

## Valuable fractions of a huge pie

### Revolutionary property investment platform

We believe today's property investing in Australia is archaic and ripe for disruption. Property investors can essentially only acquire entire properties, e.g. in their SMSF, or buy units in property funds without any influence on the investment strategy. DomaCom Limited (ASX:DCL) has developed two fully regulated financial products that we believe can revolutionize property investing in Australia. DCL operates property investment platforms that enable investors to invest in fractions of properties rather than having to buy an entire property. Additionally, the company's Equity Release product enables "asset rich/cash poor" home owners to release some of the capital locked up in their family homes without needing to downsize.

### Own part of a property with Fractional Investing

Fractional Investing is ideally suited to property investors looking to diversify investment portfolios across multiple properties, or for people with limited investment funds available that are looking for exposure to the property market and first home buyers. DCL recently cleared all regulatory hurdles for this product and hopes to have the final building block in place shortly, i.e. debt funding to introduce leverage to the property investments on its books.

### Equity Release: Ideal for the "asset rich/cash poor"

DCL's Equity Release product will formally launch in the next two months and is primarily targeted at Baby Boomers looking to release capital from their unencumbered homes, helping them to fund their retirement and for inter-generational wealth management.

### Strong take up expected by financial advisers

Given that DCL essentially adds another, important, asset class to financial advisers' advisory tool box, we expect both products will garner very strong interest once fully launched. The company is targeting the investment property segment of the SMSF market, valued at A\$ 700BN in total. Additionally, DCL has its sights set on first home buyers and the market for retiree homes worth around A\$ 500BN.

### Generating revenues from asset management fees

In his previous venture, Praemium (ASX:PPS), DCL CEO Arthur Naoumidis achieved a 4% market share with SMSFs. Even if the company only achieved 1% share of SMSFs > A\$ 700BN funds under management and in retiree homes, this would signify a tremendous revenue opportunity for DCL, given its 0.88% management fee on Funds under Management.

### Valuation doesn't seem to reflect DCL's opportunities

The company's current A\$ 14.5M market cap seems to reflect a lack of awareness and understanding of DCL's products and market opportunities on the part of equity investors. We would expect this valuation to substantially increase if and when the market latches on to the company's future potential, reflected in growth of Funds under Management.

Share Price: A\$0.115

ASX: DCL

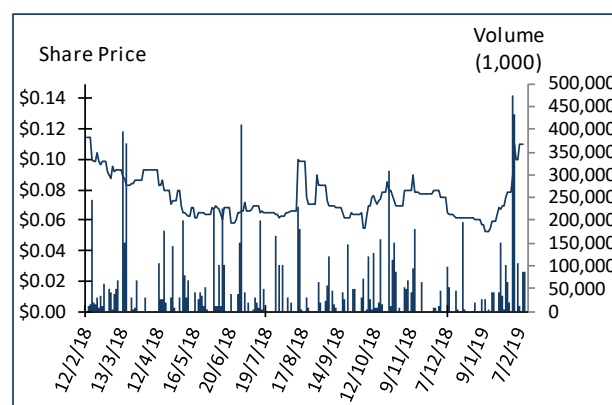
Sector: Diversified Financials

13 February 2019

Market Cap. (A\$ m)	15.1
# shares outstanding (m)	131.5
# share fully diluted	141.9
Market Cap Ful. Dil. (A\$ m)	16.3
Free Float	66.9%
12 months high/low (A\$)	0.12 / 0.05
1 / 3 / 12-month performance	69.2% / 37.5% / 0.0%
Website	<a href="http://www.domacom.com">www.domacom.com</a>

Source: Company, Pitt Street Research

### Share price (A\$) and avg. daily volume (k, r.h.s.)



Source: Thomson Reuters, Pitt Street Research

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*This report serves as an initial introduction to DomaCom and its two main products, Fractional Investing and Equity Release. We will endeavour to publish a more in-depth report shortly, including a full financial model and valuation range, highlighting the financial opportunity for DomaCom and its investors.*

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*Property investing today is  
archaic and ripe for disruption*

## The problem with property investing today

If property investors today want to purchase real estate, they can essentially only acquire entire properties, e.g. in their SMSF, or buy units in listed property funds.

