COMPANY NOTE

Estimate Change

UK | Property & Real Estate | UK Property

1 February 2018

Jefferies

EQUITY RESEARCH EUROPE

Purplebricks (PURP LN)

Buyer Beware

UNDERPERFORM

Price target 94.00p

Price 489.80p^

Key Takeaway

Purplebricks (PB) does not disclose how many home it sells. Our research sample found that it had sold 51.6% of the homes listed in November 2016 within 10 months, a similar success rate to the overall market, but below the company's claim of 88%. Unlike the traditional market, those who don't sell still have to pay PB's fees. PB's latest results reported that its average revenue per UK customer was £1,138.

An impressive disruptor. We admire the speed at which PB has grown and the sheer scale of its ambition, from recording its first revenues in FY14 to disrupting the estate agency markets in three continents by FY17. No one can doubt that it has disrupted the markets in which it operates and we can see the attractions of the revenue growth from its upfront fixed-fee model.

The £1,000 coin toss. We found that 51.6% of those who instructed PB to sell their home in November 2016 had sold their home within 10 months. These odds are finely balanced, but with around £1,000 at stake it is a close call for homeowners who will pay the fixed fees whether or not they sell their home.

Why is this important? In a Radio 4 interview in October 2016, PB's CEO, Michael Bruce, is on record as saying that the company sells 88% of homes within 10 months and that it sells more houses as a percentage of those taken to market than any other agent in the UK.

Similar to the market as a whole. We have benchmarked PB's performance over the last 14 months against the performance of more than 7,000 different estate agency brands in the UK. Our analysis suggests that PB's success rate is near the middle of the pack. However, although only just over half actually sell their home, everyone has to pay. With a traditional high street agent, the homeowner only pays if the agent sells their home.

Devil in the detail. A review of PB's accounting policies raises concerns to us that either its contractual obligations to its customers end with their home being listed on the major property portals or that revenue may have been overstated and deferred income provisions understated in its audited accounts.

Valuation/Risks

Valuation. At 490p, PB trades on a CY2018 PER of 131x against the sector trading on 13x and an EV/EBITDA of 94x (sector 8x). **Risks.** Should the model stumble, the share price may do likewise. Upside risks to our thesis include higher growth in fees, instructions and LPEs than we assume.

GBp	Prev.	2017A	Prev.	2018E	Prev.	2019E	Prev.	2020E
Rev. (MM)	--	£46.7	--	£101.5	--	£170.2	--	£269.0
EV/Rev		23.7x		10.9x		6.5x		4.1x
EBITDA (MM)	--	£(4.5)	--	£1.3	--	£20.2	--	£44.9
EV/EBITDA		NM		NM		54.7x		24.6x
Operating Profit (MM)	--	£(6.0)	--	£(0.2)	--	£18.8	--	£43.4
PBT (MM)	--	£(6.1)	--	£0.0	--	£19.0	--	£43.6
Dividend	--	0.00	--	0.50	--	1.00	--	5.00
Div. Yield		0.00%		0.10%		0.20%		1.02%
EPS Adjusted								
FY Apr	*(1.70)*	(1.20)	--	0.00	--	5.60	*12.99*	12.90
FY P/E		NM				87.5x		38.0x

Financial Summary

Net Debt (MM):	(£71.3)

Market Data

52 Week Range:	525.00p - 190.50p
Total Entprs. Value (MM):	£1,105.7
Market Cap. (MM):	£1,177.0
Shares Out. (MM):	240.3
Float (MM):	217.7
Avg. Daily Vol.:	1,265,644

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Price Performance

^Prior trading day's closing price unless otherwise noted.

Please see analyst certifications, important disclosure information, and information regarding the status of non-US analysts on pages 15 to 20 of this report.

Purplebricks (PURP LN)

Underperform: 94p Price Target

Scenarios

Base Case

- Our estimates are based on company guidance on LPE numbers and fees for FY2016 and our estimates of growth thereafter.
- FY2018E Revenue £101.5m
- FY2018E PBT £0.0m
- FY2018E EPS 0.0p

Price Target: 94p DCF-based

Upside Scenario

- Our upside scenario estimates are based on the assumption that KPIS and revenue drivers are 10% ahead of our Base Case.
- FY2018E Revenue £111m
- FY2018E PBT £35.3m
- FY2018E EPS 10.4p
- Price Target: 158p DCF-based

Downside Scenario

- Our downside scenario estimates are based on the assumption that KPIS and revenue drivers are 20% lower than our Base Case. In this scenario, we assume that when cash levels reach £5m the company will cease to trade and cash will be returned shareholders.
- FY2018E Revenue £80m
- FY2018E PBT £(10.9)m
- FY2018E EPS (74.0)p
- Price target: 2p DCF-based

Investment Thesis / Where We Differ

- We have a holistic view of the UK residential sector, covering UK housebuilders, estate agents, property portals, construction firms, building products firms and distributors.
- Purplebricks is rather modestly seeking to disrupt the global residential real estate market.
- Our concern is that the group has expanded quickly across three continents before the model has been proven and therefore that the shares are priced for perfection.
- Our research is not able to replicate the views on selling success expressed by the company.

Catalysts

- Significant growth or decline in LPEs.
- Strong level of sales transaction completions.
- Increased disillusionment with the traditional estate agent model.
- Significant change in cost structure.
- Successful US launch.
- Profitability being delivered ahead of plan.
- Sales rates lower than market expectations.

Long Term Analysis

Long-Term Financial Model Drivers FY2016-19E

Revenue growth (% pa)	95.0%
EBITDA growth (% pa)	n/a%
EPS growth (% pa)	n/a%
DPS growth (% pa)	n/a%

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The big question

Purplebricks operates a business model in which its customers pay a fee whether or not their home is sold. The fee may be deferred for up to 10 months if the customer agrees to use Purplebricks' conveyancing partners. We doubt that potential customers would want to pay a fee if they didn't think Purplebricks was very likely to successfully sell their home. In our view, therefore, the investment case of Purplebricks rests on one question, and one question alone: 'How many homes does it sell?'

