

Company Review

Ord Minnett Research

Tuesday, March 15, 2011

Cash Converters

Upgrading to a Buy

- Cash Converters' share price has come under pressure in the recent market sell off, despite a very strong 1H11 earnings result. We believe the current valuation represents a good opportunity to buy the stock.
- Fundamentals such as the store rollout program, ongoing growth in the finance business, continued expansion offshore, and strong balance sheet all provide a solid underpinning for the business. The use of the internet to manage inventory, improve price discovery (value goods) and expand lead generation is also a positive. The business tends to be more resilient to slower economic conditions than many other businesses.
- There also remains little in the way of major corporate competition in Australia. The GFC has freed up sites in the UK and also reduced the supply of small credit providers, reducing the degree of competition.
- Regulation always remains a risk but robust growth rates across multiple geographies and little major competition in Australia act as offsetting factors. OM expects that a further regulatory update with respect to interest rate caps might be possible around June or July 2011.
- The business is trading on a normalised P/E of 10.4x FY11 and a dividend yield of 5.0% (fully franked) which appear reasonable and prices in some degree of regulatory risk. The EPS growth rates remain strong supported by improving profits from the business.

Key Financials Year-end June (A\$)	FY10A	FY11E	FY12E	FY13E
Revenue (\$m)	126.6	188.6	235.4	275.1
EBITDA (\$m)	33.7	43.6	52.4	61.3
Net profit after tax (\$m)	21.6	29.2	34.5	40.4
EPS (¢)	6.6	7.5	8.8	10.3
P/E (x)	11.7	10.4	8.8	7.5
EV/EDITDA	7.6	6.9	5.9	5.1
Dividend (¢)	3.0	3.8	5.4	7.4
Net Yield (%)	3.9%	5.0%	7.0%	9.6%
Franking (%)	100%	100%	100%	100%
Normalised NPAT (\$m)	21.6	29.2	34.5	40.4
Normalised EPS (¢)	6.6	7.5	8.8	10.3
EPS Growth (%)	-0.4%	13.3%	18.1%	17.1%
Normalised P/E (x)	11.7	10.4	8.8	7.5
Relative P/E (%)	77.6%	68.5%	58.0%	49.6%
Normalised ROE (%)	13.3%	16.4%	17.9%	19.7%

Source: Iress, Company Data, Ord Minnett Est. Share price: \$ 0.775 Mar 14, 2011

ASX A\$0.775

 Recommendation
Buy (was accumulate)

 Risk Assessment
High
Sector – consumer discretionary

Stephen Scott

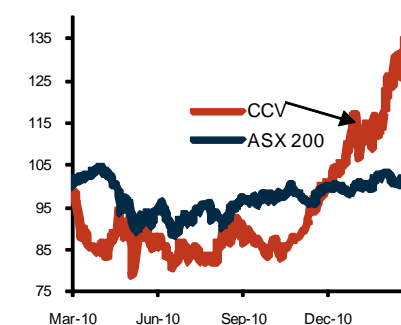
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Cash Converters

ASX Code	CCV
52 week range	A\$0.5 - A\$ 0.91
Market Cap	311
Shares Outstanding	379.6
Av Daily Turnover	420,719
ASX100	4,710
ASX200 Industrials	3,637
NTA FY11E (¢ p/s)	21.6
Net Debt FY11E (m)	5.6

Relative price performance



Source: Iress

Consensus earnings

	FY11E	FY12E
NPAT (C)	28.9	33.8
NPAT(OM)	29.2	34.5
EPS (C)	7.5	8.8
EPS (OM)	7.5	8.9

Source: Iress – only 2 analysts – guidance is \$27.5m+ (Feb 11)

Risk factors

Three areas of caution and risk:

1. The business is now ageing its new lending books. Bad debt levels were rising as a percentage of loans and are now falling compared to 2H10 which is positive. Maintaining a sound bad debt profile is important to the business's ability to grow in a controlled fashion in the UK.
2. Christmas was not as buoyant as expected in Australia but was offset by other areas of the business.
3. The federal government is taking over regulation of the National Credit Code. Phase two is to consider implementing a possible interest rate cap by mid 2012.

The UK Office of Fair Trading has recently looked at the issue and according to Cash Converters concluded "price controls would not be an appropriate solution to the particular concerns we have identified".

Operational failure – system problems.

Increased competition.

Gold prices – a decline would be problematic for the scrap market and loan values.

