

23 Aug 2012

CASH CONVERTERS INTERNAT. LIMITED

Profit growth & re-rating to drive share price

Cash Converters Limited ("Cash Converters", "CCV", "Company") reported FY12 NPAT of ~\$29.4m (versus our expected \$29.3m). The Company declared a final dividend of 1.75cps (as expected). Normalised for one-off expenses, NPAT was \$32.6m.

Oz finance continues to perform. UK finance contributes \$4.6m

The loan book continues to grow substantially to ~\$86.8m including the UK loan book of ~£12.7m. Safrock revenue in 2H was \$49.1m and PBT margins rebounded to 39.4% (from ~37% in 1H). This was despite continued high bad debts in the UK. Note, the UK finance division is now profitable with the combined Mon-e/Safrock UK division reporting EBIT of \$4.6m, mostly in 2H12.

The Aust/UK short term finance division showed deteriorating margins to 81.6% in 2H (from 83.1% in 1H and a peak of ~90% in 1H11) but are still high.

Corporate store reported profits were weak, but when normalised for one-offs showed margins (6.2%) in line with expectations. Franchise profits were consistent but are no longer particularly meaningful for the business given their low base (\$6.1m in FY12) and low growth rates.

Still plenty of growth ahead

Net operating cash flow (our measure) was \$12.9m for 2H12, in line with 1H. Investment has slowed with capex of \$6.5m in 2H, store purchases of ~\$5.4m and growth in the loan book (~\$10.5m). Gearing is comfortable (nd/nd + e = 12%, net interest coverage = 30x). We would like to see increasing financial leverage to fund growth. If the Company can secure a large securitisation facility it would be a big boost to the share price, in our view, by releasing the growth potential of the business.

Regulation passes Australian parliament

The legislation has passed both houses of parliament and is expected to be effective on 1st July 2013. We assume margin decline for the Australian financial products although we may prove to be too conservative (we assume no improvement in corporate store sales, 15% decline in margins for Mon-e and 8% decline in margins for Safrock Australia).

Hartleys increases FY14 earnings forecast

The Company made no explicit earnings guidance, but commentary is very positive. Our FY13 NPAT is barely changed at \$36.3m and we have increased our FY14 NPAT by 16.2% to \$42.4m. We expect the Company to continue to pay a 3.5cps annual dividend into the foreseeable future, with possibility of increases particularly if it secures a securitisation facility.

Retain Buy recommendation.

The stock is trading at a very attractive FY13e p/e of 7.3x and FY14e of 7.1x. We have a twelve month price target of \$1.07. We believe that the 3.5cps dividend can be maintained with potential upside, making the stock an attractive yield play. The legitimacy of the payday loan industry has been consistently reaffirmed by regulators in the UK and Australia after they carry out thorough research. The industry itself is not necessarily highly profitable (pure play Australian listed peers include MNY.asx, AUC.cn) and the returns CCV earns are a function of experience, scale, brand affinity & recognition, the unique store format and ability to fund investments (like Carboodle & the online capability). We maintain our high conviction Buy recommendation.

Share Price:	\$0.755
Valuation:	\$1.12
12mth price target:	\$1.07

Brief Business Description:

Payday lending, consumer finance & second hand retailer in UK & Aust.

Hartleys Brief Investment Conclusion:

High returns, industry tailwinds, market leader, cheap.

Chairman & CEO:

Mr Reginald Webb (Chairman)

Mr Peter Cummins (Managing Director)

Top Shareholders:

EZ Corp 32.8%

Fidelity Mgt & Res. (FMR) 6.1%

Rand Holdings Pty Ltd 5.1%

Company Address:

Level 18, 37 St. Georges Tce
Perth, WA, 6000

Issued Capital:	379.8m
- fully diluted	399.8m
Market Cap:	\$286.7m
- fully diluted	\$301.8m
Net Debt (30 Jun '12a):	\$26.2m

	FY12a	FY13e	FY14e
Op Cash Flw	25.3	26.7	44.6
Free Cash Flw	9.4	17.5	37.5
NPAT (A\$m)	32.2	36.3	42.4
EPS (\$, dil)	8.1	9.1	10.6
P/E (basic)	9.7x	7.9x	6.9x
P/E (diluted)	9.4x	8.3x	7.1x
EV / EBITDA	6.1x	5.3x	4.5x
DPS (\$)	0.035	0.035	0.035
Franking	100%	100%	100%
Dividend Yield	4.6%	4.6%	4.6%
N.D. / equity	14.1%	27.7%	32.3%

Source: Hartleys Research



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Hartleys has provided corporate advice within the past 12 months and continues to provide corporate advice to Cash Converters International, for which it has earned fees and continues to earn fees. The analyst has a beneficial interest in CCV shares. See disclosure on back page for details.