How many homes does Purplebricks sell? What the company says

Purplebricks does not disclose how many homes it sells because it believes this information to be commercially sensitive.

The closest the group has come to disclosing how many homes it sells was during an interview on Radio 4's Moneybox programme on 17 October 2016, when CEO Michael Bruce said that "88% of people sell their house prior to getting to the period of deferment, which is 10 months."

We show a portion of the radio show transcript below:

Michael Bruce: 88% of people sell their house prior to getting to the period of deferment, which is 10 months. At the end of the day, we sell more houses as a percentage of what we take to the market than any other agent in the UK. We're also the most positively reviewed agent than anyone else in the UK, and that's because we have a strong reputation for selling houses and getting the job done better than anyone else.

Radio 4 presenter: So 88% of the people who list with you sell their home?

Michael Bruce: Correct.

Radio 4 presenter: So 12% don't. So they're the ones who in a sense are subsidising them because they pay what's now £849 and don't actually get a sale.

Michael Bruce: What I said was 88% of people actually sell their house prior to the 10-month period. What I didn't say was 12% don't sell. Those people will remain on the market, and stay on the market until they sell their house.

Purplebricks also discloses conversion rates from instruction to sale agreed in its results presentations at each full year and half year, as detailed below:

- FY 16: Conversion from instruction to sale agreed over 77% (Apr 15 – Mar 16)
- H1 17: Conversion from instruction to sale agreed over 78% (May 16 – Nov 16)
- FY 17: Conversion from instruction to sale agreed over 83% (May 16 – Apr 17)
- H1 18: Conversion from instruction to sale agreed over 78% (May 17 – Oct 17)

The FY2016, H1 2017 and FY2017 results presentations also had a footnote stating 'This may represent the minimum conversion assuming those properties still on the market sell hereafter.' We note that this footnote was not part of the H1 18 disclosure.

Purplebricks also provided additional disclosure as part of its Interim Results Presentation on 5 December 2016, where it commissioned the Land Registry to verify that properties marked as sold were actually sold and recorded in the Land Registry's own records:

- A random sample of 1,611 properties marked as sold across Birmingham, Bournemouth and Southampton.
- An additional random sample of 10,000 properties marked as sold across the UK

Purplebricks reported that the Land Registry verified that 87.5% of the 1,611 and 91.9% of the 10,000 homes marked as sold were confirmed as actual sales.

In some senses, we were surprised that the Land Registry data did not confirm that 100% of homes marked as sold were actually sold: either a home is sold or it is not. This suggests to us that some properties may have accidently been marked as 'sold' before the sale had actually been confirmed.

How many homes does Purplebricks sell? What Jefferies says

Purplebricks does not disclose how many homes it sells, so we decided to try to work it out for ourselves.

Every one of Purplebricks' property listings equates to an instruction, and every instruction triggers a fee. The fee is payable by the customer to Purplebricks irrespective of whether their home is sold or not.

To get an indication of how many homes it sells, we simply started to collect details of Purplebricks' property listings and waited for them to be recorded as sales in the UK government's Land Registry database. We started collecting details of the properties Purplebricks was listing from November 2016.

The analysis we have carried out relates to properties newly listed by Purplebricks in November 2016. For commercial reasons, Purplebricks would not disclose how many listings it had in November 2016, but it did give us a range and (observing its commercial sensitivities) we can report that our sample size falls within the range given to us.

In the Radio 4 interview, Purplebricks stated that '88% of people sell their house prior to getting to the period of deferment, which is 10 months.' We would therefore have expected to see 88% of the homes for which we had listing particulars recorded as sales within 10 months. However, when analysing our dataset, we found was that 51.6% of homes newly listed in November had sold within 10 months of being listed for sale.

How does this compare with the rest of the market?

We have not yet had time to trace every listing of every agent through to the Land Registry database. However, a high-level proxy is the ratio of sale agreed homes to total listings — the ratio of 'almost sold' homes — and we have a database of more than 1.8m properties that have been listed on Rightmove across more than 7,000 estate agency brands.

The weighted average sale agreed to total stock ratio across this snapshot was 48.2%.

We should point out that:

- Such a measure may penalise agents that are experiencing a high level of growth in listings, as this influx of new stock has not had time to sell.
- Sale Agreed is not the same as 'sold'. Rightmove, the company with arguably more estate agency data than most, states on its website that: 'On average about 15% of Sold STC or UO [Under Offer] properties come back on the market after the sale has failed to proceed.'

In the table below, we show the sale agreed / total stock ratio for the larger hybrid agents. We also apply Rightmove's failure rate of 15% to estimate an instruction to sale success rate. We note that this is just a high-level estimate and the estimate for Purplebricks of 47.1% differs to our own more detailed analysis. We note that EasyProperty changed its charging structure in January to include a success fee element and the value in the table below may not, therefore, be indicative of its success rate going forward, and that Settled, even though it is ranked number two, has changed strategy and now only offers a fixed 'no sale no fee' option of £2,200.

