COLLECTION HOUSE LTD

RESEARCH NOTE

Ample growth potential in PDL business segment

Initiation of Coverage

- We have initiated coverage on Collection House Ltd (ASX Code CLH), one of Australasia's largest receivables management groups. It currently has a market capitalization of around $75M. The company's core business is the provision of debt collection services including contingent collection (CC), receivables management, purchasing debt ledgers (PDLs) and legal services. It now operates from offices in Brisbane (head office), Sydney, Melbourne, Adelaide, Newcastle, country Victoria and Auckland. CLH currently employs some 600 people throughout its network. It enjoys strong business relationships with many major financial institutions, insurance companies, large corporations, public utilities and government instrumentalities in both Australia and NZ.
- **CLH gives respectable FY12 earnings guidance; PDL arm provides longer term growth potential**. CLH now expects a 1H12 NPAT of around $5.5-5.8M and a FY12 NPAT of $11.0-11.5M. Longer term, CLH's plans to ramp up the size of its purchased debt collections (PDL) arm provides the central growth catalyst over coming years. At the same time its end-to-end product offering provides scope for CLH to extend and deepen its client base. The introduction of a DRP will help fund this collections expansion, while the 5% discount attached to the DRP will cheer income-focused investors.
- **CLH's current share price is not overly demanding.** CLH is expected to retain its reputation as a relatively high yielding stock, with a prospective FY12 dividend yield of around 9%. The removal of the circa 5M share overhang previously in place is a medium term positive for CLH, although Baycorp retains a 10% CLH holding. *Our DCF valuation is $0.82, while our 12-month price target is $0.88, both of which are comfortably above the current share price. For reinforcement, we also undertook a relative PE analysis, which arrived at a valuation of $0.78. We accordingly have a **BUY** recommendation on CLH.*

Year End June 30	2010A	2011A	2012F	2013F	2014F
Reported NPAT ($m)	8.9	10.1	11.4	12.8	14.4
Recurrent NPAT ($m)	8.9	10.1	11.4	12.8	14.4
Recurrent EPS (cents)	9.1	10.3	10.9	11.9	12.9
EPS Growth (%)	2.0	13.2	6.6	8.5	8.9
PER (x)	7.6	6.7	6.3	5.8	5.3
PEG	3.7	0.5	0.9	0.7	0.6
EBITDA ($m)	47.1	56.2	61.6	66.1	71.4
EV/EBITDA (x)	2.9	2.6	2.6	2.5	2.3
Free Cashflow	37.0	45.5	49.6	52.8	57.3
FCFPS (cents)	37.7	46.2	47.5	49.0	51.5
PFCF (x)	1.8	1.5	1.4	1.4	1.3
DPS (cents)	5.8	6.2	6.4	6.8	7.4
Yield (%)	8.5	9.1	9.4	9.9	10.8
Franking (%)	100.0	100.0	100.0	100.0	100.0

13 December 2011

12mth Rating		**BUY**
Price	A$	0.69
Target Price	A$	0.88
12m Total Return	%	28.1
RIC: **CLH.AX**		BBG: **CLH AU**
Shares o/s	m	102.0
Free Float	%	54.9
Market Cap.	A$m	69.9
Net Debt (Cash)	A$m	76.4
Net Debt/Equity	%	79.7
3m Av. D. T'over	A$m	0.03
52wk High/Low	A$	0.81/0.63
2yr adj. beta		0.57
Valuation:		
Methodology		DCF
Value per share	A$	0.82

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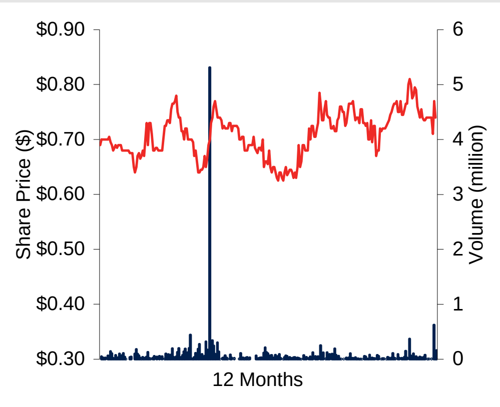
Disclosure: *Patersons was recently appointed joint lead manager to (1) underwrite any shortfall in CLH's DRP and (2) arrange a supplementary placement for the company. The latter placement, done via a single tranche, raised $3.04M (4.332,668 shares @ $0.701 each). Patersons received a fee for this service.*

12 Month Share Price Performance



Performance %	**1m th**	**3mth**	**12mth**
Absolute	-7.5	-3.3	7.2
Rel. S&P/ASX 300	-5.0	-2.7	19.3

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Investment Case

- **An Australasian leader in its field.** Collection House Ltd (ASX Code CLH) is one of Australasia's largest receivables management groups. The company's core business is the provision of debt collection services including contingent collection, receivables management, purchasing debt ledgers (PDLs), legal services and consulting and training services. Its product offerings are noticeably more diverse than its major competitors, which include Baycorp, Credit Corp and Australian Receivables. As a result, it can deliver an effective end-to-end service to its client base.

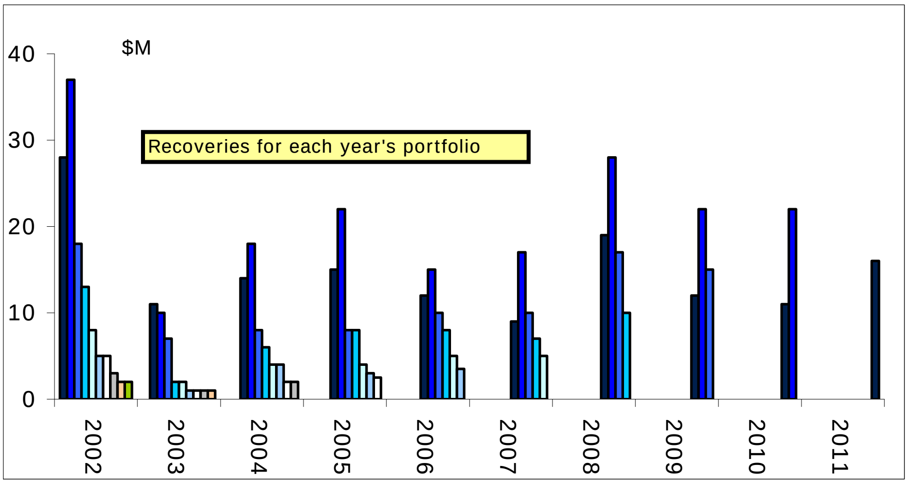
- **Pre one-offs NPATs have been quite stable despite potential for volatility.** While much of the CLH business is inherently cyclical, the company held its own over the Global Financial Crisis (GFC) when profits are measured on a pre-abnormals basis. EPS growth perked up in FY11, helped by CLH's diversified revenue streams. Importantly for income investors, CLH maintained its DPS in the GFC and has increased it since then.

- **A solid FY11 performance.** FY11 saw CLH deliver its fourth consecutive annual increase in earnings and DPS. Its bottom line profit jumped by 25% in FY11, despite the negative impact of adverse east coast weather conditions on the company's March 2011 quarter performance. The standout performer over FY11 was the PDLs operation - total PDL purchases climbed by 65% in the year, helping deliver a 12% increase in collections. The Commission Collections segment experienced an 8% FY11-on-FY10 drop in its earnings, as competitive pressures in this part of the CLH business remained high. Hopefully new marketing initiatives and product offerings will help hold the line here.

