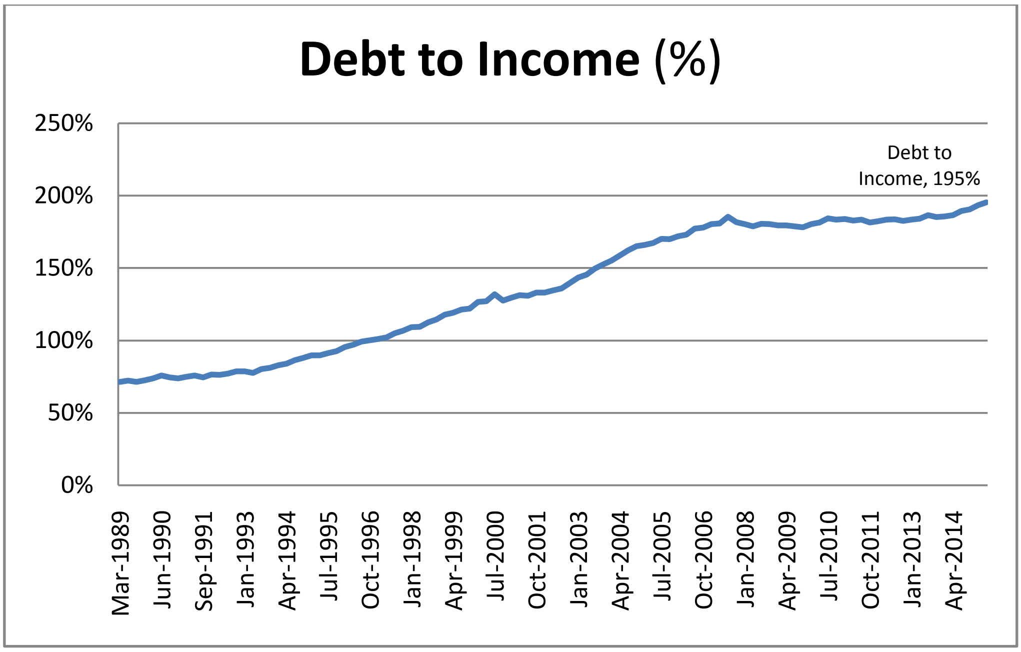
New York Securities Pty Ltd

THE GIFT THAT KEEPS ON GIVING - OUR LAST STOCK TIP FOR 2015

Every now and again we uncover a Gem buried beneath the overburden of second-rate companies. Today we share this Gem with you. **If you only buy one stock before the end of the year, this is it**. Before we give you the company overview we would like to share with you the macro reasons why we are convinced this company has a bright future ahead of it. If you have been an avid reader of our newsletters you would know we have been tracking a key statistic that continues to reveal a growing trend of highly indebted households pushing the limit of their financial boundaries. This disturbing trend has been driven by a unique set of economic occurrences creating a false sense of financial invincibility among households that continues today despite the very foundation that justified it all weakening beneath them. It's the same set of factors that the RBA governor, Glenn Stevens has been warning about since his unprecedented appearance on Channel 7's morning show "Sunrise" in March 2010 and has recently seen the Government and Regulators scrambling to protect the Australian economy from its potentially devastating effects.

The key statistic we are referring to is of course the **Debt-to-Income ratio**. This ratio is a measure of **Total Household Debt** (housing loans, personal loans, and credit cards) **relative to Gross Disposable Income**. Since the early 90's Australia has seen a significant increase in the appetite for debt with housing debt increasingly taking up a larger proportion of the total debt figure. As at September 2015 **Housing Debt alone made up 72% of Total Household Debt vs. 47% in the early 1990's.**



Data used for "in-house" calculation derived from ABS Statistics

New York Securities Pty Ltd

AFSL: 317392 ABN: 70 111 049 800

Shop 11 "South Shore Piazza" 85 South Perth Esplanade, South Perth, WA 6151 | PO Box 1196, South Perth, WA 6951 | P: (08) 9363 1700 | F: (08) 9367 2450 |

E: reception@nysecurities.com.au

W: www.nysecurities.com.au

Today Australian households owe the banks among other institutions nearly two times their gross disposable income, the highest ratio in Australia's history. Not even the US reached a Debt-to-Income ratio this high before its economy went off the rails. While many developed countries have seen their ratios fall in line with the contraction of their economies (Japan, Germany and the UK) in contrast Australia's has continued to climb as if households were immune from its effects. Initially this was the case, after all Australia did manage to avoid a recession while many countries were slowly crumbling under the weight of their own debt.

