

Leyland Lines

Silver Chef Limited (ASX: SIV)

Current Price: \$8.99

Market Cap: \$307m



Company Overview

Silver Chef Limited (SIV) is an Australian based business involved in leasing, lending and renting, focused on the hospitality sector. Since its inception in 1986, it has dealt with more than 45,000 customers, from start-up cafes to large restaurants and hotels. Silver Chef Limited listed on the Australian Stock Exchange in 2005 and operates in three countries: Australia, New Zealand and Canada employing more than 400 people.

SIV provides flexible equipment funding solutions to customers through two businesses:

- Silver Chef: Rent-Try-Buy

Silver Chef is the group's main business and operates exclusively in the hospitality industry, providing leasing for professional kitchen and restaurant appliances. This is a unique offering in the marketplace and greatly reduces risk and up front capital requirements for restaurant owners. Silver Chef initially allows clients to take out 1 year contracts, if the restaurant is a success then the appliances can be purchased at cost and 75% of their rental expense is returned. They also have the option of rolling into a cheaper leasing contract or retuning the appliance. Returned appliances are then offered again for second hand leases. Starting a new business is risky, especially in the hospitality industry, with roughly 60% of new restaurants failing in the first 3 years.

- GoGetta: Rent.Grow.Own

GoGetta provides equipment funding solutions for a range of products including the automotive, agriculture, fitness and construction sectors. Working in a similar way to Silver Chef, GoGetta offers 12 month leasing contracts, with the option to purchase, return or continue to rent at the end of the period.

Fraud Incident

On November 17th 2016 Silver Chef announced to the market that it had been the victim of a fraud event involving cyber-criminals working with fraudulent and non-fraudulent GoGetta equipment brokers. The fraud was in relation to 60 smaller contracts (valued at roughly \$60,000 or less each) in both New South Wales and Victoria. Essentially, the fraudsters applied for loans to buy equipment with a false identity through fake vendors as well as an existing long time vendor. They directed their activity at financing fitness equipment for 3 month loan periods. The Silver Chef collections department noticed that payments were not being received and alerted management. Initially the missed payments did not raise a red flag as the equipment was predominantly bought through a long term partner and equipment broker that SIV trusted (the vendor was unaware and not involved in the crime).

The share price initially dropped 18% on the back of the update, but bounced back to finish the day down 10%. As a result of the fraud, SIV had to write down the value of the stolen fitness equipment, and incurred an impairment charge on their half year 2017 accounts of \$2.3m.

Earnings were expected to be between \$6.3m - \$7.3m but were reduced to between \$4m - \$5m.

The event affected full year earnings expectations and reduced them to between \$21m - \$23m from \$23 - \$25m (after tax) implying there is still a chance for the company to hit the bottom end of guidance.

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Management stated that financial recovery avenues were being discussed, but it would take some time due to the complex nature of the fraud. Given the fact that the fraud will likely be classified as a 'cyber-crime', it will not be covered by their insurance providers.

Fraud Protection Strategy

In response to the fraud, SIV announced a number of initiatives:

- It's accelerated roll-out of third party identity and verification software:

Which will use 3rd party bank statement evaluation software as part of its loan approval process within its GoGetta business. The software has two main objectives; 1) To give insight into customer revenues, informing credit decision making processes. 2) Verification of a customer's ID against an existing bank account providing access to banks strict identification processes.

- Vendor re-accreditation:

SIV will re-accredit all vendors in its GoGetta business, with personal meetings being set up between company officials and vendor management.

- Increase to internal audit resources:

New personnel will be added to internal credit and audit teams providing additional resources and contract settlement reviews.

- Re-evaluation of fraud and cyber-crime insurance:

As a part of its 2017 insurance renewal process, the company will evaluate the benefits of adjusting the current insurance policy to include cyber-crime. Previously this option has been declined based on premium costs.

- Membership of Veda Fraud Focus Group:

Silver Chef is already a member of the Veda National Financial Fraud Focus Group, sharing information of known fraud techniques and cyber-crime.

Value

The GoGetta business should be viewed as more risky than Silver Chefs traditional Hospitality business due to the diversity of vendors and financeable equipment available. However, given the mitigation strategies outlined by management, we feel the fraud event should be treated as a one off and is not significant enough to discount the underlying strength of the company's business model. Revenue grew by 29% to \$221.1m with NPAT growing 45% to \$19.7m in 2016.



Since listing, the company has seen an 18% compound annual growth in underlying EPS with its asset base now up to \$539.2m

The company is focused on providing strong organic growth in two areas:

1) Silver Chef's Growth

Future growth in this division domestically will be driven by maintaining key relationships with its dealer network and a new product leasing agreement that allows the expanding market of boutique coffee growers, to offer coffee machines to their customers on a free on-loan program. The company relies on organic growth and does not buy businesses to fuel expansion. In 2012, SIV started operating in New Zealand, with the operations becoming profitable after 2 years. A digital marketing strategy has been employed and is continuing to popularise the SIV offering in New Zealand.

In 2014, the Canadian hospitality business was established and continues to perform well with \$12m worth of new loans being issued in 2016, double that of 2015. The business has an asset base of \$16m at cost and delivers a small accounting profit being well supported by suppliers and equipment brokers. Management expects the Canadian operations to make a 'meaningful contribution' to 2017 earnings and have ambitious new loan targets.

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2) GoGetta

Putting the fraud and cyber-crime issues aside, the GoGetta business had its best performing year yet in 2016, generating new loans of \$160m. This has been achieved by focusing on building strong relationships with equipment finance brokers in the transport and construction industries. A focus has been placed on the re-sale of assets returned from small and medium sized businesses and the marketing of these used products (via the flexible return policies). Management is expecting strong growth in 2017 and will continue to ensure best practice is utilised when assessing new loans and customer credit. As restrictions on credit are being made tighter by bigger banks, SIV expects that their rental offering will become increasingly more attractive.

Financials

Trading on a price to earnings ratio (P/E) of 11X in FY18, the company is already cheap in our view and when combined with forecast earnings growth of 25.5% in FY18 the company is trading on a P/E over growth ratio (PEG) of well below 1. Additionally, SIV is paying a gross yield of 6.7% (inc. franking) on a 53% payout ratio, showing that there is good potential for growth over the next few years whilst paying a strong, stable dividend. We find its value compelling.

	2016	2017	2018	2019
Revenue (m)	221.1	290.5	329	369.1
NPAT (m)	19.7	23	31.7	35.2
EPS (cps)	62.5	71.4	89.6	98.6
DPS (cps)	42	44	47	51
P/E (x)	15.8	13.9	11.1	10
Yield (%)	4.2	4.4	4.7	5.2
Franking (%)	100	100	100	100
ROE (%)	17.3	16.2	20.2	20.2

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Most investors want to maintain overall control, but recognise that their time and market knowledge sometimes limits their investment returns.

Please contact Leyland Private Asset Management if you would like to talk further about us managing your super fund equity investments.