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iSelect (ISU)

NIA deal nets ISU \$42m cash

Recommendation
Buy (unchanged)
Price
\$1.85
Target (12 months)
\$2.10 (previously \$1.65)

Expected Return

Capital growth	13.5%
Dividend yield	1.9%
Total expected return	15.4%

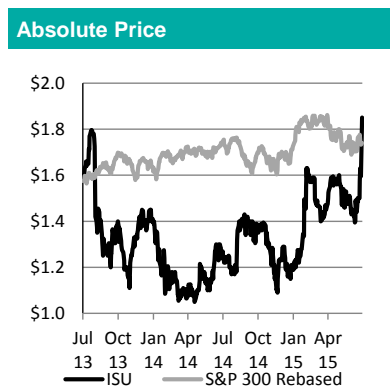
Company Data & Ratios

Enterprise value	\$374.9m
Market cap	\$483.8m
Issued capital	261.5m
Free float	88%
Avg. daily val. (52wk)	\$941,816
12 month price range	\$1.03 - \$1.86

GICS sector
Diversified Financials

Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	1.49	1.44	1.29
Absolute (%)	24.16	28.47	43.41
Rel market (%)	25.82	33.25	42.68



SOURCE: IRESS

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NIA loan settlement agreement reached

Today ISU announced it has come to an agreement to receive a cash settlement for its outstanding NIA Health loan facility. We believe this is a very good outcome for the following reasons:

- **Higher value than anticipated:** We valued the NIA loan facility separately at \$39.6m vs \$42.1m cash to be received; and
- **Enhanced product suite:** This deal has further enhanced ISU's depth of health insurance product by adding GMHBA as well as retaining Health.com.au on a cash upfront commission basis.

Balance Sheet certainty now points to capital management

We maintain our positive view on ISU for the following reasons:

- **Focus can now return to the underlying business:** The constant noise surrounding NIA has been a distraction for the company for a long period. The market (and more importantly management) can now move on to focus on the future for ISU in Health, Energy and Home Loans etc... We expect this will be a strong feature of its FY15 result presentation; and
- **Real prospect of capital management:** ISU will have more than \$100m in net cash on the Balance Sheet post the settlement of this deal. We expect that it will begin paying dividends and possibly return some capital to shareholders by way of a buyback or some other form of capital management.

Investment view: Buy, Price Target up 27% to \$2.10

Following today's announcement we have made minor upgrades to FY16 & FY17 earnings due to changes in interest revenue assumptions. We have updated our Price Target for the NIA loan settlement and rolled forward our DCF ahead of next month's FY15 result. We have also added a 15% premium to our valuation to account for the prospect of capital management initiatives. As a result our Price Target has increased to \$2.10 (previously \$1.65). We retain our BUY recommendation.

Earnings Forecast

Jun Year end	2014	2015e	2016e	2017e
Sales (A\$m)	136.7	161.2	185.5	208.0
EBITDA (A\$m)	29.2	32.4	37.8	43.4
EBIT (A\$m)	22.8	25.5	30.2	35.8
NPAT (normalised) (A\$m)	18.3	21.3	23.6	28.0
EPS normalised (cps)	7.0	8.1	9.0	10.7
EPS normalised growth (%)	-0.9%	16.1%	10.6%	18.9%
PER (on normalised EPS) (x)	26.4	22.7	20.5	17.3
EV/EBITDA (x)	12.8	11.6	9.9	8.6
Dividend (¢ps)	-	-	3.6	4.3
Yield (%)	0.0%	0.0%	1.9%	2.3%
Franking (%)	0%	0%	0%	0%
ROIC (%)	10.5%	9.9%	12.0%	16.3%
ROE (%)	7.9%	8.4%	8.6%	9.8%

SOURCE: BELL POTTER SECURITIES ESTIMATES

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NIA loan settlement agreement reached

\$42.1m in cash and new distribution partner

Today ISU announced that it has come to an agreement to receive a cash settlement for its outstanding NIA Health loan facility. The key take-outs of the deal are:

- ISU will receive \$42.1m in cash from GMHBA (a not-for-profit health fund), who will acquire Health.com.au;
- GMHBA's private health insurance product suite, including both the GMHBA and Frank health insurance brands will come onto the ISU health comparison platform;
- The health.com.au brand and product suite will continue to be distributed via iSelect; and
- ISU expects to report a \$10m impairment to the receivable on the Balance Sheet as well as \$800k in one-off costs relating to the deal.