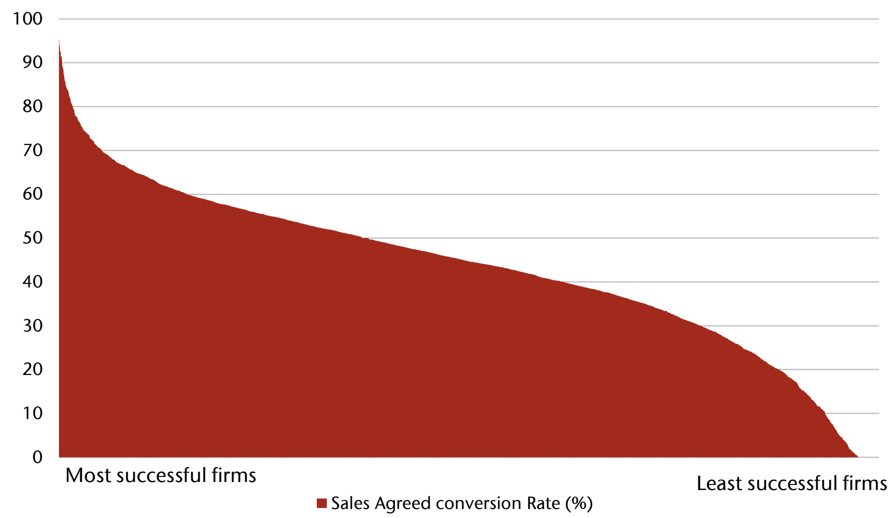
Table 1: High-level sales statistics

	Sale Agreed / Total Stock (%)	Estimated Sale Success (%)
Purplebricks	55.4	47.1
Settled	46.9	39.9
Yopa	46.2	39.3
HouseNetwork	43.8	37.2
Hatched	38.6	32.8
eSale	40.1	34.1
eMoov	38.4	32.6
Tepilo	38.9	33.1
SellMyHome	37.1	31.5
Doorsteps	29.8	25.3
247 Property Agent	31	26.4
EasyProperty	23.8	20.2
HouseSimple	9.7	8.2

Source: Jefferies estimates

We show below the sales conversion rate across the market for all firms that have marketed more than 50 properties since November 2016.

Chart 1: Sale Agreed to Total Stock by brand rank



Source: Jefferies estimates

What could explain the differences?

There is clearly a large difference between 51.6% and 88.0%: at one end the performance is middle of the pack, while at the other end it is up there with the best. When discussing our methodology with Purplebricks, they did not dispute our methodology in identifying which homes had sold. However, the company did use a couple of phrases that were new to us: 'withdrawal from market' and 'marketing breaks', which they said reflect the behaviour of homeowners adjusting to the relatively new phenomena of fixed upfront-fee estate agencies. These phrases were not used in the Radio4 interview, Purplebricks AIM Admission document or the 2016 and 2017 audited Annual Reports.

Purplebricks often attributes its success to the fact that it attracts committed and highly motivated sellers. Time-wasters, it argues, would be unwilling to spend around £1,000 on an upfront (or deferred but ultimately payable) fee unless they really want to sell their home; one doesn't spend around £1,000 to 'try' the market. The upfront fixed fee varies by location: within Greater London it is £1,199, outside of Greater London it is £849. Customers can also add a viewings package for £300.

We agree with this theory. However, the concepts of 'withdrawals from market' and' marketing breaks' were new to us

Withdrawal from market. This might be where a homeseller has decided not to sell their home due to unforeseen circumstances, such as divorce, health, a change in employment status etc. Purplebricks suggested that withdrawals from market could account for a large proportion of the difference between our results and theirs, indicating that withdrawals may account from between 'mid-teens up to 20% of listings'. We appreciate that, for some, there inevitably will be life events that change their decision to sell their home. However, we are surprised that Purplebricks believes this figure to be so high, suggesting that up to one in five committed and motivated sellers may withdraw their homes from the market, having spent around £1,000 to put them on the market.

Marketing breaks. A homeowner, perhaps after a period of low buyer interest, may take a marketing break and relaunch their home for sale when, for instance, market conditions have improved or after home improvements have been made to increase the market appeal of the home.

The Radio 4 interview and our subsequent discussions with Purplebricks lead us to conclude that once the fixed fee has been paid, for customers who are either returning from a marketing break or readmitting their property for sale after a period of withdrawal, Purplebricks will continue to offer the services covered by the fixed fee until the property is sold by Purplebricks or by another agent. The group suggested to us that until the customer's property has sold, it remains a potential sale for Purplebricks.

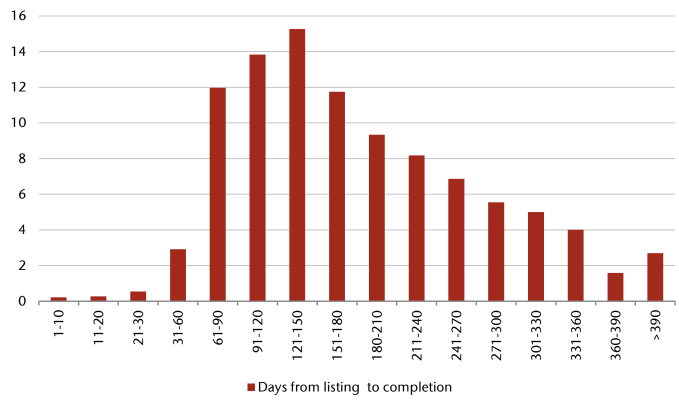
However, we note that in the Service Agreement, Purplebricks says that:

"We will advertise and market your property for the Advertisement Period on such property portals, websites or publications as we consider to be the most effective at securing interest on your property from potential purchasers and tenants in our absolute discretion. We may withdraw or no longer take advantage of the services of such property portals, websites or publications at our absolute discretion."

The Service Agreement defines 'Advertisement Period' as follows: 'Advertisement Period' means 12 calendar months.

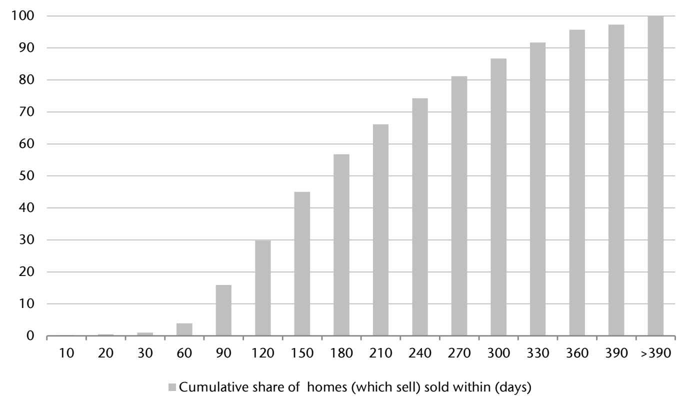
We show in the following two charts the time on market of those homes in our sample that we believe Purplebricks sold. Once a home has been on the market for more than five months, the chances of it selling appear to decline.

