



REA Group (REA) added to the portfolio

It is only when one considers the significant part that employment, cars and housing have played in building old media's "rivers of gold" that one truly understands the threat that the online world brings. Anyone doubting the shift needs only to consider the growing influence of these un-invited new players. And in much the same way that seek.com.au has come to dominate the online employment space and carsales.com.au the online auto classifieds, so too has realestate.com.au cemented its hold on the online real estate section.



We too were caught off guard with the growing dominance of these online players. When SEEK listed on the exchange in April 2005, we certainly didn't appreciate the magnitude of the print-to-online shift that was under way. However, as we noted in our September 2008 quarterly report, the share market's dramatic decline provided investors with an opportunity to revisit some former high flyers. That we added SEEK to the portfolio back then at what we considered knock down prices also now applies to the REA Group (\$4.75 entry price). Table 2 provides a snapshot of the group's climb from local obscurity to market dominance.

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The group's key strength lies in its first mover advantage in building Australia's online market site of choice for real estate classifieds. From a standing start, the REA group's local online dominance is demonstrated by both the rise in the number of real estate paying subscribers and the annual revenue charged. Each agent that joins pays an annual subscription fee, providing them with unlimited access to list new properties. Agent numbers have grown from less than 1,500 with each paying about \$200 per month in 2001, to the current level of 9,264 paying \$926 per month. Additional revenue sources including website advertising and developer income makes up the balance of the group's income. While the Fairfax-owned domain.com.au portal is the group's nearest competitor, with a 25% market share, it lags the 65% market-leading position of realestate.com.au.



Table 2: REA Group Corporate History 1995-2009

Year	Event
1995	Business established with \$24,000 of invested capital by joint founders Karl Sabljak and Martin Howell
1999	Listed in November as realestate.com.au Limited with a \$6.0 million capital raising at 50 cents per share, giving the group a \$20.8 million market capitalisation
1999	Shares hit a post listing high of \$1.50 in December
2000	Reported losses hit \$6.3 million
2001	Shares hit all time low of 5 cents per share September 2001
2001	Private placement to News Limited giving it a 40% interest
2001	Simon Baker appointed chief executive officer
2002	Group becomes operationally cash flow positive, subscribing paying agents passes 2,000 in number
2003	Macquarie Bank sells its 15.8% stake to Songpan Pty Ltd (The Ray White Group)
2003	Revenue doubles to \$18 million, records first time full year net profit of \$2.5 million
2004	Group acquires property listing website, property.com.au from RP Data in \$9 million transaction, lifting subscriber paying agents numbers by 750 to 5,200
2005	Revenue exceeds \$30 million, reported profits hit \$8 million, shares trade above 1999 level
2005	Launches print publishing trial to complement online services / expands into New Zealand
2005	News Ltd bids \$2.00 per share in takeover in August / offer raised to \$2.50 in Oct
2005	Acquires UK property portal propertyfinder.com for \$34 M in JV with News Ltd. Business revenues at \$7 million, slight loss maker with 2,000 subscribing agents
2005	News Ltd full takeover offer fails, interest lifted to 58.6%
2006	Rights issue at \$3.00 per share, raising \$25 M
2006	Online visits to company websites exceed 5 million
2006	Partners with SKY Italia to acquire 90% of Italy's largest real estate website Casa.it for \$15.9 M / split 59.4% (REA), SKY (30.6%). Founded in 1996, small profits, 2,800 subscribing agents servicing 60 million population, 15,000 estate agents
2007	Revenues exceed \$107 million, net profit hits \$15.1 million, core metric of subscribing paying agents jumps 6,298 to 17,011, shares hit all time peak of \$7.49 in November
2007	REA acquires 51% interest in Albabaworld.com – Dubai's leading website for \$1.2m
2008	CEO Baker reappointed, expands in UK via purchase of Sherlock Publications \$12m
2008	Increases direct interest in Casa.it to 69.4% for \$2.44m
2008	Group announces departure of CEO Baker / Appoints Greg Ellis as new CEO from previous role as marketing director Asia online services for Microsoft and 5 years at Sensis, 11 years at Telstra
2008	Ray White reduces stake to 11% with off market sale at \$4.50 to News Ltd (60.7%)
2009	UK print business to close / UK online business under review



As Table 3 highlights, this has given rise to some wonderful business metrics. Strong top line growth has flowed through to impressive operating profits and rising margins. But these numbers also include the group's loss making offshore operations. During 2008, these businesses lost a total of \$15.4 million, impacting the group's bottom line by \$8.8 million.

Table 3: REA Group Financial Snapshot

\$'M	2003	2004	2005	2006	2007	2008	2009 (e)
Revenue	9.5	19.0	33.4	60.4	107.3	155.6	187.0
Operating Margin (%)	12.6	14.2	19.5	24.8	21.9	23.5	26.4
EBITDA	1.2	2.7	6.5	15.0	23.5	36.6	49.5
EBITA	1.0	2.4	5.7	13.3	19.5	33.8	45.0
NPAT	(1.5)	2.5	8.1	8.2	15.1	22.3	29.5
Net Debt / (net cash)	(1.4)	(2.6)	(7.3)	(10.4)	(2.0)	(7.3)	(30.0)
Market Capitalisation	24	87.2	154.5	483.7	756.2	557.6	758.7
Enterprise Value	22.6	84.6	147.2	473.3	754.2	550.3	728.7
Subscriber Paying Agents	3,173	5,207	6,414	10,713	17,011	22,478	22,100
Earnings Yield (%)	4.4	2.8	3.9	2.8	2.6	6.1	6.2*
ROCE (%)	934.5	27.9	49.4	21.9	23.5	31.4	40.0
Cover ratio	(4.4)	13.2	13.9	7.1	7.9	9.0	9.0
GOCF / EBITDA (%)	85	162	109	73	102	90	90
Earnings per share (c)	n/a	2.4	7.5	6.4	11.9	17.5	23.2**
PER	n/a	34.2	19.2	59.4	49.9	25.0	25.7
Share Price 30 June (\$)	0.26	0.82	1.44	3.80	5.94	4.38	5.96
Issued Capital	92.9	106.4	107.3	127.3	127.3	127.3	127.3

* The earnings yield is estimated at 10.0% excluding overseas losses

** The EPS is estimated at 35.0 cents excluding overseas losses

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Under new CEO Greg Ellis, such losses are now under review. Already the UK operations have been earmarked for a possible exit while the Italian business provides the group with the largest medium term upside. Not unlike the Australian market, the group's casa.it portal leads the Italian market with an estimated market share of 40%. With some 6,000 agents signed up of a total market estimated at 15,000, the signs are good for this emerging online market. During 2008, these operations lost \$2.8 million, a figure that is now expected to exceed \$6.0 million in 2009, as management ramps up marketing.

With no net debt, a renewed capital management focus and News Limited continuing to creep on the register, the REA Group is attractively priced. Excluding offshore losses and a market capitalisation approaching \$760 million, we estimate the group is trading on a current earnings yield of 10%. The recent drop in share price has little to do with the business fundamentals, providing investors with a rare opportunity to part own an entrenched market-leading operator, trading at an attractive price.