BAFI1042
Equity Investment and Portfolio Management
Semester 2, 2024

Assessment 2: Company Valuation Report

Due date:	**6 October 2024**
Weighting:	**50%**
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Results: High Distinction

REA GROUP LTD (ASX: REA)

Recommendation: SELL

213.25 AUD
+0.95 (0.45%) ↑ today
4 Oct, 4:10 pm AEST • Disclaimer

Executive Summary

The purpose of this report is to provide an investment recommendation for REA Group based on its current valuation and future prospects. The analysis employs both qualitative and quantitative valuation methods, including an assessment of macroeconomic conditions and models such as the Free Cash Flow to Equity (FCFE) model and key financial ratios. These metrics will also be compared to three of REA's peers.

The valuation analysis indicates that REA Group is significantly overvalued across multiple metrics. The Free Cash Flow to Equity model determined an intrinsic value for the firm at $55.95, while Price-to-Earnings (P/E), and Price-to-Cash Flow (P/CF) and Price-to-Sales ratios all indicated significant overvaluation compared to REA's peers. These elevated metrics suggest that investors are paying an excessive premium for REA Group's stock at current valuation of $213.25 per share. This overvaluation presents considerable risks, particularly if the company is unable to meet the high expectations priced into the stock.

While the DuPont analysis highlights REA Group's strong return on equity (ROE) and operational efficiency, these factors are insufficient to justify the current valuation levels. The potential for market correction, combined with the overvaluation shown through key financial models and ratios, leads to the conclusion that the stock is overvalued and poses a risk for long-term investors.

As a result, a **Sell recommendation** is issued for REA Group. The current stock price reflects an inflated valuation that may not be sustainable. Investors are advised to consider reducing exposure to REA in light of these risks.

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Introduction

REA Group: A Global Leader in Digital Real Estate, founded in 1995 by Karl Sabljak, his wife Carmel, brother Steve, and business partner Martin Howell, has evolved from a garage startup in Melbourne to a global digital real estate powerhouse (REA, 2023).

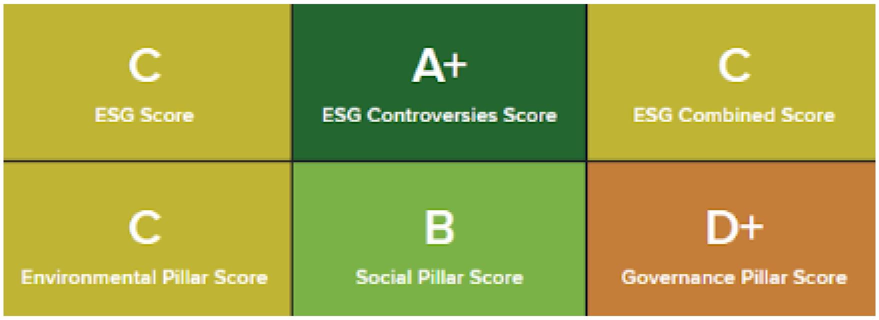
In 1999, REA Group went public on the Australian Stock Exchange (ASX), marking a crucial step in its growth trajectory (REA Group, 2023). This was followed by News Corporation acquiring a 44% stake in 2001, providing essential capital during the post-dotcom bust period (REA Group, 2023). The company's main website, realestate.com.au, reached a significant milestone in 2004 with 1 million monthly unique visitors, demonstrating its growing influence in the Australian real estate market (REA Group, 2023).

REA Group's expansion strategy has been characterised by organic growth and strategic acquisitions. The company launched its first iOS mobile app for realestate.com.au in 2010, adapting to the mobile-first consumer trend (REA Group, 2023). International expansion began in 2007 with investments in European real estate websites, followed by entry into the US market in 2014 through a 20% investment in Move, Inc., operator of realtor.com (REA Group, 2023).

In 2016, REA Group acquired flatmates.com.au and invested in PropTiger.com in India (REA, 2023). The company entered the home loans market in 2017 and acquired Hometrack, a property data services provider in 2018 (REA Group, 2023). More recently, REA Group increased its stake in India’s Elara Technologies in 2020 and acquired Mortgage Choice in 2021, further expanding its financial services offerings (REA Group, 2023).

Today, REA Group operates as a global online real estate advertising company with a presence across Australia, Asia, and North America. Its revenue streams are diversified, with 82% coming from residential and commercial real estate listings, 10% from media and data services, and 3% from financial services, including mortgage broking (REA Group, 2023). The company employs over 2,800 people and operates more than 20 brands across 8 countries (REA Group, 2023).

Figure 1: REA Group ESG Scores



Source: Refinitiv Workspace 2024.

According to Refinitiv, REA Group received an Environmental Social Governance (ESG) Combined Score of C, with an Environmental Pillar Score of C, Social Pillar Score of B, Governance Pillar Score of D+, and an ESG Controversies Score of A+ (Refinitiv, 2024). While the company has made significant strides in environmental conservation and social responsibility, its governance practices appear to lag behind. The low governance score may be attributed to factors such as limited disclosure on board independence and diversity, lack of detailed information on executive compensation structures, and insufficient transparency regarding shareholder rights and risk management frameworks (REA Group, 2023).

In comparison, Domain Holdings Australia Ltd achieved a higher ESG Combined Score of B-, with notably better scores in Environmental (C+) and Governance (C+) pillars (Refinitiv, 2024). Similarly, SEEK Limited outperformed REA Group in overall ESG performance with a Combined Score of C+, particularly excelling in the Social Pillar with a score of C (Refinitiv, 2024).

In response, the company has formed a cross-functional ESG committee comprising REA Leadership Group members to focus on 11 highly material ESG topics (REA Group, 2022). Additionally, REA has expanded the remit of its Executive Risk Committee to include climate-related risks and opportunities (REA Group, 2022). The company has also implemented a supplier governance approach and introduced comprehensive screening for new suppliers to manage potential risks (REA Group, 2024).

REA Group's efforts to improve its governance practices, while promising, have not yet fully translated into improved third-party ESG assessments, as evidenced by its current low governance score. As stakeholders increasingly prioritize ESG factors in their decision-making, REA Group's ongoing efforts to enhance its governance practices could significantly impact its market perception, investor relations, and business performance.

Industry Analysis

REA Group operates in the digital real estate advertising industry, which exhibits both domestic and global characteristics. The industry is structured around online platforms that connect property stakeholders, relying heavily on data-driven technology and user engagement (REA Group, 2023). While REA Group maintains a strong domestic focus in Australia, with its flagship platform realestate.com.au attracting 120.6 million monthly visits and reaching 61% of Australia's adult population, it has also expanded globally with operations in Asia and North America (REA Group, 2023). The company's primary competitor in the Australian market is Domain Holdings Australia (domain.com.au), although REA Group maintains a significant lead, attracting 3.3 times more visits than its nearest competitor (REA Group, 2023).

Other players in the broader online classifieds market include SEEK Limited (seek.com.au) and Carsales.com Ltd (carsales.com.au), which, while not direct competitors in real estate, compete for advertising revenue and user attention (SEEK Limited 2023; Carsales.com Ltd 2023). REA Group competes through market leadership, product innovation, data analytics, diversification into adjacent services, international expansion, enhanced consumer experiences, and technological innovation. The company's PropTrack business provides valuable insights, while acquisitions like Mortgage Choice have expanded its service offerings (REA Group, 2023). This diverse strategy, coupled with a focus on personalising user experiences and increasing membership engagement, has allowed REA Group to maintain its leadership position in the digital real estate advertising industry, setting it apart from more narrowly focused competitors (REA Group, 2023)

REA Group Historical Financial Performance Relative To Its Peers

Relevant of the 5 financial ratios chosen

The 5 financial ratios, cash flow margin, gross profit margin, operating margin, current ratio, return in investment (ROI) were chosen as they each provide critical insights about the company's overall financial health and operating efficiency.

Cash Flow margin measures the efficiency of the company's ability to produce cash from its operations relative to its revenue. High cash flow margin indicates robust operational efficiency, while low cash flow margin may indicate challenges in producing cash from operations.

Gross profit margin shows how much profit the company retains after deducting the cost of goods (COG) relative to its revenue. High gross profit margin implies cost management efficiency or robust pricing power.

Operating margin shows profitability of the company before accounting for interest and taxes (EBIT) relative to its revenue. A high or stable operating margin implies that the company is able to control its operating expense and COGS effectively.

