Silver Chef 26/06/2012 **FAT-AUS-580**

SIV AUD $3.21 Special **HIGH** B

Catering to the smaller end

An increase in investor angst has certainly seen some indiscriminate selling (or at the very least a lack of buying) of late. As a result much value is being overlooked, particularly if there is a ‘perceived element’ of unnecessary risk. Amidst recent volatility we have tended to see money that is flowing in, go into large cap defensives, many of which we hold in our portfolio. Quality mid-caps have also been in demand. However, with risk off the table, investors have shunned the smaller end of the market.

The gulf in appetite for larger cap versus smaller cap stocks is highlighted by the performance of their respective indices quarter to date. The top 100 ASX stocks are down 5.5% so far, whilst the micro-cap index (S&P/ASX emerging companies) is off 19.9% this quarter.

We continue to overweight the larger cap quality industrials, in addition to specific sectors we believe will out-perform. However we also believe that the exodus from the small end has resulted in quality micro stocks trading substantially below fair value.

One such stock we have identified is **Silver Chef** (ASX, SIV), a Brisbane-based equipment financier. The company’s share price has actually held up well during recent volatility and is trading around its highs year to date. However, given developments this year, and the value on offer, we believe the shares are being unduly held back from a higher rating.

We point to a robust half year result, strong current trading, expansion into new markets, and a high dividend yield as providing ample reasons to be more positive on the stock than is the case currently.

Origins

Silver Chef was originally created on the back of founder Allan English's vision about the need to cater to the home delivery pizza market. Observing that the average small pizza business could not afford the outlay for equipment, he sought to provide a clear need with a service, He invested in the ovens and rented them out.

That model was ultimately to prove Silver Chef's core product twenty years on. The company offers a funding arrangement called *Rent-Try-Buy* that enables small businesses in the catering sector to procure the equipment they need, without committing the capital up-front.

Largely focussed on the hospitality market in the earlier years, Silver Chef opened its wings with the injection of capital following the company's listing on the ASX in 2005.

In 2008 the company launched its *GoGetta* division which is aimed at offering flexible funding to a variety of sectors. GoGetta operates its *go.Rent.go.Grow.go.Own solution* to a dozen industries, ranging from construction, to fitness.

Results to date

Silver Chef has been able to combine a first mover advantage coupled with a smart offering to achieve a dominant position in serving the small to medium sized end of its target market. And this is in clear evidence in the half year results released in February.

Rental revenues for the six month ended 31 December rose by 30% on the previous year to $39.1 million, while net profits after tax gained 38% to $4.2 million. Overall rental assets grew 32% to $167.8 million.

The company's hospitality business saw a 19% increase in first-half revenues to $27.9 million, while assets under management shot up to $122.5 million from $99.5 million a year earlier. It is estimated that equipment hire in the hospitality sector in Australia totals $1 billion so clearly there exists much scope for SIV to make further material gains

Underpinning recent success has been a move into the franchise sector last year. Here Silver Chef has teamed up with leading frachises to enable franchisees pre-approval, lower bonds, and rental discounts. Accredited franchisors include Domino's Pizza, Gloria Jean's and Wendy's.

Rental asset purchases through the franchise segment came in at more than $5 million in the first 6 months. We expect growing awareness of the key brands that Silver Chef works with will underpin further gains in this area.

Meanwhile the company's GoGetta business also put in a stellar performance. The division's revenues jumped 79% to $10.5 million in December 2011. Assets under management here were $45.3 million up from $19.1 million at 31 December 2010.

Silver Chef has been careful not to tread on the toes of the banks and finance companies, preferring to target small to medium sized enterprises. This suits both well as Silver Chef would be unlikely to compete at the larger end, while the bigger institutions see less mileage in targeting the smaller end of the marker aggressively.

The company GoGetta division has branched out somewhat however launching a flexible multiyear rental agreement in November. *Go.Own.plus allows business to* switch from a 12 month rental contract to a 36 month rental contract at the end of the first year. As result this has lengthened the average contract out to around 29 months.

Expansion plans

In addition to organic expansion opportunities in Australia we are also encouraged to see Silver Chef also target growth across the Tasman. In November, the company launched its *Rent-Try-Buy* product to the New Zealand hospitality industry. Management report solid interest thus far and we expect these gains will start flowing through in the four year results.

Risks

Clearly in the current environment, many potential investors will be concerned about the risks that Silver Chef faces in terms of customer defaults. Upon inspection it is clear that risk management is quite rightly a key focus.

Attention to detail such as a weekly rental direct debit, a rental bond, and careful monitoring of the almost 13,000 rental agreements in place, has meant that **the company has experienced a relative low level of bad debt incidence of less than 1 percent of revenue.** Added to this no client is larger than 1% of assets under management.

Added as well that most of Silver Chef's customers are at a the relatively affordable and defensive end of their sectors, particularly in hospitality. As CEO Charles Gregory points out 'people are still having their cups of coffee'.

Financials and Dividend Policy

A low incidence of bad debts and astute market positioning makes Silver Chef something of a cash generating machine. Net operating cash flows came in at $25.7 million at the half year, up 29 percent.

And the rewards flow directly to shareholders through a strong dividend policy. The company intends to pay out 60 to 70% of net profits after tax as dividends. But as management points out this is after making a $20 to $30 million deduction for depreciation, so reducing the pay out as a percentage of cash. With full year earnings guidance of 35 cents per share ($8.3 million), this puts SIV on a prospective yield of around 7 percent.

In terms of balance sheet backing, Silver Chef also has plenty of room to manoeuvre. The company's long term debt to tangible fixed assets (of $116 million) is around 60 percent. The company has recently upped its facility with CBA from $70 million to $110 million to accommodate further growth plans. Liquidity was also boosted by a $10 million, 2 for 13 rights issue, at $2.80 in March/April.

Summary

We believe that Silver Chef is a standout play at the small cap end of the market. The company's ability to deliver 20%+ growth in earnings consistently over the last 5 years despite a challenging economic environment overall is impressive. And we believe the building blocks put in place make management targets of 15-20% EPS growth going forward highly credible.

We believe a strict approach to risk management and strong dividend policy provide additional comfort for investors. With a prospective earnings multiple of just 10 times we believe Silver Chef offers an excellent value.

We recommend SIV as a buy to Members around $3.21. Please note that Silver Chef is a small cap stock and patience needs to be exercised when buying. Members should refrain from chasing prices higher.

Snapshot SIV

Silver Chef

Latest Closing Price: $3.21

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Market Capitalisation:$88m

	FY1	FY2
Price to Earnings	9.2	8.0

Dividend Yield (%)	6.7	8.0
Price to Book	1.8	1.8
Return on Equity (%)	22.9	23.5