**SMALL CAP REVIEW - CREDIT CORP GROUP LIMITED - FEBRUARY 2014**

# BUY RECOMMENDATION FOR YIELD AND CAPITAL GROWTH

## CREDIT CORP GROUP LIMITED

**ASX Code:** CCP
**Share Price**: $9.27
**Market Capitalization**: $427,642,546
**Shares on Issue**: 46,131,882
**Dividend Yield**: 5.7% (including the franking credit)
**PE Ratio**: 13.11x **S&P300 PE Ratio:** 15.9x
**Industry**: Commercial and Private Services
**Website**: http://www.creditcorp.com.au

## BACKGROUND

Credit Corp Group Limited (CCP) was established in 1992 and listed on the ASX in 2000. It has quickly become Australia's largest receivables management company. CCP specializes in debt purchase and debt collection services, primarily focusing on the acquisition of consumer debt from finance companies and telecommunication companies in Australia and New Zealand. CCP has established a US presence through acquisition of an existing agency which was officially acquired in June 2012. In addition CCP has grown their service offering to consumer debt advice and consumer lending in recent years.

## OPERATIONS

### CORE OPERATION - DEBT PURCHASE OPERATION

CCP's latest result for 1st Half 2014 is encouraging and has led to CCP increasing its Full Year 2014 guidance.

| | **Versus Previous Corresponding Period (1st Half FY13)** | **Actual (1st Half 2014)** |
|---|---|---|
| **Purchased Debt Ledger (PDL) acquisitions** | Up 20% to | $86.5 million |
| **Revenue** (1) | Up 25% to | $84.1 million |
| **Net Profit after Tax** (1) | Up 18% to | $17.2 million |
| **EPS** (1) | Up 17% to | $37.4 cents |
| **Dividend** (2) | Steady | 20 cents per share |
| *(1) pcp comparatives exclude one-off item representing additional **NPAT** of $2 million* | | |
| *(2) 2013 interim dividend was 16 cents per share plus a 4 cents payout of the one-off item* | | |

As at 1st January 2014 the company had contracted $120 million in PDL acquisitions, its largest first half PDL purchases since inception. The outlook for the full year for PDL acquisitions is expected to be in the region of $125-$135 million, slightly short of record FYE13 PDL acquisitions of $137 million. Despite the flat outlook CCP has increased its full year guidance for FYE2014. Guidance for **NPAT** is $33 million to $35 million (VS. **NPAT** FYE2013, $31.9 million), while **EPS** is 71 to 76 cents (VS. **EPS** FYE2013, 69.8 cents). The increase in full year guidance is partly driven by the increase in the turnover and liquidation of its PDL book (improving productivity) from previous periods.

The company's US operations which contributed less than 6% of total revenue growth for 1st Half 2014, has in recent times experienced challenges due to changes in regulation, leading to the reduction of supply in PDL's. As a consequence CCP is paying slightly higher than preferred prices for debt. The company is of the opinion the supply issue will moderate during 2014 as companies adapt to structural regulatory changes. The regulatory changes in the US include greater supervision over debt collectors to protect the rights of consumers, where in the past debt collectors were in a way able to operate with little oversight. Strict guidelines existing here in Australia and New Zealand mean the company is likely to find synergies in its existing policies it can adapt overseas, so we don't consider it a hindrance. CCP has informed shareholders that until the market price for debt moderates it will continue to focus on cost reduction, seek entry to US debt issuer panels to achieve a higher market share and continue to buy debt at 'compromised' levels. Due to the amount the US operations contributes to the current bottom line and the temporary nature of the supply issue as suggested by management, we do not see this as impacting the bottom line to any large degree.

**CORPORATE SERVICES - DEBT COLLECTION AGENCY SERVICE**

Credit Corp offers agency services in assisting companies to improve their debt collection and reduce fixed costs, in essence an outsourced debt collection agency. CCP will assist in debt collection on a 'fee for service' basis, working with the company to improve their cash flow and profitability.

**CONSUMER SERVICES - DEBT ASSISTANCE AND LENDING SERVICES**

CCP has expanded into consumer lending, a move that makes sense for an expert in debt recovery. Through its subsidiary "**Credit Plan B**", which provides debt assistance services to consumers, CCP can promote its own lending products which include the following subsidiaries:

- **Money Start Loans** **Small loans from $3,000 to $5,000 on a 24 or 36 month loan term**
- **Clear Cash Loans** **Short term loans from $100 to $2,000 offering a loan term period of between 16 to 30 days**

