

Australian Equity Research

21 February 2017

SELL

unchanged

PRICE TARGET A\$0.90↓

from A\$1.06

Price (21-Feb) A\$1.27

Ticker CLH-ASX

52-Week Range (A\$):	0.93 - 1.64
Avg Daily Vol (M) :	0.4
Market Cap (A\$M):	173
Dividend /Shr (AUc):	7.0
Dividend Yield (%) :	5.5
Shares Out., FD (M) :	135.9
Enterprise Value (A\$M):	278
Cash (A\$M):	8.9
Long-Term Debt (A\$M):	118.2

FYE Jun	2015A	2016A	2017E	2018E
Sales (A\$M)	126.0	132.7	136.1↓	149.1↑
Previous	-	-	136.7	133.1
EBITDA (A\$M)	40.3	37.3	36.3↓	39.1↑
Previous	-	-	38.6	37.5
EBIT (A\$M)	37.8	33.4	33.0↓	36.3↑
Previous	-	-	34.6	34.0
Net Income (A\$M)	22.5	18.6	18.7↓	21.3↑
Previous	-	-	20.1	19.7
Net Income Adj (A\$M)	22.5	19.4	18.7↓	21.3↑
Previous	-	-	20.1	19.7
EPS (AUc)	17.2	14.0	13.8↓	15.7↑
Previous	-	-	14.8	14.5
P/E (x)	7.4	8.7	9.3	8.2
DPS (AUc)	9.10	7.80	7.00↓	8.00↑
Previous	-	-	7.50	7.25
Div. Yield (%)	7.2	6.1	5.5	6.3



Source: FactSet

Priced as of close of business 21 February 2017

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Lowering Target Price

Turnaround will be a marathon, not a sprint

The 1H17 result confirmed the operational headwinds Collection House is experiencing, with cash collections from debt ledger assets the lowest in three years. Conventional wisdom in the industry is that debt buyers try to recoup their purchase price in the first 18 months, yet recoveries on newer investments were low. With a reduced workforce, it looks like the company has been honing new recovery techniques by working older assets. The recoveries from older debt is good, but the workforce would ideally be big enough to adequately work new debt purchases. In our view, cash collections need to improve fairly quickly otherwise debt purchasing power will fall, impacting earnings.

We await evidence of better cash returns, with commentary suggesting to us that this may not be until 1H18 or later. SELL retained.

Investment highlights

- Changes to collection approach.** Management's review of the debt purchase operations revealed: i) collection staff have been too aggressive in settling for discounted cash upfront from consumers, ii) some payment arrangements had agreed terms of over 10 years, and iii) the quoted value of the payment arrangement book included arrangements that were 180 days in default, which have now been sent back to the core collections team. The upfront discounting partly explains why cash collection performance has been lower than that of Credit Corp (CCP : ASX : A\$16.48 | BUY, A\$19.23 PT), and calls into question the comparatively lower amortisation rate (discounting immediately exhausts the asset so it should be written down quicker).
- The numbers: flat on pcp, but lower quality.** While the NPAT result (\$8.2m) was flat on pcp as guided, the composition of the result was weaker in our view. The cash collected from the debt ledger assets was \$53m vs \$62m pcp, operating cash flow was \$27m vs \$31m pcp, and the amortisation rate applied to collections was the lowest in two years (which inflates earnings on a like-for-like basis). Revenues from contingency collections are now higher than those from the debt purchasing operations, but the margin in that business is much lower.
- Guidance trimmed.** The FY17 NPAT range has been reduced (\$19.4-20.0m vs \$19.4-20.4m prev, CGAu: \$18.7m); however, it looks like CLH will hit its purchasing guidance of \$63-65m. While guidance implies a strong lift in H2, the expected contributions from new business and operating improvements have been trimmed.
- Food for thought:** We question the consensus view that CLH is 'cheaper' than CCP, and that the differences between the companies' performance are accurately captured in the relative PEs (c9x vs 14x FY17e). We believe a better proxy for valuation is the payment arrangement book, which is where most of the cash collections in any period come from. After adjusting enterprise values for CCP's loan portfolio and CLH's contingency collection business and comparing them to the face value of the payment arrangement book, we think CLH still looks expensive relative to CCP (see Figure 6).

