Investors' Chronicle | Alpha

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Alpha shares analysis

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Quality still worth paying up for

This week we look at a US software as a service (SaaS) business that still has tremendous growth potential which justifies its lofty market valuation. Plus we run the rule over an events business recovering well from Covid.

Analyst: Phil Oakley

Intuit (US:INTU)

Source: LSEG

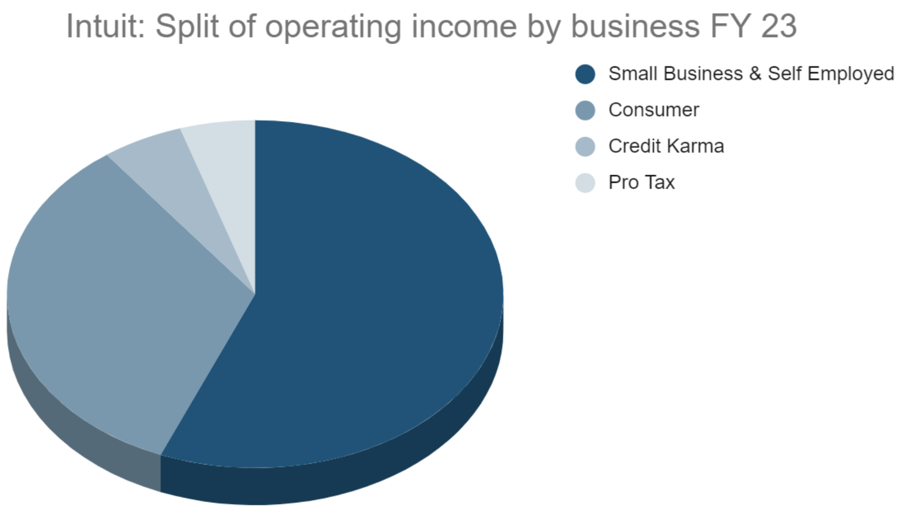
Last month we covered accounting software company **Sage (SGE)** and highlighted how profitable software as a service (SaaS) companies could be.

We also showed how Sage had underperformed its big global competitors such as Xero and Intuit.

Intuit (US:INTU) is the company behind the Quickbooks financial software brand, as well as other finance-related products. Quickbooks has been a phenomenal success with small businesses, accountants and self-employed individuals and has powered the stunning returns from owning Intuit shares.

Over the last decade, Intuit shares have trounced the S&P 500 with total returns of 753 per cent, compared with 202 per cent for the index. They have continued their strong performance this year with total returns of 33.7 per cent whilst the S&P 500 has returned 11.5 per cent.

Quickbooks provides the bulk of Intuit's profits



Source: Intuit

Intuit's business is split into four reportable segments.

It is dominated by its Small Business and Self Employed division, which includes the flagship Quickbooks accounting software. Quickbooks not only helps businesses prepare their accounts but is also a comprehensive business and financial management product.

It helps with tasks such as invoicing, payroll, payments and can even be used as a means of obtaining credit (as Quickbooks financial data can be used by lenders to make a loan decision). Quickbooks also provides its users with accounting and book-keeping advice.

The other business within this division is Mailchimp, which was bought by Intuit in late 2021. Mailchimp is an online marketing platform for small businesses. It allows companies to promote their businesses through email, social media, adverts and websites.

The Consumer division contains the TurboTax software business. TurboTax allows individuals and small businesses to prepare and file their tax returns. This business is very seasonal given that the US tax filing season runs from November through to April, which boosts revenues in Intuit's second and third quarters that end in January and April, respectively.

Intuit bought Credit Karma in late 2020. The business provides consumers with free services such as credit scores and credit reports. It also offers savings and bank accounts.

Credit Karma helps users with financial budgeting and to improve their credit scores. It makes the bulk of its money from referrals for new credit cards, loans and insurance.

The business is also leveraging the huge amount of credit data it has on individuals through a platform called Lightbox. This allows lenders to use the thousands of data points from Credit Karma so it can give customers more certainty as to whether they will be approved if they apply for a financial product.