- **PDLs segment provides a long-term growth engine for CLH.** The PDLs business is central to CLH's growth potential. It now accounts for 70%+ of the company's revenue base, and is expected to become even more dominant over coming years. These books entail distressed and overdue debts from a range of debt issuers, headed by large banks and finance companies and telecommunications groups, who are no longer willing or able to collect them. Its continued growth should be beneficial to margin performance, given the CLH business has a large fixed cost component.

- **Most revenues from each year's loan portfolio captured after several years.** The following chart highlights (1) the growth delivered by the PDLs part of CLH over recent years and (2) the extent to which recoveries are skewed to the first few years of each portfolio's life. The face value of the PDL portfolio was $1.38B at the end of 1Q12, with its carrying value $0.17B.

Figure 1: Recoveries From Arrangements Book



Source: CLH FY11 Investors Presentation, Patersons Research

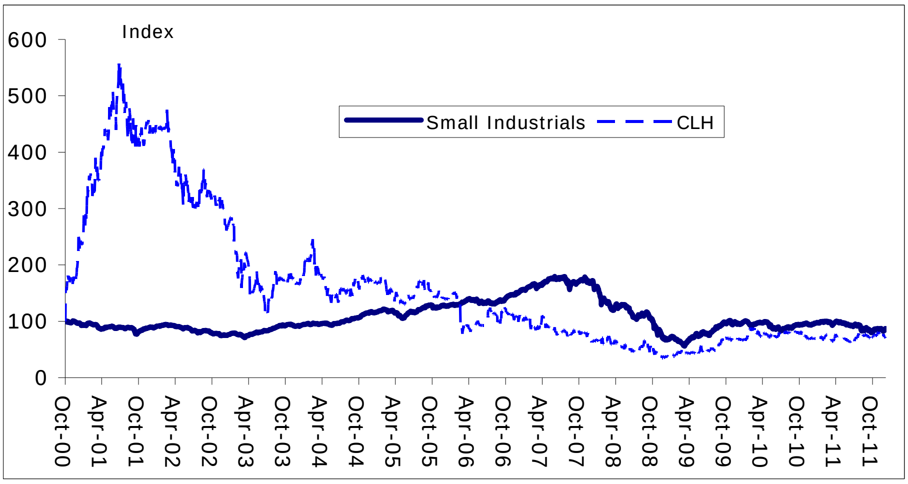
- **CLH has evolved its skill set.** Importantly, unique skills are required to make these PDL books turn a dollar. CLH has over time developed a number of in-house proprietary collection application programs that can be customized to a client's requirements. They deliver a number of efficiencies on the debt recovery front, including flexible methods for loading client data, significant automation to trim collection times, automated triggers and user-friendly question/answer based scripts and integration into the client's own operating systems. These IT-related advantages are accompanied by CLH's skilled collections staff.

- **Management forecasts respectable FY12 earnings growth; we like longer-term prospects.** CLH now expects its 1H12 NPAT to be around $5.5-5.8M and its FY12 NPAT to be $11.0-11.5M. This profit projection incorporates expected growth in loan purchases of $60-70M (with around $47M of purchases committed to date). The company's sales and marketing focus in the CC unit has been vindicated by two new contracts with Australian banks, which helped contribute a 17% increase in revenues (1Q12-on-1Q11 basis) for the latter division. We expect high single-digit EPS growth over the FY12 through FY15 period, powered by the dominant Account Asset Management unit.

- **Capital raisings likely if PDLs book continues to grow.** A sustained expansion of the PDLs business will from time to time require capital raisings, although our model assumes no additional placements post that done in November (DRP aside). Importantly, the dilutive effect of any such raisings will likely be momentary as these new funds are quickly put to work. The reintroduction of a DRP (which we assume has a steady 30% take up) and hints of a slight wind back in past payout ratio levels will provide some funding for acquisition purposes. The alternative funding source of increased gearing will also periodically be accessed, although we do not expect CLH to go overboard here.

- **A growth strategy to bring to an end a long period of underperformance.** CLH has underperformed the Small Industrials index for quite some years now – see the chart below. This after a period of strong outperformance in the years immediately after CLH's listing in late 2000. CLH's performance against its major listed competitor, Credit Corp, has also been disappointing. Its fall from grace post its momentary surge above $5 in the early 2000s in part reflected a retreat from small cap stocks post the dotcom boom. But it also showed up some stock-specific weaknesses including: (1) a loss of market darling status that prompted hasty exits by funds managers and other professional investors (2) integration problems with acquisitions made in earlier years and (3) a switch to international accounting standards (AIFRS) which materially pared the carrying value of key asset classes.

Figure 2: Small Industrials V's CLH



Source: IRESS, Patersons Research

- **It is difficult to make performance/valuation comparisons** with other Australasian collections/credit management groups as most are unlisted or part of larger offshore-owned companies. Only Credit Corp (ASX Code CCP) is listed in Australia. The latter company has had clear EPS growth and capital growth outperformance, but scope exists for CLH to play catch up here over coming years.

- ***We have a $0.88 12-month price target on CLH.*** *Our DCF analysis arrives at a $0.82 valuation for CLH. The latter incorporates a capital return of around 19% plus a yield return of 9%+. We also have a $0.88 12-month price target and on CLH. Reinforcing the above DCF-derived valuation, we have calculated a relative PE valuation is of $0.78.*

CLH Segments/Corporate Structure

Figure 3: CLH's Operational Segments (2nd column shows each unit's function)

Collection House Limited	Debt collection and receivables management	Collection House Limited Leading the way
Jones King Lawyers Pty Ltd	Legal services including insolvency administration	JONES KING LAWYERS
Lion Finance Pty Ltd	Debt purchasing and recovery	lionfinance ptyltd
Midstate Credit Management Services Pty Ltd	Debt collection services, specialising in Local Government	MCMS midstate CREDIT MANAGEMENT SERVICES Pty Ltd
Collective Learning and Development Pty Ltd	Credit management and related training services	Collective Learning and Development Pty Ltd
Cashflow Accelerator Pty Ltd	Credit risk assessment and cash flow optimisation services	CASHFLOW ACCELERATOR
Founding Partner of Financial Basics Foundation	Financial Education for young people	Financial Basics Foundation making financial futures brighter

Source: Collection House Ltd FY11 AGM press release

- Purchasing Debt Ledgers (PDLs): This business is undertaken by Lion Finance Pty Ltd, a special purpose PDL subsidiary. It operates in the following two areas: (1) one-off debt tranche purchases and (2) forward flow multiple tranche purchases. CLH is a primary buyer of the Big-4 Australian bank debt ledgers. Since 2002, CLH has paid around $436M for debt with a face value of nearly $4B. This arm currently accounts for 70%+ of CLH revenues.

