's total return is expected to be between 5% and 15%. Investors may add to existing holdings, or initiate holdings on share price weakness.
HOLD	The stock is fairly priced, and its total return is expected to be between 0% and 5%.
LIGHTEN	The stock's total return is expected to be less than 0% and possibly down 15%. Investors should consider selling into share price strength.
SELL	The stock's total return is expected to lose 15% or more.
RISK ASSESSMENT	Classified as High, Medium or Low, denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, volatility, nature of its operations and other relevant quantitative and qualitative criteria.

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