SUMMARY MODEL

Cash Converters International Ltd (CCV)					Recommendation: Buy				
Company Information					Profit & Loss (\$m)				
Today's Date	23 Aug 2012	Level 18, 37 St. Georges Tce			AUD/GBP	6/11A	6/12A	6/13F	6/14F
Share Price	\$0.755	Perth, WA, 6000			Safrock Loan Book	62.2	86.8	122.9	165.6
52 Week High-Low	\$0.755 - \$0.39	Ph: (08) 9221 9111			Safrock Revenue	56.6	87.1	104.9	133.3
Market Cap (\$m)	\$286.7	Fax: (08) 9221 9011			Safrock PBT	24.4	33.5	40.3	49.6
Enterprise Value (\$m)	\$313.0	www.cashconverters.com.au			margin	43.1%	38.4%	38.4%	37.2%
Ordinary Shares	379.8				Mon-e Revenue	13.9	16.6	17.0	18.3
Fully Diluted Shares	399.8				Mon-e PBT	12.3	13.7	14.2	13.9
					margin	88.8%	82.3%	83.5%	76.0%
					Owned # (UK + Aust) - end	88	102	122	134
					Owned Stores Revenue	100.9	122.8	126.1	146.2
					Owned Stores PBT	8.6	8.1	8.8	10.2
					margin	8.5%	6.6%	7.0%	7.0%
					Franchised # (UK + Aust) - end	249	263	271	275
					Franchise Revenue	27.4	23.5	24.1	24.9
					Franchise PBT	6.5	6.1	6.2	6.4
					margin	23.7%	25.8%	25.8%	25.8%
					Group Revenue	185.1	233.5	272.0	322.7
					growth	46.2%	26.2%	16.5%	18.6%
					Divisional PBT	51.8	61.3	69.5	80.2
					Overheads	-12.6	-19.9	-18.4	-20.4
					EBITDA - Group	43.9	51.2	59.5	70.3
					growth	34.8%	16.5%	16.2%	18.1%
					EBITDA / Sales	23.7%	21.9%	21.9%	21.8%
					Depreciation/Amortisation	-3.4	-4.3	-4.9	-5.6
					EBIT	40.6	46.9	54.6	64.7
					EBIT / Sales	21.9%	20.1%	20.1%	20.0%
					Net Corporate Interest	0.0	-1.6	-3.5	-5.0
					Pretax Profit	39.2	41.4	51.1	59.7
					Tax	-11.6	-12.0	-14.8	-17.3
					Effective Tax Rate	29.5%	29.0%	29.0%	29.0%
					Minorities	0.0	0.0	0.0	0.0
					Normalised NPAT to equity	28.6	32.2	36.3	42.4
					Norm. Net Profit / Sales	15.4%	13.8%	13.3%	13.1%
					Abnormals / discontinued	-0.9	-2.8	0.0	0.0
					Reported Profit to equity	27.6	29.4	36.3	42.4
					Reported EPS (basic, weighted)	7.28	7.75	9.51	10.9
					Normalised EPS (dil, wghtd)	7.15	8.05	9.13	10.6
					DPS (\$)	0.0350	0.0350	0.0350	0.0350
					Franking	100%	100%	100%	100%
					Payout Ratio	46.5%	41.3%	37.0%	32.5%