Business description

Cash Converters is one the largest corporate second hand goods dealers, pawn brokers and providers of alternative credit in the world (albeit in what is in a highly fragmented industry) with over 600 outlets (528 franchisee and 80 corporate stores). It has four 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 percentage of revenue despite large footprint.

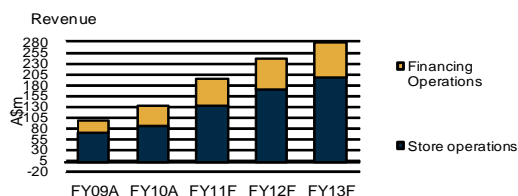
Financial Statements – Cash Converters

Cash Converters

Profit & Loss Statement (A\$m)	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue	94.4	126.6	188.6	235.4	275.1
Operating Costs	0.0	0.0	0.0	0.0	0.0
EBITDA	25.5	33.7	43.6	52.4	61.3
Depreciation & amortisation	-1.1	-1.5	-2.2	-2.2	-2.2
EBIT	24.4	32.2	41.4	50.2	59.1
Net Interest	-1.1	-1.0	0.3	-1.0	-1.4
PBT pre-unusual items	23.3	31.2	41.7	49.3	57.7
Unusual non-operating items	0.0	0.0	0.0	0.0	0.0
NPBT	23.3	31.2	41.7	49.3	57.7
Income Tax Expense	-7.2	-9.6	-12.5	-14.8	-17.3
NPAT pre-OEI	16.1	21.6	29.2	34.5	40.4
Minority interest	0.0	0.0	0.0	0.0	0.0
NPAT	16.1	21.6	29.2	34.5	40.4
Abnormals / convertible dist.	0.0	0.0	0.0	0.0	0.0
Reported NPAT	16.1	21.6	29.2	34.5	40.4
Normalised NPAT	16.1	21.6	29.2	34.5	40.4
Effective Tax Rate	30.9%	30.8%	30.0%	30.0%	30.0%
Reported - diluted EPS	6.6	6.6	7.5	8.8	10.3
Normalised (diluted) EPS	6.6	6.6	7.5	8.8	10.3
DPS (cps)	3.0	3.0	3.8	5.4	7.4
Dividend Yield (%)	3.9%	3.9%	5.0%	7.0%	9.6%
Payout Ratio	44%	45%	50%	60%	70%
Franking	100%	100%	100%	100%	100%
Free cash flow (cps)	5.6	3.5	-0.8	4.0	6.3
FCF Yield (%)	7.3%	4.5%	-1.1%	5.2%	8.1%

Cash Flow Statement (A\$m)	FY09A	FY10A	FY11F	FY12F	FY13F
Gross cashflow	8.6	7.4	19.1	33.9	45.6
Net Interest (paid)/received	-0.6	0.4	0.3	-1.0	-1.4
Tax Paid	-6.6	-7.3	-12.5	-14.8	-17.3
Other Operating Items	13.9	16.0	0.0	0.0	0.0
Operating Cash Flow	15.3	16.5	6.9	18.2	26.9
Capex	-1.5	-3.4	-10.0	-3.0	-3.0
Net Acquisitions and Investments	-18.5	-23.9	-25.0	-5.0	0.0
Other investing items	0.3	-1.9	0.0	0.0	0.0
Investing Cash Flow	-19.7	-29.2	-35.0	-8.0	-3.0
Inc/(Dec) in Equity	0.0	68.3	0.0	0.0	0.0
Inc/(Dec) in Borrowings	4.0	-2.3	0.0	5.0	5.0
Dividends Paid	-7.3	-9.2	-14.2	-20.2	-27.5
Other Financing Items	-0.5	0.1	0.0	0.0	0.0
Financing Cash Flow	-3.8	56.9	-14.2	-15.2	-22.5
Net Inc/(Dec) in Cash (ex-FX)	-8.2	44.2	-42.4	-5.0	1.4

Balance Sheet (A\$m)	FY09A	FY10A	FY11F	FY12F	FY13F
Cash and Cash Equivalents	7.0	50.7	8.3	3.4	4.7
Current Receivables	31.8	49.8	74.2	92.6	108.2
Other Current Assets -Inv	7.7	12.1	17.3	21.3	24.7
PP & E	4.6	6.8	14.6	15.4	16.2
Intangibles	60.3	70.6	95.6	100.6	100.6
Other Non Current Assets	3.2	7.1	7.1	7.1	7.1
Total Assets	114.6	197.1	217.2	240.4	261.5
Short term Debt	3.9	3.3	3.3	8.3	13.3
Current Payables	8.4	10.5	15.6	19.5	22.8
Other Current Liabilities	5.8	8.5	8.5	8.5	8.5
Long term Debt	12.9	10.6	10.6	10.6	10.6
Other Non Current Liabilities	1.3	1.3	1.3	1.3	1.3
Total Liabilities	32.3	34.2	39.3	48.2	56.5
Total Equity	82.3	162.9	177.8	192.2	205.0
Net Debt/(cash)	9.8	-36.8	5.6	15.5	19.2



Source: Ord Minnett, Company Data.