Current ratio measures the company's ability to meet its short-term liabilities with its short-term assets. A high current ratio indicates financial stability of the company while lower current ratio signals potential short term poor liquidity position.

Return on investment capital (ROIC) measures how well a company generates returns from the capital invested in its operations. A high ROIC means that the company is generating more profit from each dollar invested in its operations, which implies efficient operational and management performance.

Figure 2: Cash Flow Margin

	2024	2023	2022	2021	2020	5 year average
Rea Group	34.67%	33.95%	34.72%	31.49%	47.52%	36.47%
Domain	30.03%	19.16%	19.84%	18.04%	32.18%	23.85%
Seek	30.33%	27.60%	35.52%	45.57%	46.77%	37.16%
Car Group	41.76%	38.31%	39.97%	46.13%	42.62%	41.76%
Industry Average	34.20%	29.76%	32.51%	35.31%	42.27%	34.81%

Over the 5-year period, REA Group' cash flow margin remained robust, averaging 36.47%, slightly above the industry average of 34.81%. As shown in Figure 1, REA Group's cash flow margin has outperformed the industry average every year, except in 2021 when its margin dropped from 47.52% in 2020 to 31.49% in 2021, below the 2021 industry average of 35.31%. This was mainly due to the significant increase in income taxes paid. REA Group reported an increase in income tax from $98.2 million in 2020 to $200.4 million in 2021(REA Group, 2021).

Compared to its peers, REA Group underperformed Carsales, which maintained the highest cash flow margin over the 5-year period, consistently above 38% with a 5-year average of 41.76%. In contrast, REA Group outperformed Domain, which exhibited the weakest performance, with cash flow margins consistently below REA Group and the industry average, averaging 23.85% over the 5-year period. Seek's cash flow margin displayed more volatility with margins fluctuating between 27.6% and 46.77%. However, in 2021 and 2022 Seek outperformed REA Group's with cash flow margin of 45.57% and 35.52% respectively. Overall, REA Group's cash flow margin while lags behind Carsales has remained stable, outperforming Domain and showing less volatility than Seek.

Figure 3: Gross Profit Margin

	2024	2023	2022	2021	2020	5 year average
Rea Group	85.47%	84.98%	81.79%	92.28%	93.02%	87.51%
Domain	92.33%	91.26%	92.28%	92.28%	90.69%	91.77%
Seek	99.39%	99.38%	99.41%	99.42%	99.32%	99.38%
Car Group	94.03%	92.26%	90.18%	95.12%	92.04%	92.73%
Industry Average	92.80%	91.97%	90.92%	94.78%	93.77%	92.85%

Over the 5-year period, REA Group's gross profit margin declined from 93.02% in 2020 to 85.47% in 2024, averaging 87.51%, below the industry 5-year average of 92.85%. Gross profit margin significantly dropped from 92.28% in 2021 to 81.79% in 2022, driven by the increase in cost of revenue, mainly due to the Mortgage Choice and REA India acquisitions (REA Group, 2022).

Compared to its peers, REA Group has consistently lagged behind. Seek exhibited the best gross margins averaging 99.38% and consistently maintaining margins above 99% throughout the 5 years. Carsales's gross margin displayed slight volatility, fluctuating between 90% to 95% throughout the 5 years, averaging 92.73%. Domain's gross margin lagged relative to Seek and Carsales but outperformed REA Group with margins consistently above 90% throughout the 5-years, averaging 91.77%. The increase in the cost of revenue has slowed down REA Group's ability to maintain its gross profit margin relative to its industry peers, resulting in underperformance.

Figure 4: Operating Margin

	2024	2023	2022	2021	2020	5 year average
Rea Group	30.94%	37.58%	39.11%	47.05%	27.13%	36.36%
Domain	21.87%	17.92%	20.16%	19.88%	-77.24%	0.52%
Seek	9.98%	29.05%	30.15%	17.65%	-14.39%	14.49%
Car Group	37.88%	95.01%	43.82%	46.32%	42.33%	53.07%
Industry Average	25.17%	44.89%	33.31%	32.72%	-5.54%	26.11%

Over the 5-year period, REA Group's operating margin showed mixed performance, with a significant decline from 47.05% in 2021 to 30.94% in 2024, this is likely due to the increase in operating expenses after the acquisition of The Mortgage Choice and REA India Acquisition. This is evident in REA Group's income statement where the operating expenses have increased from $532.3 million in 2021 to $1173.9 million in 2024 (REA Group, 2024). Despite this decline, REA Group's margin in 2022 of 39.11% still outperforms the 2022 industry average of 33.31%.

Compared to its peers, Domain exhibited extreme volatility in its margins, with a deep negative margin of -77.24% in 2020 and recovered to 21.87% in 2024, with its 5-year average of 0.52% significantly lower relative to the overall industry average. Seek exhibited inconsistent margin, recovering from -14.39% in 2020 to 30.15% in 2022 and declining to 9.98% in 2024, resulting in a 5-year average of 14.49% underperforming the overall industry average. In contrast, Carsales led the industry with an impressive 5-year average of 53.07%, with above 40% margins from 2020 to 2022 and spiking to 95.01% in 2023 before normalizing to 37.88% in 2024. Overall, REA Group's operating margin performance, though declining, remains strong relative to the industry.

Figure 5: Current Ratio

	2024	2023	2022	2021	2020	5 year average
Rea Group	1.53	1.70	1.60	1.95	1.17	1.59
Domain	1.16	1.73	1.38	1.98	1.44	1.54
Seek	0.86	0.92	1.98	1.82	0.85	1.29
Car Group	1.97	1.83	1.74	4.25	3.15	2.59
Industry Average	1.38	1.54	1.67	2.50	1.65	1.75

Over the 5-year period, REA Group' current ratio increased from 1.17 in 2020 to 1.53 in 2024, averaging 1.59 which slightly trails behind the industry average of 1.75. This reflects relatively strong liquidity. REA Group's current ratio significantly increased from 1.17 in 2020 to 1.95 in 2020, this was due to the sale of its equity position in a property tech company, 99 Group. REA Group sold its 27% interest in 99 Group in exchange for an 18% equity stake in PropertyGuru (REA Group, 2021). The sale of 99 Group generated significant inflow of cash, boosting the company's current asset and liquidity position, contributing to a higher current ratio in 2021.

In comparison to its industry peers, Carsales outperformed the industry with a 5-year average of 2.59, though its current ratio has significantly declined from its peak of 4.25 in 2021 to 1.97 in

2024. This outperformance demonstrates a strong liquidity position. Domain with a 5-year average of 1.54 trailing closely behind REA Group exhibited a volatile liquidity trend, peaking at 1.98 in 2021 and declining to 1.16 in 2024. This may be due to higher short-term liabilities or inconsistent profitability. Seek significantly lags behind REA group with a 5-year average of 1.29, showed potential liquidity challenges, dropping from its peak of 1.82 in 2021 to 0.86 in 2024. With a current ratio less than 1, this indicates that its current liabilities exceed its current assets, signalling that the company might face challenges in meeting its short-term obligations. The overall industry average has declined after peaking in 2021, indicating that the industry may be facing higher short-term obligations and tighter financial environment.

Figure 6: Return On Invested Capital (ROIC)

	2024	2023	2022	2021	2020	5 year average
Rea Group	13.30%	15.80%	18.20%	19.50%	9.30%	15.22%
Domain	3.60%	2.80%	3.10%	2.90%	-17.10%	-0.94%
Seek	-1.30%	5.60%	7.20%	3.30%	-4.00%	2.16%
Car Group	5.90%	21.00%	11.50%	13.10%	13.40%	12.98%
Industry Average	5.38%	11.30%	10.00%	9.70%	0.40%	7.36%

Over the 5-year period, REA Group demonstrated robust ROIC, with margins above 13% for 4 out of the 5 years, averaging 15.22% which is the highest among its peers and double the 5-year industry average of 7.36%. In addition, the company's ROIC has outperformed the industry average every year. Highlighting REA Group's effective capital allocation relative to its peers. Notably, the company's ROIC more than doubled from 2020 to 2021, this is likely due to the property market boom and increased usage of their platforms. The launch of new services like Connect in 2021 helped REA Group support customers during the pandemic, boosting revenue through client attraction and improved customer satisfaction (Wilson. O, 2021).