					Cashflow Statement (\$m)	6/11A	6/12A	6/13F	6/14F
					EBITDA (inc Safrock interest)	43.9	51.2	59.5	70.3
					Working Capital Change	-2.2	-8.9	-14.5	-3.3
					Cash from Operations	41.8	42.3	45.0	66.9
					Corporate Interest	0.1	-1.7	-3.5	-5.0
					Tax Paid	-10.1	-15.3	-14.8	-17.3
					Net Operating Cash Flow	31.7	25.3	26.7	44.6
					Capital Expenditure	-9.5	-11.9	-9.3	-7.1
					Other (including loan book)	-16.7	-22.7	-36.0	-42.8
					Investments & acquisitions	-28.4	-6.1	0.0	0.0
					Net Investing Cash Flow	-54.6	-40.7	-45.3	-49.9
					Proceeds from Equity Issues	0.0	0.0	0.0	0.0
					Net Change in Debt & Leases	9.4	20.4	21.9	18.8
					Dividends Paid	-12.3	-11.1	-13.4	-13.6
					Net Financing Cash Flow	-3.5	9.0	8.5	5.2
					Movement in Cash	-26.3	-6.5	-10.0	0.0
					HP Lease Capex (non-cash)				
					Balance Sheet (\$m)	6/11A	6/12A	6/13F	6/14F
					Cash	23.5	16.4	6.4	6.4
					Receivables	9.0	10.9	12.7	15.0
					Inventories	14.1	17.1	33.0	38.3
					Other (including loan book)	66.4	91.1	127.2	170.0
					Total Current Assets	112.9	135.5	179.2	229.6
					Property, Plant & Equipment	13.2	19.6	24.7	26.9
					Intangibles (inc. Goodwill)	96.9	92.7	92.0	91.3
					Other	9.7	14.9	14.9	14.9
					Total Non Current Assets	119.7	127.3	131.6	133.1
					Total Assets	232.7	262.7	310.8	362.8
					Accounts Payable	20.3	19.6	22.8	27.1
					Interest Bearing Liabilities	4.6	11.3	11.3	11.3
					Other	11.2	13.8	13.8	13.8
					Total Current Liabilities	36.1	44.7	47.9	52.2
					Accounts Payable	0.0	0.0	0.0	0.0
					Interest Bearing Liabilities	18.0	31.4	53.3	72.1
					Other	3.3	0.1	0.1	0.1
					Total Non Current Liabilities	21.3	31.4	53.3	72.2
					Total Liabilities	57.4	76.1	101.3	124.4
					Net Assets	175.3	186.6	209.6	238.4
					Net Asset Value / Share (\$)	0.46	0.49	0.55	0.61
					NTA / Share (\$)	0.21	0.25	0.31	0.37
					Net Debt (net cash)	-0.8	26.2	58.1	77.0
					Analyst: Trent Barnett	Last Earnings Estimate Changes:			
					Phone: +61 8 9268 3052	23 August 2012			
					Sources: IRESS, Company Information, Hartleys Research				

