

Cash Converters Intl.

April 2012

GICS Sub-Industry: Diversified Financials– Consumer Finance

Research Overview

Business Description

Cash Converters [ASX:CCV] is engaged in the franchising of second hand goods and financial services stores. The Company provides both secured and unsecured personal loans, pawn broking loans and cash advances. It is also the operator of a number of corporate stores operating under the Cash Converters brand.

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.
- FY11 Results:** NPAT rose 27.5% to \$27.6m on the back of a 47.6% jump in sales to \$186.1m. A final dividend of 1.75c was declared taking the full year payout to 3.5c, representing a payout ratio of 48%.
- UK business ramping up:** Strong FY11 result follows the continued expansion of financial services products into UK stores and store acquisitions.

ASX :CCV

Last traded	A\$	0.60
Market Cap	A\$m	227.9
Nº of Shares	m	379.8
2011A EPS	¢	7.3
2011 PE	x	8.2
2011 EV/EBIT	x	5.9
DPS 2011A	¢	3.50
Div Yield 2011A	%	5.8%
Revenue 2011A	m	15.5
EBITDA 2011A	m	187.6
NPAT 2011A	m	27.6

Share Price | 1 Year



Investor Queries

Peter Cumins
Managing Director
Cash Converters

+61 8 9221 9111
peter.cumins@iho.cashconverters.com

BUSINESS DESCRIPTION

Cash Converters International's [ASX:CCV] main business is the provision of consumer finance, pawn broking services and second hand goods retailing. Since 2005, CCV has been working on enhancing their business model, and at present time has been increasingly active in the lending services sector, which has been becoming a substantial part of CCV's revenue. CCV's operations have also grown due to store rollout and acquisition of established franchise stores. CCV currently operates a total of 97 corporate owned stores and 522 franchise stores, located in Australia, United Kingdom and internationally. Further store expansions and franchise store acquisitions are expected.

BOARD OF DIRECTORS & MANAGEMENT TEAM

Reginald Webb | Non-Executive Chairman

Mr Webb was appointed Chairman in January 2006 after serving as a non-executive director for many years. He is a Fellow of the Institute of Chartered Accountants of Australia and was for many years a Partner of PwC. In that position, he worked in North America and Europe as well as Australia. He was a partner for 20 years and served on the Policy Board of that firm. He is currently a Director of D'Orsogna Limited.

Peter Cumins | Managing Director

Mr Cumins joined the group in August 1990 as Finance and Administration Manager when the Company had just 23 stores, becoming General Manager in March 1992. He became Group Managing Director in April 1995. Mr Cumins is a qualified accountant, and has overseen the major growth in the number of franchisees in Australia as well as the international development of the Cash Converters franchise system. His experience in the management of large organizations has included senior executive positions in the government health sector, specifically with the Fremantle Hospital Group, where he was Finance and Human Resources Manager.

John Yeudall | Non-Executive Director

Mr Yeudall is a Chartered Engineer and member of the Australian Institute of Company Directors. He was founder of the IKEA franchise in Western Australia. Mr Yeudall was previously Australia's senior Trade Commissioner in the Middle East and Consul General for Dubai. He joined the board in 2002.

William Love | Non-Executive Director

Mr Love has served as an independent director of EZCORP since October 2008 and has served as chairman of the Audit Committee of the EZCORP board of directors since November 2009. He joined the board of Cash Converters International Limited in 2009. Mr Love is a licensed Certified Public Accountant and a Certified Valuation Analyst, and since January 1993 has practised public accounting in the Austin, Texas based William C Love accounting firm. From 1972 to 1993, Mr Love worked with the accounting firm KPMG Peat Marwick and its predecessors, including appointments as Partner in Charge of Audit, Partner in Charge of Tax and Managing Partner of its Austin, Texas office.