Compared to its peers, Domain's ROIC recovered from a -17.10% in 2020 to 3.60% in 2024. This shows that Domain's operating efficiency and capital allocation strategy has significantly improved over the past years, although its ROIC has consistently lagged behind REA Group. Seek exhibited inconsistent ROIC, recovering from -4% in 2020 to 7.2% in 2022, only to decline back to -1.30% in 2024. This volatility in Seek's ROIC implies inconsistency or inefficient capital allocation, while REA Group's robust ROIC reflects better financial performance. Carsales's ROIC was relatively stable up till 2023, with its ROIC of 21% outperforming REA group ROIC of 15.8% in that year. However, Carsales's ROIC experienced a significant drop from 21% in 2023 to 5.9% in 2024, indicating a lower return on its invested capital. Overall, REA Group's ROIC continues to outperform its peers, showing superior capital allocation.

DuPont Analysis of REA and Competitors

Figure 7: REA Group Dupont Analysis

Year	Net Income (M)	Sales (M)	Total Assets (M)	Total Equity (M)	Net Profit Margin (%)	Asset Turnover	Equity Multiplier	ROE (%)
2020	$ 112.40	$ 881.90	$ 1,590.50	$ 864.10	0.127	0.554	1.841	0.13
2021	$ 322.70	$ 1,005.40	$ 2,355.20	$ 1,095.00	0.321	0.427	2.151	0.295
2022	$ 384.80	$ 1,418.50	$ 2,568.80	$ 1,302.00	0.271	0.552	1.973	0.296
2023	$ 356.10	$ 1,392.40	$ 2,626.60	$ 1,466.80	0.256	0.53	1.791	0.243
2024	$ 302.80	$ 1,699.80	$ 2,655.00	$ 1,538.40	0.178	0.64	1.726	0.197

REA Group has demonstrated stable financial performance over the past five years, establishing itself as the strongest competitor among its peers. In 2020, REA's Return on Equity (ROE) was 13%, which surged to 29.5% in 2021 due to a significant increase in its Net Profit Margin (NPM) and higher leverage, as indicated by its equity multiplier of 2.15. This growth was driven by a reduction in operating expenses. However, by 2024, rising operating costs (from $863.7 million to $1,173.9 million) led to a decline in NPM, which caused ROE to drop to 19.7%. Despite this, REA's asset turnover improved from 0.55 in 2020 to 0.64 in 2024, enhancing its efficiency. The company's reduced reliance on debt, with the equity multiplier falling to 1.72, suggests a more conservative approach, limiting further ROE growth. Overall, REA maintained a solid financial position, balancing sales growth, asset efficiency, and debt management, keeping its ROE stable compared to its more volatile peers.

Figure 8: Carsales (CAR) Dupont Analysis

Year	Net Income (M)	Sales (M)	Total Assets (M)	Total Equity (M)	Net Profit Margin (%)	Asset Turnover	Equity Multiplier	ROE (%)
2020	$ 114.70	$ 413.60	$ 997.60	$ 290.80	27.74	0.4144	3.4305	0.135
2021	$ 130.70	$ 434.60	$ 1,163.60	$ 938.70	30.08	0.3734	1.2394	0.139
2022	$ 160.80	$ 509.40	$ 1,861.10	$ 1,011.60	31.56	0.2737	1.8389	0.159
2023	$ 645.60	$ 781.20	$ 4,684.70	$ 3,069.00	82.65	0.1667	1.5272	0.211
2024	$ 250.00	$ 1,098.70	$ 4,668.50	$ 2,884.50	22.75	0.233	1.618	0.086

CAR exhibited highly volatile financial performance, with its ROE fluctuating between 13.5% and 13.9% from 2020 to 2022. In 2023, a sharp reduction in operating expenses to $39 million drove ROE up to 21.1%. However, by 2024, ROE fell dramatically to 8.6% as operating costs surged to $682.5 million, and NPM dropped to 22.75%. CAR's asset turnover also declined significantly, from 0.41 in 2020 to 0.23 in 2024, reflecting poor efficiency in utilising its growing investments in goodwill and intangible assets (up from $477.6 million in 2021 to $3,057 million). CAR's ROE instability raises concerns about the sustainability of its profitability without improvements in asset efficiency.

Figure 9: Seek (SEK) Dupont Analysis

Year	Net Income (M)	Sales (M)	Total Assets (M)	Total Equity (M)	Net Profit Margin (%)	Asset Turnover	Equity Multiplier	ROE (%)
2020	$ (113.10)	$ 650.60	$ 4,336.50	$ 1,082.50	-0.174	0.15	4.006	-0.1
2021	$ 752.20	$ 760.30	$ 4,600.60	$ 1,834.30	0.989	0.165	2.508	0.41
2022	$ 168.80	$ 1,116.50	$ 4,713.20	$ 1,807.10	0.151	0.237	2.608	0.09
2023	$ 1,045.60	$ 1,157.90	$ 5,230.90	$ 2,675.70	0.903	0.221	1.955	0.39
2024	$ (100.90)	$ 1,084.10	$ 4,754.70	$ 2,582.20	-0.093	0.228	1.841	-0.04

SEK's ROE was the most volatile among the companies, driven by fluctuating profitability. Its NPM swung from -17.4% in 2020 to 98.9% in 2021, before dropping to -9.3% in 2024. This volatility was mirrored in its ROE, which ranged from -10% to a peak of 41%. Despite slight improvements in asset turnover, from 0.15 in 2020 to 0.22 in 2024, SEK's weak revenue generation and high operating costs limited its financial performance. The company also reduced its financial leverage, with the equity multiplier dropping from 4.006 to 1.84, further constraining its ability to enhance ROE during profitable periods.

Figure 10: Domain Holdings (DHG) Dupont Analysis

Year	Net Income (M)	Sales (M)	Total Assets (M)	Total Equity (M)	Net Profit Margin (%)	Asset Turnover	Equity Multiplier	ROE (%)
2020	$ (227.20)	$ 265.40	$ 1,273.10	$ 900.20	-85.607	0.208	1.414	-0.252
2021	$ 34.30	$ 288.60	$ 1,298.30	$ 948.10	11.877	0.222	1.369	0.036
2022	$ 32.30	$ 347.30	$ 1,549.10	$ 1,102.30	9.3	0.224	1.405	0.029
2023	$ 26.10	$ 345.50	$ 1,490.10	$ 1,092.30	7.554	0.232	1.364	0.023
2024	$ 42.40	$ 390.90	$ 1,483.80	$ 1,100.30	10.847	0.263	1.349	0.038

DHG consistently underperformed, with an ROE of -25.2% in 2020 due to an NPM of -85.6%, stemming from high operating expenses and low revenue. Although profitability improved, with NPM reaching 10.84% in 2024, DHG's overall financial health remained poor.

Asset turnover increased marginally from 0.21 to 0.26 over the period, and the company's low equity multiplier, from 1.41 to 1.34, indicated limited use of debt to drive returns. By 2024, DHG's ROE was just 3.8%, making it the weakest performer in this analysis.

Conclusion:

REA's stable performance, with a balanced approach to profitability, asset efficiency, and financial leverage, makes it the strongest investment option. CAR's volatility and SEK's inconsistent profitability present risks, while DHG's consistently poor financial metrics make it the weakest competitor. REA stands out as the most reliable option for long-term investors.

Analysis of Company's/Industry's current issues

Macroeconomic Level:

The Reserve Bank of Australia (RBA) has been implementing a tight monetary policy to combat inflation, with the cash rate target currently at 4.10% as of September 2023 (Reserve Bank of Australia, 2023). Given the recent economic data and the RBA's focus on bringing inflation back to its target range of 2-3%, it's likely that interest rates will remain elevated in the near term, with the potential for further small increases.

The high-interest rate environment significantly impacts the housing market and, by extension, REA Group. Higher interest rates typically lead to reduced borrowing capacity for potential homebuyers, potentially cooling the housing market. For REA Group, this could result in a slowdown in property transactions and a decrease in listing volumes, potentially affecting its revenue streams.

Australia's GDP has shown strong growth, peaking recently, but is unlikely to maintain high increases in the near future due to global economic uncertainties and the impact of higher interest rates.

The employment rate in Australia has remained robust, with the trend unemployment rate at 4.2% in July 2024 (Australian Bureau of Statistics, 2024). This low unemployment rate, coupled with strong GDP growth, has contributed to inflationary pressures, prompting the RBA to maintain higher interest rates.

