STOCKS DOWN UNDER

13 DECEMBER 2021

ASX Top 200 Stocks Down Under

Someone asked me, if I were stranded on a desert island what book would I bring: 'How to Build a Boat.

- Steven Wright (b. 1955), American comedian

ASX

EXCHANGE CENTRE

CORPORATE TRAVEL MANAGEMENT

In the cockpit for industry consolidation

PEXA GROUP

No longer a growth stock

BSP FINANCIAL GROUP

A synonym for no liquidity

CORPORATE TRAVEL MANAGEMENT

In the cockpit for industry consolidation

Stocks Down Under rating: ★★★

ASX: CTD
Market cap: A$3.1BN
Dividend yield: 0.9% (50% Franked)

52-week range: A$15.56 / A$25.90
Share price: A$23.02

In March 2020 it was no longer business as usual for Brisbane-based Corporate Travel Management. The global travel service provider was beginning to feel the effects of grounded corporate travel due to the Coronavirus. The stock crashed to its lowest level since 2013, but quickly returned to pre-pandemic pricing. With the share now up 17.7% over the last 12 months, we wonder if the market has given too much credit to the company in an environment where corporate travel is not the same — and may never be again.

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Market cap: A$3BN

52-week range: A$14.85 / A$18.50
Share price: A$16.88

It seems that there can only be one group of shareholders that are happy with the Melbourne-based Pexa Group, i.e. only those who bought between 9 September 2021 and mid-November are. Investors who bought in at the 1 July 2021 IPO price are sitting on an unhealthy 1.9% loss. Since this is by far the largest digital property settlement platform in Australia, the poor performance of the stock during such a hot property market is cause for concern. But don't be fooled into thinking the stock is now a steal, because this stock's valuation is still balancing on stilts.

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Dividend yield: 7.2% (0% Franked)

52-week range: A$4.25 / A$5.65
Share price: A$4.27

New Guinea-based BSP Financial Group IPOed on the ASX on 25 May 2021 and with 116 branches and subbranches across its mostly Pacific-based network, BSP has K23bn ($8.7bn) in deposits across approximately 2.7m customer accounts. However, the company has a lot of risks ranging from virtually non-existent trading liquidity to currency exposure and the very regions it operates in. Unfortunately, BSP seems to be a synonym for no liquidity and a non-risk adjusted valuation.

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Share price chart

Source: Tradingview

Travel volumes down

Corporate Travel Management (CTM) offers travel services across the corporate, events, leisure, loyalty and wholesale markets. The group operates in four segments, which are classified by geography — Australia/New Zealand, North America, Europe/UK and Asia with approximately 75% of revenue derived outside ANZ. Regular business meetings typically come to mind with corporate travel, but CTM provides other support too, like helping workers relocate by arranging for travel, accommodations and personal property transport. Rather than managing their own travel, customers turn to CTM to save money and focus on their core businesses. CTM's strength lies in its technology platform, which it effectively leverages to command a significant share of the global corporate travel market.

Managing director James Pherous has been with CTM for more than a decade now and leads a strong leadership team. He is also the largest shareholder with a 14% stake in the company. We like it when corporate executives have a lot of skin in the game as Mr. Pherous does. Lately, CTM management has had to navigate the extreme circumstances brought on by COVID-19. Due to government restrictions and corporate policy decisions, many businesses banned or limited travel. The wave of uncertainty resulted in suspended earnings guidance, cancelled dividend payments and cost containment measures, such as staff reductions and discretionary spending cutbacks.

The rough last three months of FY20 dragged down results at CTM. Total transaction value (TTV) was down 29% to $4.56bn, revenue fell 22% to $349.9m and underlying EBITDA plunged 57% to $65m.

Things got worse in FY21 with a full six months of constrained COVID-19 trading conditions, followed by the Delta strain emerging towards the end of FY21. TTV dropped 65% to just $1.6bn, revenue was down 43% to $200.5m and underlying EBITDA swung to a loss of $7.2m.

