STOCKS DOWN UNDER

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ASX Small Caps Stocks Down Under

In this world, nothing is said to be certain except death and taxes.

- Benjamin Franklin (1706-1790), Founding Father of the United States

PROPEL FUNERAL PARTNERS

Dealing with a certainty of life

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Stocks Down Under rating: ★ ★ ★ ★

ASX: PFP
Market cap: A$568.3M

52-week range: A$3.81 / A$5.20
Share price: A$4.82

Propel Funeral Partners (ASX: PFP) is one of two ASX stocks in the funeral business. As today's quote and article title note, death is one of life's two certainties. Propel has gained 26% in the last 12 months, 8% in CY22 and 76% since its IPO 5 years ago. But was it inevitable that the stock would do well? As the negative performance of Invocare (ASX: IVC) and the difficult days of early 2020 depict, not necessarily.

Share price chart

Source: Tradingview

Good money to be made

Propel began as an idea on a whiteboard back in 2012 and was listed five years later, at $2.70. At the time it held 80 funeral homes, mostly in regional Australia, but only had a 4.1% market share. Its only listed peer, Invocare (ASX: IVC), was the industry giant, then with a 32% stake and 250 funeral homes (which included brands like White Lady Funerals and Simplicity Funerals). Propel hasn't caught up to Invocare just yet, but now operates at 144 locations, including 32 cremation facilities and 9 cemeteries. It is 14.8%-owned by co-founders Fraser Henderson and Albin Kurti. Although, the pair sold down 1.25m shares in April, they retain 17.4m shares, worth roughly $82.5m.

Funerals are a 24-hour, labour-intensive business with extensive planning and use of various facilities. There are significant expenses, including the services of a funeral director, dealing with various paperwork and merchandise, such as flowers, caskets and crosses. Even cremation has its costs. This, in theory, means good money for funeral operators, including Propel. But it's not always exponential growth.

Yes, funerals can be cyclical too

During its listed life, Propel has performed better in some years than others, growing 38% during 2019 when there was a bad flu season, but then falling during the Corona Crash and not regaining pre-Crash highs until mid-2021. Ironically, keeping COVID out of Australia and social distancing were bad things for a company.

Although funerals could still go ahead, there were less funerals and less people were allowed to attend them, meaning less revenue per funeral for operators.

But the shift to living with COVID and the lifting of caps on funerals has been a good thing for Propel. In FY22, it recorded $145.2m in revenue (up 20.6%), $39m in EBITDA (up 25.2%) and an NPAT of $16m (up 53%). For FY23, consensus estimates expect $166.2m in revenue and $44.6m in EBITDA, which would represent growth of 14% in both instances. These estimates derive an FY23 EV/EBITDA multiple of 14.3x and a P/E multiple of 28.6x. Meanwhile, Invocare's consensus estimates for FY23 forecast 11% revenue growth and 14% EBITDA growth while it is trading at 11.8x EV/EBITDA and 24.5x P/E for FY23. The latter pair of multiples would arguably be even lower had Invocare not been rumored to be a private equity target in the middle of this year.

In its FY22 results, Propel observed positive trading momentum to start FY23 with total and comparable funeral volumes being materially higher than 12 months ago. The average revenue per funeral was 6% higher. Although Propel said it expected to benefit from favourable demographics, a strong funding position and its M&A strategy, it did not provide formal guidance for the full year.

A four-star stock, but you still need to watch it

Given all of the above, we think Propel is four stars. But there are a few things that prevent it from being five stars – meaning it would be the perfect company with virtually no risks. First, as we have noted already, death volumes can fluctuate from year to year and this can be evident in Propel's financials and its share price. The share price has had good runs in 2019 and 2022 with higher death volumes, but it could retreat if 2023 is a less 'deadly' year. The second is general competition risk. And you have to remember that the brands Propel owns aren't exactly household names like some of the others that InvoCare owns.

Third is the risk that future acquisitions could be blocked by the ACCC and this could stop the company in its tracks. This is less likely to happen to Propel rather than Invocare given the latter's stronger market position. But this risk is one that has happened to Invocare and Invocare's own investors have suffered as a consequence. And as Propel grows bigger, the more likelier this scenario is. Still, we think there is some time before this eventuates given over 70% of funerals are conducted by independent and/or family-owned service providers. Fourth is the risk of inflation. It may not have much of an impact on Propel's revenues, but it might be seen in its costs – this is a risk the company itself acknowledged in its recent results. As we've done with a few other companies this year, let's look to the US to get an indication of what could happen. Data out of the US Labour Department in June showed the cost of funeral services grew 2.7% in 12 months, well behind inflation, which was then 8.6%. Still, the industry has had a good run, growing revenues over twice the rate of inflation in the preceding 30 years.

But now, we're being picky and talking hypothetical matter. One reality is that its dividend yield was well short of inflation at just 2.6% (or 3.7% grossed up for tax), so dividend-minded investors may want to look elsewhere. Yet, for growth and value minded investors, we think the certainty of death, Propel's track record of growth and its profitability are enough to outweigh any of those risks above. Four stars.

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