

Hyperion Asset Management

Company Profile

REA Group Ltd

Main Business Activities

REA Group Ltd (REA) operates the first ranked real estate classifieds websites in the Australian market, and the top ranked (first or second) sites across several Asian markets (via the iProperty Group acquisition). The sites enable buyers to view a large range of properties for sale and rent, and allows vendors to access the largest pool of prospective property buyers. The company also has associate investments in the U.S. (Move) and India (PropTiger). REA also operates a financial services business offering mortgage broking (Smartline), no-frills REA-branded mortgages (NAB partnership) and Hometrack (a property data service to the financial sector, including the big 4 banks that rely on its valuation model).

94% of revenue (FY20) comes from the Australian operations with 80% coming from real estate agents, comprised of depth and subscription revenue. Advertising revenue is largely vendor paid where agents pass through the cost of marketing to vendors which is typically paid upfront. Australian revenue also includes Media Display revenue (11% FY20) and Financial Services revenue (3% FY20). Subscription revenue has been declining for some years (40% of revenue in FY12 to 6% in FY20) as revenue growth is being driven by listing depth products which allows vendors to position their property at the top of the search results.

6% of revenue comes from Asia, where all markets remain early stage and REA is building scale and improving the customer value proposition to either capture or entrench the number one market position (to whom the majority of advertising dollars disproportionately flow due to virtuous network effects, if the number one dominance is strong enough). Results in Asia have been mixed, with REA incurring multiple impairments in recent years.

REA also has various investments, including Move Inc in the U.S., and several in Asia including Elara Technologies (owner of India marketplaces PropTiger, Housing.com and makaan.com), PropertyGuru which owns leading portals across SE Asia (including Malaysia, Thailand, Singapore, Indonesia), and myfun.com in China.

Key Value Proposition to Customers

REA helps real estate agents, property developers, property-related financial services providers, and advertisers promote their services.

The value proposition to REA's core ultimate customer, residential property vendors, is a low fee for close to whole-of-market distribution to a large, engaged audience of prospective buyers.

Based on Hyperion estimates, the average vendor spend on an REA listing in FY20 was less than \$1,500, which equates to approximately 0.2% of the average vendor's property value, less than 10% of the total amount a vendor spends to sell a residential property (where approximately 80% is the real-estate agent's commission), and approximately 50% of the average vendor's total marketing spend (with the balance going to the second ranked portal Domain Holdings Australia Ltd (Domain), print advertising, and billboards).

Sustainable Competitive Advantages and Outlook

REA is among the most dominant marketplaces in the world, with a strong sustainable competitive advantage underpinned by a sustained first mover advantage and virtuous network effects between real-estate buyers and sellers.

The network effect is driven by the motivation of real estate sellers (agents and vendors) to advertise their sale or rental listings on the website with the greatest number of visitors (to maximise the probability of finding a buyer, and maximising price); while the motivation of prospective real estate buyers or renters is to conduct their search where there is the greatest variety or depth of listings (to maximise the probability of being fully informed).

These self-reinforcing motivations drive a virtuous cycle for the realestate.com.au marketplace, where it is irrational for either a buyer or a seller not to have a presence on the marketplace. Absent significantly poor execution by management, Hyperion believes disrupting an established, dominant network effect is extremely difficult.

Adding to REA's sustainable competitive advantage, ancillary product providers are also attracted to the realestate.com.au network due to its large and engaged audience, which creates optionality in adjacencies such as display advertising, mortgage broking and data services.

Overall Company Growth Options

REA is primarily a price-driven (rather than volume-driven) growth story, underpinned by the company's pricing power afforded by its market dominance of residential real-estate advertising in Australia. The evolution of REA's revenue model from being subscription-based or 'all you can eat', to volume-based or pay-per-listing, to migrating customers onto higher-priced 'depth' or premium listings, is evidence of the company's pricing power.

REA's sustained pricing power is explained by the strength of the customer value proposition to its core customers, residential property vendors (detailed above). In addition to the strength of REA's absolute customer value proposition, REA also has an excellent value proposition relative to alternatives, with realestate.com.au site traffic and user engagement statistics consistently far superior to all competitors', making it irrational for a vendor not to advertise on realestate.com.au.

As REA increases the overall yield per listing (with price increases and value-add features), REA's share of a vendor's total cost to sell will increase, eroding the share of other advertising channels and eventually the real-estate agents' aggregate commission pool (via reduced selling commissions). In addition, as the cost of advertising on REA increases (assuming marketing budgets remain similar), vendors will eventually be forced to focus marketing budgets on the highest value channel rather than spending in all channels (i.e. reduce spend on Domain and print). Australia being a vendor-paid market also helps here as marketing costs are typically passed through to vendors, meaning agents are less incentivised to slow price/yield increases. Agents make money when properties are sold and typically do not share the marketing costs, so their incentive is to maximise the probability of a sale, which is achieved by firstly having the listing on realestate.com.au, and secondly making the listing as prominent as possible.

Anything to drive increased housing turnover or velocity will also benefit REA, given listings are monetised when added to the marketplace (i.e. regardless of success). Frictional costs such as stamp duty are considered to reduce housing velocity, and the removal of this tax would provide an earnings tailwind.

Important Disclaimers

For Recipients in Australia: This report has been issued and distributed by Hyperion Asset Management Ltd (ABN 80 080 135 897) (AFSL 238380). Hyperion Asset Management Ltd is the provider of the general advice ('the Service') and takes responsibility for the production of this report. The Service is provided through the research of investment securities.

To the extent the Report contains general advice it has been prepared without reference to an investor's objectives, financial situation or needs. Investors should consider the advice in light of these matters and, if applicable, the relevant Product Disclosure Statement before making any decision to invest. Refer to our Financial Services Guide (FSG) for more information at <https://www.hyperion.com.au/fsg/>