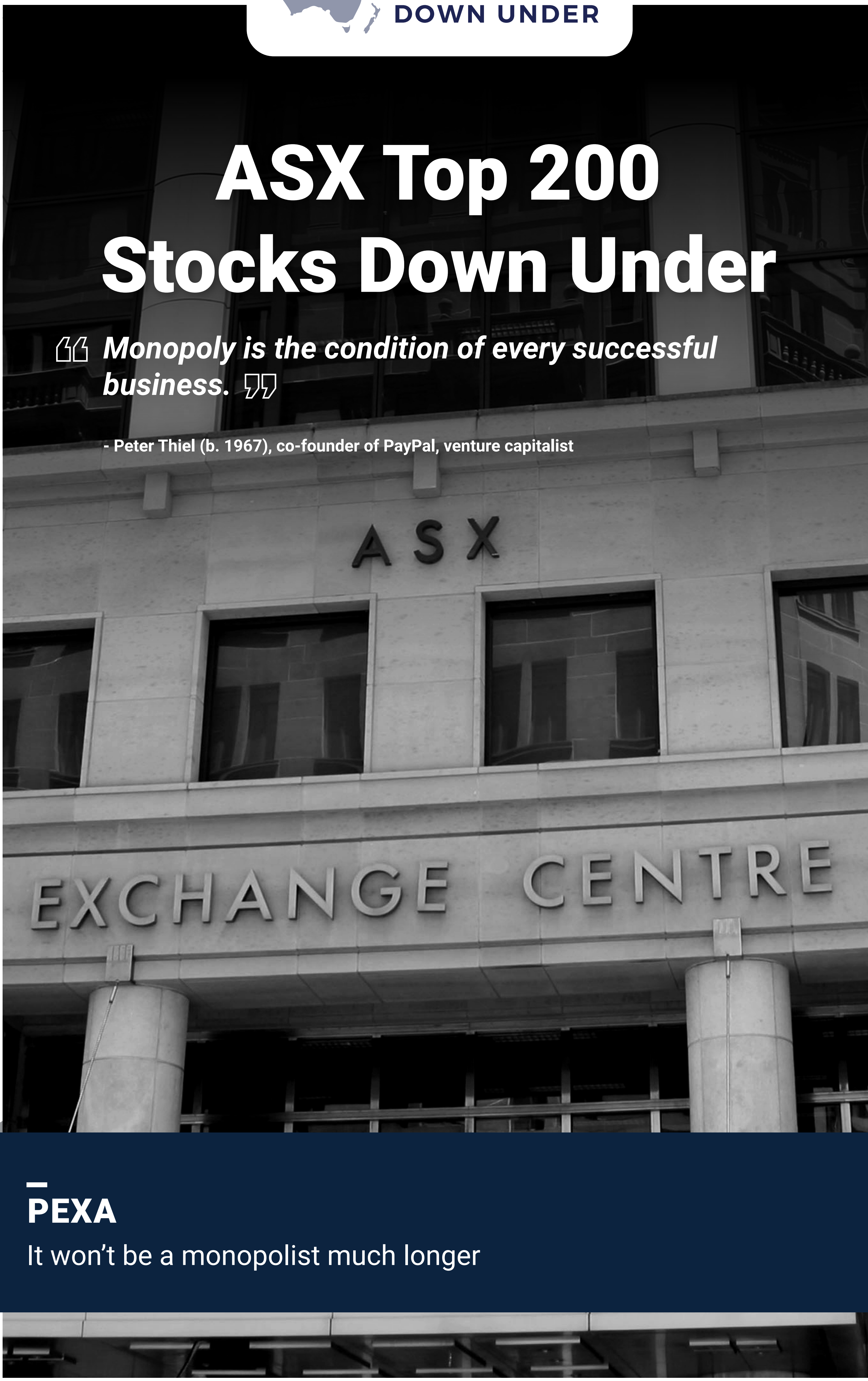
STOCKS DOWN UNDER

20 JUNE 2022



ASX Top 200 Stocks Down Under

> *Monopoly is the condition of every successful business.*

- Peter Thiel (b. 1967), co-founder of PayPal, venture capitalist

PEXA

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Stocks Down Under rating: ★★

ASX: PXA
Market cap: A$2.1BN

52-week range: A$10.87 / A$20.81
Share price: A$11.58

Pexa (ASX: PXA) was one of the biggest IPOs of 2021. It is a platform for electronic conveyancing - the process of transferring properties and their legal title. Conveyancing occurs when properties are transferred between different owners or when owners refinance their properties with different lenders. Pexa's first few months of listing were positive because the property market ran hot and Pexa had that heat virtually all to itself. Unfortunately, it has been let down by the cooling of the property market, a slow roll out into the UK and the threat of losing its monopoly.