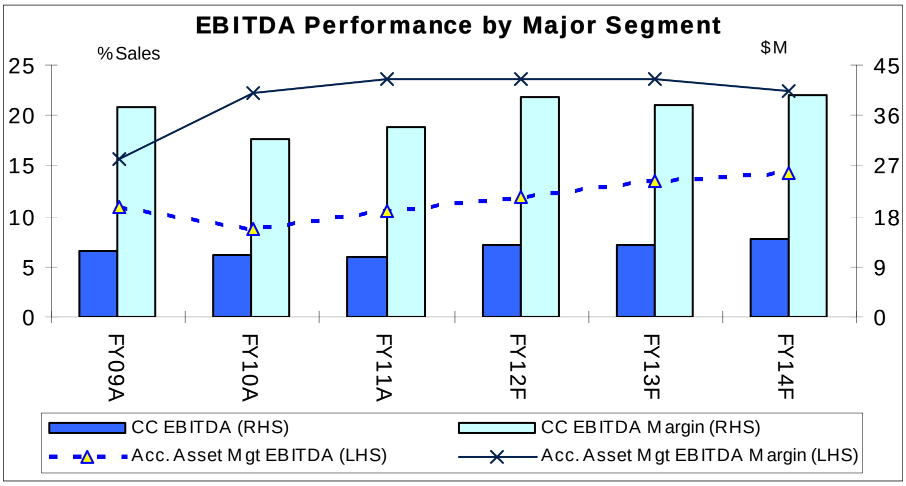
- Contingent Collection (CC): This function is performed by Collection House Ltd and Midstate Credit Management Services Pty Ltd. The broad roles performed by this division are: Contingent – banking, finance, credit cards, telecoms, utility services, government, legal recovery and insolvency administration; Insurance – motor vehicle, property, general insurance, public liability; Workers Compensation – premiums; Local Government – council rates assessments; International – collections from overseas debtors, collections from overseas clients. CLH is a recognised market leader in the CC segment. In FY11, this business delivered 23% of CLH's revenues

- Cash Flow Management: This function is undertaken by Cashflow Accelerator Pty Ltd. It covers the pre-collection phase for banking, finance, motor vehicle finance, equipment finance and rental, credit cards and utility services. CLH is also a major player in this segment. This is effectively where a CLH client outsources all its collection activities. It provided 6% of CLH group revenues in FY11.

- Legal Services: Jones King Lawyers Pty Ltd is a subsidiary and incorporated legal practice operating in Queensland, NSW and Victoria with an affiliated law practice in SA, specializing in debt collection litigation, corporate and personal insolvency and insolvency administration.

CLH's segmental reporting is centred round the two major divisions of (1) Contingent Collection services (CC), which covers the earning of commissions on the collection of debts for clients and (2) Account Asset Management (AAM), which is the collection of debts from client ledgers acquired by CLH. The following chart highlights recent and prospective earnings trends across these two divisions.

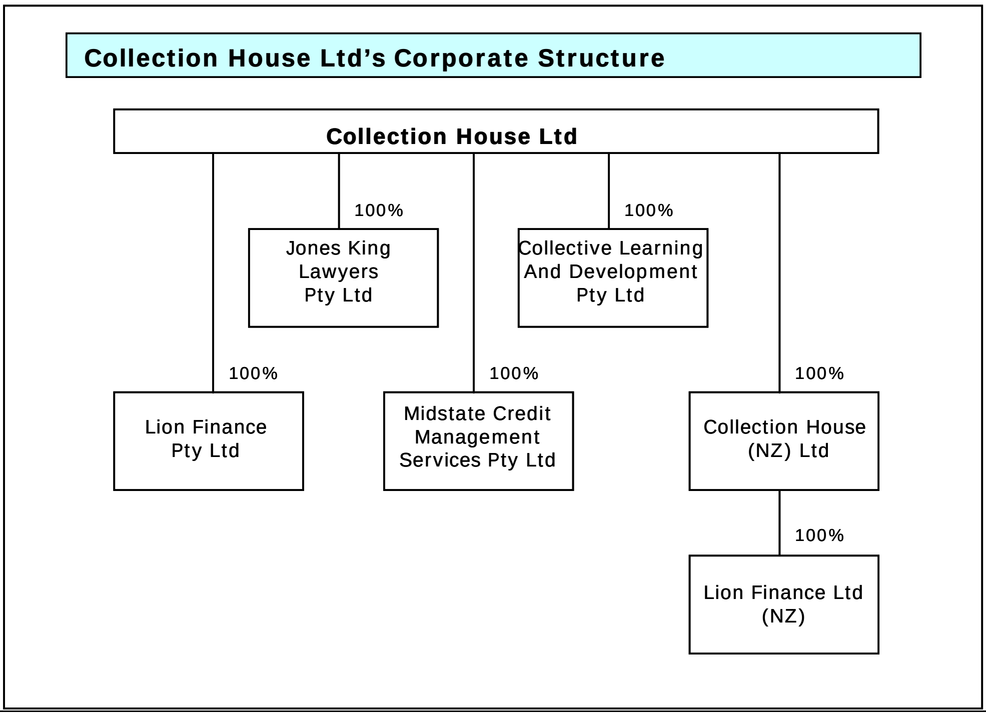
Figure 4: EBITDA and EBITDA Margins – Segmental Basis



Source: CLH Annual Reports and Patersons Research

The company's corporate structure is shown below.

Figure 5: CLH's Corporate Structure



Source: CLH, Patersons Research

History

- CLH was founded in 1992. It initially focused on the provision of accounts receivable management services. CLH made a number of collection agency acquisitions over the 1995 through 2000 period that created a widespread, scalable network throughout Australia and New Zealand. This expansion strategy helped facilitate its transformation from traditional debt collection practices into a specialised financial services group. The company listed on the Australian Stock Exchange in October 2000. CLH is now one of the top-3 operators in the Australasian debt collection sector.

CLH's Operations More Diverse Than Rivals

- CLH has a more diverse product offering than its major competitors, as shown in the following table.

Figure 6: CLH's Competitive Advantages Over Rivals Itemised

CLH Has Competitive Advantage Over its Rivals In Providing An End-To-End Service

	Credit Risk Consulting	Credit Mgt Training	Cash Flow Mgt	Consumer Collections	Corporate Collections	Insurance Collections	Purchase Debt Ledgers	In-house Legal Services
Collection House Ltd	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Advanced							Yes	Yes
ARMS Group				Yes	Yes	Yes		Yes
Austral				Yes	Yes	Yes		Yes
Australian Receivables				Yes	Yes	Yes	Yes	Yes
Baycorp				Yes	Yes	Yes	Yes	Yes
Charter Mercantile				Yes	Yes			Yes
Ctredit Corp Ltd							Yes	Yes
Dunn & Bradstreet			Yes	Yes	Yes	Yes		Yes
National Credit Mgt				Yes	Yes		Yes	Yes
Probe				Yes	Yes			Yes
Recoveries Corp				Yes	Yes	Yes		Yes

Source: CLH, Patersons Research

How Does Debt Collection Process Work?

- A trust account is maintained by CLH for client collections. These collections are sent through to each client on a regular basis.
- Transactions are processed, statements issued on client customer (i.e., debit accounts) and bulk mail outs are provided.
- CLH charges its clients a fee for provision of these services. It is based on a percentage of debt collected by CLH staff on behalf of each client.
- Loan Book Size and Growth Dynamics
- The PDL arm spent $49M on debt collections book acquisitions in FY11. These books entail distressed and overdue debts from a range of debt issuers who are no longer willing or able to collect them. These are chiefly acquired from large banks and finance companies and telecommunications groups.

The following table, sourced from CLH's FY11 Results Presentation, shows the extent to which the company can milk value out of these distressed portfolios.

