# One growth stock for the watch list

## by Roger Montgomery

With a market capitalisation of $1.3bn, Invocare (IVC) has quietly become the number one operator of funeral homes, crematoria and cemeteries in Australia, New Zealand and Singapore, with 250 funeral locations and 14 cemeteries and crematoria. The company commands 34% of the Australia/New Zealand market and 10% in Singapore.

In Australia, the company operates three national brands: White Lady, Simplicity and Value, which focus on different service/value segments, and a large number of state-based brands. The fact a brand and reputation take time to build, many of those that have acquired have been retained.

Some commentators might make light of the very sensitive services Invocare provides its customers, often at a time of great sorrow, so given the relatively straightforward and predictable business we won't dwell on the details here.

The development of pre-paid funerals however, which allow customers to purchase a future funeral service at today's price, accounts for approximately 14% of Australian volumes. For Invocare, the development of this market serves as a form of debt funding, with a low interest rate effectively being the rate of price increases for the company's services (around 3-4% p.a.). At the end of FY15, prepaid funds on the balance sheet were $422m and are primarily invested in fixed interest and property, with less than 20% allocated to equities.

Invocare is a very high quality business with a demonstrated track record of stable long-term revenue growth, serving customers who are not sensitive to price but very sensitive to brand, which takes years to build, while also material competitive advantages and barriers to entry.

Given the local nature of funeral service provision, it is possible for Invocare to be dominant in some markets, while still offering investors substantial growth elsewhere. And it perhaps goes without stating that the company is favourably exposed to Australia's ageing population, which is expected to drive accelerating volume growth over the next 15 years.

The resultant earnings growth and expectations of more suggest it should be unsurprising that Invocare has provided outstanding investment returns over an extended period of time. The corollary, of course, is that the market has come to appreciate the economic merits of the business, and, over time, has fully incorporated these into the share price. It is therefore very rare to be able to buy this business cheaply.

Earnings for the company are relatively predictable and both the capital structure and the cash flows are also stable. The national death rate may vary year-to-year, but in the absence of a material change to life expectancies, the average death rate over longer periods is effectively locked in and forecast by the Australian Bureau of Statistics to increase from 1.5% today to 2.8% in 2032. We have factored this into our valuation.

It is also worth noting that the provision for funeral services is not a competitive market, producing not only limited threats to margins but also the ability to implement price increases, to the extent that reputation can be preserved. With these factors in mind, a less conservative valuation is justified.

It's also worth making the observation that while Invocare's return-on-equity remains above 20%, it has declined consistently over time, with a gradual "normalisation" occurring, as incremental capital becomes a larger part of the denominator. With the majority of shareholder funds now being incremental to that at listing, profitability metrics should converge with those achieved on incremental equity. In other words, current returns on equity should be expected to be maintained.

In light of the secure nature of Invocare's earnings and growth prospects, we'd argue when valuing the company's shares, that a discount rate at the low end of our normal range is warranted. However, we find that even using a low discount rate assumption, the estimated value appears to fall short of the current market price. We estimate value to be in the order of $8.00-9.00 per share, compared with a current market price closer to $12.00 per share.

The share price today is partly a reflection of business quality and underlying growth, but it is also driven by an increasingly favourable treatment of earnings. The company's shares have become more popular. That suggests that we should be more optimistic that the opportunity to buy at a rational price can be presented. It might be worth remembering our valuations, if any correction in the market for highly reliable and stable revenue-earning companies occurs.

**Invocare (IVC)**


*Source: Yahoo!7 Finance, 2 May 2016*

**Important:** *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. Consider the appropriateness of the information in regards to your circumstances.*