

Eyeballs have it: internet

Small caps

Justin Bailey

Fears that sovereign debt problems in Europe could cause another liquidity crisis, and a wild week on international markets, pulled small caps into negative territory last week.

The Australian Small All Ordinaries finished the week down 7.3 per cent, the index's worst week since November 2008.

Small caps have now lost about 9 per cent this year and have dropped 13 per cent since hitting a 16-month high in January.

Smart investors will see the market's latest selloff as a buying opportunity. Stocks that just weeks ago were running hot have now lost upwards of 15 per cent from recent highs.

For those betting the economy will shrug off the problems emanating from Europe and surge forward, a great place to be is the internet sector, analysts argue.

As a group, the likes of carsales.com, realestate.com and Seek are looking at earnings growth of 20 per cent or greater over the next few years, Smallco Investment managing director Rob Hopkins predicts.

"And there aren't too many businesses you can say that about," he adds.

Internet classified providers are benefiting from a structural shift from print to online, particularly as broadband penetration increases.

Online retailers' and media companies' revenue streams have not necessarily risen in line with the migration of advertising, but eventually this is sure to happen.

"To a large degree, the eyeballs have gone online. No one uses the paper to sell their car any more, but the revenue hasn't followed to any great degree," Hopkins says.

"In real estate, a large majority of the eyeballs have gone across, but only 10 per cent of the revenue. In time, that disconnect will change."

REA Group, the operator of realestate.com, is a favourite of Stephen Black, co-manager and founder of small-cap fund manager Pengana.

"We still have a very strong view on realestate.com. They've got a very strong niche in the real estate market."

Realestate.com has most of the market sewn up, but with

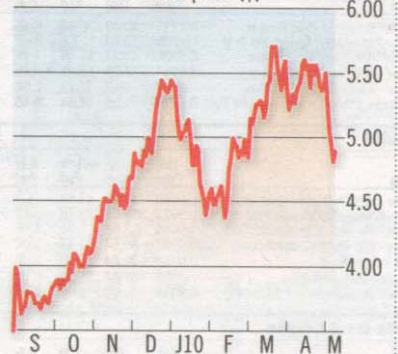
Online

REA Group Share price (\$)



| | |
|----------------|---------|
| 52-week high | \$12.60 |
| 52-week low | \$4.57 |
| 1-year return | 125.6% |
| Forward EPS | 39¢ |
| Forward P/E | 26.6x |
| Dividend yield | 0.9% |
| YTD change | 13.8% |

Carsales.com Share price (\$)



| | |
|----------------|--------|
| 52-week high | \$5.86 |
| 52-week low | \$3.50 |
| 1-year return | n/a |
| Forward EPS | 17¢ |
| Forward P/E | 27.9x |
| Dividend yield | 1.4% |
| YTD change | -9.4% |

reinvigorated management and a website just launched, they are now in a position to be smarter with their pricing.

"So you will see better pricing coming through over the next two-to-three years, a lot of which will drop straight through to the bottom line," Black says.

REA Group is Australia's predominant online real estate advertiser.

The company offers classified advertising, display advertising, web development and home loan services.

Its clients include residential and commercial agents, franchise groups, developers and consumers.



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Rob Hopkins,
Smallco Investment
managing director



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| | |
|----------------|--------|
| 52-week high | \$8.57 |
| 52-week low | \$3.52 |
| 1-year return | 97.0% |
| Forward EPS | 24¢ |
| Forward P/E | 32.4x |
| Dividend yield | 1.3% |
| YTD change | 13.8% |

SOURCE: BLOOMBERG

REA also operates real estate websites in New Zealand, the United Kingdom, Italy, France and Luxembourg.

The company reported net profit of \$24.51 million for the half-year ended December 2009.

Revenues from ordinary activities were \$91.87 million, up 13.2 per cent from the same period last year.

REA said results were driven by good performance across the entire product portfolio for the half-year.

Brokers also like REA. Of the eight that cover it, five have a buy recommendation on the stock and three have a hold.

Since listing last October, **carsales.com** has climbed 37.7 per cent from its issue price of \$3.50.

"We really like carsales.com and are impressed at how they are expanding into other verticals, like motorbikes and boats," Hopkins says.

Carsales.com net profit surged 51 per cent to \$19.06 million for the six months to December 31, 2009.

Revenue from ordinary activities was \$56.33 million, up 26 per cent from the same period last year.

The result was driven by solid increases in automotive enquiry volumes, which were up 50 per cent, and low double-digit growth in automotive private ad volumes.

Carsales.com offers online access to automotive classifieds

and is the largest consumer website in the country that covers automotive, motorcycle and marine and display advertising.

The company operates 27 individual websites that are focused on different products, as well as ads for new and used goods from both business and private sellers.

Carsales.com employs 200 staff nationwide and also offers finance and broker services.

A couple of brokers also like carsales.com. Of the seven that cover it, two have a buy recommendation on the stock and five have a hold rating.

Of all the online classified operators, **Seek is Hopkins' favourite.**

"We probably prefer Seek, just because the company has a very good cyclical upturn coming through. They have a couple of extra growth legs on their operations and they are getting very heavily into the education space using their very strong brand name to sell courses," he says.

Seek has two operating divisions – online job classifieds, and training and learning.

The company is an Australian online job classifieds provider, with close to 60 per cent of the Australian and New Zealand market.

Its Australian operations are conducted through www.seek.com.au and the site accounts for 90 per cent of total revenue and profits.

Seek's website is customised to target various market segments through several sub-sites, including Seek Executive, Seek Volunteer and Seek Commercial.

The company's training and learning division includes Seek Learning, Brasil Online Holdings and THINK: Education Group.

Seek reported a 12.6 per cent rise in net profit to \$36.55 million for the half-year ended December 2009.

Revenues from ordinary activities were \$130.37 million, up 19.2 per cent from the same period last year.

The education business performed extremely well, with Learning revenue of \$19.4 million, an increase of 46.5 per cent, driven by organic growth.

Brokers also like Seek. Of the 14 that cover it, nine have a buy recommendation on the stock, four have a hold rating and one a sell.