Joseph Beal | Non-Executive Director

Mr Beal has served as an independent director of EZCORP since August 2009 and serves on the Compensation Committee. Mr Beal also joined the Cash Converters International Limited Board in 2009. Until his retirement in January 2008, Mr Beal was the General Manager and Chief Executive Officer of the Lower Colorado River Authority, a Texas conservation and reclamation district with over \$1 billion in annual revenues, over \$3 billion in assets and more than 2,200 employees. Mr Beal joined LCRA in 1995 to lead its Water Services Division and was appointed by the LCRA board in January 2000 to become its eighth General Manager and Chief Executive Officer. Before joining LCRA, Mr Beal was Senior Vice President and Chief Operating Officer at Espey Huston & Associates, an international engineering and environmental consulting firm based on Austin.

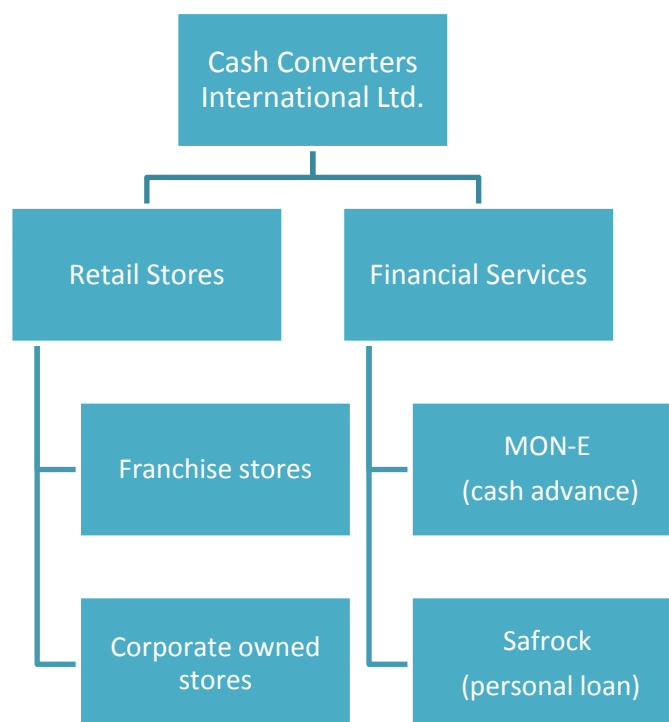
MAJOR SHAREHOLDERS

CCV – Top 20 Shareholders as at 13 September 2011

		SHARES HELD	ISSUED CAPITAL
1.	EZCORP Inc	124,418,000	32.76%
2.	JP Morgan Nominees Australia Limited	21,227,307	5.59%
3.	HSBC Custody Nominees (Australia) Ltd	19,558,996	5.15%
4.	National Nominees Limited	13,091,752	3.45%
5.	Alli Nominees Pty Ltd <Madden Account>	11,726,597	3.09%
6.	Benos Nominees Pty Ltd	10,915,870	2.87%
7.	Hosking Financial Investments Pty Ltd <Hosking Investments A/C>	9,128,057	2.40%
8.	Fawngrove Pty Ltd <Global Graziers Family A/C>	8,273,792	2.18%
9.	Mrs Diana Kathryn Cumins <Diana Cumins Family No 1 A/C>	5,752,511	1.51%
10.	Mrs Heather Janette Hubbard + Russell Leonard Tyrrell <Hubbard Retirement Fund A/C>	4,493,926	1.18%
11.	Australian Executor Trustees Limited <No. 1 Account>	4,481,632	1.18%
12.	Merrill Lynch (Australia) Nominees Pty Limited	4,178,478	1.10%
13.	Mrs Merle Cooke <Cooke Super Fund A/C>	3,573,000	0.94%
14.	Citicorp Nominees Pty Ltd	2,734,255	0.72%
15.	Riolane Holdings Pty Ltd <Cumins Super Fund A/C>	2,273,519	0.60%
16.	RBC Dexia Investor Services Australia Nominees Pty Limited	2,246,100	0.59%
17.	Michael Edward Constable	2,233,801	0.59%
18.	CS Fourth Nominees Pty Ltd <Credit Suisse Equities Aust LTD>	1,844,049	0.49%
19.	Mrs Andreeana Debra Groom	1,666,971	0.44%
20.	Toscana Holdings Pty Ltd <W Hubbard Family A/C>	1,664,282	0.44%
TOTAL FOR TOP 20 SHAREHOLDERS:		255,482,895	67.27%