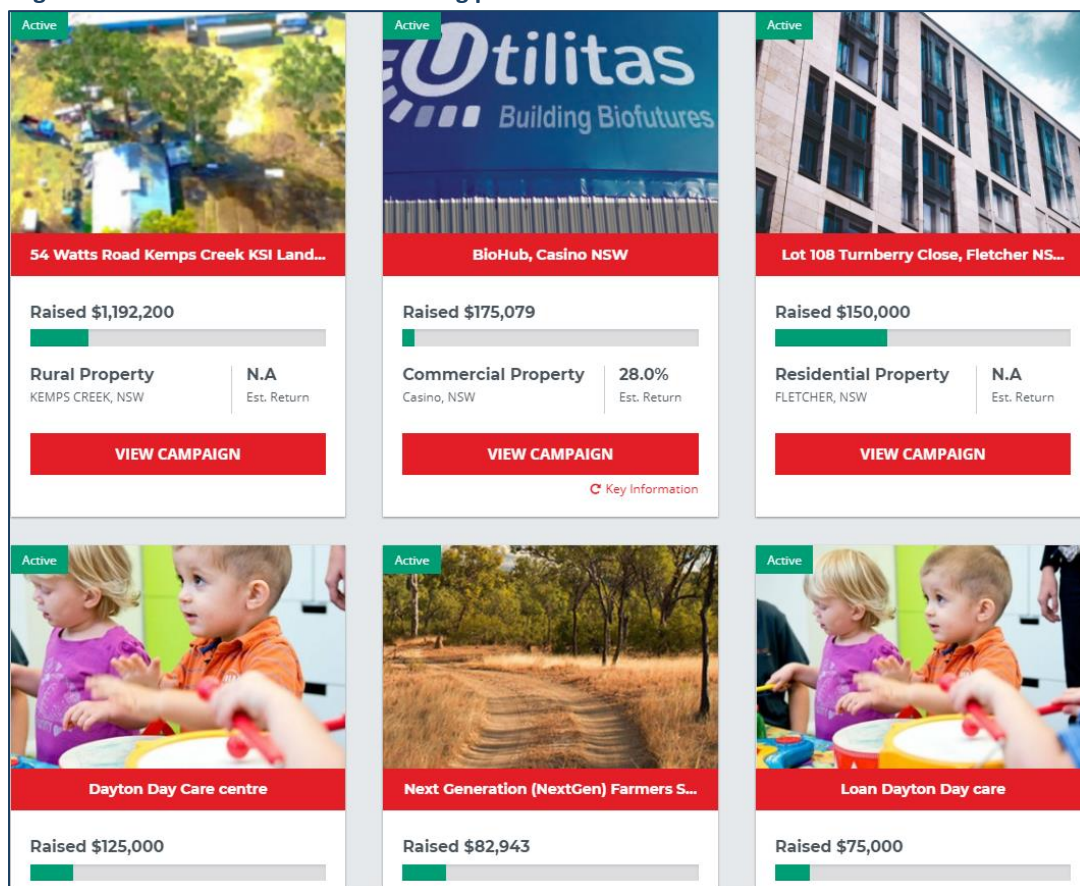
Buying an entire investment property is impractical if an investor has limited funds available or if he prefers to diversify his investments across different properties. And buying units in a property fund restricts investments to whatever investment decisions the fund manager makes, i.e. the fund manager decides on what type of properties to invest in, the location of these investments, when to divest etc. Fund investors have no influence whatsoever. Additionally, property funds typically don't invest in residential property. In other words, we believe property investing today is archaic and ripe for disruption.

## The solution: Fractional Investing and Equity Release

### Fractional Investing: Buying part of a property

DomaCom Limited (ASX: DCL) is a Melbourne-based operator of real estate investment platforms (Figure 1). DCL enables investors to partly own real estate through fractional investing, e.g. instead of purchasing an entire house, investors can purchase a fraction of a house together with other investors. DCL is the first regulated operator of its kind in Australia that provides an online platform for fractional investing in property, which includes investing in residential, commercial, industrial and rural properties.

