companyREPORT

Cash Converters Intl.

2nd March 2012

GICS: **Diversified Financials – Consumer Finance**

1H12 Results Overview…

RECENT NEWS

Cash Converters [ASX:CCV] recently announced its first half trading results. One-off expenses hit earnings with the underlying result boosted by continued growth of financial service products.

UPDATE REPORT

Event

- **1H12 Results:** Underlying NPAT rose 7% to $15.3m on the back of a 28.2% jump in revenue to $111.7m. An interim dividend of 1.75c was declared, representing around 50% of half year EPS.

- **Financial Services:** Financial services was the main driver of underlying earnings growth in the half. Personal loans before tax profit was 32.8% higher and 11.1% higher for financial administration. Margins were squeezed due to rising bad debt in the UK loan book.

- **Credit reforms review:** The Australian Government have put forward proposals for interest rate and fee caps on payday loans. Parliamentary committee review suggested changes should be made to the proposed reforms.

Our view

- **Changes to our FY12 forecasts:** Our FY12 underlying NPAT forecast is reduced from $32.2m to $30.9m. Bad debt in the UK loan book will continue to have an impact in the second half.

Valuation | Recommendation

We downgrade to a BUY recommendation following the strong rise in share price since our last report. Our price target of $0.75 represents a 25% premium over the last traded price of $0.60. Favourable outcomes from the regulatory review of the short term lending industry in Australia and improved performance from its UK loan book should see the company re-rated.

CCV

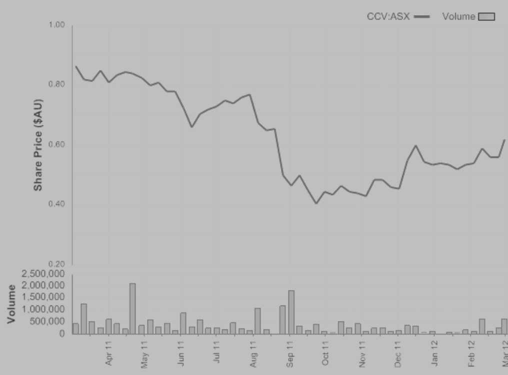
BUY

Price Objective: **$0.75**

Last traded	A$	$0.60
Market Cap	A$'m	227.9
Nº of Shares	m	379.8
2011A EPS	¢	7.2
2012F EPS	¢	7.6
2012F PE	x	7.4
2012F EV/EBITDA	x	4.4
2012F DPS	¢	3.75
2012F Div Yield	%	6.3
Sales 2011A	m	186.1
Sales 2012F	m	241.6
EBITDA 2011A	m	41.7
EBITDA 2012F	m	51.8
NPAT 2011A	m	27.6
NPAT 2012F*	m	28.8

*2012F NPAT is reported NPAT (inclusive of extra-ordinary items)

Share Price | 12month



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1H12 RESULTS OVERVIEW

Cash Converters reported revenue growth in personal loans (+$14.0m), corporate stores (+$12.5m) and financial services administration fees (+$1.4m) were major contributors to the 28.2% rise in first half revenues to $111.7m. Headline NPAT was down 7.5% to $13.2m with first half EPS of 3.5c, down 7.9% from pcp (1H11: 3.8c). Excluding one-offs, underlying NPAT was 7% higher at $15.3m, from $14.3m previously.

Underlying NPAT was 7% higher on the back of a 28.2% rise in revenues. Financial services and corporate store revenue growth drove this result.

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 $2.1m negative impact to NPAT. Higher marketing, support staff, share based payments and interest expenses also increased 1H12 expenses by around $2.5m.

The board declared a fully franked interim dividend of 1.75c, representing approximately half of NPAT.

Financial Services

Revenue from UK and Australian personal loans increased 58.2% to $38.0m from $24.0m in pcp. The administration division (cash advance) grew 21.2% to $8.0m from $6.6m. Loan books in both jurisdictions showed strong growth and EBT was 32.8% higher for personal loans and 11.1% for the administration division. Margins decline was due to were higher bad debt expense in the UK loan book.

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

Australia

The cash advance business lent $111.7m in the half, with a 14.7% growth in active customers. The Australian personal loan book grew to $62.1m, a rise of 17.8% half-on-half (Dec 2011: $52.7m). We would expect similar levels of growth for the personal loans book in the second half considering tighter lending conditions from traditional banks and weaker non-mining economic conditions.