Chart 2: Distribution of time from listing to legal sale, (%)



Source: Jefferies estimates

Chart 3: Cumulative distribution of time from listing to legal sale, (%)



Source: Jefferies estimates

We believe that Purplebricks was keen to point out to us the concepts of 'withdrawal from market' and 'marketing breaks' because they have a material impact on how the group's results are perceived. Purplebricks believes the impact of these factors could explain much of the difference between the sales rates we found and the sales rates that it reports. The difference is material, defining the company either as an also-ran or a title contender.

Given the importance of these two concepts, we turned to Purplebricks' 2017 audited Annual Report to see how these concepts were discussed and disclosed.

The Annual Report

Fact-checking conversations we had with Purplebricks while writing this report caused us to turn to the group's audited Annual Reports and AIM Admission document to ascertain how the materiality of 'withdrawals' and 'marketing breaks' was disclosed and how our understanding of what appears to us to be a fixed-fee, but not fixed-term, product impacts Revenue Recognition.

Definition of terms

Purplebricks' audited 2017 Annual Report states within the 'Operational Highlights' on page 7 that:

- The UK monthly run rate of sales agreed increased to 5,171 in May 2017 (May 2016: 2,386)
- Conversion from instruction to sale was 83% (2016: 77%)

We note the difference in language between the two bullet points: the first relates to 'sale agreed', the latter to 'sale'.

The Annual Report does not contain a glossary or definitions section. We therefore think it fair to assume that 'conversion from instruction to sale' implies that a home was actually sold. If what Purplebricks meant was 'conversion from instruction to sale agreed', we believe it would have said that.

Annual reports often contain footnotes to help explain accounting terms and where non-standard definitions are used. For instance, on page 6 of Purplebricks' Annual Report, a footnote defines Adjusted EBITDA as 'the loss from operating activities excluding amortisation of intangibles, share based payment charges, fundraising costs, fair values on derivatives and depreciation.'

There is no footnote to the phrase 'conversion from instruction to sale was 83%' explaining that properties withdrawn from the market and/or on marketing breaks have been excluded from the calculation. In our view, therefore, most, including ourselves, would understand the phrase 'conversion from instruction to sale was 83%' to mean that in the accounting period 83% of instructions ended in the legal sale of the customer's property.

In our opinion, investors would be able to more fully interpret the accounts if the terms used were more fully explained.

A thought experiment

We understand that up to 20% of listings may be withdrawn from the market and it is our belief that they can return to Purplebricks at any time, where for no extra cost the seller will continue to receive services from Purplebricks until the home is sold, should they choose to stay with Purplebricks.

In the theoretical world of thought experiments, we have a situation where in years one to five 20% of properties are withdrawn, and all of these withdrawn properties return to the market with Purplebricks in year 6. This would imply that in year 6, Purplebricks has double the number of homes to sell (5 x 20% + 100% of the current year). We raised concerns in our initiation of coverage note (Purplebricks: Initiating at Underperform; You Do The Arithmetic, 31 May 2016) about how many hours Purplebricks Local Property Experts (LPEs), the company's version of proper estate agents, would have to work in order to meet On Target Earnings expectations. We are therefore very concerned about how they would cope with this additional workload, especially as this workload comes with a bitter pill: they have already been paid for the work yet to be completed.

UK estate agency is a people business and Purplebricks describes itself (on its UK website homepage) as a 'Proper Estate Agent'. However, if it were just a conduit for homeowners to be able to list their homes for sale on the major UK property portals, the human resources problem largely disappears. Properties could be reloaded to the portals by a click of a button. However, this thought experiment led us to consider Purplebricks Revenue Recognition accounting policy.

Returning customers and Revenue Recognition

The concept of customers and their properties returning from withdrawals and marketing breaks raises interesting questions with respect to Revenue Recognition.

The 2017 audited Annual Report states on page 40, under the title 'Rendering of services':

'*Revenue from a contract to provide services is recognised in the period in which the services are provided in accordance with the stage of completion of the contract when all of the following conditions are satisfied:*

- *the amount of revenue can be measured reliably;*
- *it is probable that the Group will receive the consideration due under the contract;*
- *the stage of completion of the contract at the end of the reporting period can be measured reliably, and;*
- *the costs incurred and the costs to complete the contract can be measured reliably.*

Fees earned on instruction of residential property are accounted for over time as the Group's obligations are completed. Where the Group's obligations have not been completed fees are recorded as deferred income and presented within liabilities.'

We are particularly interested in the final bullet point and the final paragraph. We would be curious to understand how the costs to complete the contract can be 'measured reliably' when the contract appears to us to operate for an open-ended time period and the company has only started to record revenue in FY2014.

Perhaps the answer lies in the final paragraph: 'Fees earned on instruction of residential property are accounted for over time as the Group's obligations are completed. Where the Group's obligations have not been completed fees are recorded as deferred income and presented within liabilities.'

Based on this statement, and Purplebricks' subsequent guidance, we could expect to see up to 20% of revenues deferred to account for customers withdrawing homes and taking marketing breaks.

We show in the table below Purplebricks' audited revenue and deferred income balances.

Table 2: Purplebricks audited Revenue and Deferred Income Balances, £

	FY2013A	FY2014A	FY2015A	FY2016A	FY2017A
Revenue	0	11,855	3,394,464	18,603,679	46,706,078
Deferred Income	0	0	109,930	760,358	2,306,512
Deferred Income as % of Revenue	n/a	n/a	3.2	4.1	4.9

Source: Purplebricks AIM Admission Document and Audited Accounts

The Deferred Income as a percentage of Revenue increases over time, from 3.2% in FY2015 to 4.9% FY2017, perhaps reflecting the changing behaviour of customers with market withdrawals and marketing breaks as they get used to the new upfront fixed-fee method of selling a home.

