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SEEK-ing out Structural Growth

Our weekly view on Australian equities.

23 September 2021

Issued by Wilsons Advisory and Stockbroking Limited (Wilsons) ABN 68 010 529 665 - Australian Financial Services Licence No 238375, a participant of ASX Group and should be read in conjunction with the disclosures and disclaimer in this report.

The Opportunity

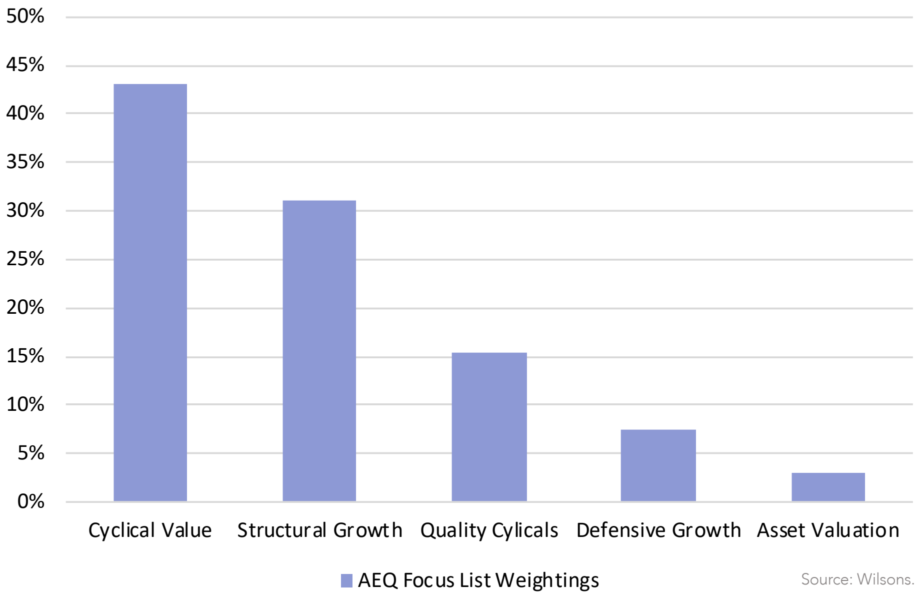
We are adding further structural growth exposure to Wilsons Australian Equity Focus List with the addition of SEEK (SEK) following the removal of Sydney Airports (SYD).

The recent global macro concerns centered around China property developers have coincided with a seasonally weak period of the year for equity markets.

This creates an opportunity to add a high growth exposure to the Focus List that has been over-sold on market concerns rather than on stock-specific grounds.

With the addition of SEK, one-third of the Focus List is now directly exposed to companies we believe have strong structural growth characteristics over the medium to long-term.

Exhibit 1: Structural growth style bucket now represents 31% of the Focus List



Source: Wilsons.

Adding to our Structural Growth Thematic

The structural growth thematic identifies pervasive trends that are largely immune from the economic cycle. These can provide multi-year pathways for revenues and earnings to grow, which can be well above GDP for companies exposed to these industry trends.

In many cases, structural growth overlaps with the disruption thematic, as consumers pivot away from traditional forms of consumption. For investors, this process can create attractive investment opportunities, as the transfer of market capitalisation from established companies to new, higher-growth companies takes place.

The Focus List aims to have a meaningful proportion of its members exposed to structural growth. The addition of SEK has increased the Focus List's weighting exposed to structural growth from 28% to 31% across ten companies.

Exhibit 2: Structural growth exposed Focus List members

Ticker	Company Name	Weighting	EPS Growth (FY0-FY3)	12 mth fwd PE	EBITDA Growth (FY0-FY3)	12 mth fwd EV/EBITDA	Sales Growth (FY0-FY3)	12 mth fwd EV/Sales	Secular Thematic
CSL	CSL	8%	9%	44x	7%	30x	7%	10x	Healthcare and Wellness
EML	EML Payments	4%	44%	23x	37%	20x	19%	5x	Global Payments
SEK	SEEK	3%	28%	50x	19%	25x	16%	11x	Technology
GMG	Goodman Group	3%	13%	29x	14%	28x	5%	23x	E-commerce/Industrial Property
TLX	Telix Pharmaceuticals	2%					216%	151x	Healthcare and Wellness
RMD	Resmed Inc	2%	13%	44x	13%	32x	11%	11x	Technology
XRO	Xero	2%	65%	490x	26%	90x	25%	21x	Technology
APT	Afterpay	2%	300%	3210x	163%	191x	50%	24x	Global Payments
SLA	Silk Laser Australia	2%	30%	23x	26%	9x	21%	3x	Healthcare and Wellness

Source: Company Data, Refintiv, Wilsons.