Buy

Divisions (A\$m)	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue					
Store operations	70.1	85.4	133.2	170.8	199.8
Financing Operations	30.1	47.4	61.6	70.9	81.5
Intersegment	-5.8	-6.2	-6.2	-6.2	-6.2
Total	94.4	126.6	188.6	235.4	275.1
Drivers					
Corporate stores	37	58	86	101	116
Comp sales		0.0%	2.0%	2.0%	2.0%
Financing book Y/E \$m	21.4	38.7			

Operational Metrics (%)	FY09A	FY10A	FY11F	FY12F	FY13F
Revenue growth	27.1%	34.1%	49.0%	24.8%	16.9%
EBITDA margin	27.0%	26.6%	23.1%	22.3%	22.3%
EBITDA growth	9.0%	32.2%	29.3%	20.3%	16.9%
EBIT margin	25.8%	25.4%	21.9%	21.3%	21.5%
EBIT growth	4.6%	32.0%	28.5%	21.4%	17.7%
Normalised EPS growth	3.1%	-0.4%	13.3%	18.1%	17.1%
Return on asset	14.7%	11.3%	13.3%	14.6%	15.8%
Normalised ROE	19.6%	13.3%	16.4%	17.9%	19.7%

Valuation Ratios (x)	FY09A	FY10A	FY11F	FY12F	FY13F
Reported P/E	11.7	11.7	10.4	8.8	7.5
Normalised P/E	11.7	11.7	10.4	8.8	7.5
Price To Free Cash Flow	13.8	22.4	-94.1	19.4	12.3
EV / EBITDA	7.7	7.6	6.9	5.9	5.1
EV / EBIT	8.0	8.0	7.3	6.2	5.3

Leverage	FY09A	FY10A	FY11F	FY12F	FY13F
Net Debt / Equity	12%	-23%	3%	8%	9%
Net Debt / (ND + Equity)	11%	-29%	3%	7%	9%
Net Debt / Total Assets	9%	-19%	3%	6%	7%
EBITDA Interest Cover (x)	23.2	n.m	n.m	n.m	n.m
EBIT Interest Cover (x)	22.2	n.m	n.m	n.m	n.m

Substantial Shareholders	m	%
Ezcorp	124.4	32.8%
Staff	21.0	5.5%
Rand Holdings	14.9	3.9%

Valuation	
WACC (%)	10.9%
Fully Diluted Number of shares (m)	389.6
Cost of Equity	12.0%
D/EV	20.0%
Risk Free Rate	5.5%

	A\$m	A\$
Operational NPV (5 year Forecast)	78.2	0.20
Terminal Value	277.1	0.71
Less Net Debt	-5.6	-0.01
Franking Credits Value (50% weight)	16.6	0.04
Group NPV	349.8	0.94
Current Share Price		0.78
NPV Discount to Share Price		21.3%

Sensitivity Analysis

	WACC					
	9.9%	10.4%	10.9%	11.4%	11.9%	
Terminal Growth Rate	1.6%	\$1.02	\$0.96	\$0.91	\$0.86	\$0.81
	1.8%	\$1.05	\$0.98	\$0.92	\$0.87	\$0.83
	2.0%	\$1.07	\$1.00	\$0.94	\$0.89	\$0.84
	2.2%	\$1.09	\$1.02	\$0.96	\$0.90	\$0.85
	2.4%	\$1.12	\$1.04	\$0.98	\$0.92	\$0.87

	β					
	0.9	1.0	1.0	1.1	1.1	
Equity Risk Premium	5.2%	\$1.14	\$1.10	\$1.07	\$1.04	\$1.02
	5.9%	\$1.07	\$1.03	\$1.00	\$0.97	\$0.95
	6.5%	\$1.00	\$0.97	\$0.94	\$0.91	\$0.88
	7.2%	\$0.95	\$0.91	\$0.88	\$0.86	\$0.83
	7.8%	\$0.90	\$0.86	\$0.84	\$0.81	\$0.78

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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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