As mentioned earlier, we understand from Purplebricks that withdrawals and marketing breaks could be in the region of 'mid-teens to 20%' of property listings. A deferred income balance of less than 5% in FY2017 is therefore lower than we would expect to see. In order to investigate this further, we turned to the specific wording of the group's Revenue Recognition accounting policy.

We note that the wording of the Revenue Recognition policy changed between FY2016 and FY2017. We summarise all of the Revenue Recognition policies since FY2013 in the following section, and highlight the key change below:

FY2013-FY2016

- Fees earned on instructions of residential property are accounted for at the point of publication of the advert to property portals. Where property particulars have not yet been published to property portals, the fees are recognised as deferred income and presented within liabilities.

FY2017

- Fees earned on instruction of residential property are accounted for over time as the Group's obligations are completed. Where the Group's obligations have not been completed fees are recorded as deferred income and presented within liabilities.

Pre-FY2017, Deferred Income relates to revenue received before property particulars have been published on the property portals. In FY2017, Deferred Income relates to income received where the Group's obligations have not been completed.

Is this a change in policy or just a change in wording? Given that in the FY2017 audited accounts the comparative FY2016 Deferred Income balance has not been restated from the audited FY2016 accounts, it appears to us that the policy hasn't changed. This leads us to conclude that the group believes that its contractual obligations have been met when a customer's home has been listed on a portal rather than actually being sold.

Is this a case of heads you lose, tails you lose?

If our interpretation of the accounting policy is correct, it might be inappropriate for Purplebricks to lead in the UK with a marketing message that they are 'Proper Estate Agents' rather than just offering a service to list properties on the property portals.

If our interpretation is incorrect and Purplebricks does indeed have an ongoing and open-ended 'Proper Estate Agent' obligation to its customers, it may have overstated revenue in its audited accounts and understated its deferred income liabilities. Revenue may have been recognised too early and potentially insufficient allowance made for the future costs relating to providing estate agency services to customers who have withdrawn properties and for those currently taking a marketing break.

Future potential costs

Purplebricks' website tells potential customers that they will have: 'Real people at every step. Our experts are some of the most experienced estate agents in their area and know your local property market like the back of their hand, working tirelessly for our customers'. The LPE is on hand to manage all viewings and negotiate the best price, and: 'Our dedication does not stop there. When you've agreed your sale our Post Sales Support team will be there to help you right through to the day the keys are handed over.'

As a minimum, the additional costs would be the ongoing portal costs (at least for the balance of the Advertisement Period unused prior to the withdrawal or marketing break). The portals charge hybrid agents such as Purplebricks on a 'branch equivalent' basis, for instance if the average branch has 50 listings and the hybrid has 60, it will be charged as if it had two branches. In the event that up to 20% of properties come back onto the market, portal costs may rise up to 20%.

Another area with cost implications will be the LPEs themselves. Last time we checked, the LPE churn rate was around 20%. If the LPE in a particular area changes while a property is on a 'marketing break', the incoming LPE will have to provide proper estate agency services to the customer but will receive no remuneration for the services already paid for, unless of course these are clawed back from the ex-LPE or Purplebricks itself pays the LPE directly.

In addition to LPE costs, properties returning to the market would also place extra burdens and workload on the Post Sales Support team. From our analysis of Purplebricks' audited Annual Report, we are unclear what provisions for these potential future costs have been made in the accounts.

Purplebricks' Revenue Recognition policies over time

AIM Admission Document

The AIM Admission document covers the following accounting periods:

- Year-ended 30 April 2013
- Year-ended 30 April 2014
- Year-ended 30 April 2015
- Five months ended 30 September 2015

Revenue comprises the fair value of consideration received or receivable in respect of services provided relating to the sale of property, net of discounts, rebates and any sales taxes.

Revenues are recognised on the basis of the performance of contractual obligations and to the extent that the right to consideration has been earned and the flow of economic resources is probable. Fees earned on instructions of residential property are accounted for at the point of publication of the advert to property portals. Where property particulars have not yet been published to property portals, the fees are recognised as deferred income and presented within liabilities.

Annual Report 2016

Revenue comprises the fair value of consideration received or receivable in respect of services provided relating to the sale of property, net of discounts, rebates and any sales taxes.

Revenues are recognised on the basis of the performance of contractual obligations and to the extent that the right to consideration has been earned and the flow of economic resources is probable. Fees earned on instruction of residential property are accounted for at the point of publication of the advert to property portals, the point at which the company's obligations are complete. Where property particulars have not yet been published to property portals, the fees are recognised as deferred income and presented within liabilities.

Annual Report 2017

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured as the fair value of the consideration received or receivable, excluding discounts, rebates, value added tax and other sales taxes.

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The following criteria must also be met before revenue is recognised:

Rendering of services

Revenue from a contract to provide services is recognised in the period in which the services are provided in accordance with the stage of completion of the contract when all of the following conditions are satisfied:

- the amount of revenue can be measured reliably;
- it is probable that the Group will receive the consideration due under the contract;
- the stage of completion of the contract at the end of the reporting period can be measured reliably, and;
- the costs incurred and the costs to complete the contract can be measured reliably.

Fees earned on instruction of residential property are accounted for over time as the Group's obligations are completed. Where the Group's obligations have not been completed fees are recorded as deferred income and presented within liabilities.

Disruptors facing headwinds?

In a period when traditional agents are reporting a shortage of stock to sell and newspapers talk of slowing housing transactions, we suggest that it may be harder for hybrid agents to secure instructions where the customer has to pay the fee irrespective of whether or not the home actually sells.

Perhaps as a result of such pressures, several hybrids are now offering a 'no sale no fee' option, with the fee being a fixed fee rather than a percentage of the selling price of the home sold. One hybrid, Settled, started the year by ditching the pay upfront option altogether and now just offers a £2,200 fixed fee option (which includes basic conveyancing services).