The Australian government has proposed a National Planning Level (NPL) for new international student commencements of 270,000 for the calendar year 2025 (The PIE News, 2024). This cap represents a reduction from the current levels of international student intake.

Potential Impact on REA Group:

1. Decrease in rental listings, particularly for properties typically favoured by international students.
2. Potential decrease in demand for certain types of properties could impact property values in some areas, affecting REA Group's 'Buy' revenue stream.
3. Fewer international students seeking accommodation, may decrease advertising revenue targeting this demographic.

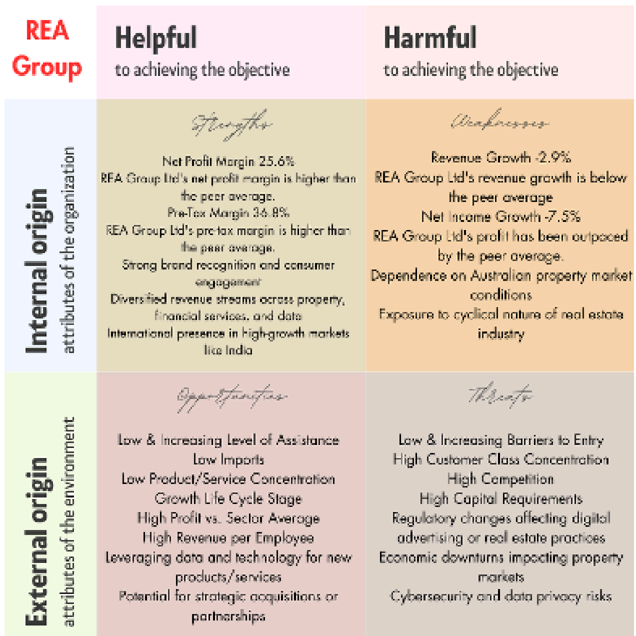
However, REA Group's strong market position and history of adapting to market changes suggest it is well-positioned to navigate these challenges. Additionally, the RBA is expected to cut rates soon (Seeto. T, 2024), interest rate cuts will support economic growth, this could stimulate renewed activity in the housing market, benefiting REA Group's core business.

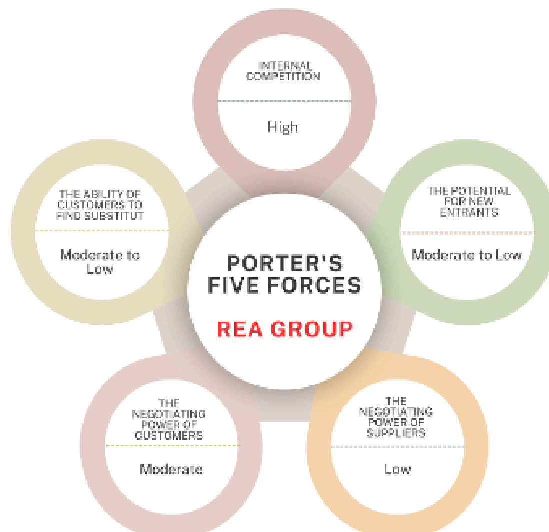
<u>Microeconomic Level:</u>

REA Group's microeconomic landscape is characterized by several key factors that contribute to its market dominance and operational success. The company's data and analytics capabilities, particularly through its PropTrack business, provide a significant competitive advantage in property data and automated valuations (REA Group, 2024). This is complemented by ongoing investments in technology and digital platforms, exemplified by the acquisition of Realtair, which strengthens REA Group's market presence and innovation capabilities (Broker News, 2024). Operational efficiency is evident in the company's financial performance, where revenue grew by 23% while operating expenses increased by only 18%, indicating effective cost management (Montgomery, 2024). REA Group's market share and audience engagement are particularly strong, with realestate.com.au extending its audience leadership to 4.6 million Australians, reinforcing its position as the primary platform for property transactions (Broker News, 2024). This dominant market position is further illustrated by the company attracting 3.3 times more visits than its nearest competitor, demonstrating its ability to capture and retain user engagement (Montgomery, 2024). These microeconomic factors collectively contribute to REA

Group's robust performance in the real estate advertising industry, enabling it to maintain pricing power and drive revenue growth despite challenging market conditions.

Figure 11: SWOT & Porter's Five Forces Analysis:





In conclusion, REA Group maintains a strong position in the industry due to its powerful network effects and continuous innovation. However, the company must continue to adapt to maintain its market leadership, particularly in the face of potential technological disruptions.

Intrinsic Value Estimation

REA Group returns Vs ASX/S&P200 (AXJO) index

Figure 12: Regression analysis (unadjusted beta)

	Coefficients
Intercept	0.0005351
X Variable 1	1.257134

Unadjusted beta based on regression analysis: 1.257

- Adjusted beta = (0.67) * unadjusted beta + 0.33

- Adjusted beta: (0.67) * (1.257 +0.33) = 1.06
- Risk free rate (bid as of 4/10/24): 4.252% (Appendix 10)
- Estimated market return: 6.5%
- CAPM calculation = risk free rate + beta * (market return – risk free rate)
- CAPM: 4.252% + 1.06*(6.5% - 4.252%) = 6.63%

Figure 13: Dividend Discount Model (DDM)

period	0	1	2	3	4	5	6
cashflow	$ 1.89	$ 2.08	$ 2.29	$ 2.63	$ 3.02	$ 3.48	$ 3.56
growth		10%	10%	15%	15%	15%	2.31%
terminal value (y5)						$82.37	
present value (CF)		$1.95	$2.01	$2.17	$2.34	$2.52	
present value (TV)						$59.76	
Intrinsic Value (IV)	**$70.75**						
				k (ROR)	6.63%		
				g	2.31%		
				beta	1.06		
				Er	6.50%		

Using the DDM model, the intrinsic value (IV) of REA Group is $70.75

Period 1 growth rate (g1) = retention ratio (RR) * return on equity (ROE)

RR = ($302.8 - $249.7/ $302.8) = 0.175

ROE = $302.8 / $1538.4 = 0.197

g1 = 0.175 * 0.197 = 3.45%

Growth in period 1 (g1): 15%

- The group decided to use REA Group's average DPS growth of 10% (appendix 5) instead of the calculated growth rate of 3.45% as it is more reflective of the company's historical dividend growth performance.

Growth in period 2 (g2): 18%

- The group's assumption for REA Group's stage 2 growth rate of 15%, higher than stage 1 growth rate of 10% due to the company's robust cash flow margin and future interest rate cuts.
- REA Group's robust cash flow margin provides a strong foundation for growth. With consistent and relatively stable cash flow generation, the company has the capability to invest in growth and distribute higher dividends in the future.

- The expected interest rate cuts by the RBA will reduce borrowing cost, stimulating more property transactions and new developments. This will increase listings and transactions on REA Group's platforms which will positively impact revenue and profitability growth, contributing to higher dividend growth.

Growth in period 3 (g3): 2.31%

- For stage 3 growth rate, the group used Australia's GDP average growth rate of 2.31% (appendix 3) over the past 10 years to have a better estimate of the country's GDP growth. Using a longer time frame provides a balanced view of Australia's GDP growth, normalising the volatility seen in recent years.

Free Cash Flow to Equity (FCFE) model

Figure 14: REA Group FCFE Average Growth Rate

Period	2024	2023	2022	2021	2020	2019	2018
Net income	302.8	356.1	384.8	322.7	112.4	105	264.3
Depreciation & Amortisation	113.5	91.8	93.1	82.6	78.6	59.6	48.7
Capital expenditure	-125	-117.6	-95	-66.9	-73.4	-68	-59.3
Change in Working Capital	12.2	7.2	6.2	-2.4	1.4	-4.4	3.2
Net Borrowing	-192.5	-101	-8.6	166.1	-77	-122.7	-64
Free Cashflow	111	236.5	380.5	502.1	42	-30.5	192.9
Shares Outstanding	132	132.1	132.1	132.1	131.7	131.7	131.7
FCFE per share	0.84	1.79	2.88	3.8	0.32	-0.23	1.46
Growth FCFE growth rate	-53.03%	-37.84%	-24.22%	1091.86%	237.70%	-115.81%	
Growth rate average	183.11%						

REA Group calculated average FCFE growth rate: 183.11%

- The group decided not to use the average FCFE growth rate of 183.11% as using such a high growth rate is excessively high and unsustainable for a mature company like REA Group. As shown in figure 10, REA Group's FCFE growth rate is volatile due to fluctuation in capital expenditure and net borrowing. Additionally, it is not reasonable to use such a high growth rate when the company's revenue growth rate averaged 12.9% over the past 6 years (appendix 3), which is significantly lower than the FCFE growth rate of 183.11%.