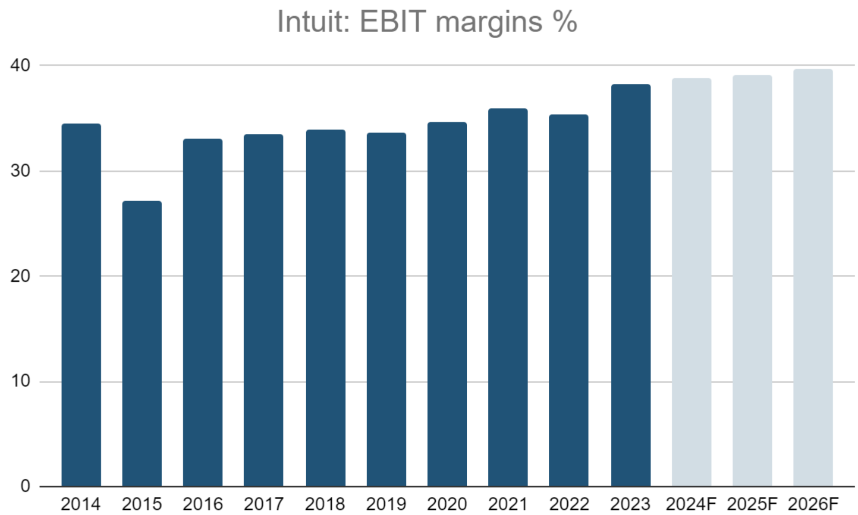
Pro Tax is a software system that allows accountants to electronically file tax returns. As with TurboTax, this business is seasonal.

Rapid growth combined with very high profit margins

Quickbooks' success has been built around its ease of use, customer support and excellent marketing. It has helped propel Intuit's revenues from $4.2bn in 2013 to $14.4bn in the year to July 2023.

This growth has been combined with very high and expanding profit margins, which have contributed to Intuit growing its earnings per share(EPS) at a compound annual growth rate (CAGR) of 13.1 per cent for the last decade.

Whilst growth in Quickbooks customers has been the principal driver of profits, the mix of the business has become more favourable as users have migrated from desktop software packages to subscriptions. This has resulted in 80 per cent of Quickbooks revenue now being classed as recurring which gives Intuit a high degree of stability to its revenues.



Source: FactSet

Leveraging artificial intelligence (AI) to driver further growth

Whilst accountancy is seen as being a business threatened by AI, Intuit is embracing the technology across its business to generate continued revenue and profit growth.

The company has developed a product called Intuit Assist to help its customers with tasks and even do some for them. This is a very prominent feature of Quickbooks Live and is also seen as a way of converting more customers to TurboTax.

Intuit wants to develop and expand an online ecosystem across its portfolio of software products to drive up average revenue per customer (ARPC) and grow revenues and margins. For example, outside the US, Quickbooks is being sold as a bundle with Mailchimp as a complete small business management and growth package.

From a revenue point of view, Mailchimp is a very lucrative product. Its ARPC was $1,298 last year compared with $699 for Quickbooks, but it needs to grow faster.

Intuit also sees significant growth potential from moving Quickbooks into the mid-sized company market where ARPCs can be $5,000 or more. Quickbooks is also driving up ARPC by getting more customers to buy extra services such as Bill Pay, payroll and accessing capital services.

The performance of TurboTax has been rather subdued in recent years as there has been little growth in tax filings by US households. The business has also had to cope with free software being offered by the Internal Revenue Service such as IRS Free File.