Share price chart

Source: Tradingview

Digitising conveyancing

Pexa began in 2010 after the Council of Australian Governments (COAG) agreed to digitise and automate conveyancing. Conveyancing fees are paid as part of a property's settlement and substantially vary dependent on the nature of the transaction, but are typically between $200 and $2,000.

Pexa has undergone rapid growth ever since its establishment, especially in the past five years. Back in 2017, only 20% of all refinancing transactions were completed on Pexa. But now, it processes 99% of all refinancing transactions and 80% of property transfers. Pexa debuted on the ASX in early July last year having raised $1.2bn at $17.13 per share. Financial administrator Link (ASX: LNK) owned a stake of 42% and CBA held another 24%. Previously, Macquarie, the WA state government, billionaire Paul Little and the other Big Four banks held major stakes, but they all cashed out prior to the IPO.

It helped to be a monopolist in a hot market

Since reaching an all-time high of $20.81 over the summer, Pexa has shed nearly a third of its value. Remember that when Pexa listed, the property market was running hot thanks to record low interest rates. In Pexa's first quarter as a listed company (the September quarter of CY21), property refinances in the five mainland states rose 28% compared to the previous quarter. The heat of the market showed in Pexa's FY21 results, with $221m in revenue (up 42% from FY20) and $101.8m in pro forma group EBITDA (up 124%). However, it made a statutory net loss after tax of $11.8m.

In 1HY22, the company recorded a 46% jump in revenue from 1HY21 with $145.4m recorded, a 71% jump in pro forma EBITDA to $75.5m. In further good news for shareholders, it made a pro forma NPAT of $25.9m and its exchange processed 2.1m transactions (up 37%). For the full FY22 it is guiding to $265m-$275m in revenue, $120m-$130m in pro forma EBITDA and $70m-$80m NPAT. These figures would all be ahead of prospectus estimates and up from FY21.

Shareholders were also excited about Pexa's plans to expand into the UK. In August 2021, the company secured an agreement with the Bank of England to test the product and had commercial banks on board. The company asserts there are no competitors providing the same offering in the Old Dart. And to achieve the same revenue and profit, Pexa would only need a third of the market given the UK market is thrice as large. Pexa hopes to have a working system in place by the end of this calendar year and by 2024 it hopes to start making money in the UK market.

Interest rates are spoiling Pexa's party

But now, Pexa is suffering from the deteriorating state of the Australian property market. After the COVID bull run, property prices are expected to fall in 2022 as interest rates rise. Consensus estimates for FY23 reflect this, forecasting $271.8m in revenue and $115.7m in EBITDA, which would be up 0.7% and down 8%, respectively, compared to the midway point of the company's FY22 guidance.

Pexa is forecast to return to growth in FY24 with $296.3m in revenue and $120.2m in EBITDA, but these represent growth rates of just 9.1% and 3.9%. Looking to Pexa's multiples, it is trading at 31.6x P/E and 20.8x EV/EBITDA for FY23, which we think are high. We also note it has a 1.7x PEG ratio, which indicates it is overvalued relative to its forecast growth.

The threat of Pexa losing its monopoly make us lose our appetite for it

Shareholders might take some comfort in Pexa's big market share in Australia, but we don't think they can. The states and territories want to open up the market to competition and are aiming to do this in the first half of 2023. Pexa has warned this would cause risks for consumers and the market, but the government and the ACCC appear undeterred.

If Pexa was to retain its monopoly, we'd probably still have confidence in the company even with a souring property market. Market downturns happen in property, but they are not forever – in the long term, property values only go up. But it seems inevitable the conveyancing market is opening up to competition whether Pexa likes it or not. We can't see what niche or speciality it will have to entice consumers to pick it over would-be competitors. Pexa has tried to degrade would-be competitors, such as Sympli and LEXTECH, by stating they cannot complete the full process and cannot host the volumes of transactions that they do. But it will only be a matter of time before these platforms can.

We concede it will take some time for the interoperability system (allowing for competition in the property settlement market) to be implemented in practical terms. But even now Pexa is vulnerable to the bearish property market. Furthermore, we are not convinced that even if it expands in the UK it can make up for a lower market share in Australia or that it can gain a market share as fast in absence of the government granting it a literal monopoly in that market. Therefore, this one is two stars for us.

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