Figure 7: Arrangements and Litigated Accounts

Arrangments and Litigated Accounts - Recent Trends

	FY09	FY10	FY11
Total Portfolio			
- Face Value ($B)	1.00	1.20	1.30
- Number of Accounts	145,000	233,000	239,000
Arrangements			
- Face Value ($B)	0.105	0.128	0.152
- Number of Accounts	20,000	25,000	27,000

Source: CLH, Patersons Research

CLH Has an Undisputed Technology Advantage

- CLH has over time developed a number of in-house proprietary collection application programs that can be customized to a client's requirements. These are maintained by a dedicated team of programmers.
- They deliver a number of efficiencies on the debt recovery front, including flexible methods for loading client data, significant automation to trim collection times, automated triggers and user-friendly question/answer based scripts and integration into the client's own operating systems.
- A comprehensive reporting package is also incorporated into this technology. These include portfolio status summaries, vintage analysis, collection summary statistics, and activity/billing reports.
- The PDL business has also been able to leverage off this technology advantage. For example, it delivers economies of scale benefits, a web-based payments system for debtors and the ability to undertake rapid debtor profiling to determine debtor(s) ability to pay.

C5 Technology Project Detailed

CLH has acquired an industry-leading client relationship management (CRM) platform to re-engineer its proprietary system. CLH intends to morph its in-house intellectual property into new technology tools. It will facilitate:

- A consolidation of all products and subsidiaries onto a single operating platform.
- Greater productivity in the collection process.
- Efficiency enhancements and reduced risks on better compliance.
- Fully integrated call blending environment plus better predictive dialing capacity.
- Advanced client profiling.
- Better management reporting (from collection strategy and campaigns perspective).

Dividend Reinvestment Plan (DRP) Reinstated

- CLH recently implemented a DRP, with it operating on the final FY11 dividend payable in November 2011. This move was not surprising given the company's desire to grow its loan book size (something that can only be done with increased gearing or enhanced capital resources).
- All CLH shareholders in Australia and NZ are eligible to participate in the plan. These shareholders have the choice of either full or partial participation. DRP shares will be issued at a 5% discount unless determined otherwise by the CLH board. The price they are issued at will be the weighted average sale price of CLH shares sold during the 5 trading days immediately after the relevant record date.

Board of Directors

- **Chairman John Pearce**, a co-founder of CLH and an ex-MD of the company, was appointed to the board in 1993. He was appointed chairman in mid 2009. He is also a director of the Rutherglen Cemetery Foundation and Brisbane Lions Foundation.
- **Deputy Chair Dennis Punches** has been a board member since 1998. He co-founded and for a time was chairman of Payco American Corp. He is also Co-chairman of the International Collections Group.

- **Non-executive director Tony Coutts** was previously a GM of CLH and has been working in the finance and insurance industry for nearly 20 years. This includes 15 years in the debt collections segment (13 of which have been with CLH).

- **Non-executive director Kerry Daly** has 30 years experience in the financial services sector. He was previously MD/CEO of the Rock Building Society. He is a former executive director of Grange Securities fixed interest brokerage and investment banking operation.

- **Non-executive director David Gray** is also chairman of Queensland Cyber Infrastructure, deputy chairman of the Civil Aviation Safety Authority (CASA) and director of Brisbane Airport Corporation.

Management Team

- The **CLH CEO Matthew Thomas** has nearly 20 years experience in debt collections. This covers a range of industries, including banking and finance, insurance, telecommunications, small business and statutory recoveries (e.g., Workers Compensation premiums). He has been with the company since 1999, initially in a collection management role, before being promoted to CIO, Technology in 2001. Over his time in this role, Thomas wrote material chunks of the CLH proprietary collection system. In 2007, he was appointed to the new role of Chief Process Officer which encompassed all collection operations as well as group IT strategy and business analysis. He moved to the role of COO in 2008 and became CEO in mid 2010. This rotation through different parts of the CLH business has given him a deep understanding of the company's operations.

- The **CLH CFO Adrian Ralston** has many years experience in the Australian financial services sector, over which time he has been exposed to a spread of financial management, risk management and process management issues. Ahead of joining CLH in 2003 Ralston had stints as GM-Finance & Administration at Hevi Lift and CFO for the BDS Group.

- The **CLH general counsel/company secretary** Michael Watkins has 30+ years experience in the legal industry. He joined CLH as general counsel in 2000 and added company secretary responsibilities in late 2006. He is also Solicitor Director of legal practice and wholly owned CLH subsidiary Jones King Lawyers Pty Ltd.

- The **CLH GM, Human Resources Kylie Lynam** has over 15 years in human resources. She joined the company in mid 2000 and was promoted to her current role in July 2006. On top of her human resources responsibilities, Lynam also looks after the company's corporate services business (which covers centralized administration, purchasing, facilities and vendor liaison).

The Macro Environment

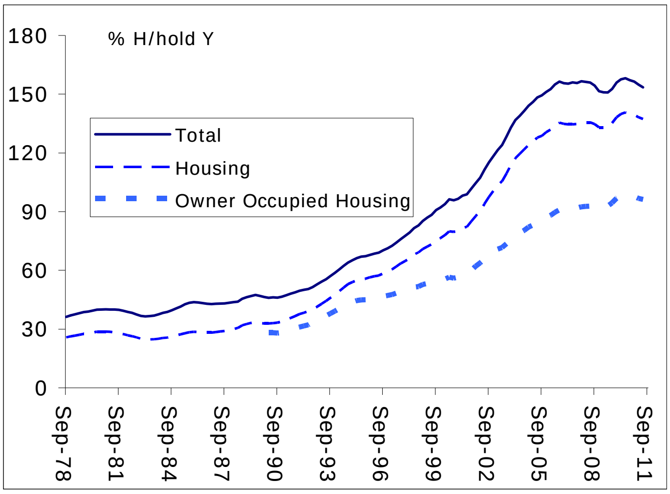
The household and SME segments have been confronted by a number of factors that have crimped their ability to pay bills on time – this despite Australia being one of the better performed advanced economies in the wake of the GFC. Such an environment works in CLH's favour – both from its ability to:

- purchase debt collection portfolios, and

- provide credit collection services to clients (current and prospective).

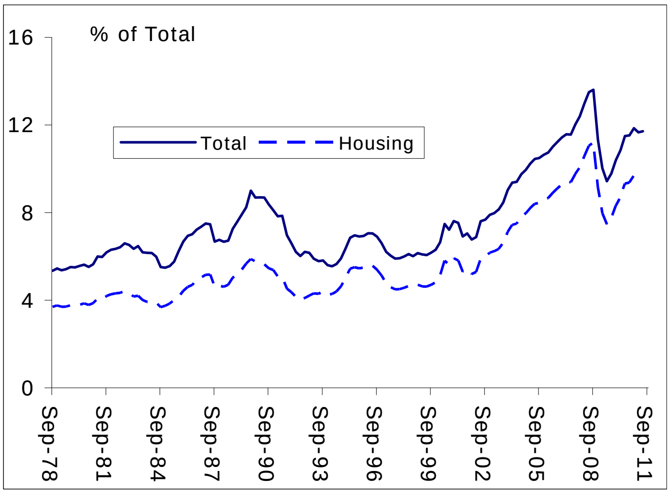
From a household sector perspective, labour market conditions remain robust and saving levels (at the aggregate level) remain high relative to levels seen over the past 30 years or so. At the same time, the high A$ and the evolution of China as a manufacturing base has made a wide spread of consumer durables more reasonably priced. However, householder balance sheets have been weighed down by (1) high debt levels, largely home mortgage-related and (2) rising costs in key areas like rents and utilities charges – see the charts below. These challenges to consumers' financial well-being have increased the chance of an ongoing uplift in bills in arrears/delinquencies amongst an array of services (including utilities, bank accounts and retailer charge cards).