BUSINESS SEGMENTS

CASH CONVERTERS BUSINESS DIVISIONS



SOURCE: COMPANY DATA

Australia

The Australian operations consist of around 148 stores with 43 corporate owned stores and 105 franchise stores. Stores are represented in most states with the largest number in QLD. NSW is under-represented with only 17 stores. Further store expansion in NSW presents a lucrative opportunity going forward due to the greater population concentration. The overall strategy for Cash Converters is to acquire well-established and profitable franchise stores going forward. Product mix changes and greater promotion of finance products will enhance store profitability.

UK

The UK operations include circa 208 stores of which 54 are corporate owned and 154 franchise stores. Management expects to continue acquiring well-established and profitable franchise stores, consistent with the domestic acquisition strategy.

International

CCV has expanded its franchise operations internationally with 301 stores. Despite the large number of stores, revenue contribution is only minimal with operators given sub-franchisee licenses in return for a passive royalty revenue stream.

Pawn Broking

Pawn broking involves taking personal items such as jewellery as collateral for small amount loans. A high percentage interest rate is charged on the loans to reflect the administrative costs in the provisioning of small nominal value. Personal items taken as security are normally sold if the customer defaults on the loan. Loan terms are typically one to three months in Australian stores and 6months in UK stores.

Retail Store Operations

Franchisees pay between \$50,000 upfront to CCV to establish the business with weekly fees and charges. Cash Converters franchisees pay a fixed weekly amount (irrespective of turnover) in addition to a fixed contracted amount on every anniversary of the store opening. The Company also generates revenue via royalty payments from sub-franchisors, franchise renewal fee and support service fees from its franchisee network. There are currently around 657 Cash Converter stores in 18 countries with around 97 corporate owned stores in Australia (43) and the UK (54). FY11 turnover from franchise operations was \$27.4m, contributing circa 13.8% of total revenue (FY10: 18.2%).

CASH CONVERTER'S RETAIL STORE COMPARISON

	UK store operations	Australian store operations
No. of franchise stores	154	105
No. of corporate owned stores	54	43
Store rollout plans	<ul style="list-style-type: none"> 1 franchise store per month 2 corporate stores per month 	<ul style="list-style-type: none"> 10 franchise stores per annum 4 corporate stores expected in FY12 annum

SOURCE: COMPANY DATA, MICROEQUITIES ESTIMATES

A franchise system was adopted to allow the Group to expand internationally and manage cultural and commercial differences around the world. Under the franchise agreement, Cash Converters provides each franchisee with the right to use the Cash Converters trademark, training system and business systems including inventory management, finance and advertising.

Australian franchise stores trade in second hand household goods, jewellery and personal items. It also provides pawn broking loans, cash advances personal unsecured and secured loans. UK franchise stores also trades in second hand goods, provides pawn broking loans, salary advance loans and cheque cashing services.

In the recent years, CCV has been acquiring established and profitable franchisee stores, and concentrated on increasing operating margin. Going forward, CCV has indicated further store acquisitions and potentially expanding its corporate owned store network into other international regions such as parts of Europe.

Key strategies include:

- Expanding the Cash Converter brand into new geographies and in existing markets
- Continue the acquisition of franchised stores and rollout of cash advance and personal loan products into its UK stores.

Financial Services

Cash Converters also provides micro-lending, short-term lending (payday lending) and pawn broking services. This is an alternative source of credit for subprime borrowers. The company has continued to grow its loan book as banks tighten up on their lending after the global financial crisis.