Figure 1: DomaCom's fractional investing platform



Source: DomaCom



*Ideal opportunity for retirees to access the equity tied up in their family homes*

Currently, DCL only has one product in the market – Fractional Investing. However, it has already received regulatory approval to launch another product - Equity Release, which enables home owners to sell part of their family home. This allows retirees, for instance, to release part of their equity that is tied up in their homes.

### **Equity Release: Unlocking equity tied up in a family home**

In November 2018, DCL received the required regulatory approval to launch the Equity Release product. People who own their own home, but have limited cash flow, such as retirees, can monetize their properties by partly selling their mortgage-free home and releasing the equity tied up in their home.

The Equity Release product is similar to a reverse mortgage as offered by financial institutions, the difference being that investors are crowd funded on DCL's platform, rather than a financial institution providing the funds. With ~15% of current Australian population aged over 65 years, we believe DCL's Equity Release product offers an ideal opportunity for elderly people to access the equity tied up in their homes.

Additionally, with major banks having withdrawn from the reverse mortgage market, there is a significant investment opportunity to be captured by DCL, in our view.

### **The DomaCom Fund facilitates Fractional Investing and Equity Release**

The company operates through a registered managed investment scheme (MIS), called the DomaCom Fund. Through this fund, DCL provides a structured investment vehicle which is a combination of a managed fund and an online crowdfunding platform. Through its online platform, the company supports property listings, real estate trading, unit registry, and book build processes for existing properties and proposed developments.

DCL generates revenues (management fees) from the provision of management and platform services to the DomaCom Fund. The standard management fee is 0.88%.

The fund provides investors the flexibility to pick and choose their preferred investment properties, rather than being dependent on the fund manager's decisions. This unique proposition allows the investor to diversify and avoid high exposure to a single asset at a relatively low cost.

DCL's platform facilitates the equity release product and fractional investing/crowdfunding through this fund and creates a niche for retail real estate investment. Apart from retail investors looking to build a real estate portfolio, the DCL platform and the fund provide a significant opportunity for self-managed superannuation fund (SMSF) investors.

*DCL provides an investment platform to retail investors to build a diversified portfolio of property investments*



## Fractional Investing: New era in property investment

Fractional Investing is a method by which a group of investors collectively raises capital to purchase a high value asset, such as residential property, day care centers, solar farms, rural properties etc. This gives an individual investor exposure to an asset at a fraction of the total cost.

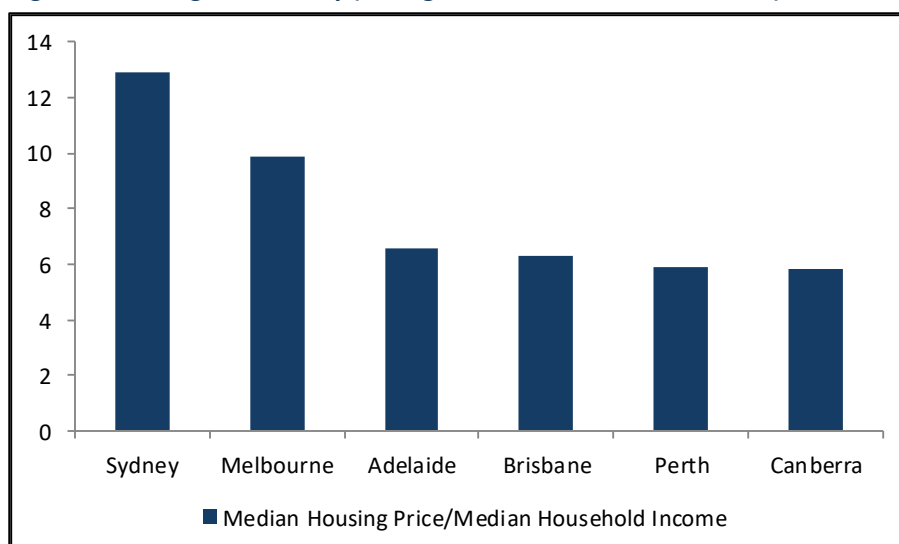
Fractional investment is a way for investors, who would otherwise not be able to purchase an entire property by themselves, to build exposure to property assets. It also allows investors to diversify their investment portfolio by giving them, fractional, exposure to different properties. Compared to traditional property investing, the barriers to entry for DCL's investors are low, i.e. investors can sign up to DCL's platform in a few simple steps.

