StockVal
informer

Issue 12 - April 2008

"You only have to do a very few things right in your life so long as you don't do too many things wrong" -

Warren Buffett

StockVal: REVIEWED

Cabcharge Limited (ASX: CAB)

Cabcharge ("CAB") was established in 1976 as a means for taxi operators and drivers to manage non-cash fares. Today CAB covers over 95% of Australian taxis, limousines and water taxis, and is also available in some fleets around the world.

The largest taxi company in Australia, Taxis Combined Services, is a wholly owned subsidiary of CAB. CAB also owns Combined Communications Network, an Australian transport logistics company that operates the country's largest fleet of taxis and provides associated specialist transport services to support owners, operators and drivers.

CAB is also in a joint venture with ComfortDelGro Corporation Ltd (Singapore)("CDC") with the latter owning 51% of the business. CDC is recognised as the largest private bus operator in New South Wales.

Strategy

In regards to electronic payment services for taxi operators, CAB has a near monopoly in Australia with over 95% of taxis, limousines and water taxis using CAB's services. CAB's market share in Australia's taxi network is also increasing, predominantly through acquisitions. CAB is currently most dominant in NSW and VIC with its Sydney fleet growing from 3,080 to 3,200, while Melbourne grew from 1,476 to 1,558 respectively over FY07. It does not appear that CAB will be facing much competition on this front, with the greatest obstacle to increasing market share within these states coming from the ACCC. The option for CAB to increase market share through acquisitions outside these states remains open and will be discussed later.

CAB derives most of its revenue from two main sources. The first being a cut of all payments made through the Cabcharge Payment System and the second being the sale of products to taxi operators. The former has experienced strong growth over recent years, with customers substituting cash payments with credit cards. Regarding the latter, the largest component of product revenue are subscription fees paid by taxi operators for radio dispatch services provided by the network, but also include a cross-sell of other products, including insurance broking, vehicle financing, smash repair services and taxi fitout services

CAB is well insulated from both higher oil prices and the fallout from the sub-prime crisis. Recent price increases, such as a 6% increase announced in NSW due to higher oil prices, are flowing through to customers. This is positive for CAB, as commissions are boosted in absolute terms on the back of high taxi fares. However, this highlights a weakness for CAB in their inability to raise prices without regulatory approval. CAB is considered a defensive stock given the demand for its services is unlikely to be materially affected by the sub-prime crisis and the flow-on effects of a US slowdown. This is due to CAB's domestic exposure, and that in the main, its services are of a necessary rather than a discretionary nature.

The outlook for CAB is positive. There should be continued strong growth in Bank Issued Card transactions, which is expected to be a major driver for future revenue and profit growth. The flow of taxi fare increases will flow

Figure 1

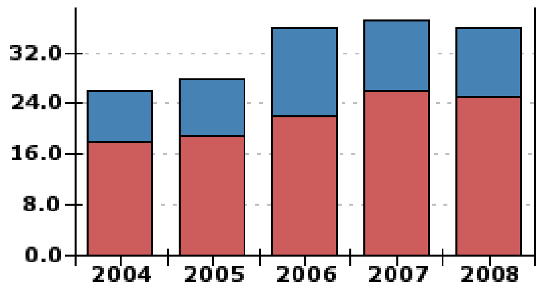
	2003	2004A	2005A	2006A	2007A	2008F	Totals
Amortisation of Goodwill		0.5	0.5	0.0	0.0	0.0	**1.0**
Abnormal Gains (Loss)		0.0	0.0	0.0	0.6	0.0	**0.6**
Net Profit inc. Abnormals less Pref Divs		23.9	27.2	38.0	51.8	62.1	**203.0**
Dividends on Ordinary Shares Only		15.2	17.1	21.3	32.2	37.8	**123.6**
% of Dividends Franked		100%	100%	100%	100%	100%	
Grossed up Dividends		21.7	24.4	30.4	46.0	54.0	**176.6**
Opening Equity		120.6	126.7	138.0	156.8	217.6	**120.6**
Retained Profits		8.7	10.1	16.7	19.6	24.3	**79.4**
Change in Reserves		-0.1	0.6	2.1	0.6	0.0	**3.2**
New Ordinary Share Capital		13.8	6.3	0.0	40.6	0.0	**60.7**
Ordinary Capital Buybacks		16.3	5.7	0.0	0.0	0.0	**22.0**
Closing Ord. Equity Ex Minorities	120.6	126.7	138.0	156.8	217.6	241.9	**241.9**
Normalised IRR Cash Flows	**-120.6**	**24.2**	**23.8**	**30.4**	**5.4**	**296.3**	**259.6**
Normalised Earnings		**30.8**	**35.6**	**49.2**	**65.6**	**78.3**	**259.6**
Normalised ROE		**25.8%**	**28.1%**	**35.7%**	**37.0%**	**36.0%**	**32.5%**

