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Ultra-High Growth Technology Companies Compared

Our weekly view on Australian equities.

16 July 2020

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Technology: Ultra-High Growth Companies Compared

The Information Technology sector has doubled in market cap since the S&P/ASX 200 bottomed in late March 2020.

Since 2017, the sector has increased in size fourfold relative to the size of the Australian equity market, yet today only represents 4% of the market by market capitalisation.

AfterPay (APT.ASX) and peer Buy Now Pay Later (BNPL) stocks like Sezzle (SZL.ASX), Splitit Payments (SPT.ASX) and Zip Co (Z1P.ASX) have led the charge. While APT is the only formal member of the S&P/ASX Information Technology sector (Z1P classified as Financial, SZL and SPT are unclassified), all four BNLP companies are growing revenues at extraordinarily high growth rates.

Since the March low, the four BNPL stocks collectively added over $A20bn of market capitalisation, with just under 10% of that through new equity raisings. Investors are viewing the sector as a beneficiary of the COVID-19 environment as companies are being able to 'pull-forward' new revenue opportunities, coupled with even lower financing costs. The combined impact has the potential to generate even faster rates of revenue growth.

Australian BNPL stocks post some of the highest revenue growth

In our view, Australian BNPL stocks are currently members of what we have identified as the "Ultra-High Growth" group of companies. These are companies which are exposed to large under-penetrated global markets, with many companies growing revenues at between 30-50% per annum. This group is dominated by cloud, Software as a Service (SaaS), and payment companies.

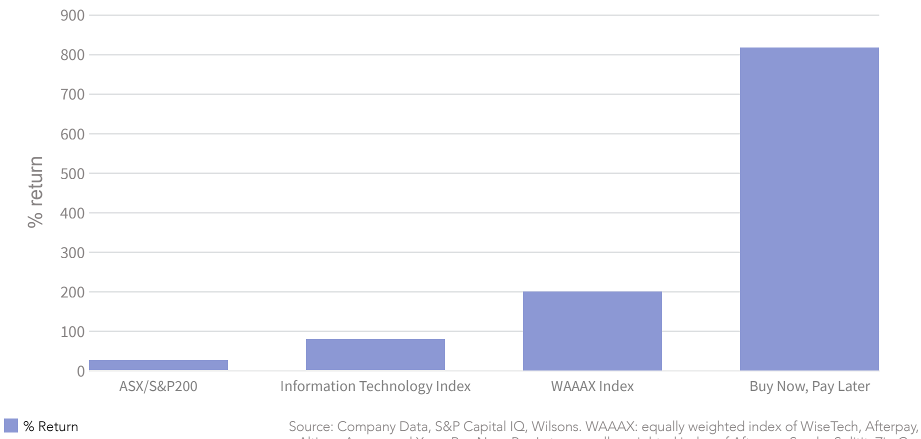
We show how the Australian BNPL sector is posting some of the highest revenue growth within this global group of Ultra-High Growth companies, with valuation measures that are not stretched relative to this peer set. We think this peer set of Ultra-High Growth companies is representative when comparing the BNPL companies to the likes of Mastercard (MA.US), Visa (V.US) and PayPal (PYPL.US).

Ultra-High Growth Companies Explained

The current group of Ultra-High Growth companies is dominated by cloud infrastructure, cybersecurity, Software as a Service (SaaS), and payments companies. They share several common characteristics:

1. Large global market opportunities, in most cases <5% penetrated
2. SaaS like revenue models with 'annuity' like characteristics
3. Founder led management teams
4. Platform like revenue ecosystems - particularly in the case of payments companies
5. Management teams prioritising revenue growth over earnings growth
6. COVID-19 has accelerated customer adoption rates

Exhibit 1: Technology-related sectors have seen strong performance since the March, 2020 low



Source: Company Data, S&P Capital IQ, Wilsons. WAAAX: equally weighted index of WiseTech, Afterpay, Altium, Appen and Xero. Buy Now, Pay Later: equally weighted index of Afterpay, Sezzle, Splitit, Zip Co.

Fast Growing Global Technology Companies Compared

Amongst this group, a subset is expected to grow revenues at greater than 50% per annum over the next few years according to S&P Capital IQ. We have selected the top five fastest-growing companies from both the SaaS and the payments sector over the last 12mths globally. and compared them to Australia's BNPL companies, along with Appen (APX.ASX), Altium (ALU.ASX), Wisetech (WTC.ASX) and Xero (XRO.ASX) or the 'WAAAX' stocks as often referred to.