We find the 'no sale no fee' price points, where offered, very interesting indeed. The hybrids sought to disrupt the market with their upfront fees, which were significantly cheaper than a traditional commission arrangement. The upfront fee was their chosen business model. We were therefore surprised that the 'no sale no fee' prices are so much higher. We appreciate that risk is being transferred from customer to agent and that this transfer of risk comes at a cost; we were just rather surprised at the scale of that cost.

We show in the table below the base fees of some the larger hybrid agents and the 'no sale no fee' option where available. If we assume that the agent is indifferent between the upfront and the success fee options, then the expected value of the two options would be the same. If the expected value of the success fee were higher than the upfront fee, the agent would try to encourage the use of the success fee. However, in our view, this would be a case of the hybrid agent admitting that the business model based on upfront fee (one of the hybrids' key planks of disruption) was not working as planned.

Table 3: Upfront fees compared with 'no sale no fee' options

		Standard Pay Upfront fee (£)	No Sale No Fee (£)	Implied Sales Rate (%)
1	eMoov	795	1495	53.2
2	SellMyHome	795	1499	53.0
3	Hatched	895	1695	52.8
4	eSale	595	1195	49.8
5	HouseSimple	695	1495	46.5
6	247 Property Agent	695	2100	33.1
7	Purplebricks	849	n/a	
8	Settled	n/a	2200	
9	Yopa	839	n/a	
10	HouseNetwork	975	n/a	
11	Tepilo	895	n/a	
12	Doorsteps	199	n/a	
13	EasyProperty	595	n/a	
	Average of those offering both	745	1580	47.2

Source: Jefferies estimates, company data

One of the theories around the upfront fee models is that it attracts motivated sellers, the argument being that you would only be willing to pay a fee irrespective of sale if you were confident that your home would be sold. However, the implied sales success rate of 47.2% suggests that, on the balance of probabilities, you probably won't sell your home.

We have tracked more than 1.8 million property listings from a population of more than 7,000 agents on Rightmove over the last 15 months, and interestingly the weighted average ratio of 'sale agreed / total stock' is 48.2%. Our implied success rate above is, therefore, very close to the 'sale agreed' rate across the industry as a whole; the big difference being an upfront fee is payable whether or not the home sells.

Purplebricks – Summary Financials

Table 4: Purplebricks – Summary P&L, £m

	2017	2018E	2019E	2020E
Revenue	46.7	101.5	170.2	269.0
Cost of sales	20.8	46.5	78.0	123.2
Gross profit	25.8	55.0	92.3	145.8
Admin costs	13.6	21.5	26.0	35.9
Marketing costs	18.2	33.7	47.5	66.4
EBITDA	-5.4	0.4	19.3	44.0
Share based payments	0.9	0.9	0.9	0.9
EBITDA Adj	-4.5	1.3	20.2	44.9
Operating Profit	-6.0	-0.2	18.8	43.4
Net Finance income	0.1	0.2	0.2	0.2
FV movements	-0.1	0.0	0.0	0.0
PBT	-6.1	0.0	19.0	43.6
Tax	3.1	0.0	-3.8	-8.7
Tax rate	0.0	20.0	20.0	20.0
PAT	-3.0	0.0	15.2	34.9
EPS	-1.2	0.0	5.6	12.9
EPS Diluted	-1.1	0.0	5.2	12.0
DPS	0.0	0.5	1.0	5.0

Source: Jefferies, company data

Table 5: Purplebricks – Summary Cashflow, £m

	2017	2018E	2019E	2020E
Profit after tax	-3.0	0.0	15.2	34.9
D&A	0.6	0.6	0.6	0.6
Other	-2.1	-2.0	-2.0	-2.0
Changes in Wcap	1.4	1.5	1.5	1.5
Net cashflow	-3.1	0.1	15.2	35.0
Capex / Devel	-5.5	-25.0	-25.0	-0.2
Changes in share capital	49.3	0.0	0.0	0.0
Dividends	0.0	-1.2	-2.4	-12.0
Net movement in cash	40.7	-26.1	-12.2	22.8
Cash b/f	30.5	71.3	45.1	32.9
Cash c/f	71.3	45.1	32.9	55.7

Source: Jefferies, company data

Table 6: Purplebricks – Summary Balance Sheet , £m

	2017	2018E	2019E	2020E
Non-current assets				
Intangible	5.4	5.4	5.4	5.4
PPE	0.7	0.7	0.7	0.7
	9.2	6.1	6.1	6.1
Current assets				
Trade and other receivable	4.9	7.1	11.9	18.8
Corp tax receivable	0.0	0.0	0.0	0.0
Cash	71.3	45.1	32.9	55.7
	76.2	52.2	44.9	74.5
Current liabilities	9.7	-15.7	-35.5	-27.2
Net Assets	75.4	74.0	86.5	107.9
Equity				
Share Capital	2.7	2.7	2.7	2.7
Share Premium	74.9	74.9	74.9	74.9
Other Reserves	0.8	0.8	0.8	0.8
Retained earnings	-3.0	-4.4	8.1	29.5
	75.4	74.0	86.5	107.9

Source: Jefferies, company data

Table 8: UK Estate Agency Valuation Matrix

	Countrywide	LSL	Foxtons	Purple bricks
Bloomberg Code	CWD LN	LSL LN	FOXT LN	PURP LN
Rating	Hold	Hold	Hold	Underperform
PT (p)	125	220	90	94
Share Price (p)	85	282	69	490
Market Cap (£m)	202	289	188	1,337
Av daily volume (£m)	0	0	0	
Net debt /(cash) (£m)	248	18	- 9	- 30
EV (£m)	450	307	179	1,307
				35
PER (x)				
CY 2016	4.4	10.9	12.0	- 610.7
CY 2017	7.5	11.2	22.5	- 1,217.4
CY 2018	6.3	9.9	21.7	131.1
EV/EBITDA (x)				
CY 2016	5.4	7.6	7.3	- 433.0
CY 2017	6.9	8.1	11.4	- 1,984.7
CY 2018	6.2	7.3	11.1	93.9
				35.6
Div yield (%)				
CY 2016	5.9	3.7	2.9	
CY 2017	-	3.6	2.9	0.1
CY 2018	-	4.0	3.6	0.2

Source: Bloomberg, Jefferies estimates

Company Description

Purplebricks is a UK based estate agent, which operates without traditional high street branches. The Group provides web based real estate services. The Company offers property search, listing services. Its main touch points with customers are through a network of Local Property Experts and its IT platform. The Group operates a very different revenue model to traditional agents, charging a fixed fee on instruction rather than a success based on the sales price of the home.

