

16th March 2006

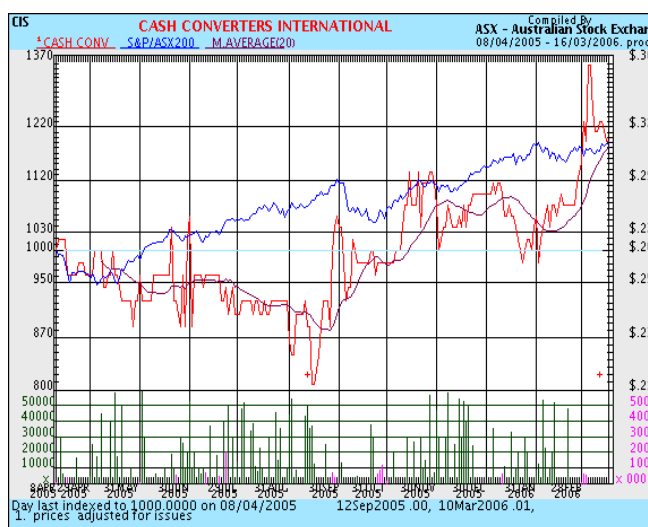
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## CASH CONVERTERS

Code: CCV

30c BUY

Year to June 30th	2005A	2006A	2007A
Net Profit (\$m)	3.1	4.2	5.1
Diluted EPS (c)	2.3	2.9	3.5
DPS (c)	1.0	1.5	2.0
P/E (x)	13.0	10.3	8.6
Yield (%)	3.3	5.0	6.7
EPS Growth	-14	+26	+23



Graph supplied by www.ASX.com.au

### Key Points

There are so many positive developments at Cash Converters - few are appreciated by the market generally. Despite a 35% rise in interim profits, CCV is still rated as a lowly retailer rather than a fast growing financial services group.

The shares also come with a "free option" on the new online auction site. The internet allows the group to leverage its vast franchise network in Australia and the UK. For electrical goods in particular, a warranty backed internet site must be attractive. The recent sale of Trade Me to Fairfax for \$670m shows the upside.

Earnings of 4 cents and a rating of 15x are comfortable medium term targets - hence we expect the CCV share price to double over the forecast period.

- - Cash Converters and its franchise network are in their best shape ever;
- - cash advance income is growing exponentially, up 108% in the first half;
- - overall group earnings growth is running at 30% p.a.;
- - better earnings quality, as one off fees are replaced by recurring income;
- - the new on line auction site has massive upside potential for the brand.

## Cunningham Securities

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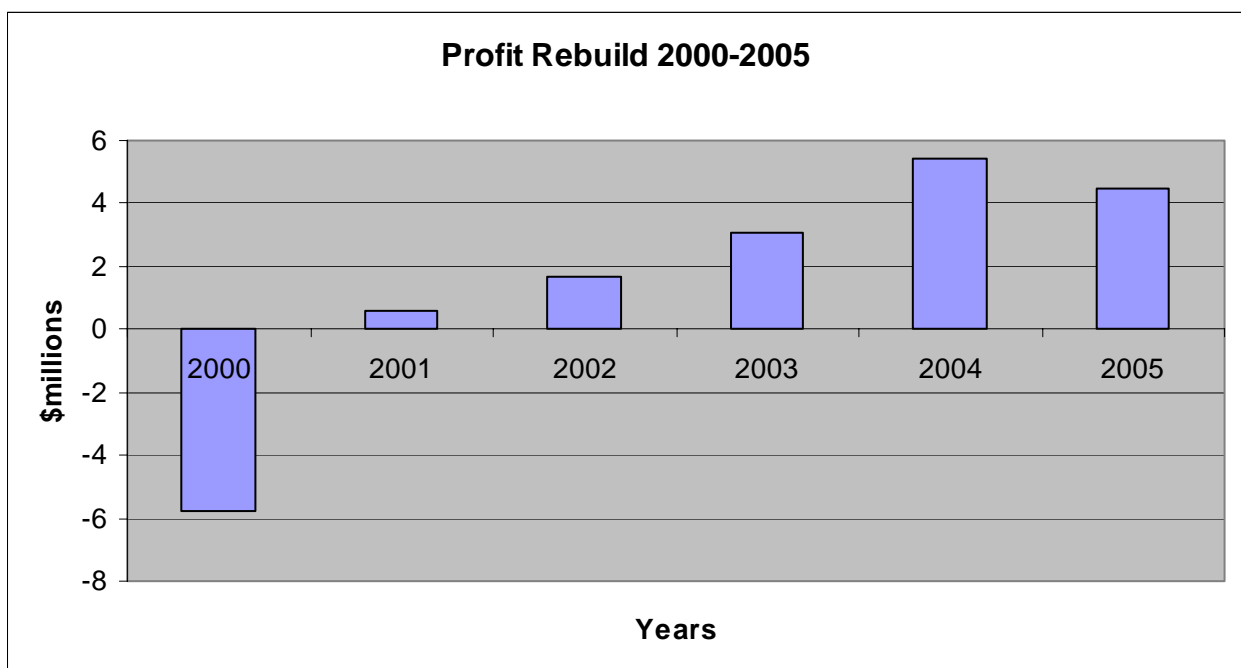
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## Background

