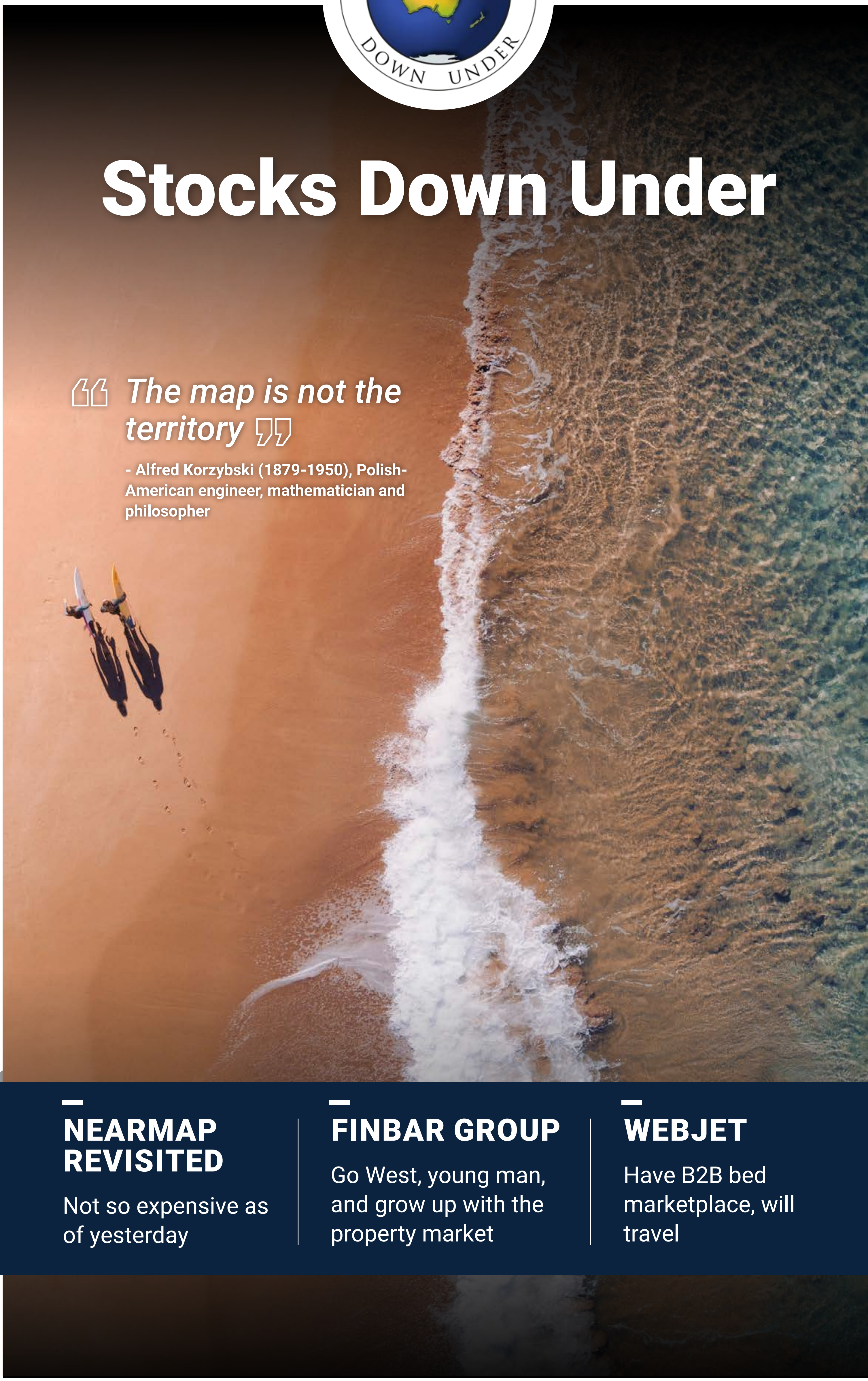
31 JANUARY 2020

Stocks Down Under



> *The map is not the territory*
>
> **- Alfred Korzybski (1879-1950), Polish-American engineer, mathematician and philosopher**

NEARMAP REVISITED

Not so expensive as of yesterday

FINBAR GROUP

Go West, young man, and grow up with the property market

WEBJET

Have B2B bed marketplace, will travel

NEARMAP REVISITED

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Stocks Down Under rating: ★★★

ASX: NEA
Share price: A$ 1.71
Market cap: A$ 774M

We wrote about Nearmap in Stocks Down Under on 17 January and rated it only two stars. Our key message two weeks ago was that NEA was quite expensive at an 11x price to revenue multiple for the current financial year (FY20 ending June), given the market disappointment over the FY19 numbers back in July.