Exhibit 2: Fast Growing Global Technology Companies: SaaS, Payments, Buy Now Pay Later

Company	Product	Exchange	Headquarters	Mcap ($bn)	Currency	Revenue FY21E ($m)	EBITDA FY21E ($m)
Global Payment Companies							
Adyen	E-commerce point of sale	Euronext	Amsterdam, Netherlands	42.3	EUR	905	535
Coupa Software	Business spend management	NASDAQ	San Mateo, California	19.0	USD	492	73
Shopify	E-commerce point of sale platform	NYSE	Ottawa, Ontario	115.6	USD	2,937	120
Bill.com	SME focused payments	NYSE	Palo Alto, California	6.4	USD	178	-21
Square	Mobile Payments	NYSE	San Francisco, California	52.1	USD	6,544	527
Global Service as a Software							
Zoom	Cloud based video conferencing	NASDAQ	San Jose, California	73.4	USD	1,804	475
Datadog	System monitoring for cloud	NASDAQ	New York, United States	25.9	USD	757	38
Crowdstrike	Cybersecurity monitoring company	NASDAQ	Sunnyvale, California	22.9	USD	771	30
Twilio	Cloud based messaging platform	NYSE	San Francisco, California	31.5	USD	1,901	159
Elastic	Cloud based search	NASDAQ	Mountain View, California	7.6	USD	537	-62
Global Buy Now Pay Later							
Afterpay	No interest, installment based platform	ASX	Melbourne, Australia	18.5	AUD	881	61
Zip Co	BNLP + Instalment Finance	ASX	Sydney, Australia	2.7	AUD	362	-7
Sezzle	No interest, installment based platform	ASX	Minneaplois, Unitied States	1.3	USD	80	-13
Splitit	No interest, installment based platform	ASX	New York, United States	0.6	USD	n/a	n/a

Source: Company Data, S&P Capital IQ, Wilsons.

Valuation Challenges

Valuing Ultra-High Growth companies creates all sorts of dilemmas for investors. Traditional valuation measures typically cannot deal with these growth rates, with many of these companies doubling in size every 12 months.

Discounted Cash Flow (DCF) valuation techniques can undershoot as investors fade growth rates to GDP like levels over short periods of time.

Earnings based valuation measures tend not to work well as many companies are not generating earnings. In some cases, near term profitably is not being prioritised – think Amazon (AMZN.US), or Xero in the early days.

Equally challenging is finding the right companies to make comparisons. MasterCard and Visa, while being in the payments sector, are seeing revenues grow in the low double digits/ mid-teens given more mature business models - BNPL companies are growing five times faster.

This often leaves investors focusing on a range of technology/payment specific valuation techniques, with the most common and widely focused measure being price to sales. While not without its flaws, an Enterprise Valuation/Revenue, or EV/Revenue multiple does provide a guide to valuation*. Ignoring the entire cost base when trying to value a company has some shortcomings!

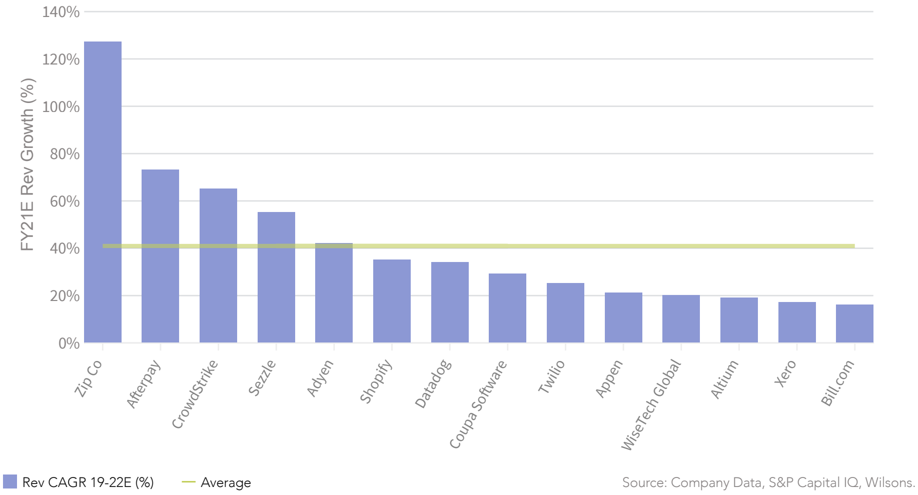
*Enterprise Valuation: Market Capitalisation + Net Debt = EV

Revenue Growth

Zip, Afterpay and Sezzle all rank highly in terms of which is expected to deliver the highest rate of revenue growth into FY21e, as measured by S&P Capital IQ.