Australia's saviour has of course been China's insatiable appetite for commodities, keeping the mining sector afloat while other industries regressed. While we managed to avoid a recession unfortunately it led many households to develop a false sense of financial invincibility and self entitlement leading to a greater appetite towards debt (mortgages or otherwise), only to be exacerbated by a trend of declining interest rates and the "red hot" property market. Armed with an imprudent mentality households continued to advance into the perfect storm of these "once in a lifetime" set of economic occurrences spending big and seeking great fortune in property. While those were the good times as the China influence regresses they will soon come to realize they have led themselves (and consequently the nation) into a "Debt Trap", victims of false pretence **where the serviceability of their debt obligations will in due course be called into question. While many Industries will remain under pressure the Debt Services Industry will be a major beneficiary of these turn of events.** While its common "life events" such as illness, disability, marriage breakdown and loss of employment that has driven the Debt Services to become a Billion Dollar industry, it's the unwinding of the unique set of economic occurrences that will **accelerate the already consistent growth profile of this industry and this means great opportunity awaits those companies who are prepared to capitalize on it.**

INTEREST RATES

The property market has played a pivotal role in pushing household debt to the levels we see today. Enticed by the declining interest rate environment, households and investors have pushed property prices to outstrip average incomes by a ratio of 5.4:1 (Feb2015, HIA) compared to 3.5:1 (Feb1995, HIA). This reveals households have been committing to larger loans overtime, locking in typical tenures of between 25 to 30 years, **long enough for the interest rate cycle to wreak havoc on their personal finances**. An unfavorable shift in Interest Rates has the capacity to drastically increase the growing number of households experiencing **Mortgage Stress**, defined where households commit more than 30% of their **gross income** to mortgage payments. To demonstrate the effect of rising interest rates on households in our current market, I have put together the following scenario;

Based on ABS statistics (May 2015) an Australian couple working full time, could expect to earn circa $12,000 per month, before tax. Using the current variable rate of 4.83% over a 25 year term, in today's market **mortgage stress begins at a loan value of $620,000** (***shown by red line***).

Loan Value	Monthly Repayment	Percentage of Gross Income
$400,000	$ 2,298.91	19%
$500,000	$ 2,873.64	24%
$600,000	$ 3,448.37	29%
$700,000	$ 4,023.10	34%
$800,000	$ 4,597.83	39%
$900,000	$ 5,172.55	44%
$1,000,000	$ 5,747.28	48%

Rate at 4.83%, 25 Year Term ***ABS Statistics***

If we adjust the variable rate to reflect the 15 year average (2000 to 2015) of 7.36% we find **mortgage stress begins at a principal loan value of $480,000** (***shown by red line***), well below the current national median residential price of $604,700 (***shown by green line***).

Loan Value	Monthly Repayment	Percentage of Gross Income
$400,000	$ 2,919.64	25%
$500,000	$ 3,649.54	31%
$600,000	$ 4,379.45	37%
$700,000	$ 5,109.36	43%
$800,000	$ 5,839.27	49%
$900,000	$ 6,569.18	55%
$1,000,000	$ 7,299.09	61%

Rate at 7.36% (15 year average) ***25 Year Term*** ***ABS Statistics, Loansense***

Based on the median residential price of $604,700 if variable rates revert to the 15 year average of 7.36%, the average household will be allocating near 40% of their gross income to cover their mortgage payments. Sydney would fare the worst given their median residential price currently sits at $777,400 *(abs statistics)*. In this scenario the average household would allocate more than 45% of their gross income to cover mortgage repayments, severely restraining the capacity of households to repay other debt obligations.

It should be noted as a result of recent regulatory changes interest rate risk no longer just stems from the RBA alone. Truthfully it never did but it wasn't up until APRA'S move earlier this year (forcing banks to increase capital required on mortgage exposures) that we ever felt the need to worry about a second influence. As a result of this move the banks needed a solution and so to shore up their balance sheet they increased the interest rate on mortgages or in other words the cost of debt for households, highlighting indirect influences as a real risk we need to consider moving forward.