Cash Converters was originally established by Brian Cummins in Perth in 1984 as a retailer of second hand jewelry and electrical goods. The business grew rapidly throughout Australia by selling master franchises to individual territories, which were then sub-franchised to the various store operators. In 1992 the franchise to the UK market was sold to the Hare brothers who quickly built up the UK market before selling the master franchise back to Cash Converters in 1996 for 12m sterling. The business listed in the UK in 1995 followed by its Australian listing in 1997. Cash Converters remains dual listed.

Unfortunately, the five year period after flotation in Australia was riddled with legacy issues from this rapid expansion. Disgruntled franchisees in both the UK and New South Wales claimed to have suffered misrepresentation, and other legal issues arose in France and the USA. All these actions were eventually settled but incurred significant legal costs.

The effects of the above were to taint Cash Converters right through until mid 2003 when the share price was still below 10 cents. However, the renewal of most of the important licenses in 2004 for a period of ten years is a good indication of the success of the clean up operation that took place since 2001. More recently, head office has focused on reinvigorating growth in the Cash Converters brand. This is being achieved through the roll out of the massively popular Cash Advance loan product in Australia, and will continue with the launch of an online auction site in Australia and the UK.



The five year record shows the recovery that has taken place. Although 2005 figures appear at first glance lower than 2004, they did not have the benefit of 2004's exceptional renewal fees, and, in fact, represented 70% underlying growth in financial services commission