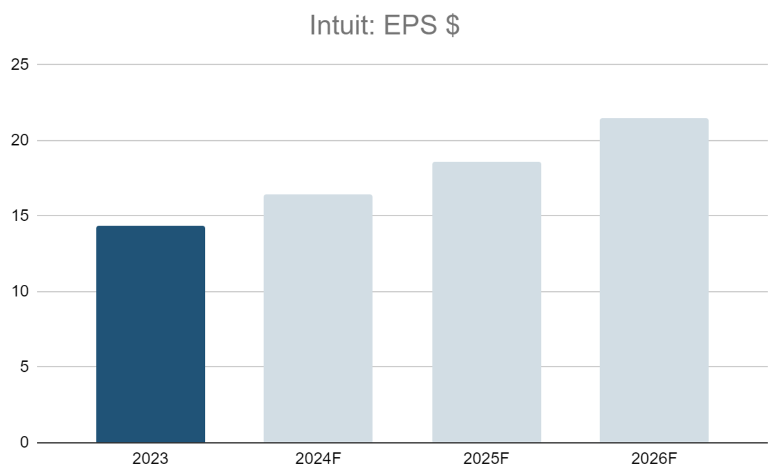
That said, Intuit remains bullish for its highly profitable TurboTax product. It reckons that there are 87 million assisted tax return households that could potentially use the software. Many of these do not currently use it because they find the thought of doing their own tax returns too daunting.

By using Intuit Assist within TurboTax Live, Intuit is going after this market by making the process much easier for customers. Assisted tax returns generate ARPC of $219, compared with $120 for the basic service. QuickBooks is also seen as a source of small business tax customers for TurboTax which has even richer revenues with an ARPC of $854.

Profits to keep marching higher

There is currently no end in sight to Intuit and Quickbooks' incredible run of success. The company remains very bullish on its future prospects and is targeting 15-20 per cent revenue growth from its Small Business division over the medium term and expects 16-17 per cent growth this year.

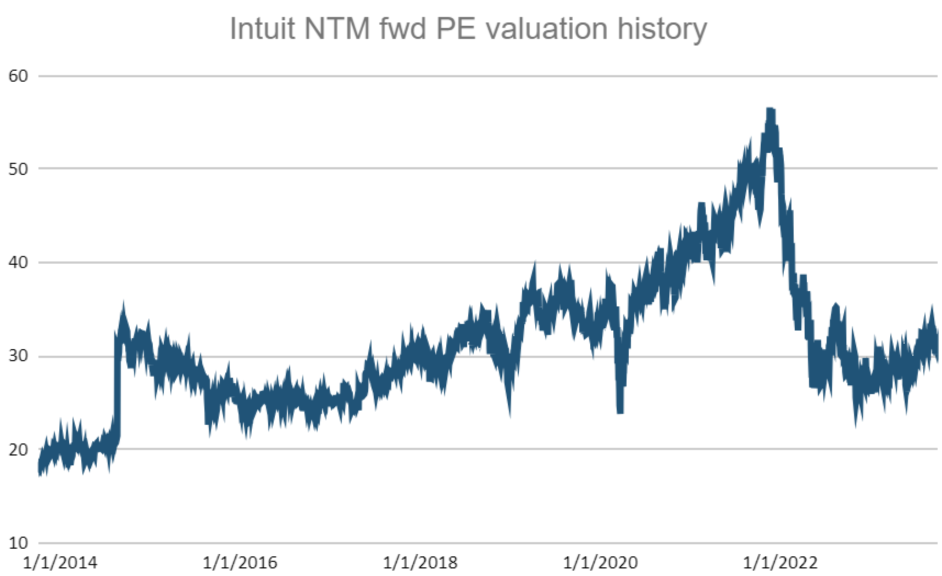
Consequently, Wall Street analysts continue to expect Intuit's EPS to keep up its strong momentum.