The Structural Growth Trends Expected to Benefit SEEK

1. Online migration

While the migration of employment classifieds from offline to online has already taken place in developed markets, the opportunity in emerging markets remains large. SEK has a 20% share of placement volumes in Asia, compared to 30% in Australia.

The online opportunity extends beyond just employment classifieds and in other value-added employment-related services, including training/education and a range of services across human capital management. As we have seen in other industries and classified portals, the dominant players can evolve into a broader product offering, driving move value for the customer and increasing the addressable market.

Exhibit 3: SEK's network effect will increasingly be leveraged into creating an employment platform

SEEK GROWTH FUND
13 Assets

Source: Company Data, Wilsons.

2. Network effect

The network effect - where an increasing number of users increases the value of the service - is not just applicable in the classifieds business. Increasingly, SEK is integrating its development projects into the core classifieds offering, creating a larger and more powerful network. In time, several of SEK's early-stage growth businesses could develop into material cash generators.

The network effect is increasingly being used as a tool to drive additional value for SEK – particularly in Australia New Zealand (ANZ). Just like Carsales.Com (CAR) and REA Group (REA), the push into 'depth-based pricing' can drive significant margin accretion for equity holders.

Depth pricing, a concept of differential pricing for the same service – the same way an airline has different classes of service - allows SEK to charge much higher rates for job advertisements that are more prominently displayed. Not only is this more effective/impactful in driving results for paying employers, but the additional revenue also comes with almost no additional costs. It's almost entirely profitable.

The ability to monetise a network of a technology company is directly proportional to the strength of its network effect. Depth-based pricing is just one way of doing this, enhancing its earnings power over time.

SEEK: Three Key Investor Debates

1. **Cyclical recovery**

Despite a strong structural growth story, SEK has not been immune from COVID. ANZ job ad volumes remain 20% below FY19 levels. Economic reopening by early 2022 is likely to see volumes return. Improved volumes will allow SEK to continue to push through price rises and further reposition its depth product. The market is looking for +30% revenue growth in FY22E.

Chinese jobs portal Zhaopin (SEK 24%) also offers cyclical recovery with revenues down in FY21 on FY20. In the last quarter there appeared to be improving momentum on visitors and job ads. We remain optimistic of a strong rebound in FY22E as China further reopens.

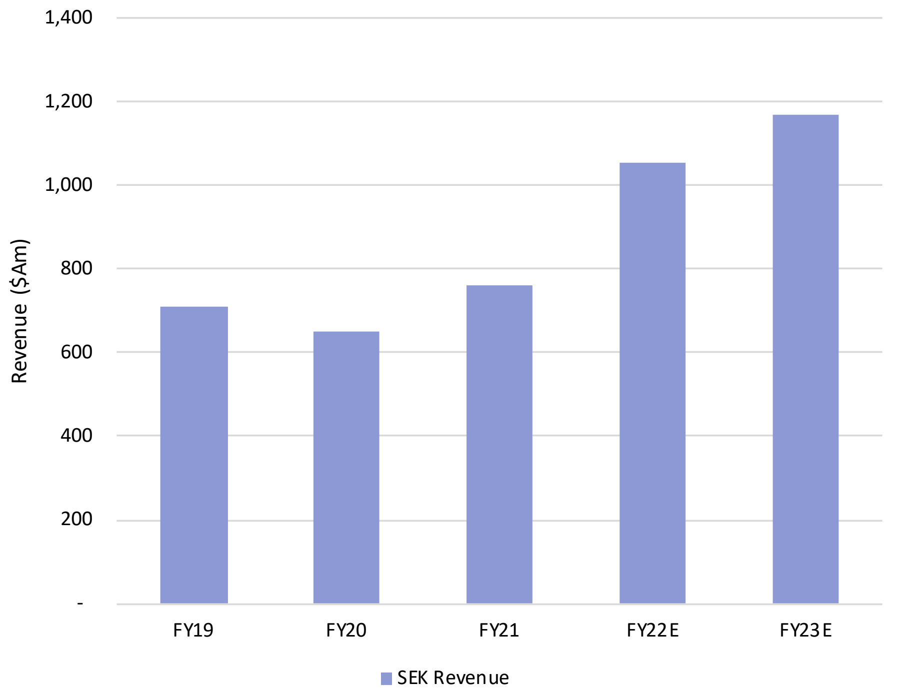
2. **SEK Growth Fund**

The SEEK Growth Fund (SEK 85%) has A$1.2bn assets under management across Online Education Services (OES), Chinese job-seeking platform Zhaopin and several early-stage investments across education, HR SaaS, and contingent labour-hire (temporary labour in 'the gig' economy).

