BELL POTTER

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Cover-More (CVO)

Headwinds to turn into tailwinds

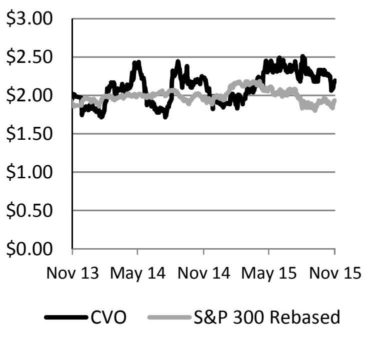
Recommendation
Buy (unchanged)
Price
$2.19
Target (12 months)
$2.60 (previously $2.70)

Expected Return	
Capital growth	**18.7%**
Dividend yield	**4.3%**
Total expected return	**23.0%**
Company Data & Ratios	
Enterprise value	**$728m**
Market cap	**$696m**
Issued capital	**317.8m**
Free float	**84%**
Avg. daily val. (52wk)	**$3.6m**
12 month price range	**$1.71-$2.55**
GICS sector	**Insurance**

Price Performance

	(1m)	(3m)	(12m)
Price (A$)	2.28	2.18	2.25
Absolute (%)	-3.95	0.46	-2.67
Rel market (%)	-4.67	0.91	-0.50

Absolute Price



SOURCE: IRESS

Material leverage at the revenue line

CVO appears to be winning material market share in the Domestic Travel Insurance segment given recent AGM guidance points to 1Q16 volume growth of 3-5%. This compares favourably to estimated industry volume growth for the first quarter of -1.2% (based on ABS Short-Term International Departures for Holiday purposes) and annual growth of -1.5% for the year to September 2015. Our analysis suggests that this slowing in Outbound Holiday Travel is a reflection of a softer domestic economy and to a lesser extent the lower currency. Given the recent evidence regarding market share gains, CVO has material revenue leverage to the inevitable recovery in Outbound Holiday Travel as the economy improves.

Lower currency is hurting margins

The lower currency (particularly vs $US) is having a negative impact on margins given claims costs are generally repriced on a quarterly basis (CVO outsources claims costs to underwriters but exposure reviewed quarterly). The Company generally elects to pass on these costs in the form of higher prices but must be mindful of any adverse impact on volumes. We note the material decline in the currency over the last 12 months and the associated lows in interest rates and commodity prices and the inter-related nature of these variables. We also note the fact that history tends to indicate that we are at or around the lows for all of the variables.

Investment View – Retain Buy PT $2.60 (Prev $2.70)

Our EPS estimates have been downgraded by 8% in FY16 and 4% in FY17 due to the impact of the lower currency on short-term margins. Similarly our 12-month price target has declined 4% to $2.60 due to our earnings divisions partially offset by the roll forward of our model and has been derived from a DCF valuation (WACC 10.7% and terminal growth rate 3%) cross checked to peer CTD's EV/EBITDA and PE multiples. We retain our Buy recommendation as a forward looking approach highlights the material leverage of the Company to the inevitable recovery in Outbound Travel and the currency.

Earnings Forecast

Year end June	2015	2016e	2017e	2018e
Sales (A$m)	222.9	244.3	269.1	296.5
EBITDA (A$m)	52.0	55.6	65.3	75.2
NPAT (reported) (A$m)	25.8	28.6	35.5	42.2
NPAT (adjusted) (A$m)	31.1	34.1	41.0	47.7
EPS (cps)	9.8	10.7	12.9	15.0
EPS growth (%)	10.3	9.7	20.3	16.4
PER (x)	22.4	20.4	17.0	14.6
EV/EBITDA (x)	14.0	13.1	11.2	9.7
Dividend (¢ps)	9.6	9.5	11.7	14.0
Yield (%)	4.4	4.3	5.4	6.4
Franking (%)	100.0	100.0	100.0	100.0
ROE (%)	15.0	16.9	20.5	24.1