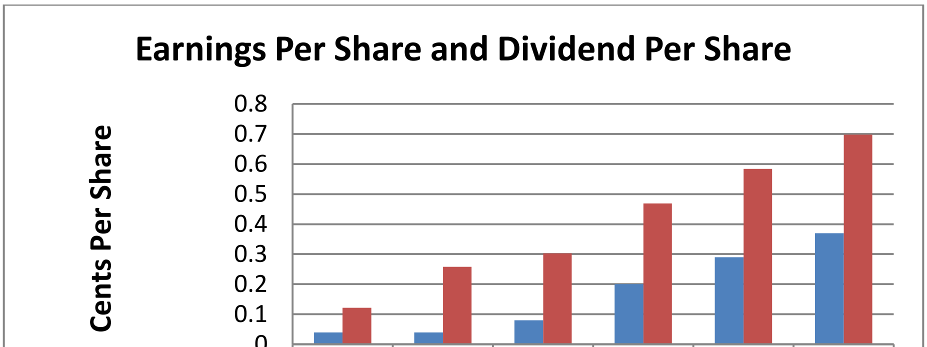
In addition CCP offers car loans through its subsidiary **Car Start Loans** from **$5,000 to $20,000** with the choice of a **36 or 48 month period**. It's a one stop shop where the company will find your car (based on your preferences through its network of car dealers) and lend you the funds to acquire it.

The consumer lending business, still in its infancy, continues to grow its share of revenue. In the first half of FYE14 the consumer lending business contributed 30% of total revenue growth. Although not delivering positive earnings on its own accord, the company has earmarked FYE2015 for the operation to turn its first profit.

## LOOKING AT THE NUMBERS

### EARNINGS PER SHARE AND DIVIDENDS PER SHARE

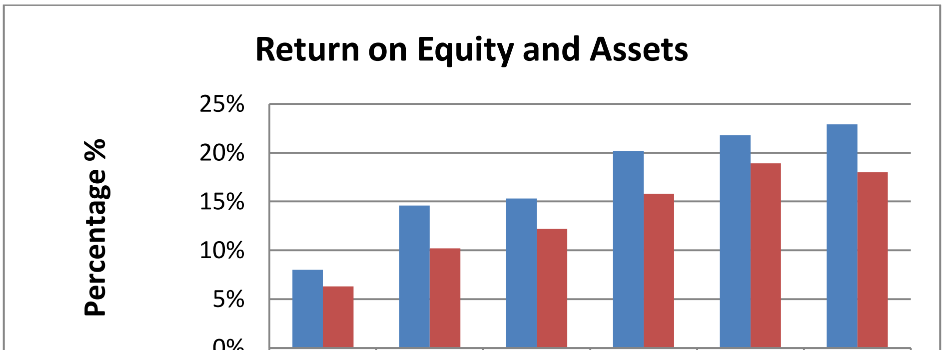
What makes a company attractive is its ability to increase profits over time and reward shareholders with higher dividend payments. The company's dividend payout as a percentage of EPS has been slowly increasing over time to 53% in FYE13, its highest level since inception. The steady growth in the payout ratio reflects a conservative approach by management to ensure it can sustain a dividend over the longer term.  The relatively low payout ratio means a good proportion of its profits are retained in cash. This brings with it a number of positives. Firstly, there is plenty of room for the company to increase its return to shareholders and secondly it's reduced gearing levels substantially and hence its reliance on debt to fund its operations.




| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| Dividend Per Share | 0.04 | 0.04 | 0.08 | 0.20 | 0.29 | 0.37 |
| Earnings Per Share | 0.122 | 0.258 | 0.303 | 0.469 | 0.584 | 0.698 |

### RETURN ON EQUITY AND ASSETS

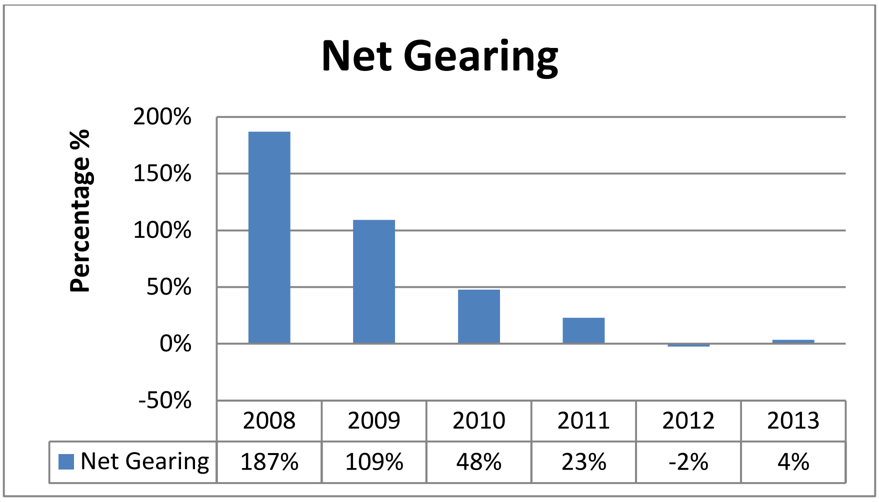
In line with their growing bottom line the company's ROE and ROA has experienced consistent gains. Retained cash generated from management's conservative dividend policy is being used effectively by the company to generate larger profits. The ROA retraced lightly in 2013 reflecting the increased rate of growth in its asset base. We believe due to the positive trend in the turnover and liquidation of its PDL's amongst the larger asset base, there is a good case for an earnings surprise in FYE2014.