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Investment Recommendation Record

(Article 3(1)e and Article 7 of MAR)

Recommendation Published	, 11:31 ET. February 1, 2018
Recommendation Distributed	, 11:31 ET. February 1, 2018

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Underperform - Describes securities that we expect to provide a total return (price appreciation plus yield) of minus 10% or less within a 12-month period.

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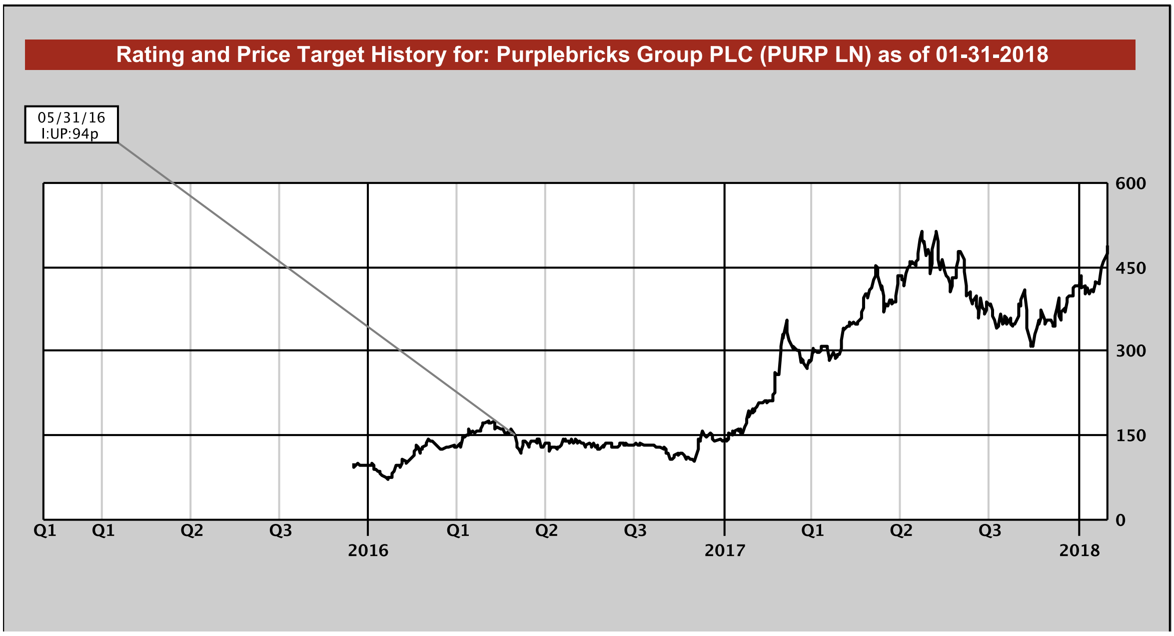
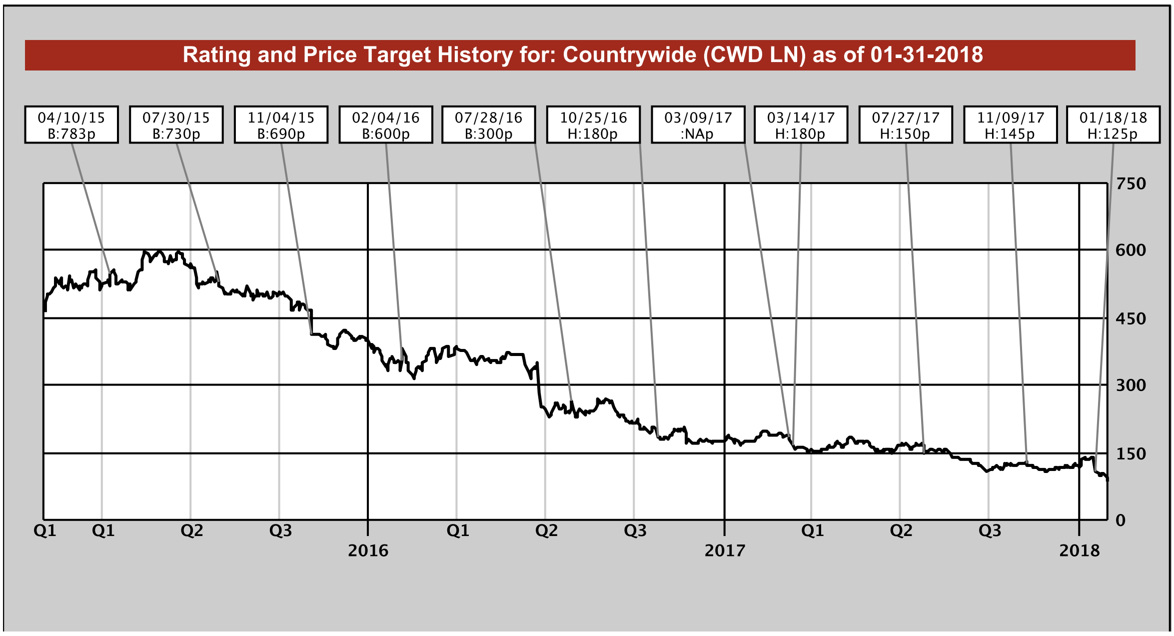
Other Companies Mentioned in This Report

- Countrywide (CWD LN: p84.90, HOLD)
- Foxtons Group (FOXT LN: p68.50, HOLD)
- LSL (LSL LN: p282.00, HOLD)