Valuation

We use a DCF for the debt purchasing operations, and apply a 5x EBITDA multiple to the contingency collections business. We revise forecasts on the lower cash collections from the debt purchasing operations, which leads to our TP falling from A\$1.06 to A\$0.90.

Figure 1: Collection House Limited (CLH) - Canaccord Genuity forecasts

Collection House (CLH)	\$1.27					Year end 30 June			
Profit & Loss (\$m)	2015A	2016A	2017E	2018E	Ratios	2015A	2016A	2017E	2018E
Sales Revenue	126.0	132.7	136.1	149.1	Valuation				
EBITDA	40.3	37.3	36.3	39.1	EPS (norm.)	17.1	14.6	13.7	15.6
Depreciation	-2.4	-3.9	-3.3	-2.8	P/E (x) (norm.)	7.4	8.7	9.3	8.2
EBITA	37.8	33.4	33.0	36.3	PE Rel - XAO			0.58	0.54
Amortisation	0.0	0.0	0.0	0.0	PE Rel - XSO			0.56	0.56
EBIT	37.8	33.4	33.0	36.3	EV/EBITDA (x)	6.9	7.5	8.2	7.3
Net interest	-5.9	-6.1	-5.8	-5.9	EV/EBIT (x)	7.4	8.4	9.0	7.9
Pre-tax profit	31.9	27.2	27.2	30.4	DPS (cps)	9.1	7.8	7.0	8.0
Tax expense	-9.4	-7.8	-8.5	-9.1	Dividend Yield (%)	7.2%	6.1%	5.5%	6.3%
NPAT (pre-ISIs)	22.5	19.4	18.7	21.3	Franking (%)	100%	100%	100%	100%
Significant items	0.0	-0.9	0.0	0.0	CFPS (cps)	55.9	60.0	44.8	57.5
NPAT (reported)	22.5	18.6	18.7	21.3	P/CFPS (x)	2.3	2.1	2.8	2.2
NPAT (normalised)	22.5	19.4	18.7	21.3	NTA per share (\$)	1.30	1.35	1.39	1.48
					Price/NTA (x)	1.0	0.9	0.9	0.9
Cash Flow (\$m)	2015A	2016A	2017E	2018E	Profitability				
Operating EBITDA	40.3	37.3	36.3	39.1	PDL cash collected	127.2	127.2	108.6	128.3
Interest and tax	-18.2	-12.0	-15.0	-71.0	Amortisation rate	39.0%	41.3%	38.5%	42.0%
Working capital	0.0	0.0	0.0	0.0	Recovery multiple (x)	2.56	2.42	2.60	2.38
Ledger amortisation	51.3	54.6	39.7	53.9	Collections/WDV	52%	49%	39%	45%
Other	0.0	0.0	0.0	56.5	Collection costs	38%	36%	38%	38%
Operating Cashflow	73.4	79.9	61.0	78.5	ROE (%)	14%	11%	10%	11%
Ledger acquisitions	-71.4	-61.9	-64.0	-55.0	ROA (%)	13%	10%	10%	11%
General capex	-0.8	-0.7	-1.0	-2.0	Capital structure				
Net acquisitions	-3.1	-4.6	-2.0	0.0	Ledger book (\$m)	256.0	265.3	287.5	288.6
Other	0.0	0.0	0.0	0.0	Enterprise Value (\$m)	278.6	278.5	298.4	286.9
Free Cashflow	-1.9	12.7	-6.0	21.5	Net Debt (cash)	111.8	109.3	125.3	113.4
Dividends	-11.1	-11.4	-10.5	-9.6	Gearing (%)	40%	38%	40%	36%
Net equity issued	3.0	3.1	1.6	0.0	Debt/financial assets	44%	41%	44%	39%
Net Cashflow	-9.9	4.4	-14.9	11.9	Interest Cover (x)	6.4	5.4	5.7	6.1
Opening cash	0.7	7.2	8.9	2.9	EFPOWA (m)	131.4	133.3	136.3	136.6
Borrowings/other	16.8	-2.7	8.9	-10.0	Growth				
Closing cash	7.5	8.9	2.9	4.8	PDL cash collected (%)	19%	0%	-15%	18%
Balance Sheet (\$m)	2015A	2016A	2017E	2018E	Ledger amortisation (%)	14%	6%	-20%	29%
Cash	7.2	8.9	2.9	4.8	Ledger purchases (%)	-12%	-13%	3%	-14%
Receivables	10.3	10.0	10.1	10.1	Ledger book (%)	9%	4%	8%	0%
Debt ledgers	256.0	265.3	287.5	288.6	EPS (norm.) (%)	18%	-15%	-6%	14%
PPE	5.5	4.3	3.1	2.3	DPS (%)	14%	-14%	-10%	14%
Intangibles	35.6	37.4	37.7	37.7	Valuation				
Other assets	1.1	1.1	1.1	1.1				(m)	%
Total Assets	315.7	327.0	342.5	344.6	DCF of ledger assets				
Borrowings	119.0	118.2	128.2	118.2	Cost of equity	11.0%	WACC		8.3%
Payables	16.0	15.1	10.5	10.5	Cost of debt	4.2%	TGR		2.5%
Other Liabilities	10.0	13.4	13.8	14.3	Debt weighting	37.7%			
Total Liabilities	145.0	146.7	152.5	143.0	Debt ledger DCF				\$ 0.53
NET ASSETS	170.7	180.3	190.0	201.7	Contingency business @ 5x EBITDA				\$ 0.37
Board of Directors			(m)	%	Combined value per share				\$ 0.90
Kerry Daly - Non Executive Director			0.39	0.29	Substantial Shareholders				
Philip Hennessy - Non Executive Director			0.05	0.04	Lev Mizikovskiy			16.1	11.8
Leigh Berkley - Non Executive Director			0.00	0.00	Top 20 Shareholders			64.5	47.5
					Description				