The risk associated with the cost of debt comes at a time when the other side of the equation, income is also being challenged. Weak Chinese demand has really tightened its grip on the mining sector of late, wage growth sits at its lowest level in 16 years, GDP continues to hold below trend, the unemployment rate remains historically high, our terms of trade balance remains subdued while Government debt sits at its highest level we have ever seen, all factors that are placing pressure on the **earnings capacity of highly indebted households, the very means by which households service their debt.** It's not unreasonable then to conclude a greater number of households will be pushed into financial hardship as the pressure infiltrates our economic landscape. **If our view is correct this means the Debt Services industry will continue to thrive but at a higher pace while most sectors continue to struggle among the pressure.** So here in lies the opportunity we present to you today, a relatively young company in the early stages of its growth profile, managed by a dynamic, innovative and experienced board, residing in a niche area within a broader Industry that is expected to be a strong performer and a company that is reshaping the views associated with financial hardship.

PIONEER CREDIT LIMITED (ASX CODE: PNC) – A HARDSHIP SERVICES PROVIDER

While to some it may seem mercenary to derive earnings from those experiencing financial hardship, once you understand the unique business model of Pioneer you come to the realization not only are you buying a company that satisfies strict investment criteria and is well positioned for growth, but it's a company that offers a unique social benefit in **breaking down the stigma attached to experiencing financial hardship**, **a stigma highly undervalued in the market place until now**. Despite being constantly categorized among the broader "Debt Collection Industry" **Pioneer doesn't hold a Debt Collectors Licence**, rather the company operates in a niche market, residing close enough for exposure to the lucrative debt collection industry, yet far enough removed not to be burdened with the negative connotations of being a debt collector, something its competitors carry.

The **key difference** between Pioneer and its competitors, such as ASX listed companies Credit Corp (CCP) and Collections House (CLH) comes at the point of debt acquisition. Rather than call for immediate repayment of the debt, as a typical debt collector would, Pioneer utilizes its Credit Licence to "re-originate" debt obligations into new loans typically at interest rates of circa 15%. This evolutionary approach gives Pioneer flexibility in working together with its customers to maximize its return on its investment.

CUSTOMER FOCUS

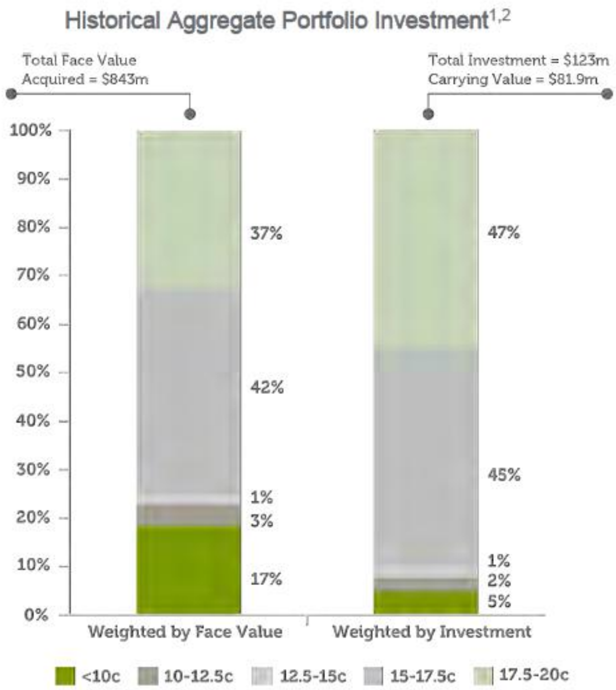
Earlier this year I had the opportunity to visit Pioneers new premises in the City of Perth and the set-up was impressive. As you walked through their offices you could immediately sense the positive corporate culture that existed within the company. Employees are regular attendees to the excellent training facilities where they are able to develop and refine their customer engagement skills and keep up to date with changes in the industry and/or company. Although expected from a company whose bottom line relies on effective engagement with its customers it was important to experience firsthand their commitment in assisting customers to "break through the barriers" of financial hardship.