Source: FactSet

Worth paying up for

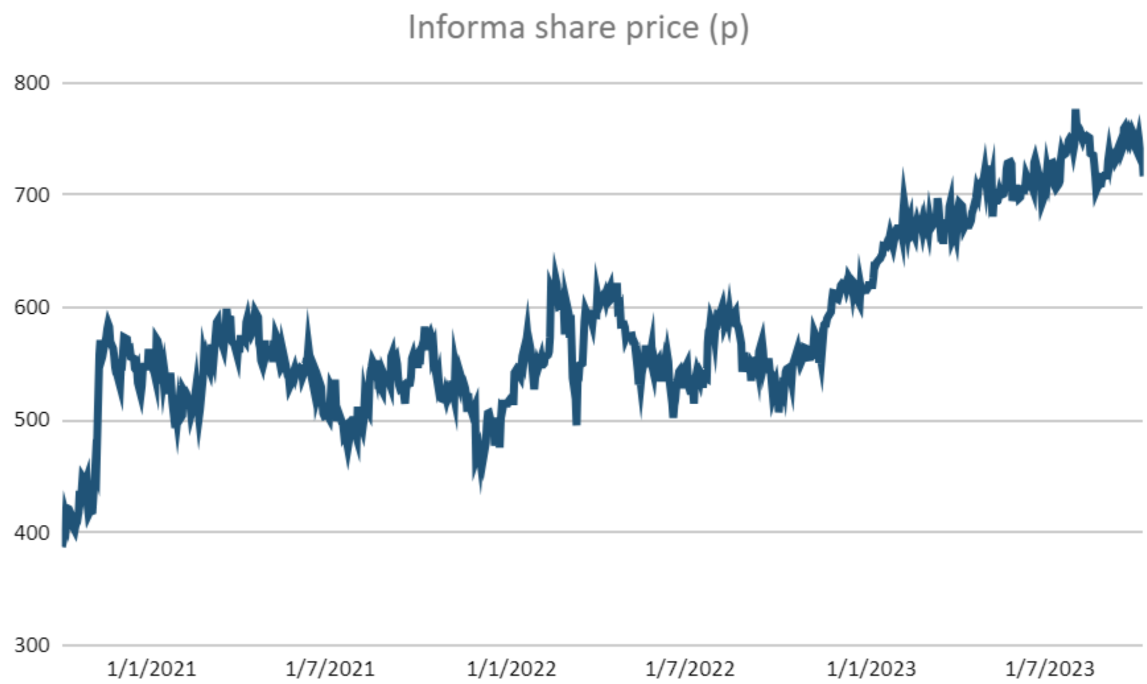
Intuit shares have commanded a high stock market valuation for some time now. They are a great example of how a share with an expensive price tag can still deliver stunning returns to investors if its profits growth continues to be strong.



Source: FactSet

The valuation of the shares has been savagely derated over the last couple of years mainly because of higher interest rates. Whilst they will still look expensive to value conscious investors at over 30 times its next 12 months' forecast EPS, the quality of the company's business model and its continued growth potential suggest that the shares are still worth paying up for.

Informa (INF)



Source: LSEG

Informa (INF) is a play on the global knowledge economy. Its exhibitions, events, digital content and academic publishing operations aim to help businesses and professionals enhance their knowledge of their specialist areas so that they can perform better.

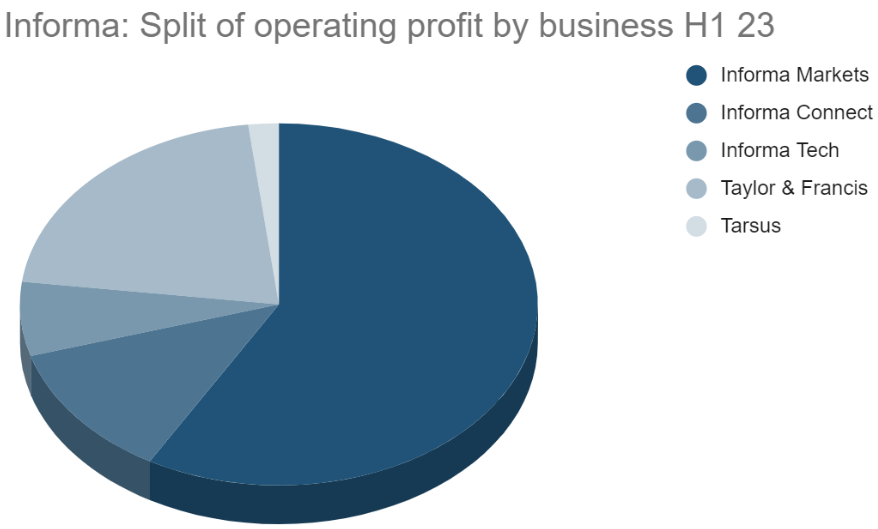
Its events business and profitability were hammered by the impact of Covid-19, but both are now recovering strongly as companies and their customers want to meet face to face again.