directly to revenue. CAB will likely continue to acquire taxi networks, with acquisitions likely in states outside of NSW and VIC, due to further acquisitions in these states potentially triggering ACCC concerns. The company also stated that it will pursue initiatives with their Singapore partners, via CDC and CityFleet (UK).

Performance

The performance of CAB has been strong, with NPAT increasing by 36.3% from 38.0m to 51.8m over FY07. NROE also increased slightly over the period from 35.7% to 37.0%.

Performance Chart



	2004	2005	2006	2007	2008
Dist.	18.2%	19.2%	22.0%	26.0%	24.8%
Reinv.	7.6%	8.8%	13.6%	11.1%	11.2%
NROE	25.8%	28.1%	35.7%	37.0%	36.0%

CAB appears to focus on the following metrics; Total Revenue, EBITDA, NPAT and EPS. NPAT is forecast to grow to 61.1m. CAB announced on 19/02/2008 half year profit was $30.1m, which represented an increase of 17.7% from the half year profit in the previous corresponding period. Whilst this result was partially achieved on the back of a $406m equity raising in FY07, the numbers are still impressive with the forecast NROE set to come in at 36%. This is steady from the prior year, which had a NROE of 37.0%

Whilst the payout ratio has decreased from 62.2% to 60.9%, it has remained relatively steady over the last 5 years, fluctuating between 56% to 67%. Given the relatively high stable NROE and the opportunities for further acquisitions and NROE growth, it would be preferable for the dividend payout ratio to be reduced, diverting the retained funds to expanding growth opportunities.

Position

The balance sheet (Figure 1) of CAB is relatively strong. Over the past 5 years debt has remained low, with the debt to equity ratio never exceeding 30%. This is positive, given the recent developments in debt markets globally. Debt to equity is expected to remain at similar levels in FY08. The terms of CAB's debt is that $23m is repayable within 12 months, and $34.75m is long-term debt. The long-term portion is repayable by $3m in 2009, $13m in 2010 and $18.75m in 2011 financial year. Borrowings increased by $16.5m over FY07.

CAB issued $41.15m, amounting to 5.118m shares for the acquisition of shares in associate CityFleet (UK) Pty Ltd and subsidiaries, Newcastle and Arrow.

Cash Flow

Free cash flow has been relatively volatile over the past 5 years, with this metric decreasing from $38.4m to $24.3m during FY07. The decrease is on the back of declining net cash provided by operating activities and an increase in purchase of property, plant and equipment from $4.3m to $8.9m. The reason for the decline in operating activities was twofold, with the ratio of payments to suppliers, licensees and employees to receipts from customers and others increasing from 93.9% to 94.9% whilst purchase of property, plant and equipment also increased to $8.9m, up from $4.3m.

Cash flow has increased in FY08 on the back of increased operating cash flows and substantially decreased cash from investing activities.

Working capital decreased during FY07, down from $50.8m to $28.6m, which generally is a positive trend. However, this decrease has resulted primarily to an increase in short-term borrowings, outstripping a large increase in Trade and Other Receivables, which is a negative.

Management

During FY07, a new member joined the Board, Mr Hong Pak Kua. Mr Kua is the Managing Director and CEO of ComfortDelGro Corporation Limited. He was appointed to this position in 2003.

CAB also farewelled long serving Chief Financial Officer and Director, Mr Ewaz Barukh in FY07. Mr Barukh's departure gave CAB the opportunity to restructure senior management. A number of their senior staff stepped up to the plate to take on key management roles. This is seen as a positive, as intellectual knowledge is being retained by the company.