Collection House (CLH) engages in debt recovery services. It also engages in providing receivables management, debt collection, and debt ledger purchasing and legal services to support those collection activities.

Source: Company Reports, Canaccord Genuity estimates

Figure 2: 1H17 result - flat on pcg but of lower quality, with lower debt ledger collections and lower amortisation rate applied to collections

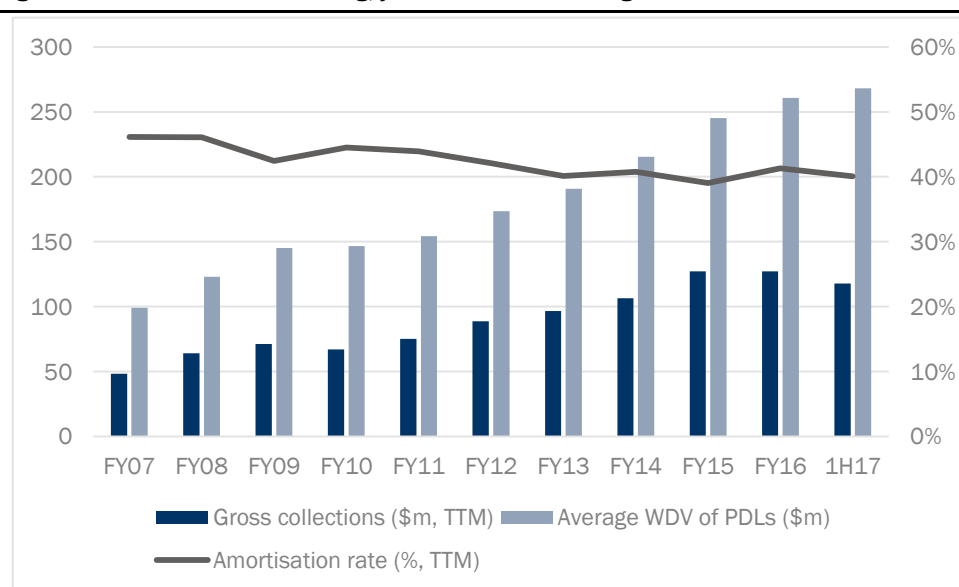
	1H16	2H16	FY16	1H17	chg (%)	CGAu est	diff (%)
Ledger purchases	30.1	31.8	61.9	26.1	-13%	22.5	16%
Gross collections (\$m)	61.8	65.4	127.2	52.5	-15%	62.4	-16%
Net ledger revenue (\$m)	36.3	38.3	74.6	32.3	-11%	35.5	-9%
Amortisation rate (%)	41.3%	41.4%	41.3%	38.5%	-276bps	43.2%	-470bps
Contingency collections/other (\$m)	28.3	29.8	58.1	33.7	19%	28.2	19%
Reported group revenue (\$m)	64.6	68.1	132.7	66.0	2%	63.7	4%
EBITDA (\$m)	17.7	19.6	37.3	16.9	-4%	16.8	1%
D&A (\$m)	-1.5	-2.4	-3.9	-1.8	20%	-2.0	-8%
EBIT (\$m)	16.1	17.2	33.4	15.1	-7%	14.8	2%
Net interest (\$m)	-3.1	-3.1	-6.1	-2.9	-7%	-3.0	-3%
PBT	13.1	14.1	27.2	12.2	-7%	11.8	3%
Tax expense (\$m)	-3.6	-4.2	-7.8	-4.0	12%	-3.5	13%
NPAT pre-ISIs (\$m)	9.5	9.9	19.4	8.2	-14%	8.3	-1%
Significant items	-1.2	0.3	-0.9	0.0	0%	0.0	0%
Reported NPAT (\$m)	8.3	10.2	18.6	8.2	-2%	8.3	-1%
Normalised NPAT (\$m)	9.5	9.9	19.4	8.2	-14%	8.3	-1%
Normalised EPS (cps)	7.1	7.5	14.6	6.0	-15%	6.1	-1%

Source: Company Reports, Canaccord Genuity estimates

