STOCKS DOWN UNDER

10 JUNE 2022

ASX Small Caps Stocks Down Under

> ***Reputation, you know – [takes] a lifetime to build, seconds to destroy.***

- Robert De Niro (b. 1943), Film producer, director and actor

ISELECT

We'll believe things are turning around when we see it

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Stocks Down Under rating: ★★

ASX: ISU
Market cap: A$33.6M

52-week range: A$0.14 / A$0.55
Share price: A$0.145

If you thought some of the ASX IPOs over the past couple of years were a disaster (such as Nuix and Youfoodz), you haven't heard of iSelect (ASX: ISU). It listed in 2013 at $1.85, but now trades at barely a fraction of that. We last covered this company in December 2020 and gave it two stars, thinking there were more questions than answers in relation to its growth outlook. Are things any better 18 months on?

Share price chart

Source: Tradingview

iSelect is a comparison service, helping Australians save on their insurance and utility bills. iSelect gets paid a commission by the company it refers its users to as a percentage of the policy, product or plan that the user buys. It receives both an upfront commission along with an ongoing trailing commission when the user sticks with the policy. Competitors include Canstar, Compare the Market and Finder.

The tip of the iceberg looked good. But...

From an investor perspective, iSelect looked like a good company at first glance. Most notably, it was an Internet-based business with low capital intensity that theoretically just had to sit back and watch the cash come in. Who doesn't like the idea of a cheaper insurance deal? Unlike some other competitors, it was not owned by an insurance company – theoretically drawing more consumers wanting an unbiased opinion on what was best for them. And the cherry on the cake was that iSelect was still led by its founder Damien Waller. He founded the company in 2000 after a post-university stint at Goldman Sachs and ran it to that very day. Waller's inspiration for the company came after breaking his arm in a roller-blading accident and realising how difficult it was for the average person to compare health insurance policies.

Unfortunately, the business model was never that simplistic. And whatever sweeteners the company had become sour. The company listed at $1.85 per share in 2013, raising $215m, but today is less than a tenth of its listing price.

The reality is that iSelect is no eBay or CarSales. It has no pricing power or network advantage - given the competitive nature of the comparison website market - and there is no commission paid until a policy is bought. It's not as if insurers have to pay to be listed on the site, let alone have the choice of either listing on the site or risk missing out on a significant portion of would-be customers. And even when a policy is bought, much of the 'profit' included in iSelect's books doesn't actually show up in the company's bank account until sometime later given that part of the commissions are trailing (meaning they are paid down the track as consumers continue to hold the policy and pay their premiums).

Adding insult to injury

Sometimes, investors will overlook structural disadvantages, such as those listed above, if the company's thematic is hot (or if the market generally is a bull market) and the company is free of internal turbulence.

The rot began on iSelect's IPO day, with a drop triggered by major shareholder Spectrum Equity Investors cashing out of the company. The private equity firm's trade was one shareholders didn't expect, but one executed by the IPO's own joint lead manager Baillieu Holst. Spectrum cashed out because it was worried about the impact of the withdrawal of United States central bank stimulus on iSelect. Other investors worried about Spectrum's withdrawal quickly followed them to the exits, with the most prominent being Wilson Asset Management. And the company missed its first prospectus forecasts. The run of poor results continued over the years and, in 2017, Damien Waller departed and cashed out, netting over $45m.

By the start of the pandemic, things had not improved and the hits continued. Remember, the pandemic began in March. This is typically the biggest time of year given the 1 April 'roll over' date for health insurance policies. When the pandemic began, insurers deferred their annual rate increases and elective surgeries were suspended, thereby reducing the need and utility for health insurance comparisons. In October 2020, the ACCC handed the company a $8.5m fine for false and misleading conduct during the last decade. iSelect claimed it recommended the most suitable or competitive plans when it actually did not. This was by virtue of not offering all plans in the market, thanks to commercial arrangements with its partner retailers and not disclosing that certain cheaper plans were only available via the phone. Consumers could have found a better deal had they shopped around or used the government's comparison site.

Don't catch a falling knife

In the last 12 months, the fall has continued – the stock sits over 50% lower than it did in June last year. In FY21, its results were better than in FY20, but the company still made an NPAT loss of $5.1m compared to $43.5m in FY20. It made $110m revenue compared to $123m a year before. In 1HY22, it made an NPAT of $0.5m, but its revenue fell from $51.8m to $44.6m. The company has a cash balance of $12.4m. The company admitted trading conditions were more challenging, particularly in energy with prices at low levels.

We normally like to look at consensus estimates for a company, but none exist for iSelect. And, in any event, the past decade has shown this company is too unpredictable. Its current trailing EV/EBITDA is 7.8x, a multiple that's far from excessive, but we think there are better companies out there for a similar price or worth a greater premium.

Investors might be hopeful higher energy prices over the coming months might bring consumers flocking to iSelect for a better deal. But there is little incentive for consumers to pick iSelect over its competitors. The company's current golden goose is the recent $26.6m investment into B2B comparison technology platform Cimet, unveiled at its 1HY22 results. While iSelect spruiked that Cimet has 50,000 users a month, it is loss-making and makes just $5m a year in revenue. And iSelect shares continued to fall post-acquisition.

After the dour last decade shareholders have suffered, it's difficult to imagine the one ahead will be substantially better. Therefore, it's two stars from us.

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