SOURCE: BELL POTTER SECURITIES ESTIMATES

Reviewing the Outlook

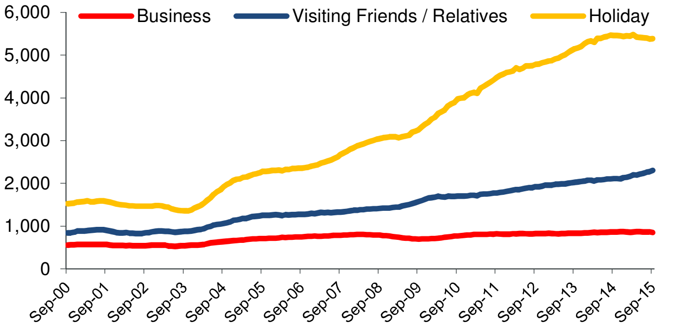
Two key drivers: Outbound Holiday Travel and Currency

The Australian Travel Insurance business and associated Medical Insurance remains the key to the CVO group. The two most important drivers of earnings for these businesses are the rate of Outbound Holiday Travel and currency levels, particularly the $US given claims costs are generally repriced on a quarterly basis (CVO outsources claims costs to underwriters but exposure reviewed quarterly).

In recent times both have been headwinds

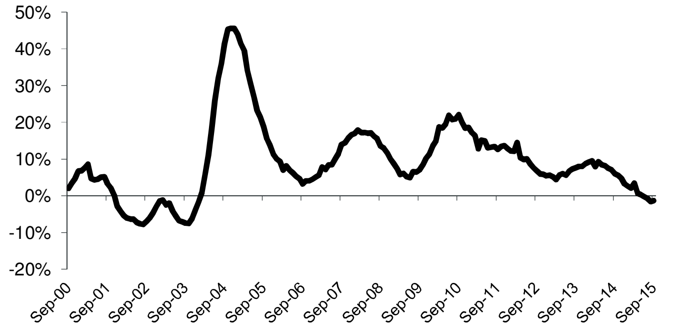
In the short-term both of the variables have represented a headwind to earnings with the growth in Outbound Holiday Travel slowing considerably due largely to the slowing domestic economy. At the same time the lower currency has also represented a negative not only on demand for Outbound Holiday Travel but it has also increased claims cost given a significant percentage of the book is priced in $US.