Fig. 1: Half year P & L and Balance Sheet

Profit & Loss (\$m)	Jun-10a	Dec-10a	Jun-11a	Dec-11a	Jun-12a	FY13e
AUD/GBP	0.582	0.609	0.656	0.639	0.671	0.670
Safrock Loan Book	38.7	47.3	62.2	75.0	86.8	122.9
Safrock Revenue	21.4	24.8	31.8	38.0	49.1	104.9
Safrock PBT	8.4	10.6	13.8	14.1	19.4	40.3
margin	39.3%	42.8%	43.4%	37.2%	39.4%	38.4%
Mon-e Revenue	5.5	6.6	7.3	8.0	8.6	17.0
Mon-e PBT	5.0	5.9	6.4	6.6	7.0	14.2
margin	89.9%	90.5%	87.4%	83.1%	81.6%	83.5%
Owned Stores Revenue	31.7	48.4	52.5	60.8	62.0	126.1
Owned Stores PBT	3.2	5.6	2.9	4.3	3.8	8.8
margin	10.1%	11.7%	5.6%	7.0%	6.2%	7.0%
Franchise Revenue	11.6	13.3	14.1	12.3	11.2	24.1
Franchise PBT	4.2	3.4	3.1	2.9	3.2	6.2
margin	36.5%	25.9%	21.7%	23.3%	28.5%	25.8%
Group Revenue	67.3	87.9	97.2	111.7	121.9	272.0
growth	13.5%	30.6%	10.5%	14.9%	9.1%	16.5%
EBITDA - Group	17.1	21.6	22.3	22.8	28.4	59.5
growth	9.9%	26.8%	3.0%	2.2%	24.7%	16.2%
EBITDA / Sales	25.3%	24.6%	22.9%	20.4%	23.3%	21.9%
Depreciation/Amortisation	-0.9	-1.1	-2.3	-2.0	-2.3	-4.9
EBIT	16.2	20.5	20.0	20.8	26.1	54.6
EBIT / Sales	24.1%	23.3%	20.6%	18.6%	21.4%	20.1%
Net Corporate Interest	0.2	0.0	0.0	-0.6	-1.0	-3.5
Pretax Profit	16.4	20.5	18.7	20.3	21.2	51.1
Tax	-4.8	-6.2	-5.3	-6.0	-6.0	-14.8
Effective Tax Rate	29.3%	30.4%	28.6%	29.7%	28.3%	29.0%
Minorities	-0.1	0.0	0.0	0.0	0.0	0.0
Normalised NPAT to equity	11.6	14.7	13.9	14.0	18.2	36.3
Norm. Net Profit / Sales	17.2%	16.7%	14.3%	12.5%	14.9%	13.3%
Abnormals / discontinued	0.0	-0.4	-0.5	-0.8	-2.0	0.0
Reported Profit to equity	11.6	14.3	13.3	13.2	16.2	36.3
						0
Reported EPS (basic, weighted)	3.10	3.77	3.51	3.49	4.26	9.5
Normalised EPS (dil, wghstd)	3.08	3.68	3.47	3.50	4.55	9.1
DPS (\$)	0.0150	0.0175	0.0175	0.0175	0.0175	0.0350
Franking	100%	100%	100%	100%	100%	100%
Payout Ratio	48.4%	46.5%	49.9%	50.2%	41.1%	37.0%
Balance Sheet (\$m)	Jun-10a	Dec-10a	Jun-11a	Dec-11a	Jun-12a	FY13e
Cash	50.7	23.4	23.5	19.5	16.4	6.4
Receivables	8.2	9.9	9.0	11.0	10.9	12.7
Inventories	10.7	12.1	14.1	14.7	17.1	33.0
Other (including loan book)	43.0	57.3	66.4	80.8	91.1	127.2
Total Current Assets	112.6	102.7	112.9	126.1	135.5	179.2
Property, Plant & Equipment	6.8	9.4	13.2	16.8	19.6	24.7
Intangibles (inc. Goodwill)	70.6	91.3	96.9	91.7	92.7	92.0
Other	7.1	6.9	9.7	11.2	14.9	14.9
Total Non Current Assets	84.5	107.6	119.7	119.8	127.3	131.6
Total Assets	197.1	210.3	232.7	245.8	262.7	310.8
Accounts Payable	10.5	17.5	20.3	14.5	19.6	22.8
Interest Bearing Liabilities	3.3	3.2	4.6	4.6	11.3	11.3
Other	8.6	9.6	11.2	13.6	13.8	13.8
Total Current Liabilities	22.4	30.3	36.1	32.7	44.7	47.9
Accounts Payable	0.0	0.0	0.0	0.0	0.0	0.0
Interest Bearing Liabilities	10.6	8.8	18.0	33.7	31.4	53.3
Other	1.3	3.0	3.3	3.5	0.1	0.1
Total Non Current Liabilities	11.9	11.8	21.3	37.2	31.4	53.3
Total Liabilities	34.3	42.1	57.4	69.9	76.1	101.3
Net Assets	162.9	168.2	175.3	176.0	186.6	209.6
Net Asset Value / Share (\$)	0.43	0.44	0.46	0.46	0.49	0.55
NTA / Share (\$)	0.24	0.20	0.21	0.22	0.25	0.31
Net Debt (net cash)	-36.8	-11.5	-0.8	18.7	26.2	58.1

Source: Company Data, Hartleys Estimates

The Australian business continues to grow and deliver reasonable margin stability.