Seven of the eight directors have been members of the Board for over 6 years, with five of these having been members for over 10 years. Directors are not incentivised by share options, but rather through cash bonus reward schemes. The compensation structure is based on a number of factors including length of service, particular experience of the individual concerned, and overall performance of the company.

No information was provided in the Annual Report regarding the operational management team.

Summary

The company is well placed to withstand the implications of a slowing economy and the fallout of the US sub prime crisis. CAB has a strong balance sheet with low debt, coupled with increased profits being generated from larger Bank Issued Card Transactions and an overall increase in the average revenue per taxi.

Until recently, a major sticking point with CAB was the stark divergence between value and price. Since early February, the V/P has moved from around -25% to -8.7% (as at 17/03/08). As a value investor, one must always bear in mind that paying a premium not only reduces the possibility of making large returns, but also increases the risk of loss of capital.

StockVal: NEWS

Why Required Returns and APC must be adjusted

By Clime Investment Management MD John Abernethy

In the 2015 part fictional movie "The reincarnation of the USA Investment Banks" there is one memorable scene where George Bush, played by a grey haired Tom Hanks, is confronted by his advisor Robert J Smith, played by Gene Hackman, with extraordinary news. "Mr President, there is a Bear Stearns trader with a gun who has barricaded himself in a trading room and he is threatening to blow the bank up!" The President thinks to himself and with a grin and a smirk of pleasure he responds, "Bob, he won't need a gun to do that". There are chuckles all round.

I thought of this scenario when I heard a forecast by a financial commentator on Thursday, 20 March, that in "five years we will all look back on the day when the USA Federal Reserve took unprecedented actions and intervention in financial markets as the day the market commenced its recovery". It was enough to make a conservative investor (me) feel quite ill. The threat of recession, the dislocation of debt markets, the decline of the USA dollar, the threat of worldwide inflation and the ever-increasing oil price were all solved. What a powerful institution the USA Federal Reserve is.

So what has the Federal Reserve done?

1. Dramatically lowered the rate of interest it charges to Banks that need to borrow from it;

2. Increased by tens of billions the amount of money it is prepared to lend to Banks;

3. Allowed Banks to swap poor quality (sub prime) loans for the Reserves' holding of Treasury notes and therefore allow banks to raise further liquidity by trading these notes;

4. Extended the duration of its loans and swap facilities from overnight to 28 days, out to six months;

5. Allowed non bank institutions to borrow from the Reserve just like the Banks, and now brokerage houses (non deposit takers) can borrow from the Reserve for the first time ever;

6. Funded JP Morgan to undertake the acquisition of Bear Stearns; and

7. Lowered the rate at which banks are required to lend to each other overnight (i.e. if they actually wanted to).

It has probably done a lot more by intervening in currency and equity markets over Easter so as to create an air of recovery and stability. We will have to wait for the endless books, and of course the movie, to fully appreciate the extent of the intervention.

All of the above is positive for the recipient banks, brokers and non-deposit taking institutions. In essence it increases the margins and liquidity of these entities and should allow them to produce profits on a part of their business to offset the declines in profits and write-offs that they will suffer elsewhere. It may even allow them to avoid further write downs, as some bad loans have been swapped into the Federal Reserve and are thus out of sight from their auditors.

The actions of the Federal Reserve indicate the seriousness of the issues that are confronting US banks. So for how long will the Federal Reserve have to lend to, swap with, underwrite and discount loans to the Banks and others to get the USA debt and capital markets to operate independently of assistance?

No one knows the answer to this, but the response of the equity markets indicates that immediate Bank liquidity concerns have been addressed. Australian Banks have recovered due to the expectation of some relief in the wholesale debt markets. Access to offshore markets for Australian Banks had been seriously affected and credit spreads had ballooned. It is likely that spreads will decline now, though not likely back to levels that were available some 12 months ago.

One of the risks for investors is that the euphoria of the Reserve intervention creates a feeling that the worst is over and that markets can return to the business climate of 2006/07. This would be the wrong approach. The world has changed dramatically and in many ways. The world is entering a period of slower economic growth. World interest rates will be higher than the previous five years because inflation will become an increasing issue. The inflation in the US will be a result of a lower dollar, higher oil prices and the increase in inflation exported from China. Similarly, inflation in Australia will be affected by Chinese imports and interest rates in Australia are substantially higher than they were just 12 months ago.