Figure 1 - S-term Int Departures by Purpose of Travel MAT '000's



SOURCE: ABS

Figure 2 - S-term Int Departures Holiday Travel MAT growth

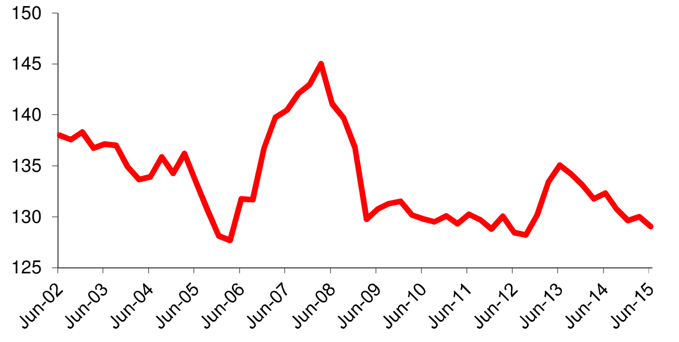


SOURCE: ABS

Important to note there has not been a switch back to Domestic Holiday Travel

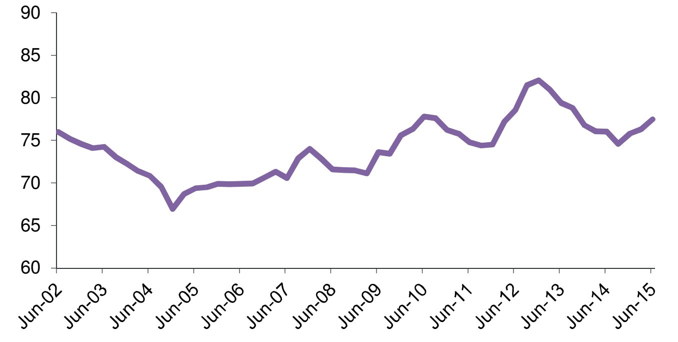
On face value a soft local economy and a lower currency should favour a shift back to Domestic Holidays (away from Outbound); however, evidence suggests that overall demand for Domestic Holiday Travel remains weak. In particular, we note the softness in demand for Overnight Holiday Travel by Australian Residents despite evidence of improvement in some destinations such as Cairns and Gold Coast. The Domestic Day Trip Holiday market has performed a little better but we note that the recovery is off a low base.

Figure 3 – Domestic Visitor Nights Holiday (Overnight Travel)*



SOURCE: *TRA, MOVING ANNUAL TOTALS

Figure 4 – Domestic Day Trips Holiday*



SOURCE: *TRA, MOVING ANNUAL TOTALS

AGM comments suggest winning material market share

We note the recent comments at the AGM that 1Q16 gross travel insurance sales at a group level increased 10.2% with Australian growth up 8.5%. If we assume price increases for the Australian business of 3.5-5.5% this implies volume growth in the range of 3-5%. We note this compares to estimated market volume growth of -1.2% (1Q16 vs 1Q15) and annual growth of -1.5%. This suggests to us that CVO is winning material market share versus its key competitors.

Highlights the leverage to the inevitable recovery in outbound

This analysis also highlights the leverage inherent in the CVO business to an improvement in Outbound Holiday Travel. Given the Company has been able to win material share in periods of declining industry volumes; we note the material leverage to improving Outbound growth rates. We remain of the view that we are currently at or around the bottom in relation to Outbound growth rates with recovery dependant on an improving Household Consumption outlook. History suggests a recovery in the domestic economy and Household Consumption is inevitable and recent consumer confidence and retail sales data are providing encouraging signs.

Currency outlook dependant on interest rate differentials and commodity prices but history suggests at or around lows

Similarly, the currency outlook is also dependant on the fortunes of the Australian economy together with global commodity prices. We note the material decline in the currency over the last 6 months and the associated lows in interest rates and commodity prices and the inter-related nature of these variables. We also note the fact that history tends to indicate that we are at or around the lows for all of the variables.

Both headwinds likely to turn into tailwinds over the next 12 months

We remain confident of a recovery in Outbound Holiday Travel in the coming 12 months and this is expected to result in material revenue leverage for CVO. This recovery is expected to be driven by the inevitable improvement in the local economy and hence Household Consumption together with the continued attractiveness of International vs Domestic Travel. At the same time, the lower currency which has adversely impacted both claims costs and Outbound Travel also has the potential to bottom out and eventually turn into a tailwind in the next 12 months.

Earnings and Valuation

EPS estimates downgraded by 8% in FY16 and 4% in FY17

We have updated our estimates to take account for expected impact of the lower currency on margins within the domestic Travel Insurance business. The net effect of these changes is that our EPS estimates have been downgraded by 8% in FY16 and 4% in FY17.

Figure 2 - Earnings Revisions

		FY16			FY17		
		Old	New	% Change	Old	New	% Change
Revenue $m	$m	244.3	244.3	0%	269.1	269.1	0%
EBITDA $m	$m	60.0	55.6	-7%	67.7	65.3	-4%
EBITDA Margin*	%	24.5%	22.7%	-180	25.2%	24.3%	-90
NPAT (adj) $m	$m	37.1	34.1	-8%	42.6	41.0	-4%
EPS (adj) cps	cps	11.7	10.7	-8%	13.4	12.9	-4%
DPS cps	cps	10.5	9.5	-10%	12.3	11.7	-4%