### Why Fractional Investing makes so much sense

Given that Australia has become the third least affordable country for housing, fractional property investing is an ideal solution for investors looking to enter the market without having to purchase an entire property.

According to the 14<sup>th</sup> Annual Demographia International Housing Affordability Survey in 2018 (Figure 2), the average house price-to-household income ratio is 12.9x in Sydney. Consequently, it is extremely difficult for an individual to invest in real estate in an individual capacity. Consequently, we believe the concept of crowdfunding of property investments shows great promise.

Figure 2: Housing affordability (average house value / annual income)



Source: Demographia Housing Affordability Survey 2018, Pitt Street Research

### A boon for financial advisors

We believe Fractional Investing is a very welcome addition to financial advisors' investment advisory toolkits. Typically, financial advisors struggle to allocate funds to property investments and diversify their clients' portfolio through traditional investment vehicles, such as unlisted trusts, A-REITS and traditional syndicates, have difficulty in diversifying across property types and geographic locations. Also, property investors do not get to choose the properties they invest in and liquidity is typically low.

*Housing affordability, or lack thereof, locks many investors out of residential property investing*

*Ideal advisory tool for financial advisors*



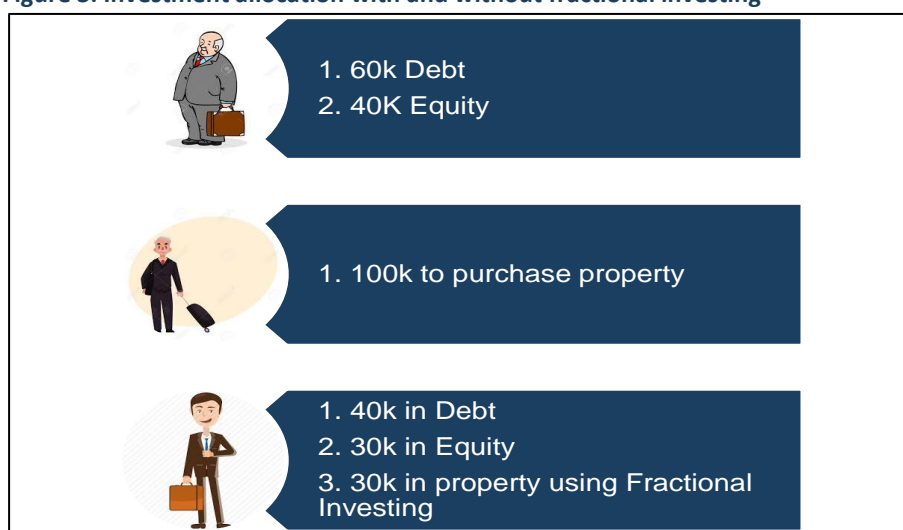
*Fractional Investing provides balance and diversification to an individual's portfolio*

Fractional property investment overcomes these problems as clients get to choose the specific property they want to invest in. DCL conducts due diligence before purchasing a property, which assuages most concerns a financial advisor might have. It reviews the purchase contract and provides legal oversight. It conducts property valuation so that investors do not buy an over-priced property and it also conducts property and pest inspections to ensure that the property is in sound condition. Lastly, DCL appoints a buyer's agent to negotiate best price and a property manager to ensure minimum vacancy.

### Fractional Investing is a new asset class

Since fractional property is a new asset class, it is a regulated product and only authorized representatives (AR) under an Australian Financial Services License (AFSL) can recommend it to their clients. The financial advisor is required to hire a property advisor to select the property based on his client's requirement and risk profile. Hence, the financial advisor only recommends the structure and not the underlying property to its clients. We believe Fractional Investing helps financial advisors optimize their clients' investment portfolios by adding fractional property as a new asset class (Figure 3).

