RE/MAX (NASDAQ: RMAX)

Business Summary:

Re/Max is a high-quality franchised real-estate brokerage business. The company's revenues are based mainly on the number of real estate agents working under the Re/Max banner. The company is a destination for high-producing agents because it has a higher payout ratio for commissions than competing real estate brokerage companies.

However, the company charges its agents a higher-fixed fee to operate under the Re/Max banner. With this structure, real estate agents who have high productivity and are entrepreneurial are attracted to the Re/Max system.

Investment Thesis:

1. Attractive Growth: We expect Re/Max to generate attractive growth. As the housing markets continue to recover, we expect the number of Re/Max agents to grow in the mid-single digits. The company will grow as the overall real estate brokerage industry grows. It should take share from other brokerages and as more agents achieve higher levels of productivity, they will be attracted to the higher payout model of Re/Max.

Re/Max runs a fixed cost structure, so as the top-line revenues grow, the company should show operating leverage on its base level of expenses. For example in Q1 2015, Re/Max reported revenue growth of 5.6%, but operating income grew 21.1%.

2. Attractive Economics: Re/Max's asset light financial model provides attractive economics for us as equity holders. The company requires very little in the form of ongoing maintenance capital expenditure, so a high percentage of earnings are converted to free-cash flow.

Even though Re/Max has been public for less than 2 years, management has already shown a commitment to return cash to shareholders. In March 2015, the company doubled the annual dividend paid to shareholders and announced an additional special dividend of $1.50 per share.

3. Less Volatile Revenue Model than Competitors: the company's revenue model is less volatile than its competitors, but it is still exposed to long-term housing cycles. Because Re/Max's revenues are mostly dependent on the number of agents operating under the Re/Max banner, the company's revenues are less likely to fluctuate with annual changes in home sales and home prices.

Real estate agents are unlikely to quit the business because of year-to-year fluctuations in volumes and/or prices. However, when there is a significant housing cycle like in 2007-2012 and real estate agents leave the business, Re/Max's revenues can still decline. The good news is there has only been one significant housing cycle since World War II.

4. Potential for Inorganic Growth: Re/Max has a potential for inorganic growth, but this will be an added bonus as an equity holder because it is impossible to predict. Re/Max has 20 sub-franchisees. These are companies that helped Re/Max to grow more rapidly in its early stages. Re/Max could potentially negotiate to buy these companies, but the timing and price is uncertain. If Re/Max were able to negotiate an acquisition, we would suspect the purchase prices would be below Re/Max's public market valuation.

5. Discounted Stock Compared to Other Franchised Businesses: Re/Max is not a cheap stock, but it trades at a discount to other franchised businesses and we believe the sell-side is underestimating the operating leverage in the business model. Re/Max trades at 13.3x Enterprise Value to Earnings Before Interest, Taxes, Depreciation and Amortization (EV/EBITDA) based on our estimates.