United Kingdom

The UK personal loan book was up 70% to £8.5m from £5.0m in Dec 2011. Customer growth was strong, rising 43.4% in the half. The UK cash advance business continued to grow, lending £13.0m during the half, with a 36.5% growth in active customers. Financial services products are currently available in all UK corporate owned stores, with expansion into the remaining 65 franchise stores expected to drive strong loan book growth in the coming periods.

One area of concern for us was the bad debt on the UK loan book, rising from 9.16% to 11% during the half. This impacted earnings before tax margins for the entire personal loan division, falling from 44.2% to circa 37.2%. A review of lending criteria, appointment of new collections manager and stronger focus on collections, should see a reduction in bad debt percentages over time. Bad debt on the Australian loan book stands at around 6.17%. We would expect bad debt on the UK book to trend down over the longer term to around 7-8%.

Corporate Owned Stores

Cash Converter's corporate owned stores recorded a 25.7% jump from pcp in first half revenue to $60.8m (1H11: $48.4m). Despite this, EBIT declined 23.2% to $4.3m and margins declined from 11.6% to 7% from pcp with a number of factors adversely impacting division earnings. These included costs associated with new greenfield store openings, additional earn-out payments, staff related costs, amortisation and a reduction in cheque cashing income. In terms of retail sales, Australian stores showed 1.4% like-for-like growth (LFL) and 8.6% in the UK. These figures again underlie the defensive nature of the Cash Converter business model with positive LFL growth despite poor economic conditions in the UK, weak consumer sentiment in Australia and many traditional retailers posting declines in LFL sales.

Corporate store revenue was up 25.7% but margin was impacted by one-off costs.

Cash Converters has progressed on its transformation strategy to corporate owned stores. A further nine greenfield stores were opened in the half with seven in the UK and two in Australia. At the end of the half, the UK had 208 stores in total (54 corporate-owned, 154 franchise) and 146 stores in Australia (43 corporate-owned, 103 franchise).

Transformation from franchise operations to corporate owned stores continued with nine new greenfield stores in the first half.

Franchise Stores

Franchise stores delivered a 16.5% fall in earnings before tax on the back of 7.3% decline in revenue. Continued transition to corporate owned stores was the main reason behind the fall in earnings.

FY12 UPDATED FORECASTS

Our earnings forecasts are lowered slightly as we expect more bad debt impacts on the UK loan book in the second half and higher interest expenses. We maintain our expectation of negative regulatory impacts in the Australian business from calendar year 2013. Our FY12 dividend forecast is reduced from 4.0c to 3.75c in light of the company's net debt position and expected capex requirements for further store acquisitions, refurbishments and loan book growth.

Our FY12 forecasts are lowered with negative impacts of bad debt and higher interest rate expense.

Figure 1: **CCV – Financial forecast summary**

Figures in A$'million unless stated	FY11A	FY12F (OLD)	FY12F (NEW)	FY13F (OLD)	FY13F (NEW)
Revenue	**187.6**	**243.1**	**242.6**	**250.4**	**257.6**
Operating Expenses	**-145.8**	**-191.9**	**-190.8**	**-208.2**	**-213.1**
EBITDA	**41.7**	**51.2**	**51.8**	**42.1**	**44.5**
% Chg YoY	*25%*	*23%*	*24%*	*-18%*	*-14%*
EBITDA Margin	*22%*	*21%*	*21%*	*17%*	*17%*
Depr & Amortisation	-3.0	-5.3	-5.3	-6.6	-7.1
EBIT	**38.7**	**45.9**	**46.6**	**35.5**	**37.4**
EBIT Margin	*21%*	*19%*	*19%*	*14%*	*15%*
Net Interest Expense	.5	.0	-2.4	.1	-2.4
Profit Before Tax	**39.2**	**46.0**	**44.1**	**35.6**	**35.0**
Tax Benefit (Expense)	-11.6	-13.8	-13.2	-10.7	-10.5
Underlying NPAT	**27.6**	**32.2**	**30.9**	**24.9**	**24.5**
Extraordinary items	.0	.0	-2.1	.0	.0
Reported NPAT	**27.6**	**32.2**	**28.8**	**24.9**	**24.5**