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ASX:FRI
Share price: A$ 0.86
Market cap: A$ 238M

From early 2014 something unusual happened in Western Australia – the state's population growth began to lag the growth rate of the rest of the country. That unhappy demographic has depressed local property prices for a while, but daring property companies, like Finbar Group, have pressed ahead with new developments. We believe that now is a great time to be backing Finbar as Western Australia starts to get back its growth mojo.

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ASX:WEB
Share price: A$ 12.01
Market cap: A$ 1.75BN

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Share price chart

Source: Tradingview

Now, everyone likes to be right, and so do we, but we didn't expect to be right on NEA quite so quickly. The company issued a revenue warning on 30 January, which took the stock down by 30% at the closing point of the day. The question for investors is: Now what?

Lower FY20 guidance for ACV

During the AGM in November, NEA told the market that it expected the so-called Annualised Contract Value (ACV) for the current financial year to end up somewhere between \$116m and \$120m. ACV is a yardstick that essentially tells you how much revenue all customers on NEA's books today would generate if they all stay on as customers for the next twelve months. ACV is a good proxy for future revenues.

However, when the company released its preliminary results for the first half of the current financial year yesterday, it indicated that the ACV is now expected to be in the range of \$102m to \$110m, i.e. 8% to 12% lower than previously stated. Is that a big deal? The market certainly seems to think so given NEA's share price reaction.

How bad is it, really?

During the last six months, three customers in the US either left NEA or downgraded their existing contract with the company, resulting in a 20.6% churn compared to 1HY19, according to the company. ACV for the US business grew from $22.7m at the end of June to $24.9m at the end of December, which is roughly half of the ACV growth the company experienced in the same six months a year earlier.

Two of the three US customers in question are active in the autonomous vehicle space, which apparently has lower mapping requirements going forward. Hence, the lower ACV from these two customers. The third customer, which cancelled the entire contract with NEA, apparently had legal issues to deal with. If you believe NEA, this meant that this customer had no future requirements for NEA's aerial imaging services.

To put NEA's US numbers into perspective, the company's Australian and New Zealand business achieved an ACV of $61m in the first half of the year, which is an additional $3.1m in ACV won during the period. These numbers imply ~5% ACV growth during this period, or roughly 10% annualised.

While 10% is nothing to be sneezed at, we believe ANZ is not the future for NEA….the US is. Which is where the steep share price drop comes from; investors were banking on the US delivering high ACV growth in the next several years. But just for the current financial year, they're getting 30% to 40% ACV growth instead of the promised 48% to 53%. Is that a bad thing? Yes, it is. But we wonder if these issues might not be short-lived, presenting opportunities for investors to get in at much lower prices.

Never catch a falling knife

One of the more popular phrases we use at the Stocks Down Under trading desk is "Never catch a falling knife", i.e. don't buy companies whose shares seem to be in freefall. Rather, wait it out until prices have stabilised, at least in the short term. Then re-assess the situation. We'd say the same thing about NEA right now.

However, if you believe NEA's low ACV growth in the US will be a short-term, or one-off issue, there is now an opportunity to buy the shares 30% cheaper than a few days ago and 35% cheaper than on 17 January.

In our view, the US is still a highly attractive market for NEA, and large enough to substantially grow revenues over a long period of time. At a current Enterprise Value (EV) to sales multiple of ~9x for FY20 and 6.7x for FY21, assuming FY20 and FY21 revenues will come in 10% lower than the market previously assumed, we believe NEA is starting to become attractive again.

Never catch a falling knife, but we are bumping up NEA to a three-star rating on the back of a much more attractive valuation. We'll keep our eyes open for a good entry point.

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From early 2014 something unusual happened in Western Australia – the state's population growth began to lag the growth rate of the rest of the country. That unhappy demographic has depressed local property prices for a while, but daring property companies, like Finbar Group, have pressed ahead with new developments. We believe that now is a great time to be backing Finbar as Western Australia starts to get back its growth mojo.

Share price chart

Source: Tradingview

Finbar is Western Australia's largest developer of apartments, although it also does commercial real estate. You can see its residential handiwork all over the better parts of Perth, the state capital, in buildings such as Fairlanes (East Perth, 2012), the St Marks Apartments (Highgate, 2013) and Spring View Towers (Rivervale, 2015). Not long ago, in 2017, Finbar completed the tallest residential building in the state, the 38-storey Concerto building on Adelaide Terrace in East Perth. So, it's fair to say that this company is something of a local icon.

An optimistic company

The impressive thing about Finbar is that when Australia's 'resources boom' ended around 2011, after an eight year run, the company chose to maintain a large pipeline of new developments for as long as the downturn lasted, which ended up being around five years. Western Australia, population 2.6 million, is a state that rises or falls on the strength of the mining industry, and with around four-fifths of its population in Perth, that city's property market was bound to suffer after 2011. The peak wasn't until late 2014 but since then prices have come down around 15-30% depending on where you look. All that time, optimistic Finbar maintained a pipeline of well in excess of a billion dollars in future projects. Mind you, it did gradually scale that pipeline back from 2015 in order to be financially prudent – this is, after all, a company that likes to keep its debt levels low.