The company has been repositioning itself after selling off its Intelligence division. It now firmly focuses on two areas: business to business (B2B) and academic markets.

Its shares have been extremely volatile and have been a solid rather than exceptional long-term investment. Total returns from the shares over the last decade have been 83.3 per cent, compared with 68.6 per cent for the FTSE All-Share index.

They have performed strongly in 2023 with year-to-date total returns of 17.7 per cent, compared with just 2.4 per cent for the FTSE All-Share.

A closer look at the business and strategy



Source: Informa

Informa is the world's largest exhibition company.

The company's profits are dominated by its Markets business. It organises exhibitions, live events and provides digital content across 450 specialist areas in the B2B segment in 30 different countries.

Tech provides digital media and content research to businesses and people who want to apply the latest technology to their roles. It is an integrated business providing services such as research, analytics data, media and live events.

Connect provides live and on demand events in a huge number of business areas, including finance, biotechnology, pharmaceuticals, food, food services and marketing. It used to be known as a conference business. Its focus now is on high value content events.

Taylor & Francis is one of the world's leading publishers of academic research and knowledge. It publishes 8,000 books per year and over 2,500 journals and has publishing partnerships with professional organisations. It has one of the world's largest collections of ebooks in areas such as science, technology, medicine and social sciences.

Growth strategy – getting better at what it does

Informa plans to grow its business by building the depth of its products and services in its targeted specialist markets. It also wants to increase the digitisation of its business and grow internationally.

It aims to keep on improving and expanding its specialist market knowledge and selling it to customers. This will be done by investing internally, but also by acquisition.

Its recent acquisition of events specialist Tarsus gives it new markets exposure in the form of packaging, healthcare, aviation and beauty. It also gives the business a bigger geographic footprint in the Middle East as well as the Americas.

The company benefits from its scale in physical events infrastructure and global reach which gives it the capability to put on events all over the world. It is reinforcing this by focusing its locations on big global cities which have very good air transport connections.

Informa is investing heavily in data and data services in order to generate improved service quality and revenue growth. The data is not just concerned with improved industry knowledge but also on targeting customers with smarter marketing and selling strategies.

Tech is expected to be a strong grower despite recent softness in spending by tech companies. Informa's Omdia business has a strong presence in tech research and data which will be complemented by the recent acquisition of Canalys which specialises in business and consumer technology research.

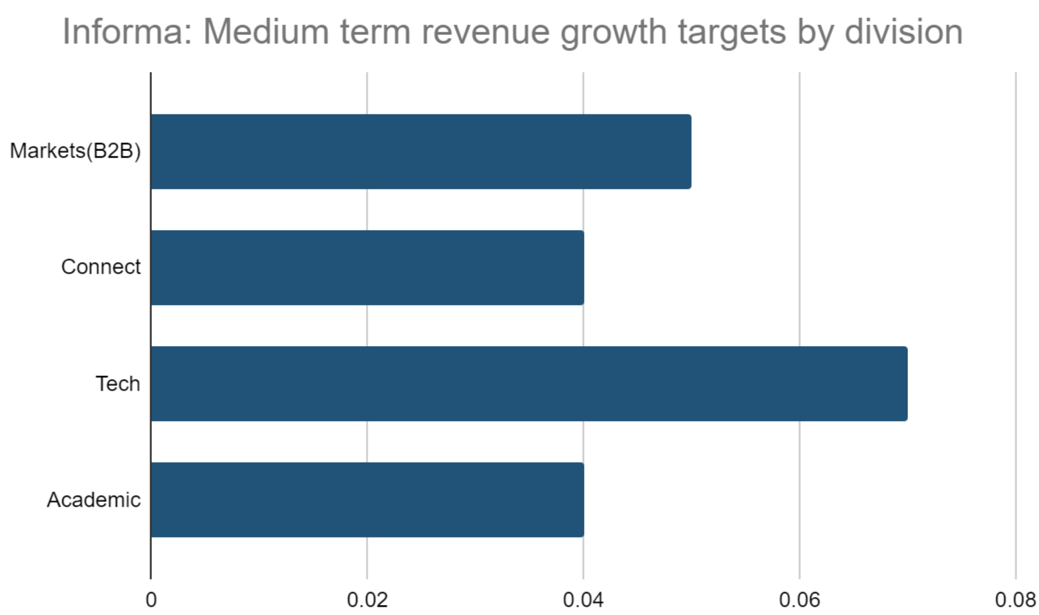
The company's growth is not just about getting bigger. It has carefully targeted areas with specific characteristics in order to generate better long-term profitability:

- Industries with fragmented supply chains which have lots of buyers and sellers. This lends itself to events with more exhibitors and delegates and therefore more revenue.
- High value markets.
- Markets where digital and data can add value.
- Long-term growth markets such as healthcare, technology, engineering and finance.
- Avoiding volatile markets such as retail.

Informa is also being very careful with its pricing and not trying to exploit the current recovery in trading conditions. It is playing the long game and is pricing for value – it will charge more only if it offers its customer more. This looks like a smart move and a good way of generating long-term customer goodwill within the business.

When it comes to academic publishing, the future growth rate is expected to be quite modest but it should be steady as global education and academic research continue to grow.

The company has targeted the following long-term growth rates for its businesses.



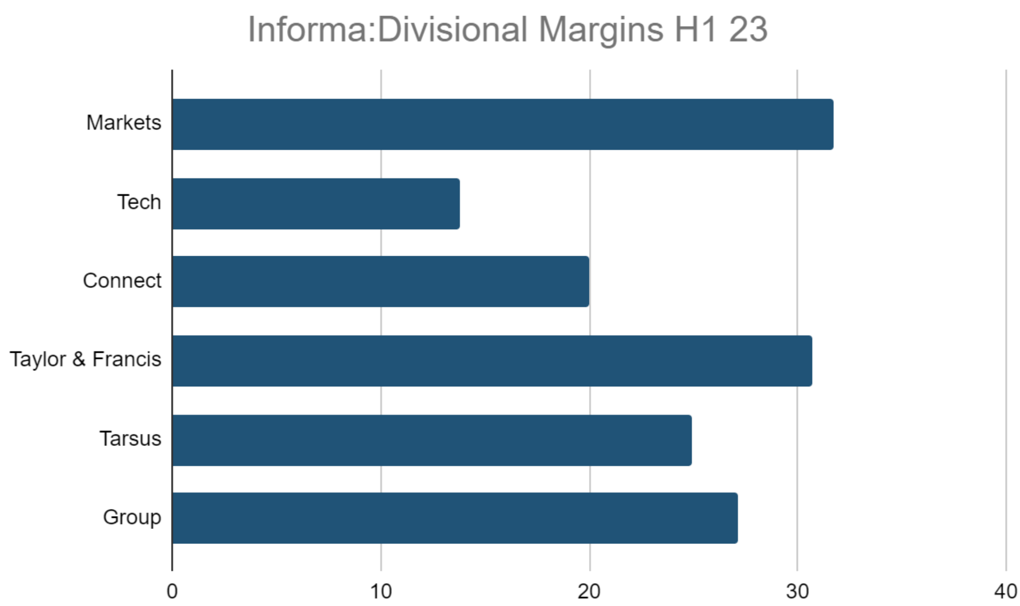
Source: Informa

If it can consistently achieve this kind of growth and combine it with its current high profit margins then the outlook for shareholders looks to be very favourable.