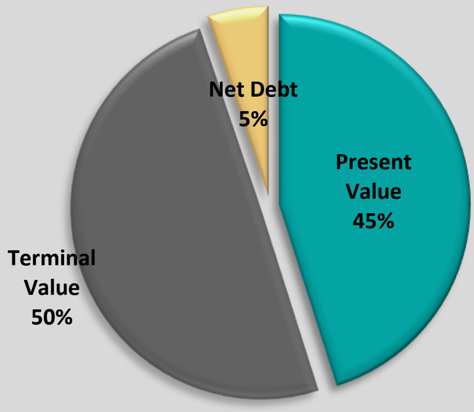
Source: Company data, Microequities estimates

VALUATION | RECOMMENDATION

DCF Valuation

Our DCF model provides us with a $0.84 valuation for CCV, representing a 40% premium to the last traded price. We have used a fundamental BETA of 1.11, a WACC of 11.5% and long-term growth rate of 1%.

DCF Valuation Breakup

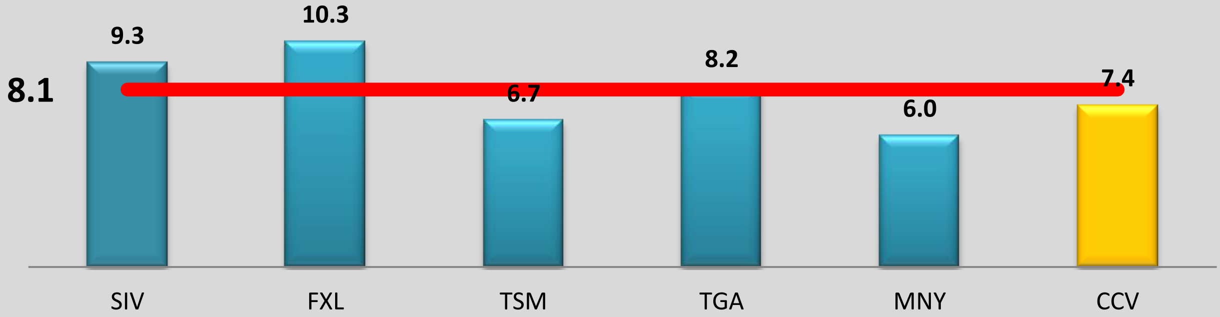


Key assumptions *(as at 01/03/2012)*			
Equity Beta:	**1.11**	**Debt:**	**$38.2m**
Risk free rate:	**4.05%**	**K_d:**	**6.3%**
Return on Equity:	**12.37%**	**WACC:**	**11.50%**
LT Growth Rate:	**1.00%**		

Relative EV/EBITDA Valuation

We have undertaken a relative valuation using the most appropriate peer comparisons in the consumer financials sector. Using a forecast FY12 PE multiple of 8.1x, we have derived a relative valuation of $0.66 per share, representing a 8.2% premium to the last traded price.

Peer group financial summary (*as at 01/03/2012*)



Investment Opinion

We downgrade to a BUY recommendation and lower our price objective to $0.75 from $0.78. The price objective is based on a combination of our DCF valuation of $0.84 and our relative peer valuation of $0.66 which we have applied a peer group average forward PE of 8.1x.

The first half result was largely in line with our expectations, with the higher bad debt expense the only negative. Despite slight downgrades to our full year earnings expectations, CCV continues to trade at an attractive discount to our valuation. Positive regulatory outcomes and/or improvements in the UK loan book should provide the catalysts for a re-rating of the business.

PRICE OBJECTIVE & RECOMMENDATION HISTORY

Changes to recommendations and/or price objectives

Date	Recommendation	Price at time of Rec	Price Objective
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	**2011A**	**2012F**	**2013F**
Revenue	**187.6**	**242.6**	**257.6**
Op. Expense	**-145.8**	**-190.8**	**-213.1**
EBITDA	**41.7**	**51.8**	**44.5**
% Chg YoY	*25%*	*24%*	*-14%*
% Margin	*22%*	*21%*	*17%*
Depreciation & Amortisation	-3.0	-5.3	-7.1
EBIT	**38.7**	**46.6**	**37.4**
% Margin	*21%*	*19%*	*15%*
Net Interest Expense	.5	-2.4	-2.4
PBT	**39.2**	**44.1**	**35.0**
Tax	-11.6	-13.2	-10.5
Underlying NPAT	**27.6**	**30.9**	**24.5**
Extraordinary items	.0	-2.1	.0
Reported NPAT	**27.6**	**28.8**	**24.5**