Basically, Finbar management was betting that Western Australia would eventually get its traditional growth mojo back. Between 1981 and 2012 the state enjoyed average annual population growth around 0.7% higher than the rest of the country, as migrants from around Australia and around the world moved to Perth for the (ordinarily) bounteous job opportunities, the great lifestyle, and the (ordinarily) lower cost of living. And no wonder - this city consistently rates as one of the 30 most liveable cities in the world (it was 21 on Mercer’s 2019 list, for example). Then, from 2013, with Western Australia not generating many new mining-related jobs anymore, there was a net outflow of people from the state that has yet to correct itself, and that in turn depressed the overall population growth rate from 2014.

The West’s ‘normal’ growth rate will resume shortly

What’s interesting to us is that the trough in terms of comparative population growth was the March 2017 quarter when Western Australia only grew 0.6% year-on-year but the rest of the country grew a massive 1.8%. Since then the West has been playing catch-up as the resources sector recovers, and on present trends the ‘normal’ rate of growth which favours the West will resume around the middle of next year. Finbar’s share price has been recovering since the 75-cent level of January 2019. We think it will keep recovering so long as the net population outflows from Western Australia continue to ease up.

Which brings us back to Finbar the company, which in FY19 recorded its 23rd consecutive annual profit - $11.7m at the NPAT line, on $154m in revenue. Property prices have yet to recover in Perth, but as at mid-2019 the company had a pipeline of $1.2bn in future apartment buildings. A lot of these apartments will start to deliver into what is likely to be a rising market from next year, and with Finbar’s balance sheet relatively clean so as to support this pipeline, the company appears set for a reasonably good FY20.

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Share price chart

Source: Tradingview

The first thing to remember about Webjet is that this is a company in very strong growth mode. In FY19 Webjet grew revenue 26%, to $366m, and EBITDA 43%, to $125m. This was a record for Webjet and a lot of it was organic growth. This is not a company with troubled businesses in danger of being swept away by the next big thing in online travel that Alphabet or Facebook cook up.

Webjet is a very powerful brand

Part of Webjet's success has to do with the power of the original brand. It's hard to turn on a television in Australia and not see, during an ad break, the familiar logo of the white computer mouse in the shape of a jumbo jet against a red background and the name Webjet in red in the tail of the jumbo. Webjet has used this advertising for its original OTA – Online Travel Agency – for so long that it's hard for consumers not to know where it stands. We think that's why Webjet has lasted so long in this world of rapid online change. Indeed, in FY19 revenue for the Webjet OTA was only up 3% and EBITDA 4% but the business still enjoyed an amazingly high EBITDA margin of over 40%.

Which brings us to the thing that is going very well for Webjet at the moment, the WebBeds unit, an online B2B supplier of hotel rooms to the travel trade, which Webjet started from scratch in 2013. In FY19 WebBeds grew its bookings by 51%, which resulted in a 61% revenue increase to $185m and a more than doubling of EBITDA, from $27m to $63m. In just six years Webjet has grown a new business as profitable as its old business, and, as a result, headed off the day when creative destruction might have a chance to destroy shareholder value for many years.

Organic growth in WebBeds 30%!

Sure, part of WebBed's growth over time has from acquisition, most notably Destinations of the World, bought for USD$173m in late 2018, but WebBeds has also shown that it has the industry smarts to lead this emerging market category by quickly realising synergies from the acquisitions. Remember, organic growth for WebBeds in FY19 was a massive 30%. B2B 'bedbanking' is a category that Webjet can own globally in a way that it was never positioned to own in its original OTA space.

Now, don't get us wrong. We understand that the travel industry will likely take a hit globally for the next four months from the dreaded Wuhan Coronavirus. However, that doesn't mean people won't be traveling or staying in hotel rooms in the part of the world that is, by and large, not impacted by the virus, which is the vast majority of it. Also, as SARS showed in 2003, global travel volumes can roar back quickly after a crisis like this. And, don't forget, travel around the world remains a strong growth industry, consistently exceeding GDP growth in the most advanced and emerging economies around the world from year to year. Webjet with WebBeds is positioned at a key and vital intersection of this growth trend.

For all that Webjet is current trading on a P/E of only 16x FY20 consensus earnings, dropping to 13.8x FY21. That looks relatively inexpensive given the growth profile of WebBeds and the resiliency of the Webjet OTA. Shorts, pay attention. You may be about to get burned.

Pitt Street Research Pty Ltd

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