As a consequence we are continuing to make the following adjustments to valuations in StockVal:

1. Adjusting Required Returns up to reflect the increase in interest rates and the risk of increases in inflation. Quite simply, this means if you can now receive 7% for money in the bank as opposed to 5% just six months ago, then clearly you must increase your Required Return when holding an equity.

2. Reviewing the "APC" of all companies with our general expectation that business performance of the last three years will be very difficult to sustain with the slowing of economic growth.

As always, we do not attempt to forecast the direction of markets. The extreme volatility being witnessed at present is symptomatic of troubling times. There is no quick fix to the unwinding of debt across the western economies. Short-term periods of euphoria are likely to be matched by periods of despair.

In this environment we must become very disciplined in our valuations and just as disciplined in not being panicked into buying shares by market commentators whom would convincingly argue that the next recession just finished.

StockVal: MEMBERSHIPS

What to become a member of StockVal?

Prices quoted include GST. Membership benefits include:

- Over 400 live valuations
- Fortnightly newsletter
- Phone and email access to a team of analysts

Membership type (initial)	Investment
12 months membership	$1795
2 years membership	$2395
Renewal type (following initial membership)	**Investment**
12 months	$1249
2 years	$1895

INFORMER bulletin board

Where's the Value? seminars

Where's the Value? is a two hour evening seminar presented by Roger Montgomery and covers everything you need to know to become a more certain and more successful value investor.

Over two hours you will learn how to apply Clime's common sense, long-term approach to investing that aims to purchase shares of wonderful businesses at rational prices. Using case studies as examples, you will discover the importance of return on equity in calculating a company's value and learn how to distinguish a wonderful company from a mediocre company.

- Learn what's causing the current market conditions;
- Find great value, particularly during corrections;
- Understand the difference between a wonderful company and a mediocre company; and
- Purchase shares of wonderful businesses at cheap prices.

Cost: $65 per seat ($99 for two) and includes Roger Montgomery's DVD on value investing that explains how to use StockVal to value businesses and invest in wonderful companies.

DATE	CITY	VENUE
Thursday 15 May	**Albury**	Sundownder Albury Paddlesteamer
Thursday 5 June	**North Sydney**	Vibe Hotel North Sydney
Thursday 12 June	**Sans Souci**	St George Motor Boat Yacht Club
Thursday 19 June	**Melbourne**	Telstra Conference Centre
Thursday 31 July	**Perth**	The Chifley on the Terrace
Thursday 14 August	**Adelaide**	Mercure Grosvenor Hotel
Thursday 28 August	**Bowral**	Bowral Golf Club

CLIME investment options

Clime is unique. In every aspect of our business and relationships we tackle the challenges that face us as portfolio managers a little differently. Even though such an attitude is uncommon, we consider our clients as partners and treat them as such.

Clime is independent and 100% locally owned. Unlike other managers, we are clear about our fees and do not hide expense recovery clauses in our documents. We hope you are as excited about our low cost, fee for performance, focused investing services as we are proud to present them to you.

Clime High Yield Underdogs Fund

Minimum investment: **$10,000**
Minimum additional investment: **$5,000**

- Nil management fee
- Nil entry fee
- Nil contribution fee
- 1% withdrawal fee within 1st year
- 10.25% performance fee
- 0.67% p.a. Recoverable Expenses

Clime Value Growth Fund

Minimum investment: **$20,000**
Minimum additional investment: **$5,000**

- Nil entry fee
- Nil contribution fee
- Nil withdrawal fee
- 1.03% management fee calculated monthly
- 15.38% performance fee charged only when Clime outperforms the 12% per annum benchmark
- 0.52% p.a. Recoverable Expenses

Discrete Share Portfolio Service

Minimum investment: **$500,000**
Minimum additional investment: **$25,000**

- Individually Managed Account Service
- Nil entry fee
- Nil exit fee after 5 years
- 1.1% annual management fee*
- 20% performance fee charged only when Clime outperforms the ASX S&P 200

If you would like to discuss an investment partnership with Clime further, please call 1300 788 568 or visit clime.com.au to download a Product Disclosure Statement.

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