A very good outcome for ISU

We believe that this is a great outcome for ISU for the following reasons:

- **Value received higher than we had anticipated:** In our valuation, we valued the NIA loan facility separately at \$39.6m vs \$42.1m cash to be received;
- **Product suite enhanced:** Health.com.au's products will remain on ISU's platform plus they will now have GMHBA's products. There was a possibility that the Health.com.au product suite would no longer feature on ISU's platform depending on who the buyer was. Through this deal, ISU has further enhanced its depth of product availability on its platform;
- **Focus can now return to the underlying business:** The constant noise surrounding NIA has been a distraction for the company for a long period. The market (and more importantly management) can now move on to focus on the future for ISU in Health, Energy, Home Loans etc... We expect this will be a strong feature of its FY15 result presentation.
- **Real prospect of capital management:** ISU will have more than \$100m in net cash on the Balance Sheet post the settlement of this deal. We expect that it will begin paying dividends and possibly return some capital to shareholders by way of a buyback or some other form of capital management.

Earnings changes

Following ISU's Announcement today we have made minor changes to earnings as a result of a slight increase to our assumed net cash balance in future years. We had previously taken into account the reduction in interest from the absence of the NIA loan and the increase in cash.

Figure 1 - Earnings changes

Earnings Changes Jun Year end	2015e			2016e			2017e		
	old	new	% change	old	new	% change	old	new	% change
Sales (A\$m)	161.2	161.2	0.0%	185.5	185.5	0.0%	208.0	208.0	0.0%
EBITDA (A\$m)	32.4	32.4	0.0%	37.8	37.8	0.0%	43.4	43.4	0.0%
NPAT (underlying) (A\$m)	21.3	21.3	0.0%	23.3	23.6	1.2%	27.3	28.0	2.7%
EPS underlying (cps)	8.1	8.1	0.0%	8.9	9.0	1.2%	10.4	10.7	2.7%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Valuation changes

We have updated our valuation by:

- Removing the NIA loan facility and recording the increase in net cash in our SOTP and DCF valuation;
- Rolling forward our DCF valuation in anticipation of the upcoming FY15 result; and
- Adding a 15% premium to our valuation to account for the expected capital management that should drive eps growth in excess of what we are currently forecasting.

The changes are outlined in the figures below and have resulted in an increase to our Price Target of \$2.10 (previously \$1.65).

Figure 2 DCF valuation

June year end	2016 CF1	2017 CF2	2018 CF3	2019 CF4	2020 CF5	2021 CF5	2022 CF6
Operating cash flow	64.7	26.0	29.7	33.8	39.6	45.5	
Capex	- 6.5	- 7.3	- 8.1	- 9.0	- 10.1	- 11.2	
Free cash flow	58.2	18.7	21.6	24.7	29.5	34.3	480.4
Present value of cash flows		17.1	17.8	18.5	20.0	21.1	267.7
Sum of present values		362.3					
Market value of investments		-					
Net debt/(cash)	-	108.8					
Equity value		471.2					
Equity value per share		\$ 1.80					
WACC		10.4%					

SOURCE: BELL POTTER SECURITIES ESTIMATES

Figure 3 - Sum-of-the-parts valuation

	FY16 EBITDA		EV/EBITDA		Valuation	
	Lo	Hi	Lo	Hi	Lo	Hi
1. iSelect ongoing operations	37.8	37.8	8.0	9.0	302.4	340.2
2. Existing trail commission book less DTL			10% haircut	Value on B/S	62.4	69.3
3. Cash on Balance Sheet					108.8	108.8
Total Value					473.6	518.3
Shares on issue					261.5	261.5
Value per share					1.81	1.98

SOURCE: BELL POTTER SECURITIES ESTIMATES

Figure 4 - Valuation changes

	Old valuation			New valuation		
	Valuation	Weighting	Price Target	Valuation	Weighting	Price Target
DCF	\$1.63	50%	\$0.82	\$1.80	50%	\$0.90
SOTP	\$1.70	50%	\$0.85	\$1.81	50%	\$0.91
Total			\$1.67			\$1.81
15% premium for capital management			0%			15%
Price Target			\$1.65			\$2.10

SOURCE: BELL POTTER SECURITIES ESTIMATES

iSelect

Company description

iSelect is an Australian online-driven comparison service. It compares insurance, utility services and personal finance products. ISU uses its comparison website to help consumers make complex purchase decisions. It supplements this with a telephone-based salesforce to drive sales for product providers. ISU employs an end-to-end advice model that utilises a sophisticated consumer needs analysis followed by detailed product advice and in-house sales. ISU generates almost all revenue on completed product sales.

Investment strategy

ISU is a leading brand in online comparison benefiting from a clear first mover advantage. We believe that ISU's new energy business can replicate the success it has in health insurance (now ~20% market share of health insurance). Other industry verticals, such as Home Loans, provide ISU with additional opportunities in the longer term. ISU has a strong balance sheet to support its growth plans and is demonstrating improving cash flow conversion as it generates more upfront commission.

Valuation

We value ISU using DCF and Sum-of-the-parts (SOTP) methodologies to arrive at a 12-month Price Target of \$2.10.