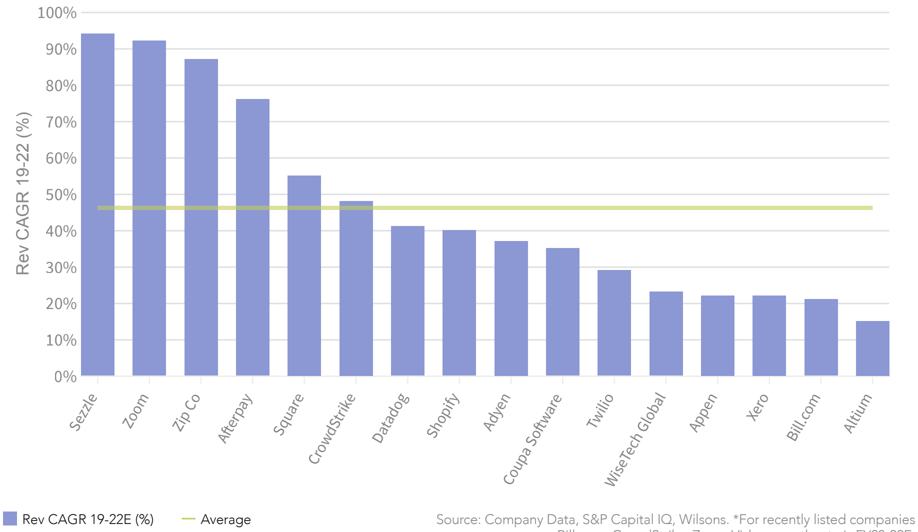
All these companies have achieved less than 5% penetration of their own identified addressable markets, which leads investors to believe there is a sustained period of high revenue growth. Consensus forecasts for revenue growth over the 2019-22E period (see Exhibit 3) show the average growth rate is still around 50% pa. It is also clear the BNPL companies are amongst the fastest growing sub-sector within both SaaS and payments over the 2019-22E period.

Exhibit 2: FY21E Revenue Growth
– BNPL sector amongst the fastest growing companies globally



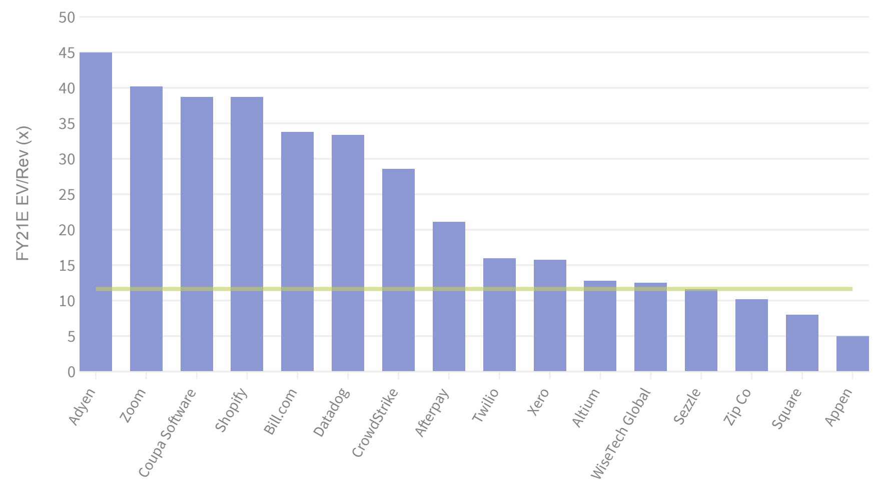
Source: Company Data, S&P Capital IQ, Wilsons.