Figure 8: Household Debt



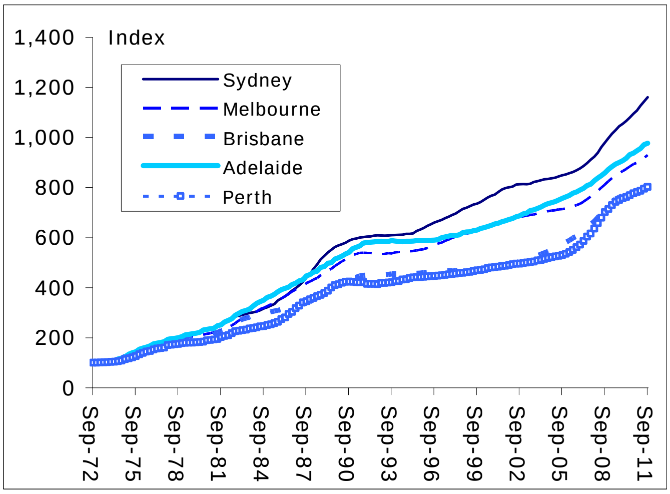
Source: RBA, Patersons Research

Figure 9: Household Debt Levels



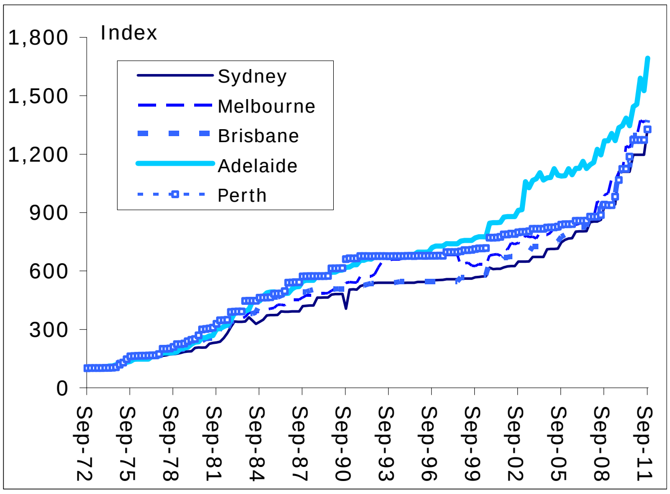
Source: RBA, Patersons Research

Figure 10: Rents Spike Higher



Source: ABS, Patersons Research

Figure 11: Utilities Charges Also Climb

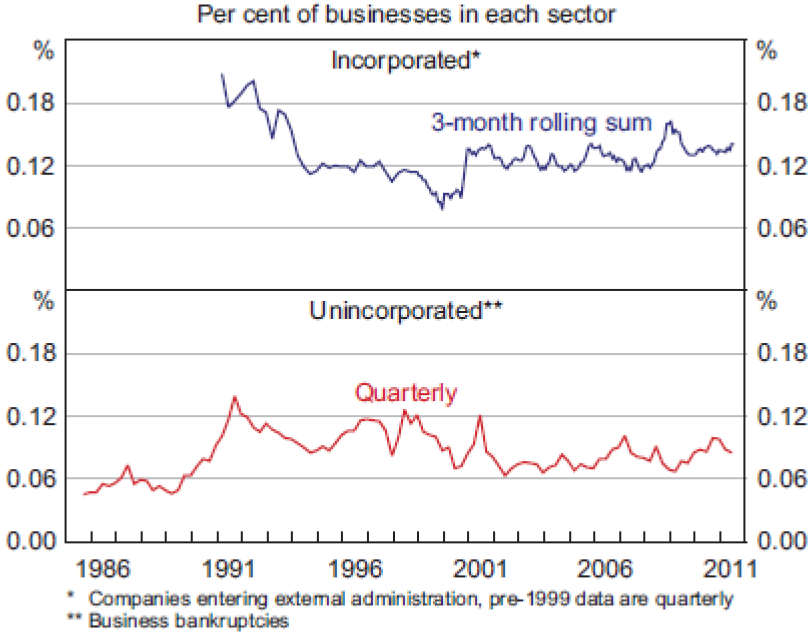


Source: ABS, Patersons Research

The abovementioned increased cost pressures have not been confined to the household sector. The small and medium sized enterprise (SME) sector has been confronted by such issues as well. The RBA recently noted that the rate at which incorporated Australian businesses are entering external administration had been relatively stable over the middle part of 2011 and that the failure rate for unincorporated enterprises had also moderated since late 2010.

This is not to say that the SME sector is not being confronted by funding challenges. Since the GFC it has faced relatively strict lending standards and evidence abounds that interest rates on corporate lending have not fallen to the extent of selected retail loan rates like mortgages. As a result, the SME sector's ability to finance growth opportunities has been made tougher, remembering that they are less able to access equity markets relative to large capitalization companies. Bottom line, scope also exists for CLH in this segment if broader economic conditions fail to perk up over FY12 and into FY13.

Figure 12: Business Failures (% of businesses in each sector)



Source: Sept. 2011 RBA Financial Stability Report

Strategic Priorities – CLH's View

Current

- Building the Repayment Arrangement Book – this has expanded to $150M+ by end-FY11 (from $128M 12 months earlier).
- Productivity enhancements - helped by CSO retention policy.
- Higher revenues from purchased debt – purchasing program ahead of original expectations (increase on a FY11-on-FY10 basis was 65%).
- New service offerings – announced in mid 2011, now in marketing phase.
- Technology enhancements – C5 collection platform development is ongoing.
- Marketing plans, staff development and analytics continue to be implemented.

Future

- Further growth in PDL arrangement book.
- Capital management – a need to fund future growth and bolster ROE levels.
- Analytics and technology enhancements.
- Rework employment models, product development and sales/marketing techniques.

SWOT Analysis – Patersons Perspective

Strengths

- Strong business relationships with major Australian, NZ and international organisations that require debt collection services (including financial institutions, insurance companies, large corporations, public utilities and government instrumentalities).
- The company offers an end-to-end service offering in the debt collection space.
- The executive team has many years of operational experience.
- The CC business has delivered stable revenue streams over the years.
- Proprietary pricing models and receivables management software as well as substantive databases on active customers and collection history.
- Encompasses all aspects of debt recovery and receivables management.
- Has an in-house legal practice (Jones King Lawyers), which specialises in debt recovery and insolvency actions for both CLH and its clients.
- The company maintained pre-abnormals earnings and dividends during the Global Financial Crisis, helped by its diversified revenue streams.
- CLH has well-regarded training programs that keep its staff abreast of all legislative changes and regulatory requirements.

Weaknesses

- The PDLs growth engine can only be materially expanded via increased borrowings (and gearing), capital raising or some combination of the above.
- The earnings potential of the PDL unit has a degree of cyclicality attached to it making the timing of debt portfolio acquisitions a matter of judgment.
- The CC business is not high growth in nature.
- Limited moves to date by CLH to transplant its business into other countries (different legal frameworks, larger competitors and added complexity attached to such growth strategies).

Opportunities

- The company's operational platform is highly scalable and open to additional platform capacity and flexibility to provide additional services.
- Scope exists for CLH to ramp up its purchasing debt ledgers (PDLs) at low points in the economic cycle (when they are cheaper).
- Management claims that opportunities exist for CLH PDL business to branch into other segments besides traditional areas like telecoms and financial services.
- The company's ability to retrieve payments from its PDLs book increases when economic conditions brighten in times of recovery.
- Retrievals from PDLs should be increased via CLH-specific analytics skills.
- Utilities, banks, telecommunications groups and other companies with debtors' ledgers could be enticed into outsourcing their recovery business or selling debtors books to CLH's PDL operation.