As and when new customers are acquired by Pioneer through their Debt Portfolio Purchases they are each allocated a dedicated Client Service Manager who works together with them in their journey towards financial recovery. On the rare occasion an amicable agreement cannot be reached the customer is referred to its internal law firm for resolution, but always with a focus of restoring the relationship for Pioneer. Importantly to date there has also been no negative outcomes awarded against Pioneer by the Ombudsman, a unique position among the larger participants in the industry. It's Pioneers personalized approach that leads to **loyalty to the brand,** an outcome Pioneer intends to capitalize on starting early 2016 via a new rollout of rebranded "white label" debit and credit cards.

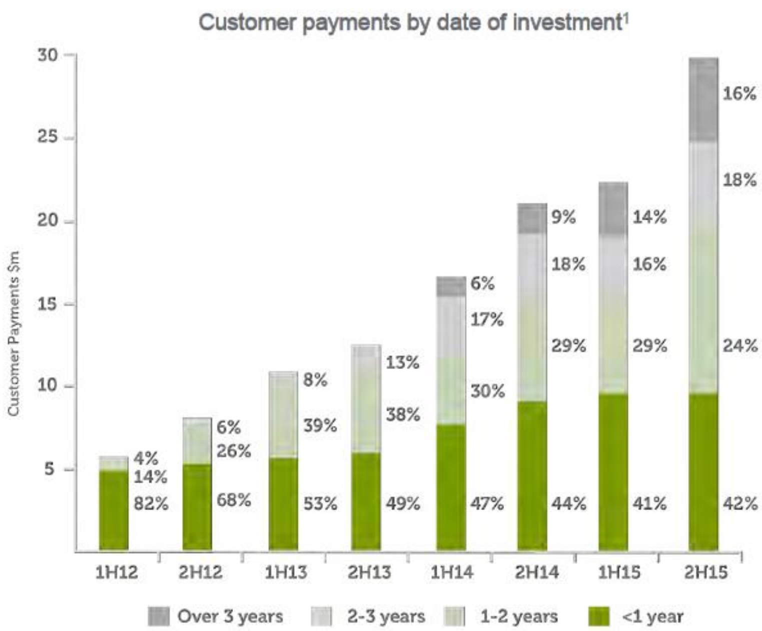
DEBT ACQUISTION

Pioneer specializes in acquiring and servicing "Tier 1" unsecured personal debt (typically 180 days overdue) from three of the four "big banks", regional banks and leading consumer leasing providers. "Tier 1" debt is deemed higher quality because the customer initially met the bank's lending criteria but a "life event" thereafter has disrupted their ability to repay. This means the customer generally has a fair capacity to pay but they are in need of a flexible solution to regain control of their finances. This is where Pioneer utilizes its unique business model to work together with the customer. Importantly Pioneer avoids exposure to lower quality payday lending, utility, telecommunication accounts and other low quality sectors.

Pioneers objective is to acquire Debt (referred to as "Debt Portfolio Purchases") at a deep discount to its full value, generating profit where the amount recovered exceeds the purchase price and the cost associated with recovering the debt. Pioneer's debt purchases are structured as "forward flow agreements" with leading institutions that reflect similar standards for risk assessment and brand values. This assists in reducing the overall risk profile of its acquisitions. The company's objective is to pay no more than 20 cents in the dollar, to date they have achieved a weighted average purchase price comfortably below this figure at 16.3 cents in the dollar (FYE 2015). The below chart reflects the composition of Pioneers debt purchases;



The key to profitability is of course Pioneers ability to "collect" on the debt purchased. The below chart reflects customer payments by date of investment. Strong and consistent liquidation during the first two years is note worthy having averaged 53% since 1H12, while the trend of older debts (>2 years) contributing a greater proportion to the total book continues to develop. A continuation of both trends overtime will reduce the reliance on 1st and 2nd year recoveries, achieving a far more desirable liquidity profile.