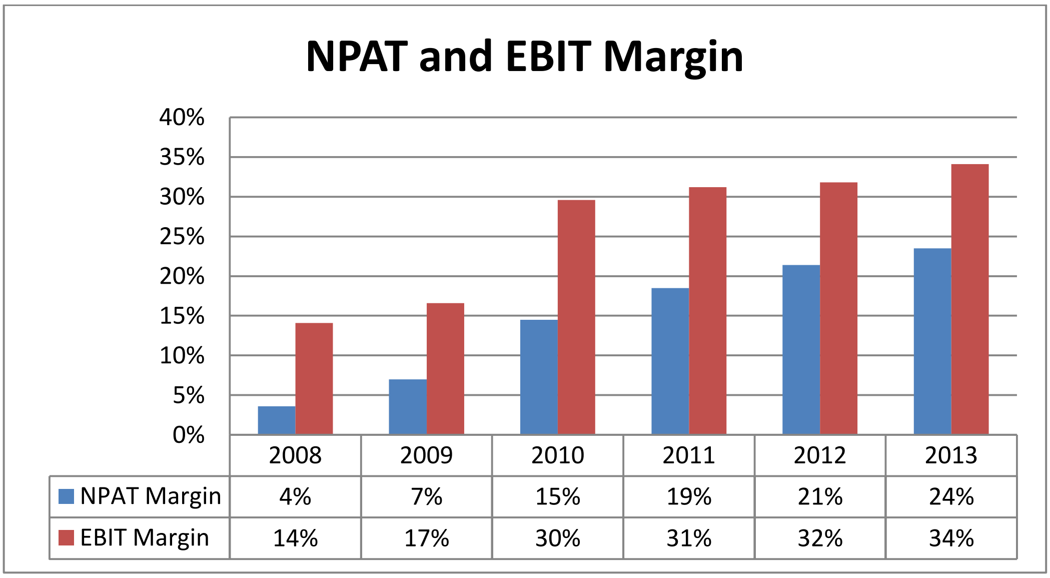

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|
| Return on Equity | 8% | 15% | 15% | 20% | 22% | 23% |
| Return on Assets | 6% | 10% | 12% | 16% | 19% | 18% |

**NET GEARING, NET PROFIT MARGIN AND EARNINGS MARGIN**

The miscellany of strong profit growth and a relatively conservative dividend policy, CCP has been able to retain a good proportion of profits to reduce its gearing level over time without compromising profits. The Net Gearing level as a percentage of Shareholders Equity currently sits at 4%, its lowest level since 2004.




**NPAT** and **EBIT** margins have improved over time, however the rate of growth year on year is slowing due to an increase in operating costs. These costs are more so associated with the management's view a larger and more productive workforce will lead to rising **NPAT** and **EBIT** over time, so it's been spending more money on increasing headcount. Time will tell but given the increased competition in PDL's here and in the US, productivity (which is always critical in business) has risen on the scale of importance for this company to maintain and improve its margins. So we agree the company is on the right path with this strategy.




Since listing on the ASX in 2000 the company has grown its market capitalization from $14 million to $427 million. During 2004 to 2009 serious questions were asked if the company could stem the rising debt levels which hit 187% in FYE2008. It was questioned by many analysts who at this point stopped covering the stock, convinced troubled times were ahead. Instead the post GFC period brought with it an opposite outcome of rising profits, an improved balance sheet and more importantly a reduction in debt levels. Management has approached the US market conservatively with a long term view, focused first on reducing costs while developing its market presence through admission to US issuer panels. We see this operation becoming a larger contributor than it is currently over the longer term. The move into consumer lending is a no brainer for a company who specializes in debt recovery and given the latest report for 1st Half 2014 which reflected interest revenue from its lending book now exceeds provisions for new loans, this area may very well surprise in the short term. Consumer lending has established itself as an important component in the overall business and we are excited about management's recent comments of introducing new products to market, possibly in New Zealand, Australian and the US.

**TECHNICAL REVIEW**


A simple analysis of the CCP chart suggests a pullback in the short term to $9.00 due to the "rollover" of the Relative Strength Index (RSI) and the stocks failure to pierce resistance at $9.70. A short term uptrend has developed since late November 2013, which price movements respected today on the close. A break of this trend at $9.20 and we would expect a pullback to $9.00 short term. As a consequence **we consider Credit Corp Group Limited a buy at $9.00 or below for a long term hold.**

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