Figure 15: FCFE Model

	discount rate	6.63%					
year	0	1	2	3	4	5	6
	2024	2025	2026	2027	2028	2029	2030
growth		22%	22%	30%	30%	30%	2%
fcfe	0.84	1.0259	1.2516	1.6271	2.1152	2.7498	2.8133
Terminal Value @ y5						65.12281	
PV		0.96	1.25	1.63	2.12	2.75	
PV of TV @ 5						47.24	
Intrinsic Value	**$55.95**						

The intrinsic value based on the FCFE model is $55.95

Period 1 growth (g1): 22% - year 1 and 2

- The group decided to use REA Group's average net income growth over the past 6 years of 22% for stage 1 growth (appendix 4) instead of FCFE growth rate of 183.11%. Net income is a more reliable indicator of a company's ongoing profitability and performance, rather than short-term factors affecting cash flows. Using a 22% growth rate based on historical earnings provides a more credible and realistic forecast relative to an unsustainably high FCFE growth rate.

Period 2 growth (g2): 30% - year 3 to 5

- The group's assumption for REA Group's stage 2 growth rate of 30%, higher than stage 1 growth rate of 22% due to key macroeconomic factors.
- The RBA is expected to cut interest rates in the coming years. Lower interest rates will reduce the cost of borrowing, which will encourage more home purchases. Additionally, developers will benefit from lower reduced cost of borrowing, encouraging more construction projects such as houses and apartments. This will drastically increase the number of listings, transactions, and traffic on REA Group's platform, contributing to higher earnings growth. While the proposed cap on international students could reduce demand for rental, affecting the company's rental property listings, REA Group's dominant and strong market position allows it to adapt to changing macroeconomic environments. The company has consistently exhibited its ability to diversify revenue streams which helps it mitigate any negative impact. Thus, these positive factors support the assumption of 30% growth rate during stage

Period 3 growth (g3): 2.31%

- For stage 3 growth rate, the group used Australia's GDP average growth rate of 2.31% (appendix 3) over the past 10 years to have a better estimate of the country's GDP growth. Using a longer time frame provides a balanced view of Australia's GDP growth, normalising the volatility seen in recent years.

The FCFE estimated growth rates used are different compared to those in the DDM model due to the different focus of each model. The DDM model estimated growth rates are based on REA Group's dividend payout growth rate, which are typically lower but more stable due to the company's payout strategy. In contrast, the FCFE model estimated growth rates are higher as it is more sensitive to fluctuations in the company's operation and financing activity such as capital expenditure and net borrowing. The difference in focus explains the difference in growth rate estimates.

Valuation of Firm compared to its peers

Figure 16: REA Group and Peers Valuation

	Company Name	P/E Ratio	P/CF Ratio	P/S Ratio
REA.AX	REA Group Ltd	86.56	44.45	15.41
CAR.AX	CAR Group Ltd	56.00	30.49	12.73
SEK.AX	Seek Ltd	-	26.97	8.18
DHG.AX	Domain Holdings	46.21	16.95	5.09

The price-to-earnings ratio (P/E) compares a company's share price to its earnings per share. REA's P/E ratio of 86.56 is the highest among its peers, followed by CAR at 56 and DHG at 46.21. SEK's P/E ratio is negative due to their net income being -100.9 million and is therefore not meaningful. REA's high ratio suggests that the company may be overvalued, as its growth potential is already factored into the share price. This means if REA's quarterly earnings is below market expectations REA's share price is susceptible to a sharp downward trend.

The price-to-cash-flow ratio (P/CF) assesses how much investors are paying per dollar of a company's cash flow. REA's P/CF ratio of 44.45 again leads its peers, with CAR at 30.49, SEK at 26.97, and DHG at 16.95. A lower P/CF ratio, typically under 10, is considered ideal as it indicates potential undervaluation. The higher P/CF for REA means investors are paying a premium for the company, reflecting significant overvaluation.

The price-to-sales ratio (P/S) compares a company's stock price to its revenue. REA's P/S ratio is 15.41, which is notably higher than CAR at 12.73, SEK at 8.18, and DHG at 5.09. This means investors are paying significantly more for each dollar of REA's sales compared to its peers resulting in REA's being significantly overvalued in this metric.

Overall, REA appears significantly overvalued based on these financial ratios compared to its peers. Alternatively, its large revenue generation of $1,699.8 million in 2024, significantly higher than competitors like CAR and SEK (around $1,000 million each) and DHG ($390.9 million), may justify the premium.

REA Group Share Price performance relative to S&P/ASX 200 index

Figure 17: Rea Group Vs S&P/ASX 200 index 5-year share price performance (As of 6/9/2024)

Source: Refinitiv Workspace

Performance Overview

Figure 16 shows over the past 5 years, REA Group share price grew by 96.86%, while the S&P/ASX 200 index increased by 23.16%. REA Group share price outperformed the S&P/ASX 200 index by 76.70%.

Key Periods of Share Price Movements

In early 2020, global and Australian financial markets were hit by the Covid-19 pandemic, leading to a sharp decline in share prices for both REA Group and the S&P/ASX 200 index. The impact of the coronavirus outbreak saw the stock market endure its worst day with around $140bn wiped from the value of shares (Doherty. B, Murphy. K, 2020). The downturn was driven by widespread economic uncertainty and concerns about the impact of the pandemic from investors.

From mid-2020 to mid 2021 both REA Group and S&P/ASX 200 index made a recovery. REA Group with its higher volatility and fluctuations, saw its share price recovery significantly outperform the S&P/ASX 200 index. This was largely due to the RBA dropping interest rate to historical lows in 2020 and government grants that fuelled Australia's property market boom. REA Group reported a 35% annual increase in monthly visits across all realestate.com.au platforms, along with a record 2.6 million monthly buyer enquiries, representing 55% annual growth (REA, 2021). Additionally, The Guardian reported that with record low interest rates and government desires to support the market, Australians are taking out home loans in record numbers (Jericho. G, 2021). These favourable market conditions fuelled the property market boom, leading to a sharp increase in user engagement on all REA group's platforms. This translated into higher growth for the company, driving its share price recovery, which exceeded the returns of the S&P/ASX200 index.

Late 2021 to mid 2022, REA Group's share price displayed increased volatility, while the S&P/ASX 200 index remained relatively stable with fewer fluctuations. The increased volatility in REA Group's share price was driven by rising inflation in late 2021 and the RBA's tightening of monetary policies. In November 2021, the RBA reported that headline inflation remained elevated and underlying inflation picked up in the September quarter with the Consumer Price Index (CPI) increasing by 3% year-over-year (RBA, 2021). To combat inflation the RBA started tightening monetary policies in early 2022. On 3rd May 2022, the RBA board increased the cash rate target by 25 basis points to 35 points and begin to withdraw some of its monetary support that was put in place (RBA, 2022). Rising interest rates lead to higher borrowing costs, suppressing property demand and reducing transaction volumes. These unfavourable market conditions significantly contributed to the correction in REA Group's share price during this period.

From mid 2023 to the present, REA Group share price surged to an all-time high, while the broader S&P/ASX 200 index experienced moderate growth. The surge in REA Group share price was driven by strong financial results that met market expectations. The Group's full-year financial highlights included a 23% revenue growth, 27% rise in EBITDA and 24% increase in net profit (McLennan. H, 2024). Additionally, REA group strategic investments and expansions contributed to the company's growth. On 19th June 2024, REA Group acquired full ownership of Realtair, which helps accelerate its agency services strategy by providing customers the best digital tools throughout the property transaction journey and streamlining how agents connect with property owners. (Realtair, 2024). The combination of REA Group's strong financial performance, strategic expansions, and investments helped drive the company's share price to new heights

REA Group share price performance relative to peers

Figure 18: Rea Group Vs Peer group 5-year share price performance (As of 6/9/2024)

Source: Refinitiv Workspace

Performance Overview

Blue line: REA Group. White line: Domain. Yellow line: Seek. Purple line: Carsales

Figure 17 shows over the past 5 years, REA Group share price grew by 92.44%, while Domain, Seek, and Carsales share price grew by -13.47%, 8.72%, and 142.81% respectively. REA Group share price outperformed Domain and Seek by substantial margins of 110.1% and 84.3% respectively but underperformed Carsales by 50.36%.