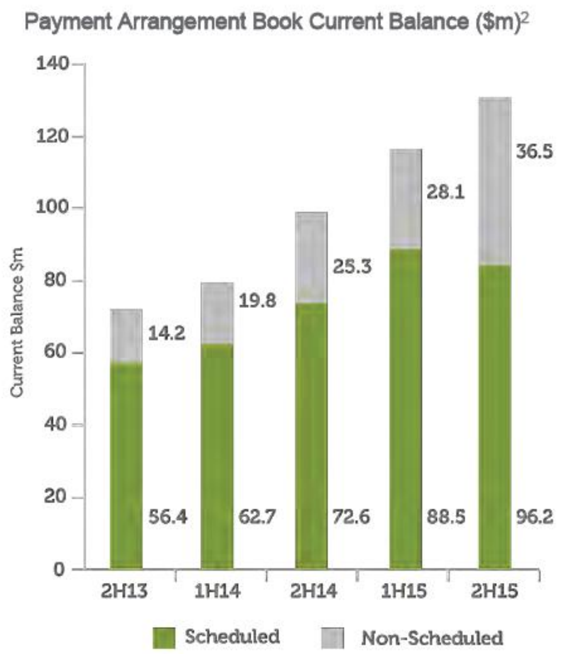
PAYMENT ARRANGEMENTS

Once Pioneer acquires a debt portfolio, customers are offered flexible payment arrangement methods dependant on the customer's financial situation. The flexibility of the payment system results in an adaptable and far more "humane" solution for the customer while operating within the legal boundaries existent in the debt services industry.

Pioneer offers its customers two payment arrangement methods;

1) **Fixed Scheduled**- periodic payments are agreed on and paid until account is paid in full. Interest charged at circa 15% (historically)
2) **Non Scheduled**- customer agrees to pay but does not commit to a fixed schedule. Interest charged at circa 15% (historically)

As at the FYE 2015 Pioneers payment arrangement book grew to $132.7 million, achieving a yearly compound growth rate of 42% since FYE 2012 (book value of $46.4 million). Fixed scheduled payments account for 73% of total payment arrangements leading to clearer predictability in Pioneers earnings.



The average account balance for payment arrangement customers is $10,163 with a weighted average age of 1.9 years (as at FYE 2015). Debt balances of this size have a greater chance of being repaid as opposed to amounts that far exceed this level i.e. $50,000 and above. In other words they are workable "situations" most people will be prepared to resolve rather than go down the track of the alternative.

NEW REVENUE STREAMS WHILE PROTECTING BALANCE SHEET

In April this year Pioneer acquired a strategic 14.1% stake in ASX listed company Gold Fields Money. The two companies immediately began discussion on the development of new financial products for mutual benefit. This led to the signing of an MOU (Memorandum of Understanding) in June outlining the framework for new banking products;

1) **Debit Card**– Development of Debit Card product to be issued by Goldfields Money under the Pioneer brand.
2) **Credit Card**– Development of Credit Card product to be issued by Goldfields Money under the Pioneer Brand. This product will only be issued only to those who have finalized their debt obligation with Pioneer.

Pioneer aims to launch these new products by March 2016.The MOU framework outlines the operational development to be handled by Pioneer, accordingly employees will be put through an extensive 3 month development course prior to the rollout of the new products. The credit risk remains with Goldfields money meaning **no balance sheet risk for Pioneer**. This development is a significant step forward for Pioneer to capitalize on its large customer base (over 110,000 and growing on average 2,500 per month) while protecting its balance sheet.

KEY FINANCIALS

First Listed: 1st May 2014 at $1.60 per share
Market Capitalization: $80 million
Shares on Issue: 45.8 million
Last Price: $1.76 per share (as at 22.12.15)
Range (12 Months): $1.45 to $2.09 per share
P/E: 10.73 **Industry Average:** 12
Dividend Yield (Historical): 6.94% (Fully Franked)
Dividend Reinvestment Plan: Yes

BOOK VALUE

Pioneer is currently trading on about 1.5 times book value, based on Net Asset Value of $52.9 million as at FYE 2015 (vs. 1.7 times book value as at 31/12/2014). In order to draw any relevance to this figure we compare it to listed companies Credit Corp and Collection House who are trading at book values of 2.7 and 1.6 respectively. Generally based on book value it can be concluded Pioneer is trading at a discounted book valuation compared to its peers.

NET GEARING LEVEL

The Net Gearing level for Pioneer as at FYE 2015 was 58%. In a **normal interest rate** environment this figure is slightly above our preferred target of 30%, however the current interest rate environment is anything but normal and the company generates significant cash flow from its operations. For this reason we are of the opinion it makes sense now for Pioneer to utilise cheap debt where finance is required, within reason. Its peers Credit Corp and Collection House have Net Gearing Ratios of 40% and 71% respectively.