*Change in basis points

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Valuation and 12-month price target $2.60 (previously $2.70)

Our 12 month price target and valuation of CVO equates to $2.60 and has been derived from a DCF valuation (WACC 10.7% and terminal growth rate 3%) cross checked to peer CTD's EV/EBITDA and PE multiples. Our price target has declined 4% due to the impact of our earnings revisions partially offset by the roll forward of our model. We have cross checked to peer CTD given both businesses are capital light, have strong growth characteristics and operate within the Travel & Tourism sector. CTD is currently trading on an FY16 PE multiple of 25.6x and EV/EBITDA multiple of 16.7x which represents a material premium to CVO. In broad terms this supports the reasonableness of our CVO valuation.

Cover-More Limited (CVO)

Company Description

CVO is predominantly a distributor of Travel Insurance and Assistance Products (Travel Medical Insurance and Employee Assistance Services). The company has historically focussed on Australia/NZ and to a lesser extent the UK, but has recently expanded into India, Malaysia, Singapore and China.

Investment Strategy

We rate CVO as a Buy with a 12-month target price of $2.60. CVO has strong growth prospects with investment appeal enhanced by the capital light nature of the business, an increasing ROIC, a solid balance sheet and an increasing dividend stream.

Valuation

Our EPS estimates have been downgraded by 8% in FY16 and 4% in FY17 due to impact of the lower currency on short-term margins. Similarly our 12-month price target has declined 4% to $2.60 due to our earnings divisions partially offset by the roll forward our model and has been derived from a DCF valuation (WACC 10.7% and terminal growth rate 3%) cross checked to peer CTD's EV/EBITDA and PE multiples.

Risks

We believe there are a number of key risks that have the potential to impact our investment thesis as follows:

- Loss of key contracts – A loss of distribution agreement contract/s with both travel agents (particularly the Flight Centre deal) or other third party distributors has the potential to adversely impact earnings;
- Inability to secure underwriting risk – CVO's business model relies on an insurer holding the underwriting risk. As a result the availability and commercial terms of this underwriting represents an element of risk to the investment thesis; and
- External shocks – External shocks such as natural disasters may have a negative impact on outbound travel levels and this represents a risk to earnings.