Key Periods of Share Price Movements

Early 2020

As shown in Figure 17, REA Group, Domain, Seek, and Carsales share prices declined sharply in early 2020. This was due to the Covid-19 pandemic's impact on the global markets, which triggered widespread economic and business disruption. The real estate market, where REA Group and Domain operates, faced significant disruption, Covid-19 induced restrictions on viewing properties and increased consumer uncertainty reduced listings on REA Group platforms (Gillezeau. N & Mason. M, 2020). The employment sector, where Seek operates was severely impacted by the spike in unemployment across the country. The Australian Bureau of Statistics reported from March 2020 to June 2020 the total number of jobs held over the quarter fell by 285,000 (The Australian Bureau of Statistics, 2022). Similarly, the automotive industry where Carsales operates, experienced disruption, with new car sales plunging almost 50% as Covid-19 caused a significant drop in consumer spending. (Gray. D, 2020). Overall, economic uncertainty from the Covid-19 pandemic resulted in a broad sell off in the financial markets, causing share prices of all four companies to decline sharply.

Late 2021:

As shown in Figure 7, the share price of REA Group, Domain, Seek, Carsales started to decline from its peak in late 2021. This was mainly due to the tightening of monetary policies, particularly interest rate hikes by the RBA to combat rising inflation. For REA Group and Domain, operating in the real estate sector, higher interest rates meant higher cost of borrowing for home buyers, leading to a decrease in property demand (Kearns. J, 2022). This reduced the number of listings and transactions on both companies' platforms. The employment sector where Seek operates, high interest rates mean an increase in cost of borrowing for businesses, leading to a decrease in expansions and cost cuts which slowed hiring. Similarly, in the automotive industry where Carsales operates, high interest rates reduced consumer spending as the cost of borrowing has increased, leading to a drop in demand for new and used cars (Palesh. N, 2023). Overall, the tightening of monetary policy and higher interest rates contributed to the decline in share price across all four companies.

Late 2023 to present

As shown in Figure 17, REA Group and Carsales share price returns have significantly outperformed Domain and Seek from late 2023 to present, due to superior earnings performance. In full year 2024, REA Group's revenue and earnings before interest expense and amortization (EBITA) grew by 23% and 27% respectively (REA Group, 2024). Similarly, Carsales revenue and EBITA grew 41% and 42%, respectively (Carsales, 2024). Both companies capitalised on their dominant market position and operational efficiency which has allowed them to sustain earning growth. In contrast both Domain and Seek earnings performance have lagged behind in earnings performance. Domain, which is REA Group's direct competitor, reported full year 2024 revenue and EBITA growth of 13.1% and 26.2% respectively (Domain, 2024), struggling to keep pace with REA Group's growth. Seek experienced a decline in earnings growth, with its full year 2024 revenue and EBITA decreasing by 6% and 14% respectively (Seek, 2024). This was due to weak global job market and slowdown in hiring, contributing to poor earnings performance.

Technical Analysis

Figure 19: REA Group 5-year Share Price Performance Chart (As of 6/9/2024)

Source: Refinitiv Workspace

Buy signal: 50-day moving average (MA) line crosses above the 200-day moving average line (MA) from below.

Sell signal: 50-day moving average (MA) line crosses below the 200-day moving average (MA) line from above.

Buy signals:

Based on figure 8, around July 16, 2020, the 50-day MA line crossed above the 200-day MA line, suggesting that REA Group's stock price was entering a bullish phase, indicating a buy signal. Although volume was relatively flat, there were more green volume bars than red volume bars which may imply that investors are accumulating shares during that period. Thus, reinforces the buy signal.

Around March 10, 2023, the 50-day MA line crossed above the 200-day MA line, suggesting that REA Group's stock price was entering a bullish phase, indicating a buy signal. The buy signal is supported by REA Group's stock price making a higher low compared to the previous low during the late 2022 to early 2023 period which indicates an uptrend forming. This is further supported by the spike in green volume bars which reflects strong buying volume, reinforcing the buy signal.

Sell signals:

Based on figure 8, around March 26, 2020, the 50-day MA line crossed below the 200-day MA line, indicating a sell signal. This was supported by a sharp increase in red volume bars, implying high selling volume during that period which reinforces the sell signal.

Around February 3, 2022, the 50-day MA line crossed below the 200-day MA line, indicating a sell signal. This occurred a few days after REA Group's stock price broke below the defined trend channel support line suggesting that the stock was entering a bearish phase. The sell signal is further supported by a spike in selling volume when the 50-day MA line crosses below the 200-day MA line.

Hold signals

Based on Figure 8, between May 2021 and Jan 2022, REA Group's stock price moved sideways within the defined trend channel indicating a hold signal. During this period, the stock price did not display any strong upward or downward momentum but rather consolidated within a price range. The 50-day MA line was relatively flat as compared to the 200-day MA line. This can be further supported by a stable volume during that period as there were no major spikes on either buying or selling volume. Thus, reinforces the hold signal.

Evaluation of Findings

The intrinsic values calculated using the DDM and FCFE model gives an intrinsic value of $70.75 and $55.95 respectively, which is significantly lower than the current share price of $213.25 (as of 4th October 2024). This difference arises because the current share price reflects investor sentiment and high expectations of future growth, which both models do not capture. The current overvaluation indicates that the market is pricing in high growth rates which may not be realistic. REA's high Price-to-Earnings (P/E) ratio of 86.56, and Price-to-Cash Flow (P/CF) ratio of 44.45 further confirm that the stock is trading at a substantial premium compared to both its peers and its historical performance. Investors are currently paying a high price for REA's potential future growth, which could lead to substantial downside risk if the company fails to meet growth expectations.

As a result, the investment recommendation is to **Sell.** While the company has shown robust operational and earnings performance, the premium investors are paying present a downside risk which outweighs short-term gains, particularly if growth expectations are not met. This contrasts with the buy signal from technical analysis, which reflects short-term momentum but does not account for longer-term overvaluation risk.

Both qualitative and quantitative analysis aligns towards a **Sell** recommendation.

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Appendices

Appendix 1: Regression analysis summary output

SUMMARY OUTPUT								
Regression Statistics								
Multiple R	0.6238201							
R Square	0.3891516							
Adjusted R Squa	0.3887789							
Standard Error	0.0160552							
Observations	1641							
ANOVA								
	df	*SS*	*MS*	*F*	*gnificance F*			
Regression	1	0.269151	0.269150532	1044.153	1.2E-177			
Residual	1639	0.422484	0.000257769					
Total	1640	0.691634						
	Coefficients	*andard Erro*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*ower 95.0%*	*Ipper 95.0%*
Intercept	0.0005351	0.000396	1.349862891	0.177246	-0.00024	0.001313	-0.00024	0.001313
X Variable 1	1.257134	0.038904	32.31336208	1.2E-177	1.180826	1.333442	1.180826	1.333442

Appendix 2: Australia's Past 10 years GDP Growth Rate

Year	GDP Growth Rate
2015	2.20%
2016	2.80%
2017	2.30%
2018	2.90%
2019	2.20%
2020	-0.30%
2021	2.10%
2022	4.30%
2023	3.10%
2024	1.50%
10 year average	2.31%

https://www.abs.gov.au/statistics/economy/national-accounts/australian-national-accounts-national-income-expenditure-and-product/latest-release

Appendix 3: REA Group Revenue Average Growth

	2024	2023	2022	2021	2020	2019	2018
Earnings Quality Score	94	83	95	69	91	97	70
Period End Date	30-Jun-2024	30-Jun-2023	30-Jun-2022	30-Jun-2021	30-Jun-2020	30-Jun-2019	30-Jun-2018
Revenue	1,699.8	1,392.4	1,418.5	1,005.4	881.9	941.4	867.4
Net Sales	1,699.8	1,392.4	1,418.5	1,005.4	881.9	941.4	867.4
Other Revenue, Total	--	--	--	--	--	--	--
Total Revenue	1,699.8	1,392.4	1,418.5	1,005.4	881.9	941.4	867.4
Total Revenue Growth	22.1%	-1.8%	41.1%	14.0%	-6.3%	8.5%	
Total Revenue Average Growth rate	12.9%						