Exhibit 3: 3-Year CAGR Revenue Growth also expected to remain strong
– particularly in the BNPL sector



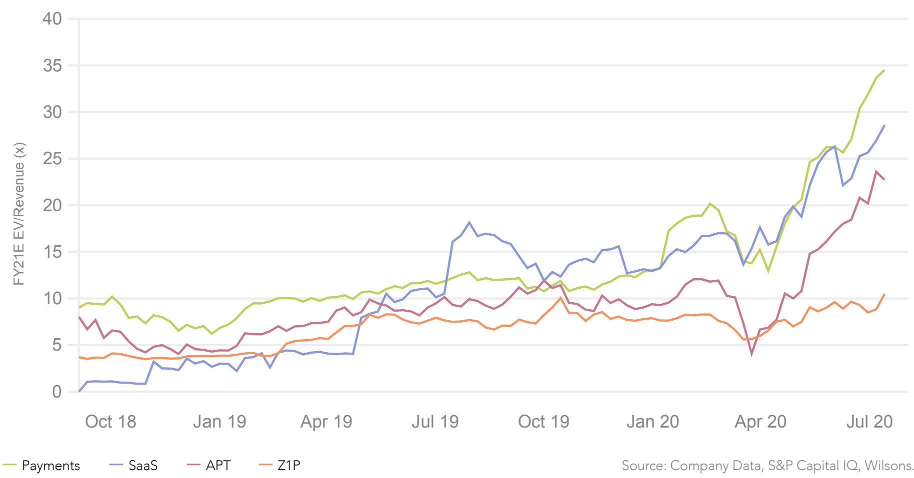
Source: Company Data, S&P Capital IQ, Wilsons. *For recently listed companies Bill.com, CrowdStrike, Zoom Video growth rate is FY20-22E.

Exhibit 4: FY21E EV/Revenue Multiples – BNPL at 20-25x vs. 35-40x for Zoom, Adyen, Shopify



Source: Company Data, S&P Capital IQ, Wilsons.

Exhibit 5: Ultra-High Growth 12mth Fwd EV/Revenue Multiples Compared



Source: Company Data, S&P Capital IQ, Wilsons.

Valuations

Valuations for Ultra-High Growth companies have expanded from around 15x to 30x EV/Revenue since the market bottomed in March, 2020. These are large valuation multiples in anyone's language.

The prospect of a "pull-forward" of new revenue opportunities, along with even lower financing costs creates the combined potential for even faster rates of revenue growth.

In the near term, the upcoming 2Q20 results season will be important to see if these high revenue growth rates have been maintained. Any loss of revenue momentum will likely see multiple compression.

At what point do EV/Revenue multiples peak? Both Tesla (TLSA.US) and Amazon peaked at ~35x. TLSA in 2018 and again in 2020, AMZN in 2011 and 2013. This valuation did not stop the share prices from continuing to rise as revenues kept accelerating.

Wilsons Australian Equity Focus List - overweight Information Technology

The Wilsons Australian Equity Focus List is overweight the Information Technology sector. Xero (XRO.ASX) is our preferred high growth technology position, with a 3% weighting. XRO has gone through break even profitability in recent years, which in our view has reduced the risk profile of the investment case. Xero remains net cash, with >$700m of cash on the balance sheet.

Xero has its sights set on offshore markets which will require investment and a period of suppressed earnings. If successful offshore, it is possible in our view that the consensus market assumption around ~20% revenue growth per year into FY2023E will look conservative.

Conclusions: Ultra-High Growth Companies

There are very few Ultra-High Growth companies on the Australian market, which in turn puts upward pressure on valuations given scarcity. So what can we conclude?

1

The Australian BNPL sub-sector contains a number of the fastest-growing companies listed globally. In our view, this is the peer set that investors will be increasingly comparing the sector to vs. the traditional payment companies like MasterCard/Visa or domestic fintech peers etc. This is particularly the case as these companies expand into new international markets.

2

Relative to valuation multiples of peer Ultra-High Growth companies, the Australian BNPL sector trades on lower valuation multiples, despite offering higher growth rates.

3

Can these high valuation multiples be sustained? While still a key unknown, if revenue growth continues to be as strong as expected, and companies operationally execute well, then there is a real possibility share prices can continue to be well supported. High absolute valuations alone are not sufficient to be an impediment to share prices.

The outlook for the company's prospects or economic environment needs to change. Sometimes it can be the unexpected which changes the investment case.

In March, 2000 the Federal Reserve slammed the brakes on the US economy by lifting interest rates, which inverted the yield curve almost overnight. Today, the Fed is creating +$US100bn of currency units per month and expects to keep rates ultra-low well into the future. In this cycle, we think surprises are more likely to come from the companies themselves.

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Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

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