Cover-More

as at 23 November 2015

Recommendation	Buy
Price	$2.19
Target (12 months)	$2.60

Table 1 - Financial summary

June Year end	2011*	2012*	2013*	2014*	2015	2016e	2017e	2018e
Profit & Loss (A$m)								
Sales revenue	146.0	161.5	196.2	213.9	222.9	244.3	269.1	296.5
. . . Change	n/a	10.6%	21.5%	9.0%	4.2%	9.6%	10.2%	10.2%
EBITDA	29.7	30.2	40.8	48.5	52.0	55.6	65.3	75.2
Deprec. & amort.	(11.0)	(11.9)	(12.7)	(12.8)	(12.5)	(11.5)	(12.3)	(13.2)
EBIT	18.7	18.3	28.1	35.7	39.5	44.1	53.0	61.9
Interest	(2.8)	(2.8)	(3.1)	(2.8)	(2.7)	(3.2)	(2.2)	(1.6)
Non recurring items	-	-	-	3.4	-	-	-	-
Pre-tax profit	15.9	15.5	25.0	36.3	36.8	40.9	50.7	60.3
Tax expense	(4.8)	(5.2)	(8.4)	(11.0)	(11.1)	(12.3)	(15.2)	(18.1)
. . . tax rate	29.9%	33.9%	33.6%	30.3%	30.1%	30.0%	30.0%	30.0%
Other	-	-	-	(0.2)	-	-	-	-
Net Profit Reported	**11.2**	**10.2**	**16.6**	**25.1**	**25.8**	**28.6**	**35.5**	**42.2**
NRI's post tax	-	-	-	(2.4)	-	-	-	-
Net Profit pre-NRI's	**11.2**	**10.2**	**16.6**	**22.7**	**25.8**	**28.6**	**35.5**	**42.2**
Normalisation adjs	5.5	5.5	5.5	5.5	5.3	5.5	5.5	5.5
Net Profit Normalised	**16.6**	**15.7**	**22.1**	**28.2**	**31.1**	**34.1**	**41.0**	**47.7**
*Pro-forma								
Cashflow (A$m)								
Reconciliation								
Net Profit			16.6	25.1	25.8	28.6	35.5	42.2
Deprec. & amort.			12.7	12.8	12.5	11.5	12.3	13.2
Change in working capital			7.1	(3.9)	0.8	1.5	(0.6)	2.5
Other			9.3	(0.8)	0.7	-	-	-
Net operating cashflow			45.7	33.2	39.7	41.6	47.2	58.0
Investing Cashflow								
Sale/purchase of PPE			(6.0)	(1.0)	(1.8)	(5.5)	(6.0)	(6.0)
Payment for businesses			-	(98.3)	-	-	-	-
Other			-	(2.5)	(4.4)	-	-	-
Net investing cash flow			(6.0)	(101.9)	(6.2)	(5.5)	(6.0)	(6.0)
Financing Cashflow								
Issue of shares			-	497.1	-	-	-	-
Buy backs			-	-	-	-	-	-
Dividends paid			-	(18.1)	(38.7)	(30.0)	(37.3)	(44.3)
Debt			-	(419.1)	8.1	-	-	-
Others			-	(0.1)	(0.3)	-	-	-
Net financing cash flow			-	59.8	(30.9)	(30.0)	(37.3)	(44.3)
Effects of exchange rate			-	(0.0)	0.9	-	-	-
Net change in cash held			39.7	(8.9)	3.4	6.0	3.9	7.6
Balance Sheet (A$m)								
Cash			8.0	20.6	24.0	30.1	34.0	41.6
Receivables			24.2	30.2	31.3	46.4	51.1	53.4
Inventories & WIP			-	-	-	-	-	-
Other			4.3	-	-	-	-	-
Current Assets			**36.5**	**50.9**	**55.4**	**76.5**	**85.1**	**95.0**
Fixed assets			7.5	5.2	4.7	6.5	8.0	8.5
Intangibles			254.8	248.3	248.8	241.0	233.2	225.4
Other assets			1.1	0.1	0.5	0.5	0.5	0.5
Non current Assets			**263.4**	**253.5**	**254.0**	**248.0**	**241.7**	**234.4**
Total assets			**299.9**	**304.4**	**309.4**	**324.5**	**326.8**	**329.4**
Creditors			31.7	31.3	34.5	51.1	55.1	59.9
Short term debt			0.3	0.1	-	-	-	-
Other			11.0	11.0	9.0	9.0	9.0	9.0
Current Liabilities			**43.0**	**42.3**	**43.5**	**60.0**	**64.1**	**68.9**
Long term debt			64.7	45.5	56.1	56.1	56.1	56.1
Deferred Tax Liability			6.9	8.3	7.2	7.2	7.2	7.2
Other			0.7	1.2	1.3	1.3	1.3	1.3
Non current Liabilities			**72.3**	**55.0**	**64.6**	**64.6**	**64.6**	**64.6**
Total liabilities			**115.3**	**97.4**	**108.1**	**124.6**	**128.7**	**133.4**
Net assets			**184.6**	**207.0**	**201.3**	**199.9**	**198.1**	**196.0**
Share capital			219.6	220.1	220.1	220.1	220.1	220.1
Reserves			(2.1)	(0.4)	6.9	6.9	6.9	6.9
Retained earnings			(32.9)	(12.7)	(25.7)	(27.1)	(28.9)	(31.0)
Outside equity Interests			-	-	-	-	-	-
S/holders' funds			**184.6**	**207.0**	**201.3**	**199.9**	**198.1**	**196.0**
Net debt/(cash) ($m)			57.0	25.0	32.0	26.0	22.1	14.5

