

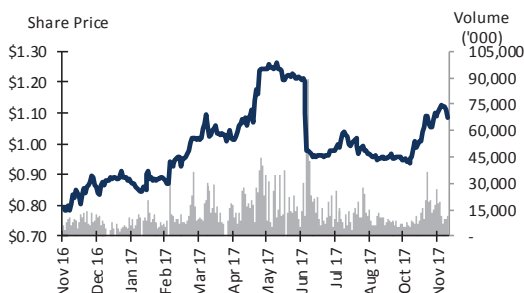


Fairfax Limited (FXJ)

Our View on Fairfax, Post Demerger: Can Fairfax Survive on its Own, with No Cash Cow?

Recommendation		BUY		
Previous		BUY		
Risk		High		
Price Target		\$1.27		
Previous		\$1.27		
Share Price (A\$)		1.07		
ASX Code		FXJ		
52 week low - high (A\$)		\$0.77-\$1.27		
Capital structure				
Shares on Issue (M)		2,313.5		
Market Cap (A\$M)		2,470		
Net Debt/(Cash) (A\$M)		118		
EV (A\$M)		2,588		
12mth Av Daily Volume ('000)		12,984		
Y/e June (A\$m)	2016a	2017a	2018e	2019e
EBITDA \$M	283.3	271.1	277.2	265.4
Op EBIT	220.4	235.2	240.9	228.2
NPAT \$M (Adj)	140.3	147.9	146.9	136.3
EPS (cents) - Adj	6.0	6.4	6.4	5.9
DPS (cents)	4.0	4.0	4.0	4.0
PER x	17.8	16.7	16.8	18.1
EV/EBITDA x	9.1	9.5	9.3	9.8
EV/EBIT x	11.7	11.0	10.7	11.3
Dividend yield (%)	3.7%	3.7%	3.7%	3.7%
Major Shareholders				
Ausbil		7.7%		
Fidelity		6.4%		
Legg Mason		6.1%		
CBA		6.0%		
Blackrock		5.0%		

Share Price Graph



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 The analyst owns no shares in FXJ.

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Event:

- Post demerger trading opinion for Fairfax (FXJ) and Domain (DHG), on 16th November 2017.

Analysis:

- With the demerger of DHG from FXJ occurring on Thursday this week, we would Buy DHG up to \$2.60 and Buy FXJ post demerger up to \$0.62. We assume FXJ excluding its 60% shareholding in DHG worth \$0.35 from SOP valuation, and its 60% interest in DHG worth \$0.27 after applying a 30% holding discount (Figure 2).
- Our valuation of FXJ pre-merger has been \$1.27 (average consensus c.\$1.10 PT) and FXJ today is trading at \$1.08. Approximately c.70% of our valuation has been attributable to DHG (assuming normal property listing levels). This equates to a DHG per share valuation of \$3.60 today.
- Between \$2.20 and \$2.60 per share (see Figure 2), DHG trades on a 2018 PER of 25.9x to 30.6x. Today, REA trades at 35.0x PER (2018). We believe that this range is reasonable and potentially undervalues DHG's assets. Our key reason for this is that we are at a cyclical low for property listings in Australia today (although some recent improvement has occurred of late). With improved listings volumes to normal market levels, coupled with c.20% price increases on premium listings, along with improved depth penetration and improvement in additional segments/States, the high operating leverage effect means that DHG's EBITDA could reach c.\$200m in 2020e.
- Based on our prior valuation (\$1.27), our FXJ Demerger valuation (ex-Domain's 60%) is c.\$0.37. Remaining segments include: Metro Media, Life Media & Events, Digital Ventures, Stan, Regional Newspapers, Radio and NZ. Potentially, we could be undervaluing FXJ's assets (excluding DHG) with the likely changes in Australian media ownership laws and associated M&A activity. Further, we are not giving FXJ the benefit of the doubt that they could be successful in monetising additional verticals from its editorial content such as cars, food, baby, among others (limited progress to date, based on newsflow).
- FXJ's core problem (excluding DHG) is the high fixed overheads of its print publishing assets (Metro Media and Regional Newspapers). FXJ earlier this year announced that they are planning to cut c.\$30m in Metro Media costs, enabling earnings stability over the next 2-years. No specific comment has occurred with regards to its regional media operations, albeit cost-outs are on-going. Based on recent past, we have been surprised by management's ability to control publishing costs in the wake of c.10% decline per annum in revenues. Stabilisation of revenues to a decline of low single digits would be a welcome relief, but no signs of that appear on the immediate horizon.

Recommendation:

- Post demerger, we would buy DHG up to \$2.60 and buy FXJ post demerger up to \$0.62.
- It is likely to be a 'wild' day on Thursday, with many variables impacting investor's views on perceived 'value'. The only certainty, with everything above, is the level of uncertainty. We have made a first attempt to draw a line in the sand.