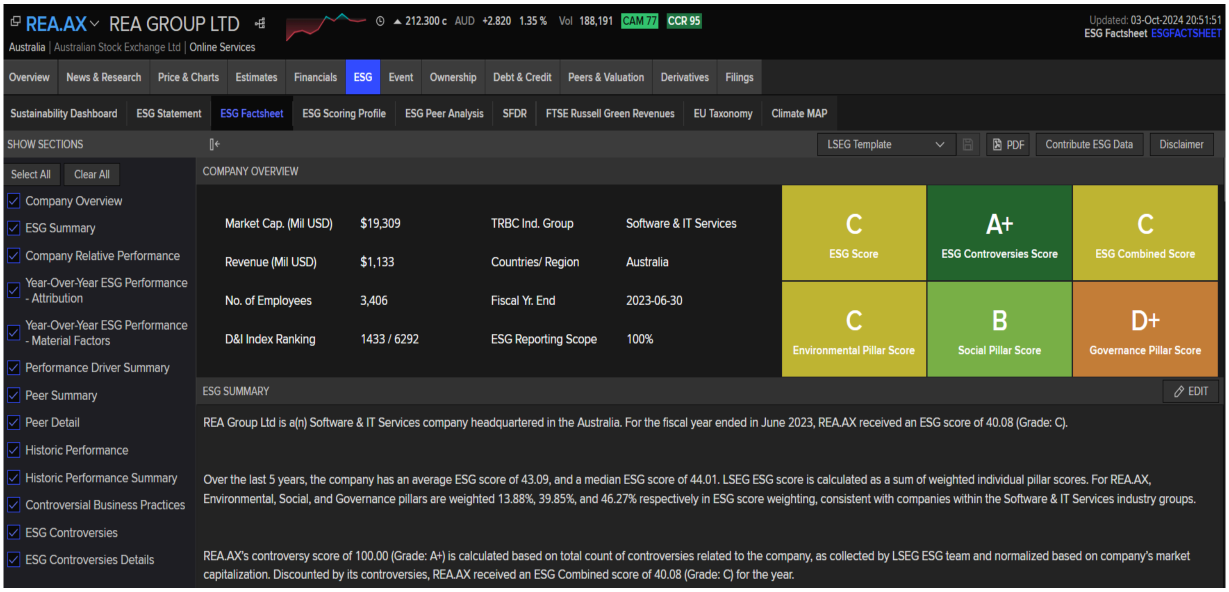
Appendix 4: REA Group Net Income Average Growth

	2024	2023	2022	2021	2020	2019	2018
Earnings Quality Score	94	83	95	69	91	97	70
Period End Date	30-Jun-2024	30-Jun-2023	30-Jun-2022	30-Jun-2021	30-Jun-2020	30-Jun-2019	30-Jun-2018
Net Income	302.8	356.1	384.8	322.7	112.4	105.0	252.8
Net Income Growth	-15%	-7%	19%	187%	7%	-58%	
Net income Average Growth	22%						

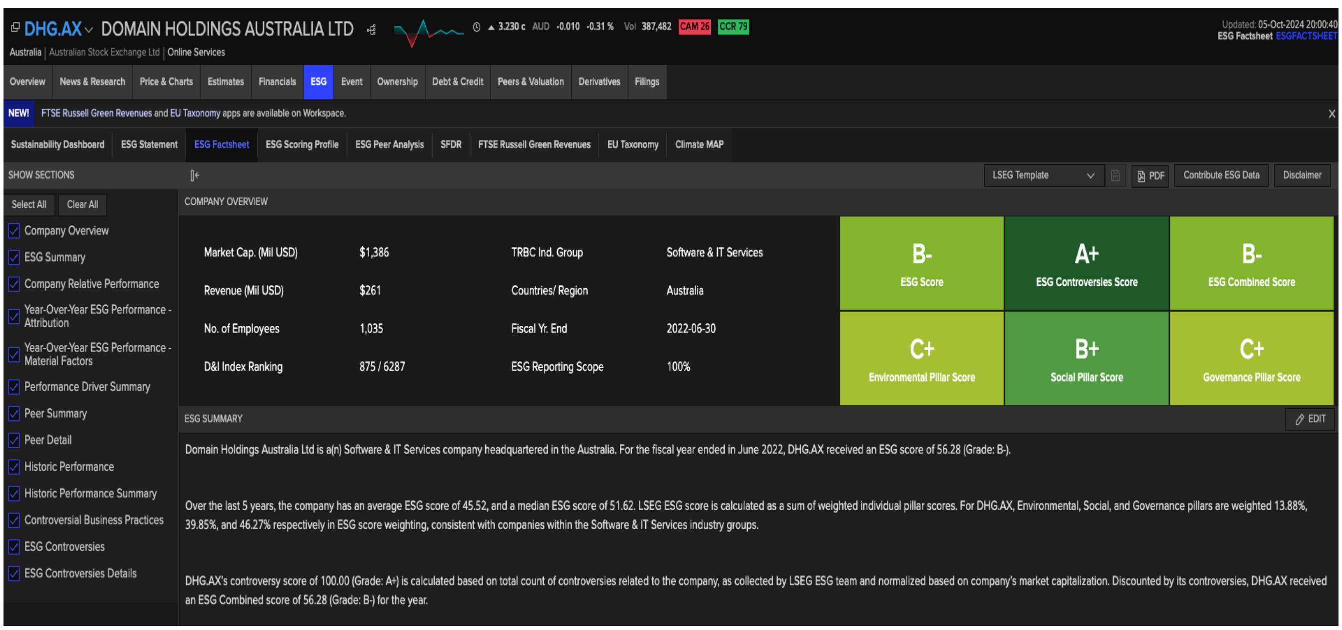
Appendix 5: REA Group DPS Average Growth

REA Group Historical DPS							
Period	2024	2023	2022	2021	2020	2019	2018
DPS - Common Stock Pr	1.89	1.58	1.64	1.31	1.1	1.18	1.09
DPS Growth	20%	-4%	25%	19%	-7%	8%	
DPS Average Growth	10%						

