MACRO OPS

RESEARCH

April 28, 2020

Frontdoor Inc. (FTDR)

Business Description: frontdoor, inc. provides home service plans in the United States. The company's home service plans cover the repair or replacement of components of up to 21 household systems and appliances, including electrical, plumbing, water heaters, refrigerators, dishwashers, and ranges/ovens/cooktops, as well as electronics, pools, and spas and pumps; and central heating, ventilation and air conditioning systems. It serves homeowners under the American Home Shield, HSA, Landmark, and OneGuard brands.

The Thesis: Frontdoor has a high-margin / capital-light core business that is growing faster than industry average in a largely under-penetrated market. Free cash flow conversion rates close to 70% provide the company with capital to either pay down debt, invest in ancillary services, give back to its shareholders in dividends, or a combination of the three.

I wrote that thesis in December. Not much has changed since then. The company continues to execute. Here's their FY 2019 numbers:

- Revenue +8% to $1.36B
- Net Income +23% to $153M
- Q4 EPS $0.22
- Q4 Revenue +7% to $300M

Despite COVID-19, management expects revenues and EBITDA in-line with guidance ($1.47B and $320M, respectively).

FTDR's expanding margins and growing top-line revenues at an impressive clip. They require little in capital expenditures. For example, they're expecting $30-$40M in capex in 2020. That's over $200M in run-rate free cash flow.

The company also benefits from a negative working capital cycle. This further increases their FCF generative abilities and provides the company with enviable float.

What's It Worth: FTDR is growing top-line at 8%+, sports near 50% gross margins and 20% operating income margin. You can buy this business for 23x free cash flow, or 20x normalized earnings. That sounds pretty darn cheap.

Let's assume they grow revenues 7.5% over the next five years and maintain 20% EBITDA margins. We'd end 2024 with $1.9B in revenues, $387M in EBITDA and $283M in free cash flow. Without a P/FCF multiple re-rating you're looking at $6.5B in shareholder value ($76/share).

Main Risks:

- Sustained shutdown delays purchase of new homes and home warranty plans
- Homeowners default on their warranty plans