For the most part, these businesses are still scaling up and will need capital to grow. Despite COVID, OES grew revenue at +40% in FY21, the early-stage education business +49%, whilst HR SaaS grew at 51%. In time, it is possible that a number of really strong businesses emerge from the current pool of 14 investments.

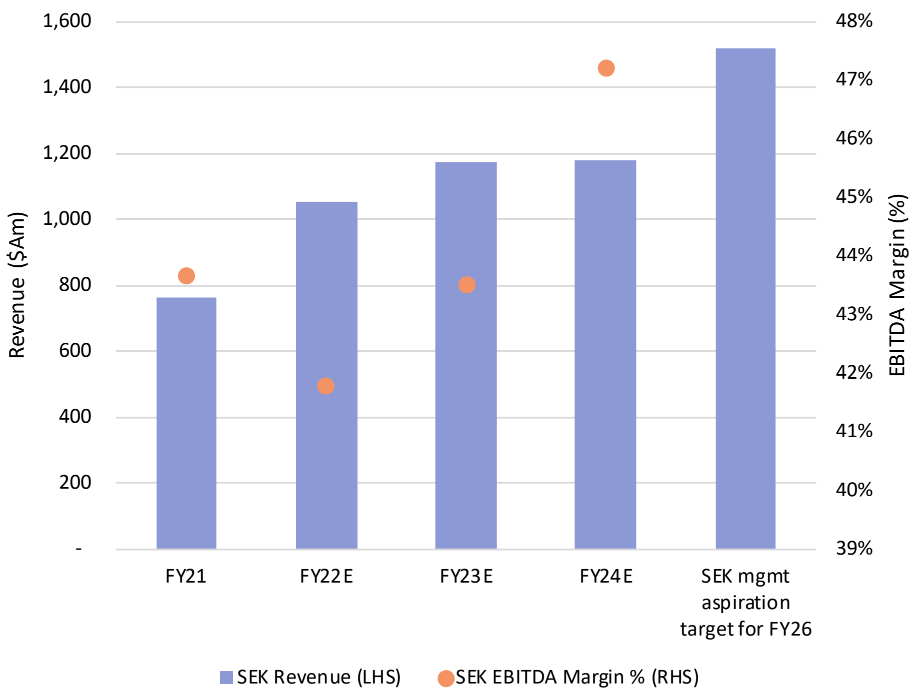
This could provide strong additional revenue growth to SEK, and form part of SEK's aspiration to double revenue by 2026, which is currently +20% above consensus forecasts in 2026E.

Exhibit 4: SEK's core AP&A business should see a cyclical recovery in revenues



Source: Refinitiv, Wilsons. AP&A = Asia Pacific & Americas

Exhibit 5: SEK's aspirational revenue targets for 2026 are +20% above current consensus



Source: Refinitiv, Wilsons.

3. Management reorganisation

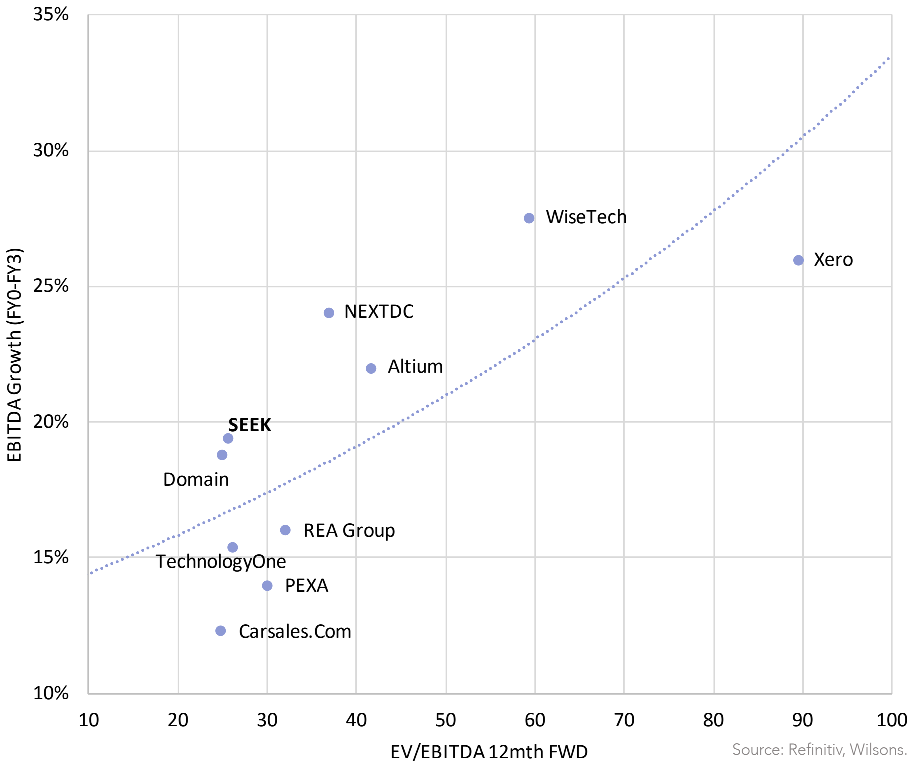
SEK has recently reorganised the business and the management responsibilities. We are supportive of the changes.