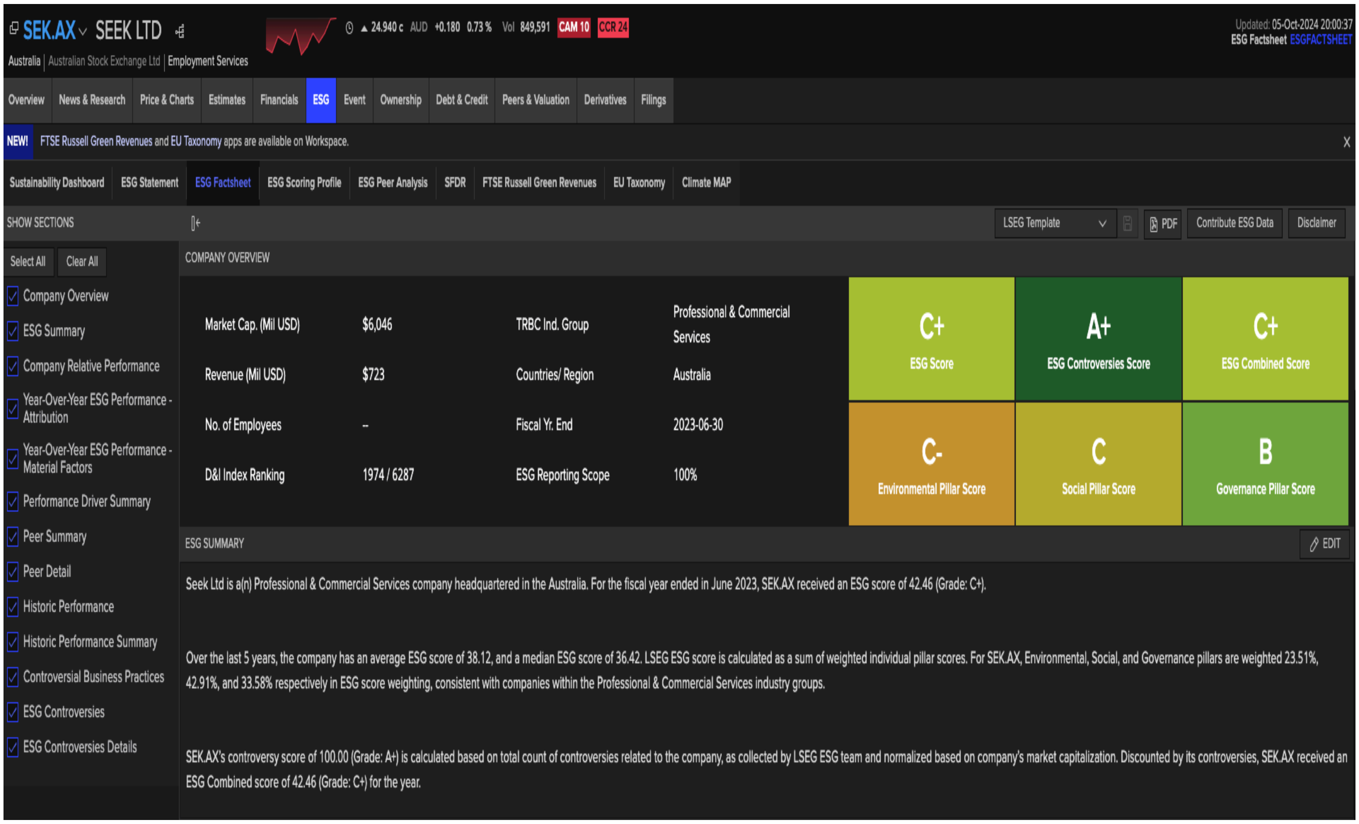
Appendix 6: REA Group ESG Factsheet



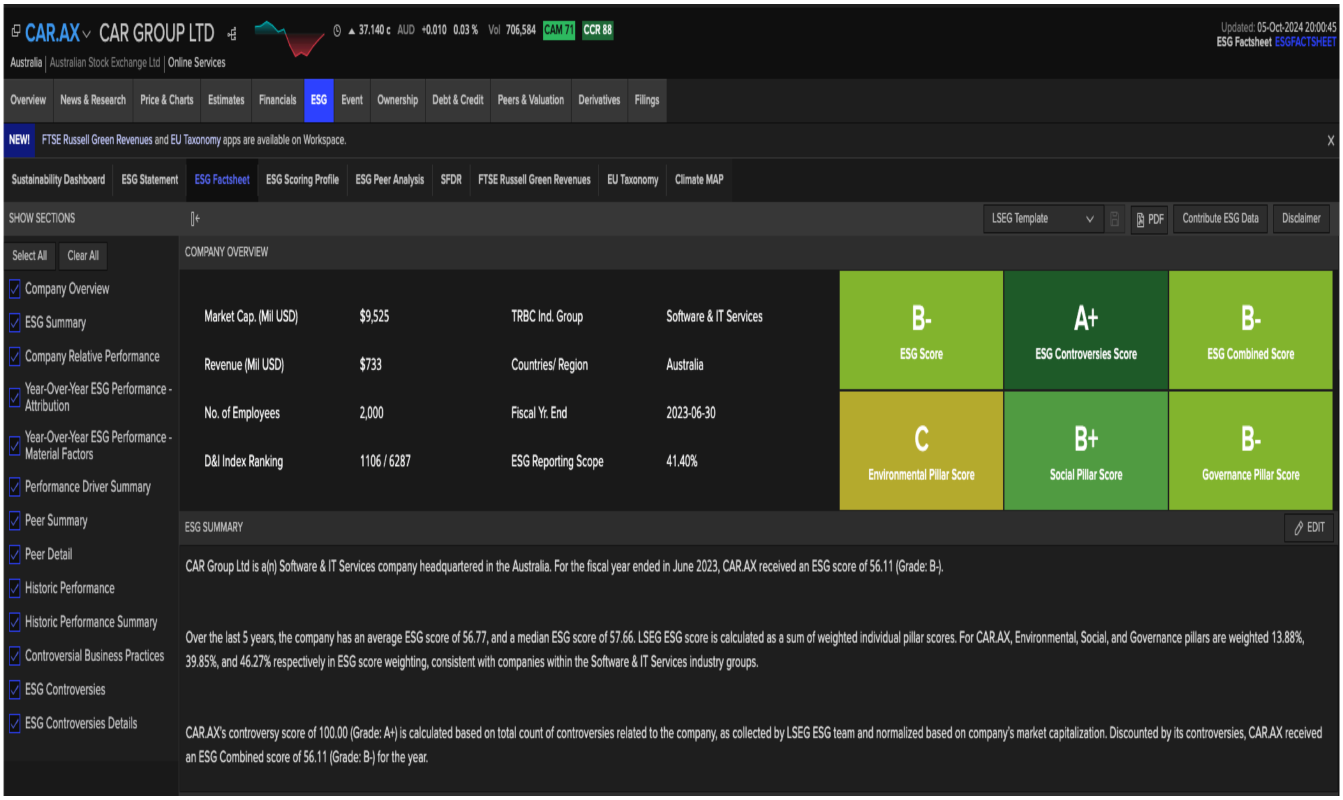
Appendix 7: Domain Holding ESG Factsheet



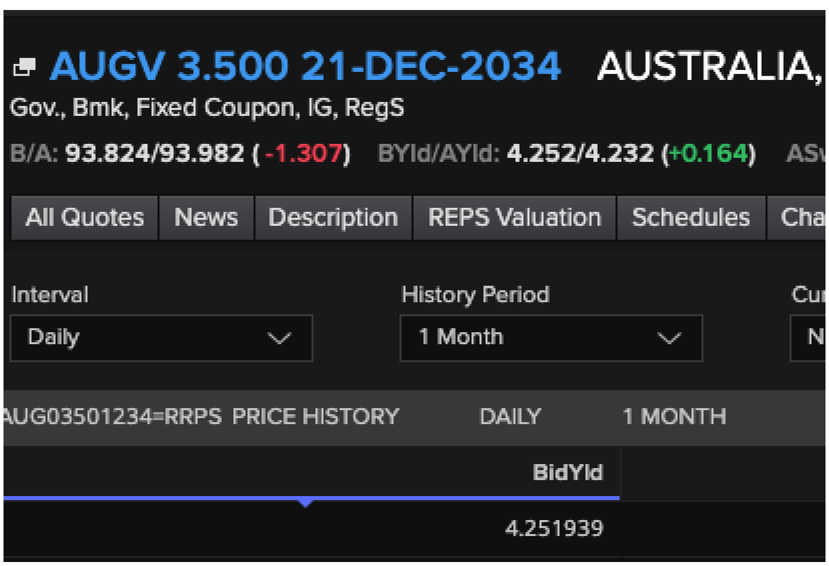
Appendix 8: Seek ESG Factsheet



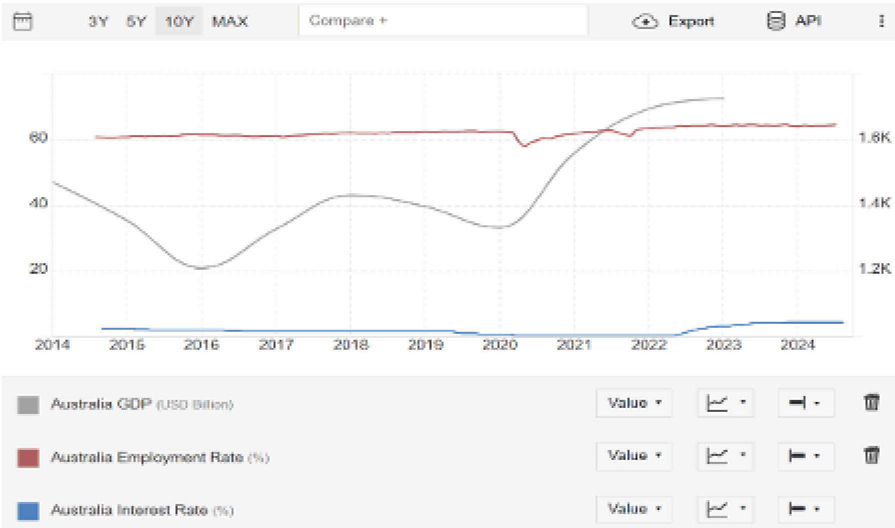
Appendix 9: Car Group ESG Factsheet



Appendix 10: 10-year Australian Government bond yield (AU10YT=RR)



Appendix 11: Australia GDP, Employment Rate, Interest Rate



[Australia Interest Rate (tradingeconomics.com)]

Appendix 12: Australia economic indicators (leading, lagging, coincident)