Financial Services – Administration

Cash Converters provide pawn broking, cheque cashing (in the UK), 'Western Union' money transfers, short-term loans and cash advances. Cash advances are secured against a person's pay or salary (subject to it being paid into a bank account). Total principal loaned in the cash advance business (MON-E) was \$204.6m in Australia and £10.5m in the UK in FY11.

Financial Services – Personal Loans

CCV's personal loans division (Safrock) includes the provisioning of both secured and unsecured personal loans. Acquired in 2006 the Safrock loan book has grown to circa \$52.7m in Australia and £5.0m in the UK at the end of FY11.

Key drivers of the financing business unit include:

- **Interest rate:** the interest rate charged by the pawn broking industry in general is under review by respective legislative authorities.
- **Critical Mass of Loans:** profitability of the business relies on a critical mass of loans made given the low average loan size.
- **Average loan or cash advance value:** the average personal loan is currently \$1,500 whilst average cash advances are currently around \$300.
- **Loan turnover rates:** the turnover rate is critical in determining the amount of total loans written in a given period and upfront establishment fees received.
- **Alternative financing:** Availability of finance such as credit cards and personal loans from traditional banks.

CASH CONVERTER'S FINANCIAL PRODUCTS

	MON-E	Safrock (secured)	Safrock (unsecured)	Pawn broking
Type	Pay day loan	Personal loan	Personal loan	Pawn broking loan
Security	Unsecured	Secured	Unsecured	Secured
Average size of loan	Australia: \$303 UK: £104	\$2000-\$5000	Average \$1500	Average \$90
Average length of loan	4 weeks	12-24 months	4-7 months	1-3 months
Credit Check	No	Yes	Yes	N/A
Loan Capital provider	Franchisee	Cash Converters	Cash Converters	Franchisee

SOURCE: COMPANY DATA, MICROEQUITIES ESTIMATES

FY11 RESULTS SUMMARY

- FY11 NPAT was up 27.5% from pcp to \$27.6m on the back of a 47.6% jump in sales to \$186.1m. EBITDA of \$41.7m showed a 25.4% improvement from pcp. A final dividend of 1.75c was declared taking the full year payout to 3.5c, representing a payout ratio of 48%.
- Driving the growth in revenue was a rise in personal loan interest revenue, establishment fees, corporate store revenue and financial services commission.

1H12 RESULTS SUMMARY

- 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. A fully franked interim dividend of 1.75c was declared.
- 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.

SEGMENT REVENUE AND RESULTS

	FY09	FY10	FY11	1H12
<i>Figures in A\$'mn</i>				
Franchise Operations revenue	\$24.4	\$23.0	\$27.4	\$12.3
EBIT	\$8.6	\$7.0	\$6.5	\$2.9
<i>EBIT Margin</i>	35.4%	30.6%	23.7%	23.3%
Store Operations revenue	\$45.8	\$62.5	\$100.9	\$60.8
EBIT	\$5.4	\$6.9	\$8.6	\$4.3
<i>EBIT Margin</i>	11.8%	11.0%	8.5%	7.0%
Administration revenue	\$9.5	\$10.2	\$13.9	\$8.0
EBIT	\$7.5	\$9.1	\$12.3	\$6.6
<i>EBIT Margin</i>	78.9%	88.6%	88.8%	83.1%
Personal Loans revenue	\$20.6	\$35.9	\$56.6	\$38.0
EBIT	\$9.8	\$15.4	\$24.4	\$14.1
<i>EBIT Margin</i>	47.4%	42.9%	43.1%	37.2%

SOURCE: COMPANY DATA, MICROEQUITIES ESTIMATE

FY12 OUTLOOK

- Regulatory changes for the Australian payday lending industry are expected to be announced.
- Further greenfield store openings and acquisitions and continued rollout of financial services into UK stores.
- Growth trajectory for cash advance in the UK is expected to continue. Personal loan book growth recorded in the first half is set to continue for the second half.