Risks

Risks facing ISU include but are not limited to:

- **Low barriers to entry:** Comparison websites require little capital to set up and product providers have little incentive to provide exclusive product to any one Site as there is no cost per Site listing. ISU is building barriers by leveraging the strength of its brand, providing full service consumer advice and utilising complex data analytics.
- **Regulatory change:** Changes in Government policy, especially in private health insurance regulation may have significant effect on the future profitability of ISU. Changes to the Federal Government Rebate or Medicare Levy would particularly affect ISU's Health division.
- **Lower than expected cash receipts from trail commissions:** Trail commissions are recognised at time of sale as the expected future revenue from the trail. Adjustments are made each period based on changes to experience in lapse rates and clawback provisions as well as other assumptions. This can negatively affect future revenue.
- **Risk of loss of product providers:** To operate effectively ISU rely on a wide range of products to compare. If product providers refuse to sell product on ISU's site, consumers will not benefit from comparison and ISU's service will become ineffective.
- **Second half skew to earnings:** In FY14, ISU earned 77% of its EBITDA in the second half. The main reason for the heavy skew is that the Health business is driven by the 30 June deadline. As other industry verticals grow we expect the skew to reduce.

Table 1 - Financial summary

Jun Year end	2013	2014	2015e	2016e	2017e
Profit & Loss (A\$m)					
Sales revenue	118.0	136.7	161.2	185.5	208.0
... Change	5.5%	15.8%	17.9%	15.1%	12.1%
EBITDA	26.5	29.2	32.4	37.8	43.4
... Change	10.0%	10.4%	10.7%	16.7%	14.8%
Deprec. & amort.	(5.2)	(6.5)	(6.8)	(7.6)	(7.6)
EBIT	21.3	22.8	25.5	30.2	35.8
Net Interest	(1.7)	3.4	5.0	3.6	4.4
Associates	-	-	(0.2)	(0.2)	(0.2)
Pre-tax profit	19.6	26.2	30.4	33.7	40.0
Tax expense	(5.2)	(7.9)	(9.1)	(10.1)	(12.0)
... tax rate	27%	30%	30%	30%	30%
Minorities	-	-	-	-	-
Underlying Net Profit	14.4	18.3	21.3	23.6	28.0
... Change		26.9%	16.4%	10.8%	18.9%
Abs. & extras.	(1.5)	(17.2)	-	(10.8)	-
Reported Profit	13.4	6.3	21.3	12.8	28.0
Cashflow (A\$m)					
EBITDA	26.5	29.2	32.4	37.8	43.4
Change in working capital and other	(37.7)	(35.1)	(27.4)	37.0	(5.4)
Gross operating cash flow	(11.2)	(5.9)	4.9	74.8	38.0
Net interest	(3.4)	3.3	5.0	3.6	4.4
Tax	-	-	-	(10.1)	(12.0)
Operating Cash Flow	(14.5)	(2.5)	10.0	68.4	30.4
Capex	(4.4)	(4.8)	(5.6)	(6.5)	(7.3)
Free Cash Flow	(18.9)	(7.4)	4.3	61.9	23.1
Acquisitions	-	-	(14.3)	-	-
Disposals	-	-	-	-	-
Dividends paid	-	-	-	(2.6)	(9.9)
Other investing items	(35.0)	-	-	-	-
Equity	119.3	(2.0)	0.8	-	-
Debt increase/(reduction)	65.3	(9.4)	(9.2)	59.3	13.2
Balance Sheet (A\$m)					
Cash	85.3	75.9	66.7	126.0	139.2
Receivables	18.7	28.0	33.3	38.7	43.6
Trail commission receivables	33.2	27.5	27.5	27.5	27.5
Other current assets	1.5	3.3	3.3	3.3	3.3
Current assets	138.6	134.6	130.7	195.4	213.5
Fixed assets	7.0	7.7	10.0	12.6	15.7
Trail commission receivables	73.8	71.5	77.3	79.3	82.6
Intangibles	38.7	37.5	48.4	44.7	41.3
NIA receivable	15.4	32.8	52.1	(0.0)	(0.0)
Other non-curr assets	0.8	0.3	0.1	(0.1)	(0.3)
Non Current Assets	135.6	149.9	187.9	136.5	139.3
Total Assets	274.3	284.5	318.6	331.9	352.9
Short term debt	-	-	-	-	-
Creditors	20.2	17.7	20.7	23.8	26.7
Provisions	4.5	6.2	6.2	6.2	6.2
Other curr liabilities	0.4	0.3	0.3	0.3	0.3
Current Liabilities	25.1	24.3	27.3	30.4	33.3
Long term debt	-	-	-	-	-
Other non-curr liabilities	21.4	23.9	23.9	23.9	23.9
Non Current Liabilities	21.4	23.9	23.9	23.9	23.9
Total Liabilities	46.5	48.2	51.2	54.3	57.2
Net Assets	227.7	236.3	267.4	277.6	295.7
Share capital	171.3	173.0	173.7	173.7	173.7
Reserves	6.4	7.0	7.0	7.0	7.0
Retained earnings	50.0	56.4	86.8	96.9	115.0
Shareholders Equity	227.7	236.3	267.4	277.6	295.7
Net debt/(cash) \$m	(85.3)	(75.9)	(66.7)	(126.0)	(139.2)