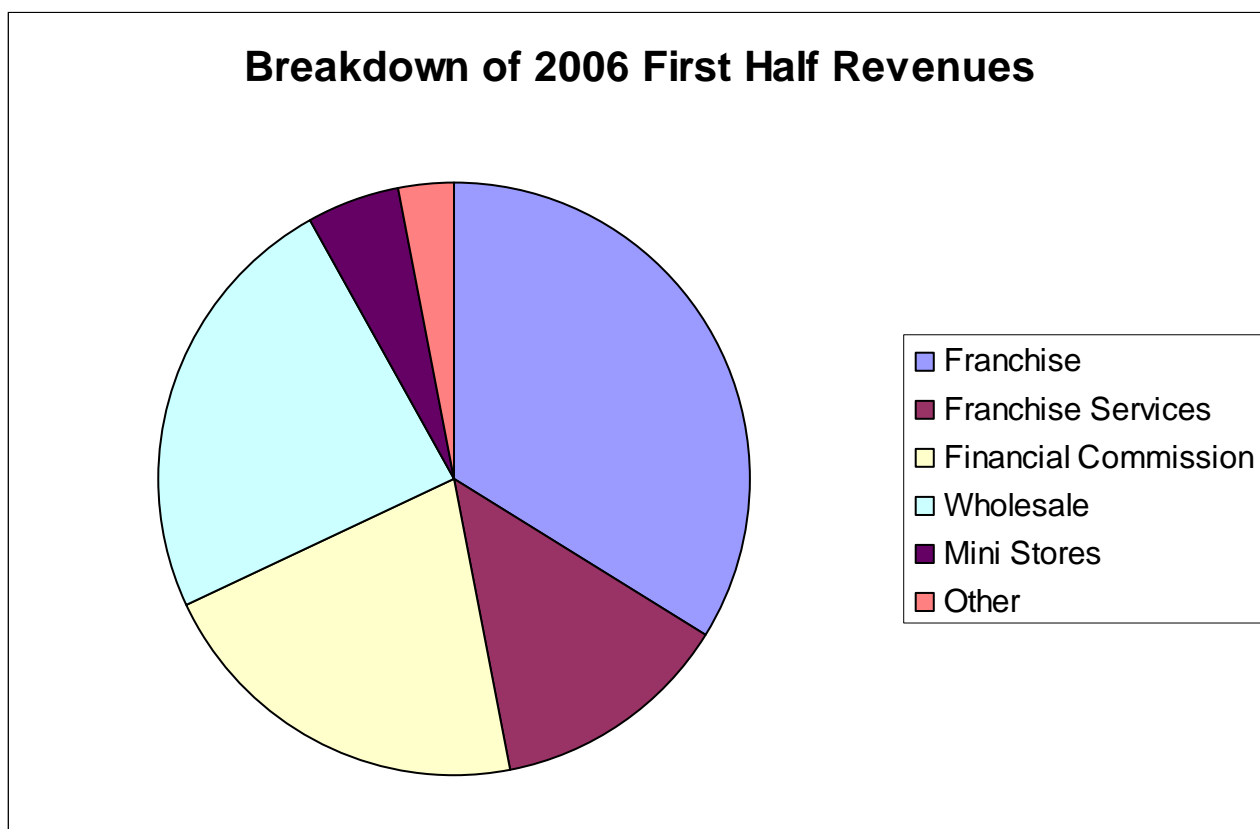
## Cash Converters today

The company has some 450 retail franchisees worldwide. For an initial \$50-100,000 license fee, and weekly payments, franchisees gain access to a proven system including initial site assistance, training, sophisticated stock management and finance systems, and advertising. The largest markets are here in Australia, with 119 stores, and the UK with 110. Australia, which, unlike the UK, offers the Cash Advance product, is by far the most profitable market for the company. In sales terms, however, the UK is actually a bigger business, as the company also acts as a wholesaler supplying inventory to the UK franchisees.

Other large markets include France, Spain, South Africa, Canada and New Zealand. The Far East has the potential to be another major market, and the USA still offers huge upside, albeit regulatory costs are burdensome.

With the exception of a newly launched mini store concept in the North of England, where CCV operates its own stores, it is important to note that the company carries no stock risk. This resides entirely with the store operators.

As the table below indicates, Cash Converter's income comes from primarily from a combination of franchise and franchise services related income, including growing software revenues, and financial services commission. In addition, in the UK, there are wholesale/retail and mini- store revenues.



## Profits Outlook

The company recently announced excellent half year results to December 2005. The key performance statistics are as follows:

- **Revenues up 15% to \$11.4m**
- **Net profit up 36% to \$2.1m and earnings up 28% to 1.4 cents**
- **Interim dividend up 50% to 0.75 cents**
- **Cash advance commissions up 108% to \$1.5m**
- **Growth in franchise services revenue and new UK mini stores**

We now analyze the outlook for each major area of Cash Converter's business:

**Franchise Income** – this will essentially track the opening of new stores, whether traditional stores, buys and loans centres or, in Australia, the new concept of stand-alone personal finance centres. During the first half alone, six new stores were opened in Australia and one in the UK. Interestingly for the future, management believe that the UK, which until recently was held back by legal issues, is capable of sustaining 150 franchised stores compared to 110 now.

**Wholesale** - although this business, which helps stock the UK franchisees, currently represents almost a quarter of group revenues, its impact on profits is fairly minimal. Its impact will reduce further with the growth in ancillary revenues.

**Corporate mini stores** – this is seen as an area with significant growth potential. These are smaller stores than the traditional franchise model, which Cash Converters intend to open in their own right in areas not in competition with their franchise network. Three stores have so far been opened in the North of England with a fourth opening in May 2006. These stores take about a year to break even, so will not be profit contributors during the roll out period. First half mini store revenues were over \$550,000. In the medium term corporate stores will become an important profit contributor in the UK, and possibly in Australia too.

**Franchise Services Income** – this is growing substantially in line with the range of services the group is able to offer its franchisees, including advertising, training and software levies. For example the increased use of software in packages such as the CCWIN management system in the UK and the cash advance product in Australia led to a 500% increase in computer levies to \$650,000 in the first half.

**Financial Services Commissions** – currently about a fifth of group revenues, but with low overheads attached, a substantially higher proportion of profits. Within this area there is cheque cashing in the UK, which saw growth of 20% in the first half. In Australia, the group receives Western Union money transfer commissions and receives a share of commissions paid to the franchisees for personal loans introduced via the network to Saffrock PTY Ltd, a Queensland based finance company.

The personal loan products, where the stores act as agents on unsecured loans up to \$2000 or secured loans up to \$10,000, are different from the Cash Advance product. Cash Advance is a smaller, short term loan where the stores take the principal risk ( although in both cases Cash

Converters simply receive a share of the commission ). The typical loan size is \$230 which is lent to a customer for a month against a direct debit on the customer's bank account. The fee charged is a healthy \$35 per \$100 lent.