- A tentative push offshore has occurred, with small scale outsourcing of collections to Manila based partners in place since last year. A Philippine-based call centre and subsidiary is to be established in early 2012 (a cost initiative aimed at making lower price segments profitable).

Threats

- The threat of overseas competitors entering the Australian market.

- Major clients could take debt recovery in-house if CLH margins become too large.

Risks

The risks outlined in the Collection House Listing Prospectus, which issued in 2000 follow:

Business Specific Risks

- Regulatory environment and adverse publicity, a threat in common with all listed concerns.

- Reliance on key personnel.

- Retention of quality staff.

- Maintenance of growth drivers, which are in large part a function of macro economic performance, the health of the CLH client base and CLH's competitive advantages in the IT space.

- Sound growth strategies, including a need to continually improve systems.

- Acquisitions must be effectively integrated - something that did not occur in the mid 2000s).

- Loss of key clients.

- Competitive pressures (new entrants are always expected in the receivables management space).

General Risks

- The economic outlook, in both Australia and overseas.

- Any changes to legislation and other standards (in the areas of Corporations law, taxation laws, Accounting standards and other legislation.

- Volatility in stock markets.

Debt Position

- On the debt front, CLH recently announced that it had fixed $51M+ of its borrowings at a quite respectable two-year average rate of 4.35%, delivering an all-up cost of around 6.5% once bank charges are tacked on.

- Its FY11 net debt/equity ratio was around 80%. However, the recently completed capital raising and moves to reinstate a DRP (with the latter applying to the FY11 final dividend) should see the latter gearing measure improve to around 73% by end-FY12, assuming another $60M minimum in portfolio acquisitions in the current year.

- The FY11 accounts indicate that CLH has nearly $77M of borrowing, more than 96% of which is non-current. CLH has acceded to floating charges totaling $174M over these loans.

- In June 2011, CLH's credit facilities were bolstered to $100M (previously $85M) at a higher loan-to-valuation ratio of 55% (previously 50%). At the same time, the Tangible Net Worth was adjusted upwards to $65M (was $60M). These shifts hint at improved asset quality across the group.
- The following table highlights the ease with which CLH is currently meeting its bank covenants.

Figure 13: CLH Bank Covenants

	FY09	FY10	FY11
LVR Ratio less than 55%	46	45	46*
EBITDA to Interest expense greater than 7 times	10	11	11
Tangible net worth greater than $65m	67	72	76*

Source: CLH FY11 Results Investor Presentation

Historic Performance – FY07 through FY11

Figure 14: Key CLH Financials – Past 5 Years

Profit & Loss ($M)	2007A	2008A	2009A	2010A	2011A
Operating Revenues	102.0	101.3	102.2	73.8	76.8
COGS/Other Op Costs	-73.9	-60.2	-55.2	-26.8	-20.6
EBITDA*	**28.1**	**41.1**	**46.9**	**47.1**	**56.2**
Goodwill/Other Amort.	-24.3	-32.0	-32.6	-32.5	-36.0
EBIT	**3.8**	**9.1**	**14.4**	**14.6**	**20.2**
Net Interest	-2.8	-3.7	-2.7	-2.8	-5.6
Pretax Profit	**0.9**	**5.5**	**11.7**	**11.8**	**14.6**
Tax expense (recurring)	2.9	1.5	-3.1	-2.9	-4.5
NPAT (Pre Non-Recur)	**3.8**	**6.9**	**8.7**	**8.9**	**10.1**
Non Recur Items	0.0	5.4	-0.7	0.0	0.0
NPAT (Reported)	**3.8**	**12.3**	**7.9**	**8.9**	**10.1**

Segment Rev/EBIT ($M)	2007A	2008A	2009A	2010A	2011A
Revenues					
Commission Collection	36.9	34.5	31.8	34.3	32.2
Acc. Asset Mgt (Pre FV Mvt)	48.4	64.2	69.8	69.5	78.0
EBIT (Pre Unallocated)					
Commission Collection	4.2	5.6	6.5	5.9	5.4
Account Asset Mgt	11.7	16.0	19.7	15.6	18.9

EPS/DPS	2007A	2008A	2009A	2010A	2011A
EPS (Reported) (Diluted)	3.9	7.1	8.9	9.1	10.3
EPS (Basic, Post One Offs)	3.9	12.7	8.1	9.2	10.4
EPS (Basic, Pre One Offs)	3.9	7.1	8.9	9.2	10.4
EPS growth (%)	-33.3	82.7	25.0	2.5	12.6
DPS (cents)	4.2	4.2	4.9	5.8	6.2
Franking (%)	100	100	100	100	100
Dividend Yield (%)	5.8	5.8	6.8	8.0	8.6
Payout Ratio (%)	107.8	59.0	55.1	63.6	60.4

* EBITDA includes changes in fair value of purchased debt ledgers

Source: CLH Financial statements, Patersons Research

Key trends apparent in the above CLH historical financials table follow:

- CLH has been able to grow its pre-abnormals NPAT over the past five years despite the adverse impact of the GFC. Results for both FY10 and FY11 were free of non-recurring items.

- The segmental data highlights the relative outperformance of the Account Asset Management business (where the PDL component of CLH is parked).

- The jump in bottom line profits in FY08 in large part reflected the disposal of the Australian Business Research/National Tenancy Database business, on which CLH booked a $9.9M pretax gain.

- This slow and steady pre one-off earnings growth has allowed the company to steadily grow its DPS, without any undue ramp up in its dividend payout ratio. The FY11 dividend yield was quite respectable for a small cap stock.

- Net interest expense has trended higher as CLH funded its PDL expansion via debt. This said the company's debt/equity ratio was still comfortable, with its end-FY11 level being just under 80%.

FY12 Outlook

- CLH provided a respectable FY12 earnings guidance statement at its recent FY11 AGM. This after the company got off to a positive start in the current fiscal year, with CLH's EPS surging by 48% on a 1Q12-on-1Q11 basis, helped by good growth in commissions plus purchased debt collections. Ongoing cost containment initiatives have also boosted bottom line performance.

- CLH now expects its 1H12 NPAT to be around $5.5-5.8M and its FY12 NPAT to be $11.0-11.5M. This profit projection incorporates expected growth in loan purchases of $60-70M (with around $47M of purchases committed to date).

- The company's sales and marketing focus in the CC unit has been vindicated by two new contracts with Australian banks, which helped contribute a 17% increase in revenues (1Q12-on-1Q11 basis) for the latter division.

Prospective Performance Vis-a-Vis Rivals

- CLH's only listed rival in the Australasian market is Credit Corp Ltd (ASX Code CCP). It too (1) provides collection and credit management services in Australia, although this is relatively small and (2) purchases charged off and delinquent debts.

- It like CLH is covered by few brokers, with Bloomberg consensus estimates incorporating forecasts from three analysts. The following table shows some key performance and valuation metrics for CCP premised on the latter Bloomberg numbers.

- As the table indicates, CCP has clearly been a superior stock in FY11 from an EPS growth perspective. And this earnings outperformance is expected to extend into FY12 and FY13. This outperformance vis-à-vis CLH has been attributed to:

    - Better scale of operations.

    - Its lack of presence in contingent collections space.

    - Excellent marketing skills.

    - Enhanced liquidity that comes with success.

- However, this superiority could well narrow in coming years as CLH gets more into the PDL business. This as:

    - Some fund managers exit CCP.