Price	\$1.85
Recommendation	Buy
Diluted issued capital (m)	261.5
Market cap (\$m)	483.8
Target Price (A\$ps)	\$ 2.10

Jun Year end	2013	2014	2015e	2016e	2017e
Valuation Ratios					
Underlying EPS (eps)	7.1	7.0	8.1	9.0	10.7
... % change	na	-0.9%	16.1%	10.6%	18.9%
PE (on underlying EPS) (x)	26.1	26.4	22.7	20.5	17.3
EV/EBITDA (x)	14.2	12.8	11.6	9.9	8.6
EV/EBIT (x)	17.6	16.5	14.7	12.4	10.5
NTA (\$ps)	0.93	0.76	0.84	0.89	0.97
P/NTA (x)	2.0	2.4	2.2	2.1	1.9
Book Value (\$ps)	1.12	0.91	1.02	1.06	1.13
Price/Book (x)	1.7	2.0	1.8	1.7	1.6
DPS (eps)	-	-	-	3.6	4.3
... % pay-out	0.0%	0.0%	0.0%	40.0%	40.1%
Yield (%)	0.0%	0.0%	0.0%	1.9%	2.3%
Franking (%)	0%	0%	0%	0%	0%

Performance Ratios					
Revenue growth (%)	5.5%	15.8%	17.9%	15.1%	12.1%
EBITDA growth (%)	10.0%	10.4%	10.7%	16.7%	14.8%
EBIT growth (%)	6.5%	6.8%	12.2%	18.3%	18.5%
EBITDA/sales margin (%)	22.4%	21.4%	20.1%	20.4%	20.9%
EBIT/sales margin (%)	18.1%	16.7%	15.8%	16.3%	17.2%
Gross cash conversion (%)	-42.2%	-20.0%	15.3%	198.0%	87.6%
Free cash-flow yield (%)	-3.9%	-1.5%	-2.1%	12.8%	4.8%
ROE (%)	6.3%	7.9%	8.4%	8.6%	9.8%
ROIC (%)	10.5%	10.5%	9.9%	12.0%	16.3%

Leverage Ratios					
Net interest cover (x)	12.6	(6.7)	(5.1)	(8.3)	(8.1)
Net Debt/EBITDA (x)	(3.2)	(2.6)	(2.1)	(3.3)	(3.2)
Net debt/equity (%)	-37.5%	-32.1%	-24.9%	-45.4%	-47.1%
Net debt/net debt + equity (%)	-59.9%	-47.3%	-33.2%	-83.1%	-89.0%

Half yearly (A\$m)	2H13	1H14	2H14	1H15	2H15e
Sales revenue	70.9	55.8	80.9	65.6	95.6
EBITDA	22.6	7.7	21.6	8.4	24.0
Deprec. & amort.	(2.7)	(3.0)	(3.5)	(3.2)	(3.6)
EBIT	19.8	4.7	18.1	5.2	20.4
Unallocated costs	(9.0)	(1.8)	(2.3)	(2.2)	(2.1)
Interest expense	(0.2)	1.6	1.8	2.7	2.3
Pre-tax profit	19.6	6.2	19.9	7.8	22.6
Tax expense	(5.4)	(2.0)	(6.0)	(2.4)	(6.7)
... tax rate	-28%	-31%	-30%	-31%	-30%
Underlying Net Profit	14.2	4.3	14.0	5.4	15.9

Segments	2013	2014	2015e	2016e	2017e
Revenue					
Health & Car Insurance	93.1	104.3	112.1	124.2	137.4
Household Utilities and Financial	24.9	32.4	49.1	61.3	70.6
Total	118.0	136.7	161.2	185.5	208.0
EBITDA					
Health & Car Insurance	36.5	31.1	32.1	35.4	38.8
Household Utilities and Financial	3.1	2.2	4.6	7.4	10.0
Corporate	-13.1	-4.1	-4.3	-5.0	-5.5
Total	26.5	29.2	32.4	37.8	43.4

SOURCE: BELL POTTER SECURITIES ESTIMATES

Recommendation structure

Buy: Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

Hold: Expect total return between -5% and 15% on a 12 month view

Sell: Expect <-5% total return on a 12 month view

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Such investments may carry an exceptionally high level of capital risk and volatility of returns.

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