As the statistics below show, (and as the writer can attest from the queue at a store he visited recently ) there appears to be a huge market for this product. The growth rates have been simply phenomenal.

	2003	2004	2005	2006 First Half
Total amount loaned	\$11,601,407	\$29,458,924	\$63,496,993	\$49,110,092
Number of loans	58,077	137,737	280,908	n/a
Group commissions	\$399,775	\$798,808	\$1,755,754	\$1,467,482

So far 92 of the 119 stores in Australia are participating, with a further six scheduled to come on stream in the second half. Add to that the fact that in most instances the loan books for this new product are immature, and the fact that the group is also facilitating the opening of stand alone personal finance centres for its more successful franchisees, and one can appreciate that this business has a very exciting future.

**Online Auction Site** – a Cash Converters Auction site was launched in the UK in September 05. So far 10 stores have been involved in a soft launch ahead of an imminent national roll out. This will be supported by a PR campaign highlighting the advantages a bricks and mortar retail network brings to an online auction site. A similar site will be launched in Australia later this year. Cash Converters will receive a commission on all business transacted on the site by its franchisees

We produce below published figures for the 10 stores launched to date in the UK, none of which had the benefit of advertising.

Average no of visitors per day	1,056
No of registered customers	5,196
No of products sold	781

Conceptually, a well marketed site for electrical goods, with the advantage of the backing of the Cash Converters network and its standard three month warranty, should be highly attractive to customers. The site will also showcase the depth of Cash Converter's product offering across its network – for example you would not necessarily know that across its Australian franchise network the group believes itself to be the largest second retailer of compact discs. All this will become apparent from an online auction site, which can only help the perception of the brand and thereby footfall in the shops too.

## Profit Forecasts

<b>CASH CONVERTERS</b>	<b>2004a</b>	<b>2005a</b>	<b>2006e</b>	<b>2007e</b>
<b>Year to 30th June</b>	\$000	\$000	\$000	\$000
<b>Profit &amp; Loss Account</b>				
<b>Revenue</b>				
Franchise fees	10006	8273	8000	8500
Cash Advance Commission	799	1756	3200	4500
Other fees	3226	3274	3600	4000
Wholesale/Corporate stores	8311	4951	7000	8000
Auction site commission	0	0	0	300
Treasury/surplus	1013	354	400	400
<b>Total Revenue</b>	<b>23355</b>	<b>18608</b>	<b>22200</b>	<b>25700</b>
Expenses	-17632	-13832	-16100	-18400
<b>Operating Profit</b>	<b>5723</b>	<b>4673</b>	<b>6100</b>	<b>7300</b>
Interest	-440	-199	-100	0
<b>Profit before Tax</b>	<b>5464</b>	<b>4474</b>	<b>6000</b>	<b>7300</b>
Taxation	-1621	-1396	-1800	-2160
<b>Net Profit</b>	<b>3842</b>	<b>3078</b>	<b>4200</b>	<b>5140</b>
Minorities	-107	-11	-50	-50
<b>Shareholders profit</b>	<b>3735</b>	<b>3068</b>	<b>4150</b>	<b>5090</b>
Basic earnings per share	2.88	2.27	2.85	3.49
<b>Diluted earnings per share</b>	<b>2.65</b>	<b>2.27</b>	<b>2.85</b>	<b>3.49</b>
<b>Dividend per share</b>	<b>0</b>	<b>1.0</b>	<b>1.5</b>	<b>2.0</b>
Diluted number of shares	140764	135667	146160	146160

## Balance Sheet/Cashflow

The group has net cash. Rising profits from financial services commissions are more than sufficient to finance near term cash absorbing activities such as growing the number of corporate mini stores and financing the development of the auction site. On our forecasts, the group will also be able to comfortably afford above market increases in dividend payouts.

<b>Year to 30th June</b>	\$000	\$000	\$000	\$000
<b>Shareholders funds</b>	<b>12073</b>	<b>14600</b>	<b>18750</b>	<b>23740</b>
Net cash/debt	905	3368	3000	5000
Gearing %	n/a	n/a	n/a	n/a
Interest cover	13.0	23.5	61	n/a
Return on assets %	47.4	32.0	32.0	30.4
<b>EBITDA</b>	<b>6410</b>	<b>5250</b>	<b>6600</b>	<b>8000</b>
<b>Free cashflow</b>	<b>4771</b>	<b>2328</b>	<b>4000</b>	<b>5000</b>
Dividends	0	-730	-1800	-2500

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