Research as a Service

RAP Report

13th June 2018

Turners Automotive Group

Not paying for growth expectations

Turners Automotive Group (TRA.ASX) is the largest second-hand vehicle retailer in New Zealand. TRA has in integrated offering including sales, service, finance and insurance and with the acquisition of Buy Right Cars (BRC) in July 2016 it has a position in the used vehicle import business. Its finance business provides asset backed finance to consumers and SME's and the insurance division offers a range of life and consumer insurance and superannuation products. TRA also operates debt collection services in NZ and Australia. The automotive retail segment is TRA's key business driver and in FY18 accounted for 41% of operating profit. Following a period of making acquisitions to build out the integrated service offering TRA is focused on achieving medium term growth from within the group and driving shareholder value through growth in sustainable profits and improved dividends.

FY18 result at top of guidance range

The FY18 NPBT of NZ$31.1m was at the top of the company's guidance range of NZ$29-NZ$31m. NPAT of NZ$23.4m was helped by a 25% income tax rate (FY17 tax rate was 28.7%. Dividends per share of 15.5cps were up 6.9% on pcp and the future quarterly dividend pay-out ratio has been increased to 50-60% of NPAT (previously 50-55%). The acquisition of BRC (for an earn out adjusted NZ$14.1m plus stock of $21.5m) contributed ~NZ$0.5m less to NPBT in FY18 than it did for 8 months in FY17 due to losses on aged inventory and replacement of the inherited management team. The earn-out to BRC vendors which in FY17 was NZ$6.3m (of which NZ$1.4m was current) has been adjusted downwards. The amount of this adjustment will be disclosed when a full set of financials is available. FY18 EPS growth of 15.6% was achieved whilst improving ROE. NPBT guidance for FY19 is NZ$34-NZ$36m a 13% increase at the mid-point (a FY19 PEG ratio of 0.77).

Reverse DCF – market pricing suggests negative growth

In our view, TRA, as the dominant player in its NZ market, should achieve growth rates, at worst, in line with its market (up 5%). Its integrated offering in automotive plus its wider finance and insurance products should mean higher rates of growth. The provision of realistic guidance (FY17 and FY18 at top of range) adds weight to the argument that TRA has a predictable business unlikely to experience earnings volatility albeit that it has exposure to the economic cycle (note increased credit provisioning in FY18). At the current share price, if we assume a 12% WACC and a 2% terminal growth rate after 10 years, the market is pricing in negative CAGR in cash flows of 5%. Alternatively, if we take a pessimistic view and assume 2% CAGR for 10 years and a terminal growth rate of 2% the implied WACC is 17.7% which suggests a high degree of business risk. TRA's much larger peer in the Australian market, Eclipx (ECX.ASX) has inferior ROE of 6.8% compared with TRA (10.8%), similar forecast growth rates (ECX 14.4% v TRA 13%) and both have dividend yields of ~5%. The relative PE multiples are 15.2x for ECX (using 12-month trailing EPS) and 10.5x for TRA.

Earnings history (A$m)

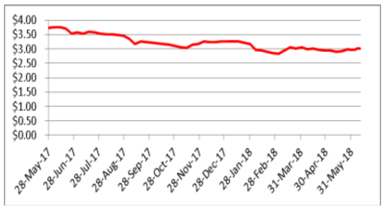
Y/E	Revenue	EBITDA	EBIT	NPAT	EPS (c)	PE (x)	Div yield (%)
3/16	171.7	8.0	10.1	15.6	24.1	12.4	3.7
3/17	251.0	12.1	10.2	17.6	25.0	12.0	4.8
3/18	330.5	51.1	45.5	23.4	28.9	10.5	5.2

Source: Company data; EPS = diluted earnings per share

Share details

ASX Code/NZX Code	TRA
Share Price	A$3.00/NZ$3.01
Market Capitalisation	$252M
Number of shares	84.8M
Enterprise Value	$258M
Free Float	69%

12-month share price performance (in NZ$)



RaaS RAP 5-point score* = 5/5

Revenue increasing (1) EPS increasing (1), Return on Capital Employed up (1); EBIT interest cover >3x (1) Gross Operating cash flow/EBITDA >90%(1)

Upside Case

- Integrated automotive operation including sales, service, finance and insurance
- Acquisition risk reduced as company focuses on internally generated earnings growth
- NPBT guidance has been provided indicating management and the board's confidence in the predictability of the result

Downside Case

- Buy Right Cars (acquired July 2016) did not meet expectations
- The Australian debt collection business has been described as a work in progress for several years
- Exposure to economic cycle (note increased provisioning in FY18)

Catalysts

- Improved performance from BRC
- Increases in quarterly dividend payments

Comparative companies (Australia & NZ)

ECX.ASX, SIV.ASX

Substantial Shareholders

Hugh Green Investments 19%, Bartel Holdings 9.05%, Baker Investment No 2 6.427%, Harrigens Trustees 6.143%

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*The RaaS RAP 5-point scorecard is derived from the last reported full financial year's performance over the prior year. Past performance is not a guarantee of future performance.