The big problem with Informa is that its events revenues and earnings have been very volatile. They are vulnerable to cutbacks in company marketing expenditures when business conditions weaken. When combined with the high levels of fixed costs and operational gearing within the business, profits can and do fall rapidly in a recession.

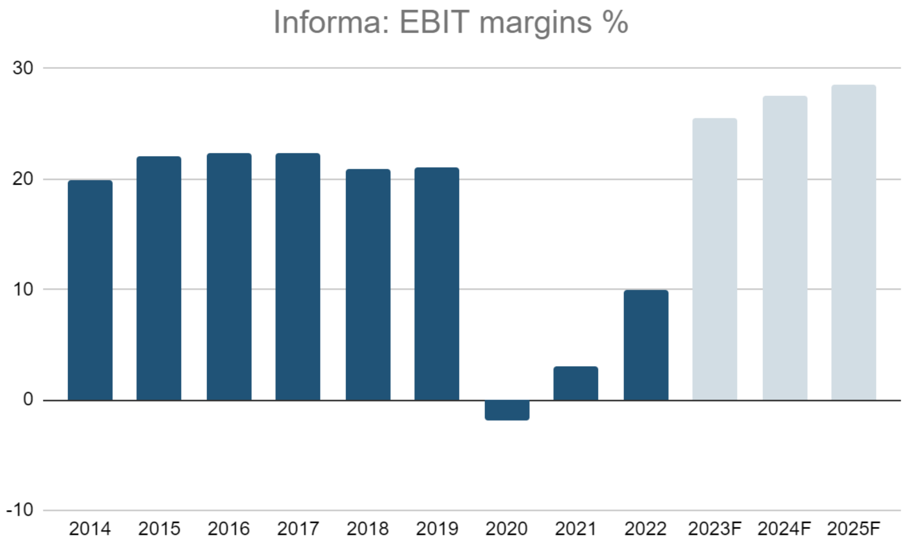
A very profitable business when times are good

Informa is a very profitable business when times are good. Once its businesses' fixed costs have been covered, there is a very high drop through rate to profits from incremental revenues. This translates into very attractive profit margins across its businesses.



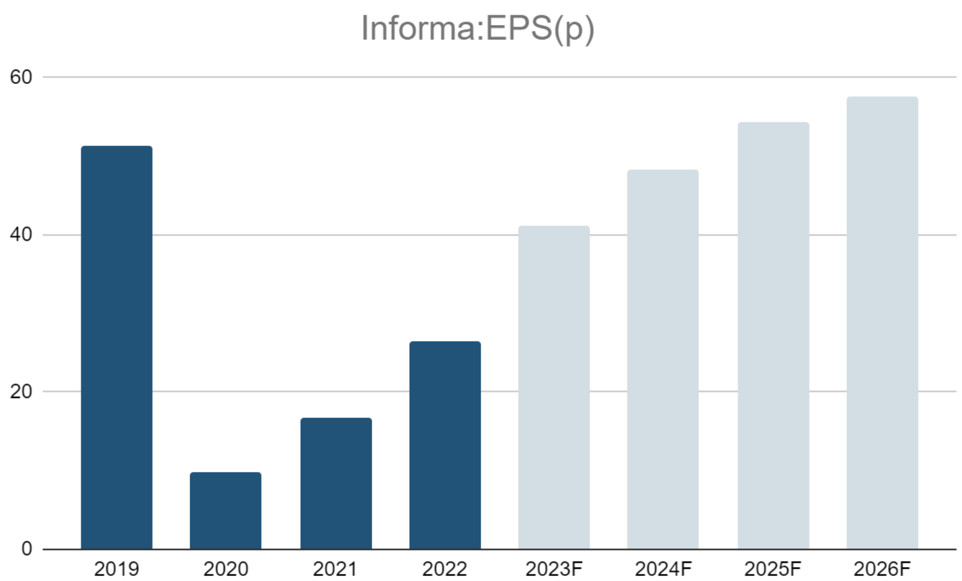
Source: Informa

The company believes that its margins can reach 30 per cent in the next few years as growth and the benefits of operational gearing kick in – even when the impact of biennial events which cause associated profit boosts and dips are taken into account.