Rating and Price Target History for: Countrywide (CWD LN) as of 01-31-2018
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07/30/15 B:730p
11/04/15 B:690p
02/04/16 B:600p
07/28/16 B:300p
10/25/16 H:180p
03/09/17 :NAp
03/14/17 H:180p
07/27/17 H:150p
11/09/17 H:145p
01/18/18 H:125p
750
600
450
300
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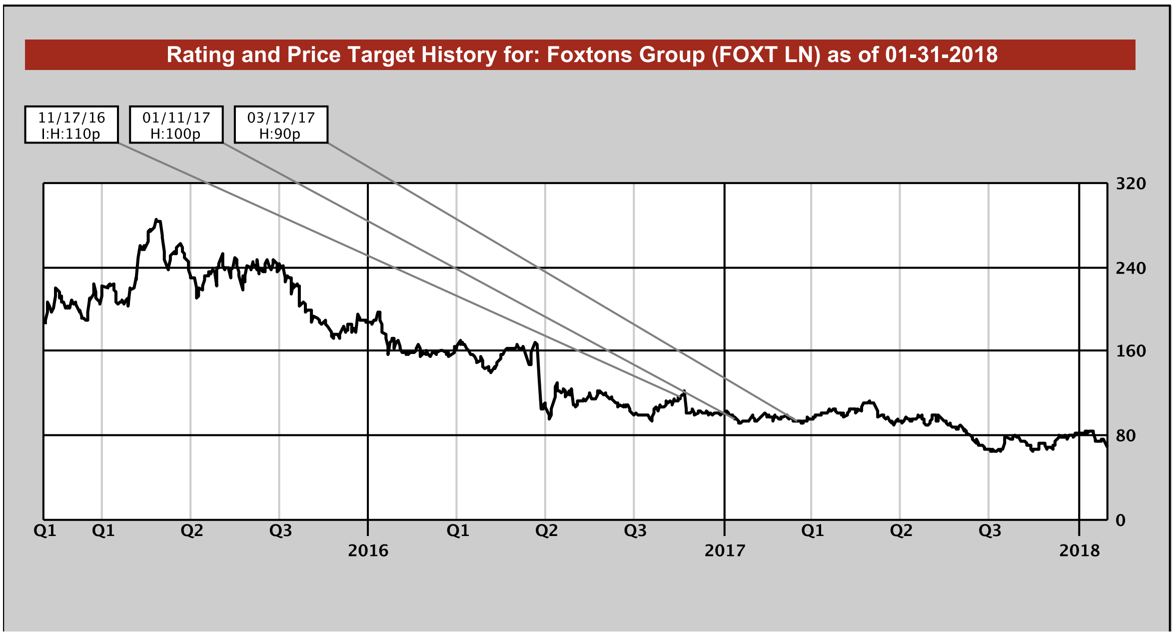
Q1
Q2
Q3
2018



Rating and Price Target History for: Foxtons Group (FOXT LN) as of 01-31-2018
11/17/16 I:H:110p
01/11/17 H:100p
03/17/17 H:90p
320
240
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80
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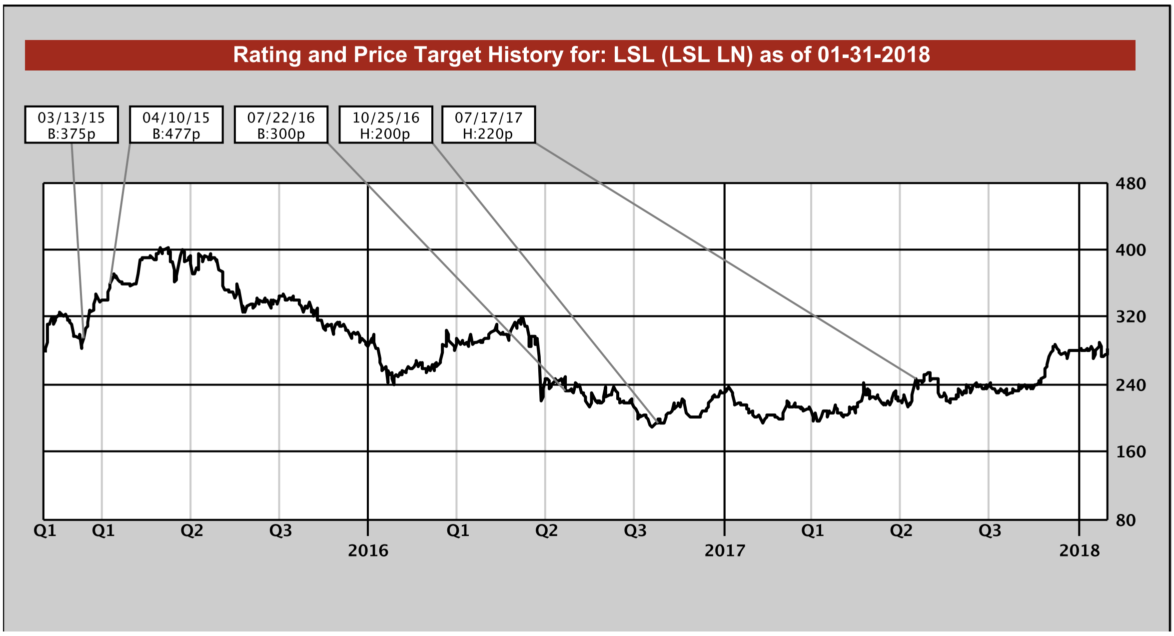
Q1
Q2
Q3
2016
Q1
Q2
Q3
2017
Q1
Q2
Q3
2018



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Legend:

I: Initiating Coverage

D: Dropped Coverage

B: Buy

H: Hold

UP: Underperform

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			Count	Percent	Count	Percent
BUY	1103	53.26%	342	31.01%	67	6.07%
HOLD	824	39.79%	162	19.66%	23	2.79%
UNDERPERFORM	144	6.95%	19	13.19%	3	2.08%

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