Industry consolidation in the flight plan

CTM's business hit rock bottom in late April 2020 and it has been in slow recovery mode ever since. Corporate travel plans have largely been contained to domestic trips, but this suits CTM just fine. Prior to COVID-19, more than 60% of its transactions were domestic. This contrasts with most industry peers, like Brisbane-based Flight Centre Travel Group (ASX: FLT) which relies heavily on international travel. What also gives CTM an edge in this environment is its exposure to essential travel. A significant portion of revenue comes from essential service providers in the government, health care, construction, logistics, mining, energy and utilities sectors.

To CTM's credit, its strong liquidity position heading into the pandemic allowed it to forego equity raises. As at 30 June 2021, it had $99m in cash, no debt and access to a $110.6m credit facility. The group returned to profitability in April 2021 and recorded a positive underlying EBITDA of $13.6m in 4Q21 thanks to strength in the ANZ and Europe/UK regions. As at CTM's FY21 result, ANZ business activity had recovered partially, bringing revenue to 40% of its pre-COVID-19 level during 4Q21. Still, 60% is a long way to go.

CTM raised $375m equity late last year, but this raise allowed the company to grab a consolidation opportunity. In September 2020 it acquired United States-based travel management company Transport & Travel for $274.5m. The move strengthens CTM's position in the key US market, which has become its biggest revenue source. Including synergies, the deal is also expected to be 30% earnings accretive. With travel volumes still down relative to 2019, further industry consolidation is probably forthcoming as travel management companies look to go the inorganic growth route to achieve scale.

From a financial standpoint, CTM is in a strong position to recover, but how well demand will recover is another question. Although there is likely to be some amount of corporate travel that returns, the way companies conduct business may be forever changed. Many have embraced and invested in technology that supports remote meetings. With Zoom and Teams meetings now the norm, many firms are expected to adopt a hybrid model reserving travel solely for critical face-to-face circumstances.

Leaning more on virtual meetings will certainly be more budget-friendly and make it more difficult to justify booking those expensive business class seats. We therefore see corporate travel undergoing a secular shift whereby it is considered appropriate to deploy technology in situations that previously involved travel.

Looking to a post-COVID-19 world

CTM's share price was briefly back above $25 for the first time since 2019. Expectations are for a strong return to full year profitability in FY22. However, with profits expected to still be well below pre-pandemic levels with the current market consensus placing EBITDA at $111.1m for FY22 and $210.8m for FY23, it doesn't add up that the share price is where it is, in our view.

The 28x consensus EV/EBITDA multiple for FY22 drops to 14.8x by FY23, but this is still too much to pay especially given the uncertainty around the global corporate travel recovery. Looking past the initial recovery stages to FY24, the market is not expecting much from CTM. In FY24, the market currently expects EBITDA to grow to $246.5m, i.e. only about 17%, which is a far cry from the near-100% EBITDA growth expected in FY23.

We are also concerned by a pair of on-market trades placed by CTM insiders earlier this year when the stock was making its initial ascent. On 16 March 2021, James Pherous trimmed his holdings by $31.5m when CTM was trading around $18. Just over a month later, Director Laura Ziolkowski sold just over $1m worth of the stock.

We like CTM's newfound scale in the US market and its potential for more acquisitions to bolster its market position. However, at the current valuation we believe the upside potential is adequately priced in. Additionally, from a charting point of view, investors seem to be unsure where CTM stock may be going next. The initial uptrend post the Corona Crash has been broken and the stock is currently hovering around a longer-term support/resistance level (depending on how you look at it). We believe the shares may be rangebound for a while. Therefore, its three stars from us as we look towards FY24.

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Share price chart

Source: Tradingview

The first to meet the need

The idea behind Pexa can be traced all the way back to 2008 when the Rudd Government and state premiers agreed to the framework behind a national electronic conveyance system. This system was pegged as saving an estimated $250m a year by reducing the costs of buying and selling property through streamlining the process. In fact, the removal of much of the literal paperwork alone must have saved a considerable amount in paper costs, let alone processing manhours.