- A strategy of decreased gearing limited earnings growth upside.
- A push into new ventures that some argue are outside their area of expertise.

- CCP understandably has a higher prospective FY12 PE than CLH (around 8x versus sub-7x for CLH).
- CLH is a clear winner from a dividend yield perspective and this should extend into the future despite a desire by the company to direct additional capital resources towards portfolio acquisitions.

Figure 15: CLH V's CCP – some broad yardsticks

	FY11A		FY12F/c		FY13F/c		FY14F/c	
	CLH	CCP	CLH	CCP	CLH	CCP	CLH	CCP
EPS Growth (%)	12.6	51.6	9.1	18.0	7.7	13.4	9.1	6.9
Dividend Yield (%)	8.6	4.8	8.9	6.3	9.5	7.1	10.3	7.7
PEs (times)	7.0	7.6	6.4	8.0	6.0	7.0	5.5	6.6

Source: Bloomberg, Patersons Research

Make up of DCF Valuation and WACC

Our current CLH valuation and price targets are premised on a discounted cash flow (DCF) analysis.

Figure 16: DCF Valuation Components

	Valuation	12m Target	Val/Shr	Target/Shr
Total Operational NPV	80	87	$0.81	$0.85
Value of Debt	-73	-78	-$0.74	-$0.76
Value of Tax Losses / Low Tax Rate	0	0	$0.00	$0.00
Value of Franking Credits	16	17	$0.16	$0.17
Value of Minorities	0	0	$0.00	$0.00
Value of Exploration and R&D	0	0	$0.00	$0.00
Value of Investments (incl. Associates)	58	64	$0.59	$0.62
Adjustment for Non.Ordinary Shares / Options	0	0	$0.00	$0.00
Analyst Premium / Discount		0		
Total NPV	**81**	**91**	**$0.82**	**$0.88**

Source: Patersons Research

Note that this incorporates the dilutive impact of the recent capital raising and the introduction of a DRP (which we assume will have a longer term take up of around 30%).

The above valuation results in a prospective fiscal 2012 capital return of around 19% and yield return of around 9%. This sums to expected total return of about 28%.

Our WACC is 9.8%, with it comprised of the following components:

Figure 17: WACC Make Up

Risk Free Rate	4.0%
Risk Premium	7.0%
Sector Beta	1.0
Analyst Beta Adj	0.5
Beta	1.50
Cost of equity	14.5%
Cost Of Debt	7.2%
Tax Rate	30%
Post-tax cost of debt	5.0%
Target D/(D+E)	50%
WACC Disc. rate	**9.8%**

Source: Patersons Research

Relative Multiple Valuation

CLH is fairly unique in the Australian setting. It is an Australian-owned receivable management provider, operating in Australia and New Zealand. CLH's core businesses include: Debt Purchasing; Commission Collections; Receivable Management; and Specialist Services. In 2010, CLH and its two subsidiaries, Lion Finance Pty. Ltd. (Lion Finance) and Midstate Credit Management Services Pty. Ltd. (Midstate), have obtained Australian Credit Licenses under the National Consumer Credit Protection Act and the National Credit Code.

We have identified three listed companies that most closely compare to CLH:

- Credit Corp Group Limited (ASX Code CCP), which is also a receivables management company, specialising in debt purchase and debt collection, primarily focusing on the acquisition of purchased debt ledgers (PDLs) comprised of distressed consumer debt from Australia's financial institutions.

- FlexiGroup Limited (ASX Code FXL), which is a provider of vendor and retail point-of-sale finance and telecommunication services in Australia, New Zealand and Ireland. FXL provides credit facilities and other financing methods to customers acquiring goods or services at the time of their initial purchase of these goods and services. FXL operates four main businesses: Leasing Retail, Leasing Vendor & Commercial, Telecommunications and Interest Free Loans.

- Thorn Group Limited (ASX Code TGA), which was formerly RR Australia Limited. It is an operator in the Australian electrical and household appliances rental market, particularly the SME sector and government. The company offers a wide range of audio visual products, kitchen and laundry appliances and computers along with a new range of furniture and gym equipment on a rental basis or a purchase option.

Only CCP is directly comparable. Whereas FXL and TGA can be considered to be operating in closely related financial services sectors.

The comparable metrics for these three peers of CLH are illustrated in the following table.

Figure 18: Relative Multiple Valuation

Company	ASX Code	Market Cap ($M)	PE (times)			EPS Growth (%)			Share Price ($)	Div. Yield (%)	Franking (%)	Broker Estimates
			FY1	FY2	FY3	FY1	FY2	FY3				
Credit Corp Group	CCP	182.3	8.0	7.0	6.6	18.0	13.4	6.9	4.40	6.0	100.0	3.0
Flexigroup	FXL	630.7	9.7	8.9	8.1	14.9	9.3	9.3	2.09	5.8	100.0	7.0
Thorn Group	TGA	238.1	8.7	7.9	7.3	18.6	10.0	8.2	1.73	5.7	100.0	7.0
Sector Average		350.4	8.8	7.9	7.3	17.2	10.9	8.1	2.74	5.8	100.0	5.7
Collection House	CLH	74.5	6.0	5.5	4.9	11.4	8.4	12.1	0.69	9.7	100.0	2.0

Source: Bloomberg, Patersons Research

Key points flowing from this analysis are:

- CLH is the smallest of the four companies examined, which is a negative a relative valuation perspective and is a key factor justifying our 1.5 beta on the stock.

- CLH's EPS growth vis-à-vis the other three companies is not inferior, while its dividend yield is clearly superior.

*These numbers alone suggest that CLH should trade at slightly less than or in line with the relative PE multiples for CCP. This would in turn justify the adoption of an FY12 multiple of 7.0x to **our** FY12 earnings of 11.2 cents/share, which derives a relative PE valuation of $0.78.*

Sensitivity Analysis

To give the prospective investor a feeling for the sensitivities of our DCF-derived valuation price to shifts in the WACC discount rate and our EBIT forecasts (FY12 through FY21) we provide the following table.

Figure 19: Sensitivity Analysis

Shifts in WACC on Valuation

WACC (%)	8.6	9.0	9.4	9.8	10.2	10.6	11.0
12 Month Price Target ($)	1.08	0.98	0.89	0.82	0.75	0.68	0.62

Shifts in EBIT Forecasts (FY12 thru FY21) on Valuation

EBIT Variation From Forecast	-5 pps	-3 pps	-1 pps	0	+1 pps	+3 pps	+5 pps
12 Month Price Target ($)	0.68	0.74	0.79	0.82	0.85	0.90	0.96

Source: Patersons Research

Collection House Ltd (CLH)				$0.69
Valuation (DCF)	**Val'n**	**12M Targ**	**Val/Shr**	**Targ./Shr**
Total Operational NPV	80	87	0.81	0.85
Value of Debt	-73	-78	-0.74	-0.76
Value of Tax Loss / Low Tax Ra	0	0	0.00	0.00
Value of Franking Credits	16	17	0.16	0.17
Value of Minorities	0	0	0.00	0.00
Value of Exploration and R&D	0	0	0.00	0.00
Value of Invest. (incl. Associate	58	64	0.59	0.62
	0	0	0.00	0.00
Analyst Premium / Discount	0	0	0.00	0.00
Total NPV	81	91	0.82	0.88

WACC	
Risk Free Rate	4.0%
Risk Premium	7.0%
Sector Beta	1.0
Analyst Beta Adj	0.5
Beta	1.50
Cost of equity	14.5%
Cost Of Debt	7.2%
Tax Rate	30%
Post-tax cost of debt	5.0%
Target D/(D+E)	50%
WACC Disc. rate	**9.8%**