Current trading is buoyant, but profits and share price have yet to recover pre-Covid peaks

The events business is expected to keep on getting a boost from the reopening of Chinese markets and the continued strength in trade events globally. The weakening of the pound against the US dollar also provides an earnings tailwind given that more than half the company's revenues come from North America.

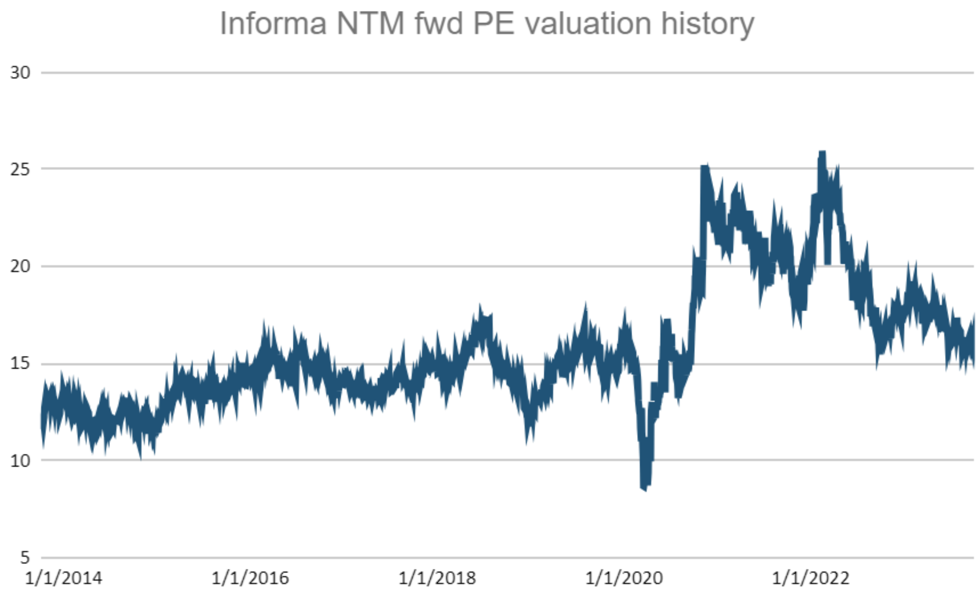


Source: FactSet

As a result, profits are expected to grow strongly in the coming years. That said, they are not expected to exceed pre-Covid levels until 2025 at the earliest. This comparison is arguably unfair given the disposal of the Intelligence division, but in terms of overall profits for shareholders it is still meaningful.

The same can be said for Informa's share price which, at 726p at the time of writing, is still some way below the 892p seen back in July 2019.

When it comes to company valuations, earnings stability counts for a lot. If informa had a track record of stability then its growth outlook and profitability would likely see its shares command a higher earnings multiple than they do currently.



Source: FactSet

The shares currently trade on 15.5 times its next 12 months' forecast EPS which does not seem too excessive.

However, if we look at the history of the shares on this measure over the last 20 years, the stock market has only given a higher valuation when its earnings have been depressed – such as during Covid – and expected to recover.

On the basis of its long-term history, there are grounds for thinking that the current valuation looks about right.

However, if the company's earnings are expected to keep on growing then investors could still make reasonable returns if the share price tracks the increases in profits.

Could Informa be a takeover target?

With attractive margins and decent cash flows, Informa is not an unrealistic takeover target. It was the target of a private equity bid in 2008, which collapsed when the financial crisis hit.

Informa itself has played the role of industry consolidator back in 2018 when it bought UBM. Could a business such as **RELX (REL)**, which has its own exhibitions business and academic publishing arm snap up Informa?

Competition authorities may scrutinise such a deal if it came about and there are doubts whether RELX would want to increase its exposure to exhibitions. However, it does no harm for investors to consider whether Informa could be worth more to someone else than it currently is on the stock exchange.

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