**Figure 3: Investment allocation with and without fractional investing**



Source: Pitt Street Research

### Adding debt to funding mix will be a game-changer

In order to introduce leverage to its property investments, DCL is currently in discussions with several debt providers to arrange a pool of debt to be used in conjunction with equity. Once finalized, investors will be able to invest in properties with a co-investment from a debt provider, thereby creating leverage for the equity investors.

The loan-to-value ratio (LTV) is likely to be capped at 30% to 40% as the property is required to be positively geared, which we believe is not excessive but sufficient to introduce attractive leverage.

In our view, adding debt to the funding mix will be a game-changer for DCL given that this mixed financing structure much closer resembles the traditional way to invest in property, i.e. through a combination of debt and equity. Consequently, we expect financial advisers will be in a much better position to advise on Fractional Investing to their clients once debt is introduced.

*Introducing debt clears the way for financial advisers to offer Fractional Investing to their clients*



## Future of Financial Advice (FOFA)

### DomaCom is in-line with regulations on responsible investing

The introduction of the FOFA legislation by the government in 2012 greatly transformed the financial planning industry, while acting as a driving force for DCL. Under this legislation, financial advisors are only able to charge a fee to their client, and can't receive any compensation from the product providers. Hence, they need to have a strong value proposition to interest their clients into investing. Furthermore, in Australia financial advisors are prohibited from advising on real estate, which deprives their clients of the benefits of the capital gains that the asset class has to offer.

However, with Fractional Investing converting property into a financial product, financial advisors are able to expand their service offering to include real estate, thereby supporting the growth of DCL.

Additionally, with DCL's reach beyond the residential property market and into other forms of real estate, such as land banks, commercial and rural properties, and renewable energy projects such as wind and solar farms, financial advisors are also able to offer risk management to their clients in the form of diversification, which is in-line with the FOFA's norms on 'best interests duty'.

### Big-4 bank trial may result in white label deal

DCL very recently announced the start of a 6-month pilot project with one of the Big-4 banks in Australia to trial DCL's Fractional Investing platform within the bank.

If successful, this trial could lead to this bank rolling out DCL's platform within the bank in a white-label model, i.e. the tried and tested Intel Inside model. DCL would offer a white label version of its platform exclusively to this bank in, what we expect, will be a revenue sharing agreement.

Not only would this deal potentially be a major revenue driver for DCL, it would also provide credence to the company's own, proprietary DomaCom platform.

*Financial advisers can't advise on real estate, but DCL opens up property as a separate asset class*

*"Intel Inside" model with bank could present a major revenue opportunity*



*Unlock the value of your home  
without having to move*

*Retirees nowadays live longer  
and thus need more capital after  
retirement*

### Equity Release: Ideal for the “asset rich/cash poor”

In Australia people over 65 years of age hold a significant proportion of the country's overall real estate holdings, typically in the form of the family home. In most cases the mortgages on these family homes have been completely repaid. However, the average pensioner doesn't have very large monthly cashflows from pensions. And while the family home represents a very substantial equity value to the owners, it is very difficult to extract funds from the home, short of selling the entire property.

Reverse mortgages provide this flexibility, but they only represent ~1% of total housing equity to date. Additionally, all major banks have gradually withdrawn from reverse mortgages over the years.

The lack of liquidity problem for pensioners is exacerbated by the fact that Superannuation guarantees only started in the early 1990's. This means older generations did not put funds into superannuation in their early years.

DCL's new Equity Release product enables those who are seeking to obtain cash by partially releasing equity in their homes to be matched with investors who wish to make investments in such properties.

Recently approved by regulators, DCL's Equity Release product provides an attractive solution to 'asset rich/cash poor' retirees and enables them to stay in their home while simultaneously unlocking part of the value of their home.