Figure 3: How we calculate gross collections and amortisation rates (1H17)

(a) Opening WDV of ledger assets	265.3
(b) Purchases during period	26.1
(c) Sub-total	291.4
(d) Closing WDV of ledger assets	271.2
(e) Implied assets amortised during period (c - d)	20.2
(f) Collections reported as revenue in P&L	32.3
(g) Total cash collected from debt ledgers	52.5
Implied amortisation rate (e / g)	38.5%

Source: Company Reports, Canaccord Genuity estimates

Figure 4: Gross collections are falling, yet amortisation is falling too

Source: Company reports, Canaccord Genuity estimates

Figure 5: FY17 NPAT guidance of \$19.4-20m implies a big H2; our numbers are slightly below this

	FY16	1H17	2H17E	FY17E	chg (%)
Ledger purchases	61.9	26.1	37.9	64.0	3%
Gross collections (\$m)	127.2	52.5	56.1	108.6	-15%
Net ledger revenue (\$m)	74.6	32.3	34.5	66.8	-10%
Amortisation rate (%)	41.3%	38.5%	38.5%	38.5%	-281bps
Contingency collections/other (\$m)	58.1	33.7	35.6	69.3	19%
Reported group revenue (\$m)	132.7	66.0	70.1	136.1	3%
EBITDA (\$m)	37.3	16.9	19.4	36.3	-3%
D&A (\$m)	-3.9	-1.8	-1.5	-3.3	-16%
EBIT (\$m)	33.4	15.1	17.9	33.0	-1%
Net interest (\$m)	-6.1	-2.9	-3.0	-5.8	-5%
PBT	27.2	12.2	15.0	27.2	0%
Tax expense (\$m)	-7.8	-4.0	-4.5	-8.5	9%
NPAT pre-ISIs (\$m)	19.4	8.2	10.5	18.7	-4%
Significant items	-0.9	0.0	0.0	0.0	nm
Reported NPAT (\$m)	18.6	8.2	10.5	18.7	1%
Normalised NPAT (\$m)	19.4	8.2	10.5	18.7	-4%
Normalised EPS (cps)	14.6	6.0	7.7	13.7	-6%