The system design truly began in 2010, when a company majority-owned by the state governments of Victoria, New South Wales, Queensland and Western Australia, called the National E-Conveyancing Development Limited (NECDL), signed a master agreement to design the platform. The actual platform was named Property Exchange Australia (PEXA). Fast forward to 1 July 2021 and the company (now named the Pexa Group) IPOed on the ASX at $17.13 per share, raising a staggering $1.2bn.

Due to its historical origins as the first company granted access to this technology, it should be no surprise that the Pexa Group has quickly grabbed the vast majority of Australia's annual property transfers. Putting this into numbers, during FY21 the PEXA Exchange facilitated 80% of all Australian property transfers and we don't see Pexa losing its market share anytime soon. In fact, on 23 September 2021, the Pexa Group announced it had received approval to launch in the Australian Capital Territory (ACT).

Pexa Group's current jurisdictions have strong penetration with NSW, Vic, Qld, SA and WA seeing relatively strong penetration. The Pexa Group defines jurisdiction penetration as the percentage of total transfers lodged through the PEXA Exchange. As of FY21, it captured 96% in NSW, 98% in VIC, 62% in QLQ, 94% in SA and 78% in WA. It is important to note here, that NSW and VIC have been at these levels of penetration since approximately August 2019, SA spiked from 78% in April 2020 to its current level in June 2020. From a pure market share perspective, QLD, WA and ACT are the only jurisdictions where this type of growth is currently viable. While not the worst problem to have, it does restrict future growth rates as VIC, NSW and SA account for 76.3% of FY21's total revenue ($219m).

Growth is slowing, kinda

The Pexa Group generates revenues through the fees it charges for the use of its comprehensive platform. The platform not only handles the transfer of property ownership, but provides a secure environment for all parties to upload documents and conduct due diligence (PEXA Workspace), it facilitates the monetary settlement and dispersion through electric funds transfer with the Reserve Bank of Australia (RBA) as well as lodgement of documents with the local Land Titles Office.

Fees are based on the volume and lodgement type of the property transaction, with fees payable once the transaction has settled. This is why the growth in transactions is so important for the Pexa Group as its revenue is heavily dependent on it. While the company technically has not yet generated a Net Profit After Tax (NPAT), it has generated an EBITDA profit. If you exclude the $36.6m in interest expense incurred during FY21, the company achieved a NPAT of $24.8m. It is not clear what we should expect the interest expense to be during FY22, because, as part of its IPO, the Pexa Group repaid $400m in interest bearing loans. The company still has $300m in unsecured, interest-bearing debt outstanding, though. Management's current forecast has revenue climbing 12.7% to $246.9m in FY22, resulting in a loss after tax of $2.5m, therefore, we believe a large portion of this loss reduction is likely to come from a reduction in interest expenses.

As the title of this section says, growth is slowing, kinda. Using the Pexa Group's website and web.archive.org, we were able to estimate the company's growth in members engaged with the network and number of property transactions processed approximately between 2018 and October 2021. From 2018 through 2020, the number of members engaged with the network grew from 5,300 to 9,459 and the total number of property transactions increased from 701,386 to 6,881,992. While the total number of transactions has increased at a greater amount each year, the percentage growth of the new transaction has seen a sharp decline (each year it has been growing at a declining rate). In 2018 total transactions increased by 211.3%, 87.3% in 2019 87.3% and 68.3% in 2020. When we factor in the company's high level of market saturation in NSW and Victoria, this declining growth rate is not surprising. We don't expect to see this rate increase drastically anytime soon.

In other words, as the Pexa Group aims to finally become profitability, it is no longer a growth stock. Yes, we expect growth to continue, but the years of more than 200% transaction growth are well behind us.

The problem with Pexa's transition

Management chose to IPO the Pexa Group at $17.13 per share. But even at the stock's current, lower, share price, the valuation suggests that Pexa Group is still a growth stock.