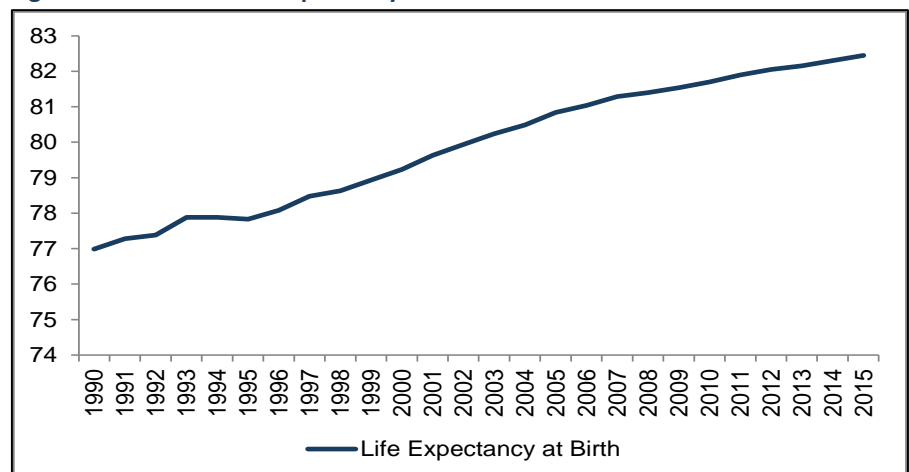
### As people live longer, they'll need more capital for retirement

The need and the opportunity for the Equity Release product become very apparent when looking at the current demographic situation in Australia (Figure 4). Just like most developed countries, Australia's population is ageing while the increasing life expectancy implies people will need more capital to retire.

Furthermore, the demographics that are worst hit by the continuously rising costs of living are mostly comprised of retirees, i.e. people who do not have an independent, growing source of income to support their expenditures, unlike their employed counterparts.

Add to that the tightening underwriting standards by mortgage providers, and we believe DCL has the perfect recipe to leverage their Equity Release product.

**Figure 4: Australia's life expectancy**



Source: Australian Institute of Health and Welfare



***Secondary trading in property investments***

### **Trading platform for DCL's property investors**

DCL has also developed a trading platform through which investors can buy and sell units in the various sub funds (individual properties) on DCL's platform. This platform is similar to a share trading platform and provides liquidity to DCL's property investors. While DCL earns a small fee from the buy and sell spread, we believe the true value of this trading platform is enhanced liquidity, and hence a higher attraction for property investors.

***Two-to-four year head start on any potential competitor***

### **First mover advantage**

While the Australian property investment market has attracted many financial service providers to the industry, DCL is the first company in Australia to introduce crowdfunding to this asset class. In order to meet the rising need for platforms/access to property investing for retail investors, DCL provides solutions that combine the benefits of digital crowdfunding with the flexibility of Fractional Investing and Equity Release.

Given the regulatory requirements around DCL's products, we expect any potential competitor will need at least two years to develop a similar product.

Moreover, DCL also has a substantial a head start in obtaining regulatory approval to be a market maker, i.e. for its trading platform. Currently, it takes 3-4 years for a company to obtain this approval, which puts DCL way ahead of any potential peers.

***Traditional funds management revenue model***

### **Generating revenues from funds management**

DCL's main revenue generator is the management fee the company earns from the sub funds (individual properties) on its platform. Simply put, individual investors pay an annual management fee of 0.88% on the total equity value of the units in the properties they own, while DCL earns a 0.44% fee on mortgage assets.

Additionally, DCL earns a management fee of 0.22% on cash under management, e.g. when a campaign is still ongoing and (some) investors have already provided cash funding for their fraction of the investment.