Source: Company Reports, Canaccord Genuity estimates

Figure 6: On an EV/payment arrangement book basis, CLH looks 7% more expensive than CCP

	CCP	CLH
Market cap at 21 Feb close (\$m)	779	173
Net debt at 31 Dec 2016	200	115
Enterprise value (\$m)	979	288
Less other assets:		
CCP's loan portfolio at book value	-126	
CLH's contingency business @ 5x EBITDA		-51
Adjusted enterprise value (\$m)	853	237
Payment arrangement book (\$m)	1235	319
Adjusted EV/\$ under payment arrangement (x)	0.69x	0.74x

Source: Company Reports, Canaccord Genuity estimates

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Investment Recommendation

Date and time of first dissemination: February 21, 2017, 14:30 ET

Date and time of production: February 21, 2017, 05:56 ET

Target Price / Valuation Methodology:

Collection House Limited - CLH

We value CLH using a DCF methodology (WACC 8.3%) for the debt ledger purchasing operations, and a 5x EBITDA multiple for the contingency collections business.

Credit Corp Group Limited - CCP

We value CCP at using a DCF methodology (WACC 7.7%) for the debt ledger purchasing operations, and adding the forecast book value of the consumer loan portfolio at 30 June 2017.

Risks to achieving Target Price / Valuation:

Collection House Limited - CLH

1. The potential for corporate activity. While direct competitors are less likely to look to acquire the business in full, businesses with subprime loan books may see CLH's collection operations as a good strategic fit.
2. Initiatives to improve operating performance materialising quicker than anticipated.
3. General improvements in debt ledger pricing providing better financial returns across the industry.

Credit Corp Group Limited - CCP

Downside risks: Further competition in the debt purchasing market impacting the company's ability to find attractively priced investments, or resulting in the company overpaying for debt ledgers.

Upside risks: Finding opportunities to buy debt ledgers in the secondary market from competitors that may be experiencing financial difficulty, earlier than expected expansion over investment in the US market.

Distribution of Ratings:

Global Stock Ratings (as of 02/21/17)

Rating	Coverage Universe		IB Clients
	#	%	%
Buy	582	60.37%	37.29%
Hold	290	30.08%	15.86%
Sell	34	3.53%	17.65%
Speculative Buy	58	6.02%	72.41%
	964*	100.0%	

*Total includes stocks that are Under Review

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12-Month Recommendation History (as of date same as the **Global Stock Ratings** table)