Note that the loan book (~\$91m + plus unearned interest) is short duration and, theoretically at least, would be turned into cash easily within twelve months if the business was wound down

Fig. 1: Free Cash Flow

Operating cash flow was okay in the half, but the roll out of financial services into the UK means free cash flow is negative

Cashflow Statement (\$m)	Jun-10a	Dec-10a	Jun-11a	Dec-11a	Jun-12a	FY13e
EBITDA (inc Safrock interest)	17.1	21.6	22.3	22.8	28.4	59.5
Working Capital Change	-6.4	-2.5	0.3	-3.5	-5.4	-14.5
Cash from Operations	10.6	19.2	22.6	19.3	23.0	45.0
Corporate Interest	0.4	0.5	-0.4	-0.6	-1.1	-3.5
Tax Paid	-3.7	-5.1	-4.9	-6.3	-9.0	-14.8
Net Operating Cash Flow	7.3	14.5	17.2	12.4	12.9	26.7
Capital Expenditure	-1.9	-3.3	-6.2	-6.5	-5.4	-9.3
Other (including loan book)	-4.0	-7.8	-8.8	-12.1	-10.6	-36.0
Investments & acquisitions	-12.2	-22.7	-5.7	-6.1	0.0	0.0
Net Investing Cash Flow	-18.1	-33.8	-20.7	-24.8	-16.0	-45.3
Proceeds from Equity Issues	9.7	0.0	0.0	0.0	0.0	0.0
Net Change in Debt & Leases	-0.2	-1.6	11.0	15.7	4.7	21.9
Dividends Paid	-5.5	-5.7	-6.6	-6.7	-4.5	-13.4
Net Financing Cash Flow	3.6	-7.5	4.0	9.0	-0.1	8.5
Movement in Cash	-7.1	-26.9	0.5	-3.3	-3.2	-10.0
HP Lease Capex (non-cash)						
Free Cash Flow Analysis	Jun-10a	Dec-10a	Jun-11a	Dec-11a	Jun-12a	FY13e
Net Operating Cash Flow	7.3	14.5	17.2	12.4	12.9	26.7
Capex (Reported) inc loan book	-18.1	-33.8	-20.7	-24.8	-16.0	-45.3
Group Free Cash Flow (rep'ted)	-10.8	-19.3	-3.5	-12.3	-3.1	-18.5
Fixed Debt Repayments	-2.4	-2.2	-2.9	-5.1	-6.7	-4.1
Equity Free Cash Flow (rep'ted)	-13.1	-21.5	-6.4	-17.4	-9.8	-22.6
HP Lease Capex (non-cash)	0.0	0.0	0.0	0.0	0.0	0.0
Free Cash Flow (normalised)	-13.1	-21.5	-6.4	-17.4	-9.8	-22.6
Capex (inc HP) / depreciation	219%	299%	274%	332%	233%	189%

Source: Various

Fig. 2: Earnings Changes

Profit & Loss (\$m)	6/12A			6/13F			6/14F		
	f'cast	actual	% diff	Old	New	% diff	Old	New	% diff
Safrock Loan Book (end)	83.6	86.8	3.9%	115.1	122.9	6.8%	133.3	165.6	24.3%
Company owned stores (end)	105	102	-2.9%	125	122	-2.4%	125	134	7.2%
- additional	17	14		20	20		0	12	
Company owned stores (avg)	93	93	-0.3%	112	109	-2.7%	125	126	0.8%
Revenue	240.7	233.5	-3.0%	284.0	272.0	-4.2%	320.1	322.7	0.8%
EBITDA	49.8	51.2	2.9%	62.7	59.5	-5.1%	63.9	70.3	9.9%
- margin	20.7%	21.9%	6.0%	22.1%	21.9%	-0.9%	20.0%	21.8%	9.0%
Depreciation/Amortisation	-5.5	-4.3	-21.4%	-7.9	-4.9	-38.0%	-9.3	-5.6	-40.5%
PBT before o/head interest	44.3	46.9	5.9%	54.8	54.6	-0.3%	54.6	64.7	18.6%
Net Interest	-1.7	-1.6		-2.8	-3.5		-2.8	-5.0	
Pretax Profit	41.5	41.4	-0.2%	51.9	51.1	-1.6%	51.8	59.7	15.3%
Tax	-12.3	-12.0	-2.0%	-15.3	-14.8	-3.4%	-15.3	-17.3	13.2%
Norm. Net Profit After Tax	30.0	32.2	7.1%	36.6	36.3	-0.9%	36.5	42.4	16.2%
- margin	12.5%	13.8%		12.9%	13.3%		11.4%	13.1%	
Reported Profit	29.3	29.4	0.5%	36.6	36.3	-0.9%	36.5	42.4	16.2%
DPS	3.50	3.50	0.0%	3.50	3.50	0.0%	3.50	3.50	0.0%
EPS	7.5	8.1	7.1%	9.2	9.1	-0.4%	9.1	10.6	16.2%
P/E	10.0x	9.4x		8.2x	8.3x		8.3x	7.1x	
Net Debt	26.8	26.2	-2.0%	39.9	58.1	45.6%	33.8	77.0	127.9%