PROFITABILITY RATIOS			
Year Ending June	**2011A**	**2012F**	**2013F**
Sales	**186.1**	**241.6**	**256.6**
% Chg YoY	*48%*	*30%*	*6%*
Price/Sales	1.1x	0.9x	0.9x
EPS (cents)	**7.2**	**7.6**	**6.5**
% Chg YoY	*9%*	*5%*	*-15%*
P/E	**7.1x**	**7.4x**	**7.1x**
Enterprise Value	196.6	227.0	227.0
EV/EBIT	**5.1x**	**4.9x**	**6.1x**
EV/EBITDA	**4.7x**	**4.4x**	**5.1x**
DPS	3.50¢	3.75¢	3.50¢
Dividend Yield	6.7%	6.3%	7.6%
ROE	*16%*	*14%*	*10%*
Debt to Assets	*10%*	*14%*	*13%*
Debt to Equity	*13%*	*18%*	*16%*

BALANCE SHEET SUMMARY ($m)			
Year Ending June	**2011A**	**2012F**	**2013F**
Cash & cash equivalents	23.5	25.6	24.7
Trade and other receivables	9.0	11.6	13.4
Inventories	14.1	16.9	19.4
Other Current Assets	66.4	101.0	120.8
Total Current Assets	**112.9**	**155.1**	**178.3**
Other financial assets	.0	.0	.0
Trade and other receivables	2.5	2.3	2.7
Property, Plant & Equipment	13.1	21.3	26.8
Intangible assets	20.0	24.7	28.3
Deferred tax assets	4.6	4.6	4.6
Other Non-Current Assets	76.9	76.9	76.9
Total Non-Current Assets	**117.1**	**129.8**	**139.3**
TOTAL ASSETS	**230.0**	**284.9**	**317.6**
Trade and other payables	19.7	14.6	15.4
Borrowings	4.6	5.0	5.4
Current tax liabilities	6.7	6.6	5.2
Other Current Liabilities	5.0	4.1	4.3
Total Current Liabilities	**36.1**	**30.2**	**30.4**
Trade and other payables	.0	.0	.0
Borrowings	18.0	34.0	35.1
Provisions	.0	.0	.0
Deferred tax liabilities	3.3	6.6	5.2
Other Non-Current Liabilities	.0	.0	.0
Total Non-Current Liabilities	**21.3**	**40.6**	**40.4**
TOTAL LIABILITIES	**57.4**	**70.8**	**70.7**
NET ASSETS	**172.6**	**214.1**	**246.9**

CASH FLOW SUMMARY ($m)			
Year Ending June	**2011A**	**2012F**	**2013F**
EBITDA	$41.7	$51.8	$44.5
Decre./(Incr.) in work. Cap	$5.0	-$10.6	-$3.4
Net Int. (Paid)/Rec	$0.5	-$2.4	-$2.4
TaxesPaid	-$11.6	-$13.2	-$10.5
Incr/(decr) in provisions	-$0.7	-$0.2	-$0.2
Other Op. Cash items	-$3.3	-$3.2	$2.7
Cash from Operations	**$31.6**	**$22.1**	**$30.7**
CAPEX	-$10.0	-$22.1	-$19.8
Disposals/(Acquisitions)	$0.0	$0.0	$0.0
Other Inv. Cash Flows	$0.0	$0.0	$0.0
Loans to/from other ent.	$0.0	$0.0	$0.0
Cash Flow From Invst.	**-$10.0**	**-$22.1**	**-$19.8**
Incr/(Decr) in Equity	$0.0	$0.0	$0.0
Incr/(Decr) in Debt	-$8.7	$16.4	$1.5
Ord, Dividend paid	-$12.4	-$14.2	-$13.3
Preferred dividends	$0.0	$0.0	$0.0
Other Fin. Cash Flow	$0.0	$0.0	$0.0
Cash Flow From Fin	**-$21.2**	**$2.1**	**-$11.8**
Net Incr/(Dcr) in cash	**$0.5**	**$2.1**	**-$0.9**
Forx & Disc. Op.	$0.0	$0.0	$0.0
Net Inc/(Decr) Cash	**$0.5**	**$2.1**	**-$0.9**
Equity FCF	$21.6	$0.0	$10.9

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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%**

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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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