From an investor perspective, it is now much clearer to see the mature assets which produce cash in SEEK vs the early stage growth assets in SEEK Investments, which still require growth CAPEX. Importantly, this will allow investors to recognise the latent value within SEEK Investments, which represents ~15% of SEK's valuation.

The reorganisation is clever from two perspectives. Firstly, this allows Andrew Bassat (co-founder) to focus on what is he has built a solid reputation on, that of being an entrepreneur, whilst remaining involved with SEK. Bassat is now CEO of SEEK Investments.

Secondly, this opens the door for a professional manager – former CBA boss Ian Narev to run SEEK – which given its size, both in terms of people and geographic spread, arguably warrants a different skill set. Through these changes, Bassat has not changed his equity position in SEK.

Exhibit 6: SEK screens well on both growth and valuation measures



Source: Refinitiv, Wilsons.

SEEK Valuation vs Growth

SEK compares favourably against peer technology names from both an earnings and valuation perspective. Earnings (EBITDA) growth of almost 20% compound annual growth rate (CAGR) against an EV/EBITDA multiple of 25x, this is down from almost 30x in results season. During the August reporting season, SEK was one of only two companies amongst peers to see consensus earnings upgrades.

Focus List Changes

SEEK (SEK) has been added at a 3% weighting following the removal of Sydney Airports (SYD). SYD has performed well for the Focus List primary due to the takeover bid, generating a return of ~40% since 2Q this year.

The prospects of a higher bid or a competing bid emerging for SYD is low, following a third bid from the IFM consortium valuing SYD at $A8.75 per share. SYD has granted due diligence to IFM, which is unlikely to uncover anything material that is not already in the public domain, leaving prospects of further price escalation low.

A$8.75 bid is the mid-point of the valuation range we had ascribed to SYD in early May 2021.

> Read Sydney Airport: in the Lounge, Waiting for Final Call

With ~5% upside to the A$8.75 offer price, the market is primarily discounting the time value of money, rather than a view that the bid is not going to proceed. On timing, the potential receipt of cash for SYD - post numerous regulatory approvals - is unlikely until 1Q22.

Focus List Weightings

Ticker	Company Name	Weighting	Style	Sector
WBC	Westpac Banking Corp	9.0%	Cyclical Value	Financials
BHP	BHP Group	8.0%	Cyclical Value	Materials
CSL	CSL	8.0%	Structural Growth	Health Care
NAB	National Australia Bank	7.0%	Cyclical Value	Financials
IAG	Insurance Australia Group	5.0%	Quality Cylicals	Financials
STO	Santos	5.0%	Cyclical Value	Energy
TLS	Telstra Corporation	4.5%	Defensive Growth	Communication Services
EML	EML Payments	4.0%	Structural Growth	Information Technology
SVW	Seven Group Holdings	4.0%	Cyclical Value	Industrials
JHX	James Hardie Industries	4.0%	Quality Cylicals	Materials
QAN	Qantas Airways	4.0%	Cyclical Value	Industrials
ALL	Aristocrat Leisure	3.5%	Quality Cylicals	Consumer Discretionary
HCW	Healthco	3.0%	Structural Growth	Real Estate
NWS	News Corp	3.0%	Asset Valuation	Communication Services
OZL	OZ Minerals	3.0%	Cyclical Value	Materials
NST	Northern Star Resources	3.0%	Defensive Growth	Materials
SEK	SEEK	3.0%	Structural Growth	Communication Services
GMG	Goodman Group	3.0%	Structural Growth	Real Estate
MQG	Macquarie Group	3.0%	Quality Cylicals	Financials
ANZ	Australia and New Zealand Banking Group	3.0%	Cyclical Value	Financials
TLX	Telix Pharmaceuticals	2.0%	Structural Growth	Health Care
RMD	Resmed Inc	2.0%	Structural Growth	Health Care
XRO	Xero	2.0%	Structural Growth	Information Technology
APT	Afterpay	2.0%	Structural Growth	Information Technology
SLA	Silk Laser Australia	2.0%	Structural Growth	Consumer Discretionary

Source: Refintiv, Wilsons.

Disclaimer and Disclosures

Recommendation structure and other definitions

Definitions at www.wilsonsadvisory.com.au/disclosures.

Disclaimer

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