Price	$2.19
Recommendation	Buy
Diluted issued capital (m)	317.8
Market cap ($m)	696.0
Target Price (A$ps)	$2.60

June Year end	2012	2013	2014	2015	2016e	2017e	2018e
Valuation Ratios							
Reported EPS (¢ps)	5.2	7.1	8.1	9.0	11.2	13.3	
Core EPS (¢ps)	7.0	8.9	9.8	10.7	12.9	15.0	
. . . % change	n/a	27.5%	10.3%	9.7%	20.3%	16.4%	
PE (x)	31.5	24.7	22.4	20.4	17.0	14.6	
EV/EBITDA (x)	17.8	15.0	14.0	13.1	11.2	9.7	
EV/EBIT (x)	25.9	20.4	18.4	16.5	13.7	11.8	
NTA ($ps)	(0.2)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	
P/NTA (x)	(9.9)	(16.9)	(14.7)	(16.9)	(19.8)	(23.7)	
Book Value ($ps)	0.58	0.65	0.63	0.63	0.62	0.62	
Price/ Book	3.77	3.36	3.46	3.48	3.51	3.55	
DPS (¢ps)	-	7.2	9.6	9.5	11.7	14.0	
. . . % pay-out	0.0%	81.2%	98.6%	88.2%	91.0%	93.0%	
Franking (%)	100%	100%	100%	100%	100%	100%	
Yield (%)	0.0%	3.3%	4.4%	4.3%	5.4%	6.4%	
Performance Ratios							
EBITDA/sales (%)	20.8%	22.7%	23.3%	22.7%	24.3%	25.3%	
EBITA/sales (%)	18.3%	20.3%	21.1%	21.2%	22.6%	23.5%	
OCF realisation (%)	156%	88%	104%	104%	99%	105%	
FCF realisation (%)	258%	118%	139%	132%	121%	127%	
ROE (%)	n/a	15.3%	15.0%	16.9%	20.5%	24.1%	
ROIC (%) pre-tax	n/a	15.1%	17.0%	19.2%	23.7%	28.8%	
Asset Turn (years)	3.21	3.79	4.17	4.84	5.29	5.68	
Capex/Depn (x)	2.76	2.00	2.46	1.50	1.32	1.10	
Interest cover (x)	9.1	12.8	14.7	13.8	23.9	38.6	
Net debt/EBITDA	1.40	0.51	0.62	0.47	0.34	0.19	
Net debt/equity (%)	30.9%	12.1%	15.9%	13.0%	11.2%	7.4%	

Divisional	2012	2013	2014	2015	2016e	2017e	2018e
Revenue by Product							
Travel Insurance	105.8	135.6	149.1	156.9	177.0	196.5	218.1
Medical Assistance	55.7	60.6	64.8	66.0	67.3	72.7	78.5
Total	161.5	196.2	213.9	222.9	244.3	269.1	296.5
EBITDA by Product							
Travel Insurance	20.5	29.1	32.5	32.7	38.6	43.6	49.5
Medical Assistance	11.3	13.3	17.0	19.3	20.4	22.5	24.7
Corporate	(1.6)	(1.6)	(1.0)	-	-	-	-
Adj/Other	-	-	-	-	(3.4)	(0.9)	0.9
Total	30.2	40.8	48.5	52.0	55.6	65.3	75.2
EBITDA by Region							
Aust/NZ/UK	29.2	39.5	44.4	47.3	52.5	57.7	66.0
Asia	2.6	2.9	5.1	4.7	7.3	9.7	11.3
Corp	(1.6)	(1.6)	(1.0)	-	-	-	-
Adj/Other	-	-	-	-	0.2	0.3	0.5
Total	30.2	40.8	48.5	52.0	60.0	67.7	77.8

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.

Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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John O'Shea owns 15,000 shares in CVO.

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