MANAGEMENT Q&A



Peter Cumins
Managing Director

Cash Converter's share price has faced strong headwind from proposed changes to legislation on the payday lending industry. What are the proposed legislative changes that will affect Cash Converters in its Australian operations?

The proposed rate cap is the change which would have the most effect.

Since the findings of the parliamentary committee, has management had indications of when the final decision from the Federal government will be announced? And when can we expect this new legislation to take effect?

The Minister's office met with the Company and Industry in February and indicated that an announcement would be made in April with the Bill back to Parliament in May.

Have there been any similar legislative proposals on payday lending in the UK?

No. The Office of Fair Trading is currently researching the lending practices of 50 pay day lenders in the UK to determine if there is a need for further regulation. Cash Converters is one of those lenders and we are fully supportive of further regulation that improves protection to credit consumers.

“The Company's long term goal is to buy back the Country Licence rights of the most successful networks so that those Countries would operate as wholly owned subsidiaries like Australia and the UK”

The interest charged on personal loans and cash advances are much higher than interest rate on credit cards or personal loans through a typical high street bank. Who is Cash Converters main target market for financial services products and why do you get a lot of repeat customers considering the high percentage interest rate charged on the loans?

Short term unsecured lending is high cost, for 2 reasons: It is high risk, and the establishment costs of the loan cannot be recouped over the term of the loan like a traditional loan and therefore need to be paid up-front. Customers like the convenience of these loans, the simple fee structure and the lack of any alternative.

The company has a large franchise network outside of the UK and Australia with only franchise fees earned by Cash Converters. What is the company's intention for these stores going forward?

The Company's long term goal is to buy back the Country Licence rights of the most successful networks so that those Countries would operate as wholly owned subsidiaries like Australia and the UK.

What is the current store numbers (both franchise and corporate owned) in Australia, the UK and rest of the world? Which region offers the most store expansion opportunities and what is the management plans for store expansion in the next few years (both greenfield and store acquisitions)?

FUTURE OF STRATEGIC ALLIANCES WITH EZCORP:
“EZCORP are committed to a continued alliance as demonstrated by their acquisition of the CCV Licence for Canada and the purchase of 7 CCV stores in America, which included the Licenses for Virginia, Pennsylvania and Florida”

UK: 54 corporate stores & 154 franchised. Australia: 43 corporate stores and 103 franchised & 303 franchised International stores.

Greenfield stores: UK 10 per year & Australia 4 per year Store acquisitions: 10 per year in total between the UK & Australia

EZCORP remains the largest shareholder in Cash Converters. Have they given any indication of their intentions with their shareholding and whether they are still interested in pursuing strategic alliances in the future?

Yes, EZCORP are committed to a continued alliance as demonstrated by their acquisition of the CCV Licence for Canada and the purchase of 7 CCV stores in America which included the Licenses for Virginia, Pennsylvania and Florida.

Is management concerned about the jump in bad debt levels on its UK loan book? What initiatives have been put in place to address this issue?

No. The UK personal loan business is effectively a startup business and as such all our customers are new and therefore are at the higher risk end of the spectrum. Over time we will begin to get repeat customers which significantly reduces the risk profile. We have also introduced a telephone system designed for specifically for collections and appointed an experienced collections Manager.