The company has guided to EBITDA growth of only 5.6% in FY22 with the market estimating 7.1% growth in FY23. However, the stock is currently valued at an FY22 and FY23 EV/EBITDA ratio of 31.1x and 29.4x, respectively. For a stock that does not offer a dividend and with this level of expected EBITDA growth, this valuation is way too high, in our view.

There is one potential share price catalyst that could justify part of the stock's current valuation. Management knows that it has achieved almost complete Australian market penetration and due to the similarity between Australian and England's legal systems, believes it can easily expand into England. This expansion is underway, but the company hasn't provided any updates. But even factoring in potential growth in the UK, we believe the valuation is excessive and, therefore, Pexa Group is a two-star stock in our book.

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Share price chart

Source: Tradingview

Conquering the Asia Pacific region

BSP Financial Group has made significant strides in capturing market share in the Asia Pacific region, excluding China. Currently, the bank operates in Papua New Guinea (its main base of operations), the Solomon Islands, Fiji, the Cook Islands, Samoa, Tonga, Vanuatu, Cambodia and Laos. These countries all have two things in common, i.e. a need for financial services and high levels of economic and political risk. For CY20, the World Bank put Papua New Guinea, Cambodia, the Solomon Islands, Vanuatu and Samoa's total GDP at US$56.5bn (it did not report on Laos, the Cook Islands and Tonga for CY20), or approximately 24.1% of the Commonwealth Bank of Australia's total market capitalisation.

Unfortunately, while the small size of these economies offers higher than average returns, the risks are significantly magnified as well. And the risks are beyond standard default risks for a bank. For this part of Asia Pacific, natural disasters, insurgencies and less than average accountability from governments, courts and highly volatile currencies are arguably why the reward needs to be higher than average.

The details make the result less impressive

In 1HY21 (calendar year), BSP saw its net profit increase 17.9% year-over-year to K449.3m (Myanmar Kyat) on the back of an 8.4% increase in revenue (K1.1bn). Unfortunately, the discrepancy between net profit growth and revenue growth was not due to an expanded Net Interest Margin (NIM) or lower operating expenses, but rather to a decline in impairment expenses. Compared to 1HY20, impairment expenses declined 43.9%, but both operating expenses and income tax expenses increased faster than revenue did during 1HY21, at 8.6% and 22.4%, respectively. In fact, while BSP has an impressive NIM at 6.4%, this is hardly surprising considering the risk and reward considerations we mentioned above, and unfortunately, BSP's NIM has been declining since 2HY19.

A case study in low liquidity

Sure, BSP only listed on 25 May 2021, but the company's lack of liquidity is worse than most of the micro caps we cover. And no, this is not a case of shares not being available, BSP currently has a free float of 62.3%. Over the last three months the daily average volume was just 4,800 shares, or $20,496 (at Friday's closing price). Still, that's the average and so far, the vast majority of days traded have seen zero shares traded and we don't see much management action to change this dynamic. Unfortunately, BSP's banking services are in countries with greater amounts of risk and despite the 7.2% indicative annual dividend yield, we believe the liquidity and geographic risk alone precludes this stock from a four-star rating.

Still, forgetting the risks, BSP just is not growing quickly enough, in our view, to justify its Price/Tangible Book value (P/B) of 1.5x and trailing 12-month P/E ratio of 5.8x, significantly higher than other, faster growing, Australian-based banks.

BSP grew its Net Profit After Tax (NPAT) by 17.6% in 1HY21 (calendar year). But when we compare it to a four-star turnaround stock like the Bank of Queensland (ASX: BOQ | see 20 September 2021 report) – at a P/B ratio of 1x and a trailing 12-month P/E ratio of 12.7x – we can see that BOQ was growing at a much faster rate of 21.4% in FY21 (adjusted for FY20's $175m COVID-19 loan impairment expense). Additionally, the Bank of Queensland does not have exposure to the extremely volatile Papua New Guinean Kina on which BSP bases its results. All-in-all, BSP gets a two-star rating from Stocks Down Under.

Pitt Street Research Pty Ltd

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