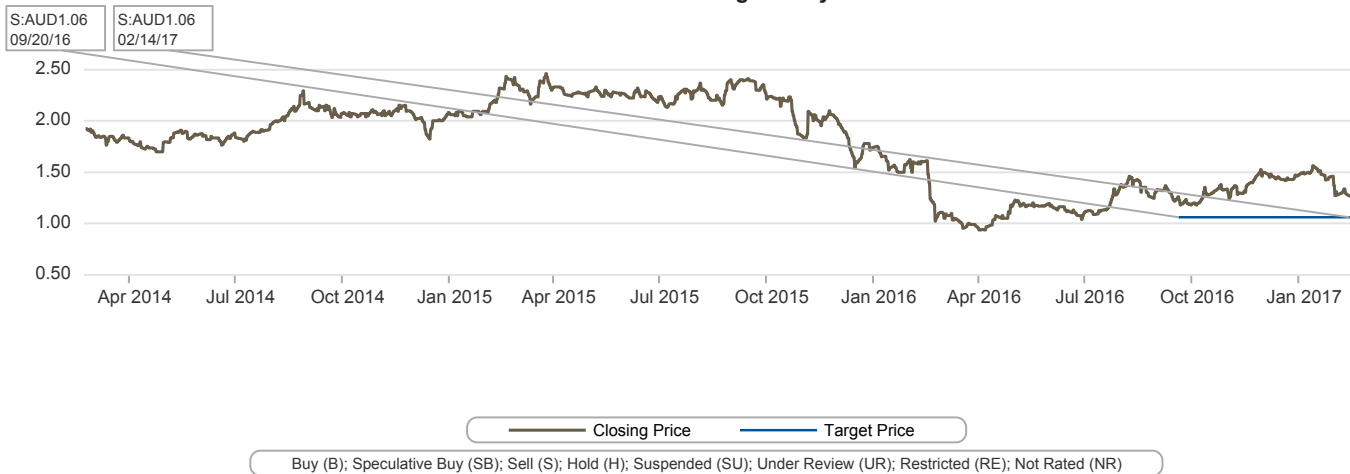
A list of all the recommendations on any issuer under coverage that was disseminated during the preceding 12-month period may be obtained at the following website (provided as a hyperlink if this report is being read electronically) <http://disclosures-mar.canaccordgenuity.com/EN/Pages/default.aspx>

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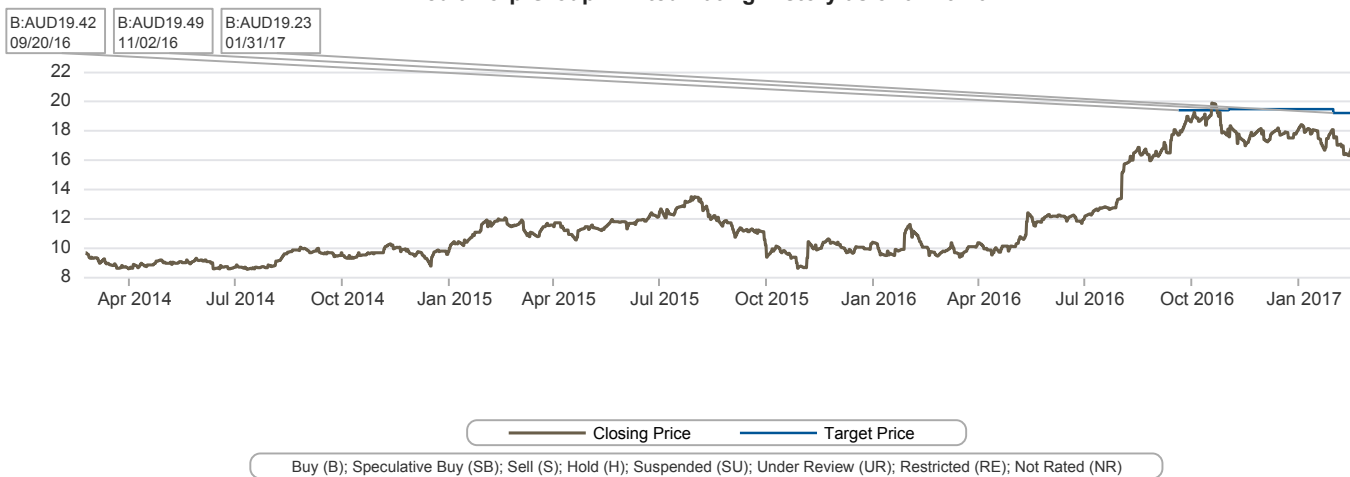
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An analyst has visited the material operations of Credit Corp Group Limited. No payment was received for the related travel costs.

Collection House Limited Rating History as of 02/19/2017



Credit Corp Group Limited Rating History as of 02/19/2017



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