FINANCIAL SUMMARY

INCOME STATEMENT				KEY RATIOS			
Year to June	2009A	2010A	2011A	Year to June	2009A	2010A	2011A
Revenue	94.8	126.6	187.6	Sales	93.9	125.9	184.6
Expense	(71.5)	(95.4)	(148.3)	% Chg YoY	-%	34%	47%
- Net Interest Expense	0.7	(0.3)	(0.5)	Price/Sales	2.4x	1.8x	1.2x
+ Depreciation & Amortisation	1.2	1.6	3.0	EPS (cents)	6.8	6.6	7.3
EBITDA	25.1	32.4	41.7	% Chg YoY	-%	(3%)	10%
% Chg YoY	-%	29%	29%	P/E	14.1x	10.5x	8.2x
EBITDA MARGIN	27%	25.6%	22.3%	Enterprise Value	237.8	191.0	227.0
Depreciation & Amortisation	(1.2)	(1.6)	(3.0)	EV/EBIT	9.9x	6.2x	5.9x
EBIT	24.0	30.9	38.7	EV/EBITDA	9.5x	5.9x	5.4x
EBIT Margin	25%	24.4%	20.6%	DPS	3.00¢	3.00¢	3.50¢
Net Interest Expense	(0.7)	0.3	0.5	Dividend Yield	5.0%	5.0%	5.8%
Profit Before Tax	23.3	31.2	39.2	ROE	20%	13%	16%
Tax	(7.2)	(9.5)	(11.6)	Debt to Assets	15%	7%	10%
NPAT	16.2	21.7	27.6	Debt to Equity	21%	9%	13%

BALANCE SHEET				CASH FLOW STATEMENT			
Year to June	2009A	2010A	2011A	Year to June	2009A	2010A	2011A
Cash & cash equivalents	7.0	50.7	23.5	Receipt from customers	79.1	103.3	165.0
Trade and other receivables	6.7	8.2	9.0	Payment to suppliers and employees	(70.5)	(94.9)	(146.4)
Personal loans receivable	25.1	41.6	64.2	Interest received	0.5	1.3	1.0
Inventories	7.0	10.7	14.1	Interest received from loans	14.0	16.0	23.1
Other assets	0.9	1.4	2.2	Net increase in personal loans	(7.5)	(8.8)	(17.0)
Total Current Assets	46.6	112.6	112.9	Interest and costs of finance paid	(1.1)	(1.0)	(0.9)
Trade and other receivables	1.4	3.1	2.5	Income tax paid	(6.6)	(8.3)	(10.0)
Plant and equipment	4.6	6.8	13.1	Cash from Operations	7.8	7.7	14.8
Deferred tax assets	1.9	2.8	4.6	Net cash paid for acquisitions	(11.0)	(8.0)	(27.0)
Goodwill	49.9	54.3	76.9	Acquisition of intangibles	-	(5.8)	(2.5)
Other intangible assets	10.5	16.3	20.0	Purchase of PPE	(1.5)	(3.4)	(7.0)
Other financial assets	-	1.3	2.6	Payment for financial assets	-	(1.3)	(1.4)
Total Non-Current Assets	68.2	84.5	119.7	Instalment credit loans to franchisees	(0.5)	(2.1)	(0.2)
TOTAL ASSETS	114.8	197.1	232.6	Instalment credit loans repaid by franchisees	0.7	0.2	0.5
Trade and other payables	8.4	10.5	19.7	Cash Flow From Invst.	(12.3)	(20.2)	(37.6)
Borrowings	3.9	3.3	4.6	Dividend paid	(7.2)	(9.2)	(12.3)
Current tax payables	3.3	5.4	6.7	Incr/(Decr) in Debt	4.0	(1.9)	9.4
Deferred establishment fees	1.3	1.8	2.9	Capital element of finance lease and hire purchase payments	(0.2)	(0.3)	(0.4)
Provisions	1.1	1.4	2.1	Incr/(Decr) in equity	(0.4)	68.8	-
Total Current Liabilities	18.0	22.4	36.1	Share issue costs	-	(0.4)	-
Borrowings	13.0	10.6	18.0	Net issue of unsecured notes	(0.0)	(0.2)	(0.2)
Deferred tax liabilities	1.3	1.3	3.3	Cash Flow From Fin	(3.8)	56.8	(3.5)
Total Non-Current Liabilities	14.2	11.9	21.3	Net Cash +/-	(8.3)	44.3	(26.3)
TOTAL LIABILITIES	32.3	34.3	57.4				
NET ASSETS	82.5	162.9	175.3				

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