RETURN ON ASSETS (ROA)

ROA reflects how efficient a company is in using the asset base to generate profit. As at FYE 2015 the ROA for Pioneer was 9.3% vs. ROA for FYE 2014 of 1.8%. This compares to 14.4% and 8.4% for Credit Corp and Collection House respectively. Importantly the ROA is moving in the right direction and relative to its peers who are far more established than Pioneer the company is performing very well in this regard.

RETURN ON EQUITY (ROE)

Similar to ROA, Return on Equity reflects how efficient a company is at generating profit from shareholder money and retained profits. As at FYE 2015 the ROE for Pioneer was 14.8% vs. ROA for FYE2014 of 2.2%. This compares to 21.3% and 13.2% for Credit Corp and Collection House respectively.

FREE CASH FLOW

Free Cash Flow is an important element in any business as it gives scope for expansion, reducing debt, paying higher dividends and/or other useful purposes. Free Cash Flow (FCF) is a direct reflection of the group's ability to turn its portfolio of existing debt purchases after operating expenses into cash. Pioneer achieved a FCF of $28.1 million in FYE 2015 versus FCF of $22.5 million in FYE 2014 while FCF for FYE 2016 is forecasted to grow over to over $30 million before investments.

P/E MULTIPLE

The Earnings per Share for Pioneer as at FYE 2015 is 16.4 cents per share. On a P/E basis Pioneer is currently trading on 10.73 times earnings at a discount to its peers Credit Corp and Collection House who currently trade on multiples of 12.6 and 12 times earnings respectively.

EARNINGS YIELD

Earnings Yield for Credit Corp and Collection House are 8% and 8.3% respectively. Pioneer Credits Earnings Yield currently resides at 9.3% making it an attractive proposition compared to its peers and the alternatives in the market place after consideration of equity risk i.e. Term Deposits.

DIVIDEND YIELD

PNC's dividend policy is to distribute 50% of NPAT as a fully franked dividend. This is a prudent dividend policy and is likely to remain sustainable over the longer term with scope for upward revision. In comparison the payout ratios for Credit Corp and Collection House both stand at 53%. Pioneer looks attractive in reference to its dividend yield of 6.94% (fully franked) compared to Credit Corp and Collection House who currently offer dividend yields of 6% and 6.3% respectively.

FORECASTED EARNINGS – FYE 2016

Pioneer has forecasted for the FYE 2016 period a Net Profit of at least $8.8 million. At current prices and number of shares on issue this represents the following, all other things being equal;

- **P/E** of 8.8 times earnings
- **Earnings Per Share** of 19.2 cents per share
- **Earnings Yield** of 11.2% (vs. 10 year commonwealth Government Bond 2.8513%)
- **Dividend** of 9.6 cents per share (Dividend Policy - 50% of Profit after Tax)
- **Dividend Yield** of 8% (Grossed Up/Fully Franked)

CONCLUSION

The “Debt to Income” ratio sits at its highest level in Australian history at 1.95 time’s Gross Disposable Income. While the majority of developed nations including the US, Germany, Japan and the UK are experiencing declines in their ratios in line with weak economic conditions, Australia continues to push upon new boundaries never experienced before in history. The “red hot” property market and the gradual decline in interest rates has created an insatiable appetite for Debt and a sense of financial invincibility which now looks certain to unravel as the economic foundation weakens beneath us. Despite these weaknesses there are always opportunities to take advantage of and Pioneer Credit Limited is one of those great opportunities we foresee to be a big performer as households come to terms with their debt levels in a challenging economic environment. The Debt Services Industry will be a major beneficiary as the unwinding leads to higher numbers of households experiencing financial hardship. Pioneers unique business model and strong relationships with major financial institutions have placed them in an ideal position to capitalize on this shifting tide. Importantly Pioneer operates a brand that tackles the stigma of financial hardship by offering its customers a new approach in getting their finances under control. It’s this focus on working together with its customers that will lead to a higher rate of recovery on its debt portfolio purchases and build loyalty to the brand that will allow Pioneer to capitalize on through the provision of new financial products. Pioneer continues to build upon its core strategy while seeking low risk opportunities through the development of new products such as the debit and credit cards which will be launched to its strong customer base in March 2016.Pioneer continues to generate high levels of Free Cash Flow, giving the company the flexibility to develop new products, consider strategic acquisitions and maintain its low debt ratio.

PIONEER CREDIT LIMITED IS A BUY AT CURRENT LEVELS