Source: Hartleys Estimates

PRICE TARGET

Our twelve month price target is increased to \$1.07 (from \$0.82).

CCV Price Target Methodology	Weighting	Spot	12 mth out
DCF	59%	\$1.07	\$1.12
- 9 years explicit + terminal value (Base Case)	50%	\$1.12	\$1.17
- 9 years explicit + then wind up of loan book	9%	\$0.80	\$0.82
12mth forward P/E of 10.0x	30%	\$0.93	\$1.07
Price / NTA (Jun '12a) 1x \$0.25	1%	\$0.25	\$0.25
12mth fwd Div Yield of 3.9% (Gross yield=5.6%)	10%	\$0.89	\$0.89
Risk weighted composite		\$1.00	\$1.07
12 Months Price Target		\$1.07	
Shareprice - Last		\$0.755	
12 mth total return (% to 12mth target + dividend)		47%	

Source: Hartleys Estimate

Fig. 3: Key assumptions and risks for valuation

Assumption	Risk of not realising assumption	Downside risk to valuation if assumption is incorrect	Comment
Australian regulatory impact felt from 1 July 2013	High	Upside	The current timetable is for the legislation to be effective on 1 July 2013.
We assume Mon-e and Safrock margins are reduced significantly.	High	Upside/downside	We assume no improvement in corporate store sales, ~20% decline in margins for Mon-e Australia and Safrock Australia.
UK Safrock margins improve	Low	Moderate	We assume that Safrock UK margins increase significantly but peak at a level much lower than the peak in the Aust business.
Safrock loan book peaks at \$186m in FY17	High	High	We assume that the Australian loan book peaks at around the current level, but that the UK book increases to ~A\$110m from ~\$18m today.
\$95m in value for other projects	Low	Upside	We attribute \$95m for Carboodle (CCV has a convertible note which converts to an 80% equity interest in January 2013). Given the history of the Company's innovation, it is likely that CCV will develop new products.

Conclusion

The Company faces some reasonable risks but we believe we have been realistic or conservative in our base case assumptions.

Source: Hartleys

RISKS

For some good reading on regulatory issues, see

http://www.ofc.gov.uk/shared_ofc/reports/consumer_credit/High-cost-credit-review/OFT1232.pdf

<http://www.treasury.gov.au/contentitem.asp?NavId=002&ContentID=2131f>
www.nocap.com.au

http://www.aph.gov.au/senate/committee/corporations_ctte/Consumer_Credit_Corporations_2011/report/report.pdf

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Hartleys Recommendation Categories

Buy	Share price appreciation anticipated.
Accumulate	Share price appreciation anticipated but the risk/reward is not as attractive as a “Buy”. Alternatively, for the share price to rise it may be contingent on the outcome of an uncertain or distant event. Analyst will often indicate a price level at which it may become a “Buy”.
Neutral	Take no action. Upside & downside risk/reward is evenly balanced.
Reduce / Take profits	It is anticipated to be unlikely that there will be gains over the investment time horizon but there is a possibility of some price weakness over that period.
Sell	Significant price depreciation anticipated.
No Rating	No recommendation.
Speculative	Share price could be volatile. While it is anticipated that, on a risk/reward basis, an investment is attractive, there is at least one identifiable risk that has a meaningful possibility of occurring, which, if it did occur, could lead to significant share price reduction. Consequently, the investment is considered high risk.

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