Directors	
Name	**Position**
John Pearce	Chairman
Dennis Punches	Deputy Chairman
Anthong Coutts	Non Executive Director
Kerry Daly	Non Executive Director
David Gray	Non Executive Director

Sub. Shareholders		
Shareholder	**M**	**%**
Dennis Punches	19.1	19.6%
John Pearce and Associates	11.8	12.1%
Trans Tasman Collections	10.0	10.3%
Lev Mizikovsky and Associates	6.1	6.2%
HSBC Custody Nominees	5.2	5.3%
Subtotal		53.6%

Profit & Loss ($M)	2011A	2012F	2013F	2014F
Operating Revenues	76.8	82.8	91.2	98.6
COGS/Other Op Costs	-20.6	-21.2	-25.0	-27.2
EBITDA*	**56.2**	**61.6**	**66.1**	**71.4**
Goodwill/Other Amort.	-36.0	-39.6	-41.5	-43.8
EBIT	**20.2**	**22.1**	**24.7**	**27.5**
Net Interest	-5.6	-6.0	-6.7	-7.3
Pretax Profit	**14.6**	**16.1**	**18.0**	**20.3**
Tax expense (recurring)	-4.5	-4.7	-5.2	-5.9
NPAT (Pre Non-Recur)	**10.1**	**11.4**	**12.8**	**14.4**
Non Recur Items	0.0	0.0	0.0	0.0
NPAT (Reported)	**10.1**	**11.4**	**12.8**	**14.4**

* EBITDA includes changes in fair value of purchased debt ledgers

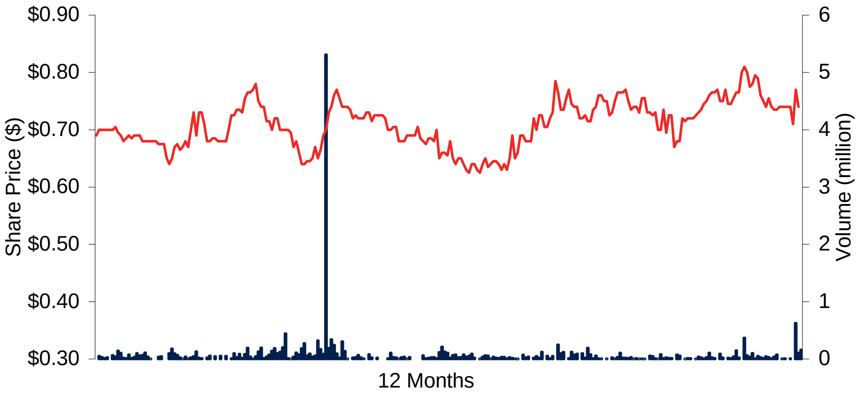
Cash Flow ($M)	2011A	2012F	2013F	2014F
	56.2	**61.6**	**66.1**	**71.4**
Working Capital Chgs	4.5	0.5	-0.2	-0.2
Interest & Tax	-8.5	-10.4	-11.6	-12.9
Other Operating C/Flows	-4.2	0.3	1.1	1.0
Operating C/Flows	**47.9**	**52.1**	**55.5**	**59.3**
Required Capex	-2.5	-2.5	-2.7	-2.0
Dividends	-5.9	-6.3	-6.9	-7.8
Free Cash Flow	**39.4**	**43.2**	**45.8**	**49.5**
Acquisitions/Disposals	-48.6	-60.0	-50.0	-50.0
Other Investing Items	-0.1	0.0	0.0	0.0
	0.0	4.9	2.1	2.3
Debt Increase/(Decrease)	7.0	11.9	2.1	-1.8
Net Cash Flow	**-2.2**	**0.0**	**0.0**	**0.0**

Balance Sheet ($M)	2011A	2012F	2013F	2014F
Cash/S/T Deposits	0.3	2.0	2.0	2.0
Trade/Other Debtors	5.6	5.5	5.8	6.0
Investments	44.6	44.6	44.6	44.6
Other Curr. Assets	1.1	0.9	1.0	1.1
Total Current Assets	**51.6**	**53.0**	**53.4**	**53.7**
Property/Plant/Equip't	6.2	5.7	5.5	4.4
Non Curr. Investments	117.4	140.8	152.4	161.7
Intangibles	22.8	22.8	22.8	22.8
Other Non Curr. Assets	0.4	0.4	0.4	0.4
Total Non Curr. Assets	**146.9**	**169.8**	**181.1**	**189.2**
Total Assets	**198.4**	**222.8**	**234.5**	**242.9**
Current Borrowings	2.7	3.0	3.0	3.0
Trade/Other Creditors	6.9	7.2	7.4	7.5
Other Curr. Liabilities	7.8	8.1	8.4	8.6
Total Curr. Liabilities	**17.5**	**18.2**	**18.7**	**19.2**
Non Curr. Borrowings	73.9	87.3	89.4	87.5
Other Non Curr Liabilities	11.2	11.5	12.7	13.6
Total Non Curr. Liab.	85.1	98.8	102.0	101.1
Total Liabilities	**102.6**	**117.0**	**120.7**	**120.3**
Total S/Holder Equity	95.9	105.8	113.7	122.6

EPS/DPS	2011A	2012F	2013F	2014F
EPS (Reported) (Diluted)	10.3	11.2	12.1	13.1
EPS (Pre Non Recur. Items)	10.4	11.2	12.1	13.1
EPS growth (%)	12.6	9.1	7.7	9.0
DPS (cents)	6.2	6.4	6.8	7.4
Franking (%)	100	100	100	100
Dividend Yield (%)	9.1	9.4	9.9	10.8
Payout Ratio (%)	60.4	57.5	56.4	56.5

Ratios	2011A	2012F	2013F	2014F
Profitability				
EBITDA Margin (%)	73.2	74.3	72.6	72.4
EBIT Margin (%)	26.3	26.8	27.1	28.0
ROA (%)	10.7	10.9	11.4	12.1
ROE (%)	10.8	11.6	12.1	12.6
Tax Rate (%)	30.7	29.0	29.0	29.0
Valuation				
Price/Earnings (x)	6.7	6.1	5.7	5.2
EV/EBITDA (x)	1.26	1.14	1.07	0.99
Price/NTA (x)	0.91	0.86	0.80	0.75
Balance Sheet				
Net Debt/Equity (%)	79.7	71.0	67.4	60.5
Net Debt/Net Debt + Equity	44.3	41.5	40.3	37.7
Interest Cover (x)	3.6	4.0	4.3	4.4
NTA ($/share)	0.75	0.80	0.85	0.91
Shares (M, period end)	98.3	104.5	107.6	111.2

Recommendation History



Date	Type	Target Price	Share Price	Recommendation	Return

Stock recommendations: Investment ratings are a function of Patersons expectation of total return (forecast price appreciation plus dividend yield) within the next 12 months. The investment ratings are Buy (expected total return of 10% or more), Hold (-10% to +10% total return) and Sell (> 10% negative total return). In addition we have a Speculative Buy rating covering higher risk stocks that may not be of investment grade due to low market capitalisation, high debt levels, or significant risks in the business model. Investment ratings are determined at the time of initiation of coverage, or a change in target price. At other times the expected total return may fall outside of these ranges because of price movements and/or volatility. Such interim deviations from specified ranges will be permitted but will become subject to review by Research Management. This Document is not to be passed on to any third party without our prior written consent.

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