A high-growth prospect

by Roger Montgomery

SEEK (SEK) is a stock we have liked and owned for a while.

The initial phase of growth for the company was one in which it replaced traditional print media as the main job advertising board.

Its focus was on being the site with the largest number of jobseekers, which in turn would attract employers looking for the largest pool of talent. This, along with the scale advantages generated from fixed costs, created a barrier to entry that allowed SEEK to generate an extremely higher return on capital and large amounts of free cash flow.

This cash flow has been invested in a number of other areas including Learning (albeit with a recent regulatory hiccup) and acquisitions of leading online job sites in Asia, Africa and Central and South America.

In Australia, the business is moving into its second stage of growth. The risk to the virtual circle created by having the highest number of jobseekers and employers will inevitably come under threat from new business models if SEEK fails to innovate and evolve the business. The job ad aggregators like Indeed are the most obvious threat to the basic job board business, and will lead to a commoditisation of this asset over time.

To SEEK's credit, management announced that it will be reinvesting in new products to create value added services that leverage its core competencies and strategic advantages, rather than just defending its job board business.

What sets the online job ad business apart from the tradition print media product is the data capture. The more interactive and engaging nature of online advertising lends itself to learning about the end users (both jobseekers and employers). This data can be used to identify opportunities and produce products that can tap demand and supply that was previously unavailable to one dimensional job ads in print media, by identifying and prompting people that might be interested in a new job opportunity but are not actively looking. These people are known as passive jobseekers.

Historically, accessing the passive jobseeker market required the use of recruitment firms that manually search their database of past applicants. The rapidly growing database at SEEK's disposal from 7.1m posted resumes provides it with a broader base of potential jobseekers than any individual recruiter.

SEEK's investment in search technology and systems also provides a faster and more efficient means of searching the database for a list of potential candidates.

Through its investment in new products and the increased capture of valuable data, SEEK is moving along the value chain of the industry to the more labour intensive and higher value added part of the industry.

As evidence of the value of its search capability, SEEK announced on February that Hays Recruitment will use SEEK's search technology to filter both its own and SEEK's database. This sees SEEK starting to integrate its technology into the recruiter's business to improve their efficiency and capabilities directly.

Increased penetration of the recruiter market will inevitably bring SEEK into greater contact with other disruptors like LinkedIn. However, the primary opportunity for both companies will be in displacing the traditional players in the market for many years before having to worry about one another.

One key deficiency in SEEK's platform relative to LinkedIn is its lack of ongoing engagement with the jobseeker once they find a job. In the results to 31 December 2015, the company discussed some new products such as Company Reviews that are designed to generate an ongoing dialogue with jobseekers after they find a new job. This is part of a suite of new products that SEEK will launch in the medium term to help jobseekers make better and more informed decisions.

Importantly, a lot of the investment being made in Australia will have applications in SEEK's overseas businesses. This provides more leverage for the investment in the longer term.

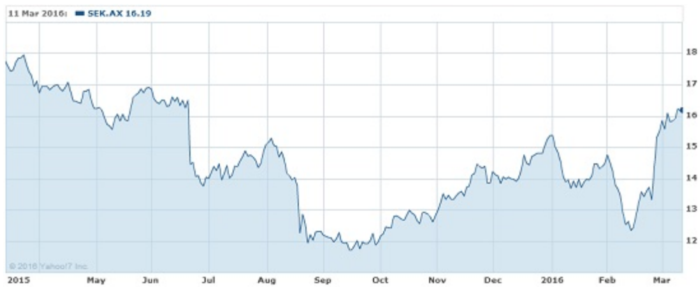
The first half result provided greater confidence in the reinvestment strategy, while also showing the benefits that will flow through from the merger of JobsDB and Jobseeker in Asia. This gave the market increased confidence in the strategy.

The flat earnings profile in FY16 is largely the result of the increased investment in new products, combined with a temporary step down in the earnings of SEEK Learning resulting from the change in VET FEE regulations and commission structures.

Both of these factors will present less of a headwind to growth from FY17, which is reflected in average sell side analyst forecasts for EPS growth of 14% in FY17 and 16% in FY18.

We remain concerned about the potential for headwinds from Learning and investment will be replaced by economic challenges. This could result in some disappointment in the near term earnings outlook, but the long term investment potential remains very positive given the strength of the company's franchises, the opportunities for growth reinvestment, and the return dynamics in the business.

SEEK (SEK)



Source: Yahoo!7 Finance, 14 March 2016

Important: *This content has been prepared without taking account of the objectives, financial situation or needs of any particular individual. It does not constitute formal advice. Consider the appropriateness of the information in regards to your circumstances.*