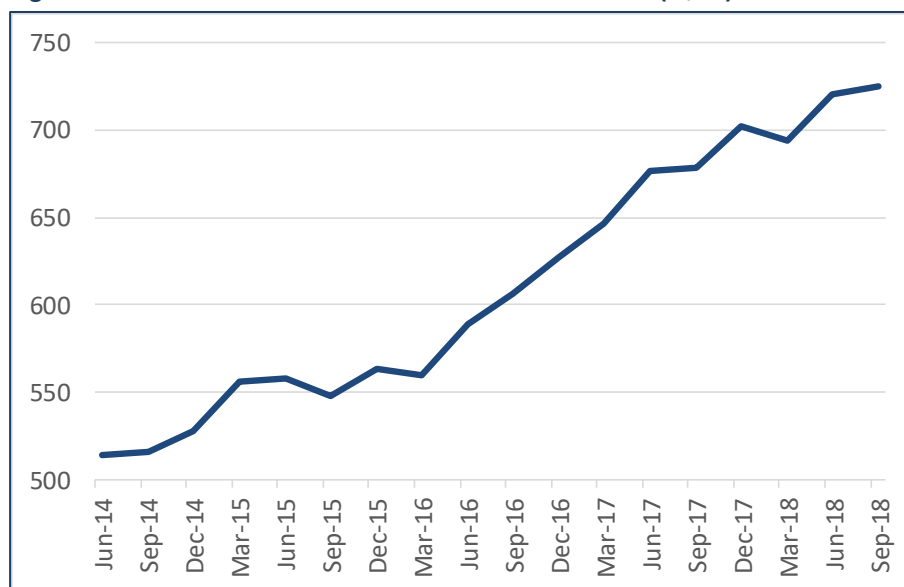


*Very substantial opportunity for Fractional Investing with existing SMSFs*

## The opportunity: SMSF investments in property

Assets under the management of SMSFs in Australia grew 6.7% Y-o-Y to A\$724.7bn per September 2018 (Figure 5). SMSFs have largely remained bereft of the benefits of diversified direct property investing, primarily due to the friction associated with setting up a Limited Recourse Borrowing Arrangement (LRBA), coupled with the restrictions on lending (Figure 6).

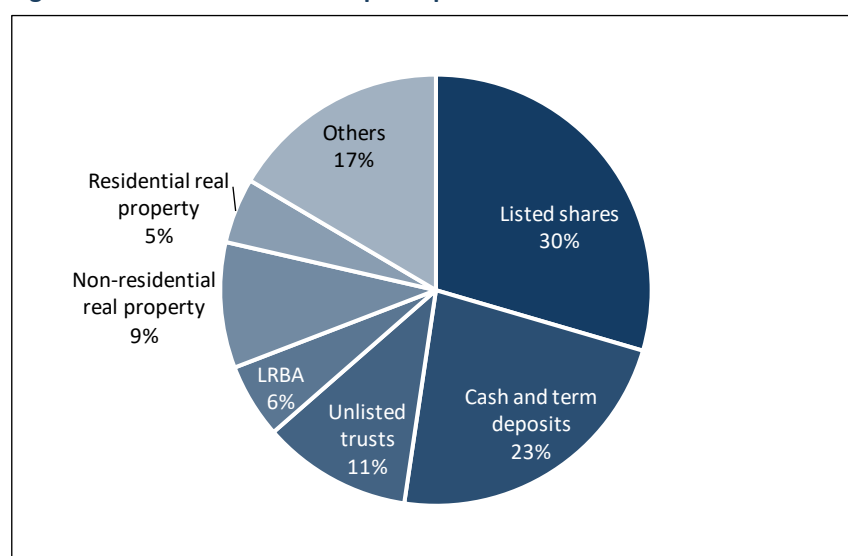
Figure 5: Total net Australian and overseas assets of SMSF (A\$ m)



Source: Australian Taxation Office

With DCL currently working to enable leveraged property transactions, SMSFs can forgo the requirement to set up an LRBA when using DCL's Fractional Investing platform. Additionally, through Fractional Investing a single SMSF can simultaneously invest in more than one property, thereby enjoying the benefits of diversification.

Figure 6: SMSF Asset Allocation per September 2018



Source: Australian Taxation Office



### **Court ruling enables inter-generational wealth management**

Furthermore, following a Full Federal Court ruling in August 2018, SMSFs are now allowed to invest in DCL's sub-funds where the tenant of the underlying asset is a related party (i.e. a family member). We believe that this ruling, which did not receive any further appeal from the ATO regarding the breach of the sole purpose test, is a landmark achievement for the company, as it paves the way for inter-generational wealth management.

### **Fractional Investing for first home owners**

In addition to the very substantial market for SMSF investments, Fractional Investing can be an ideal way for first home owners to enter the residential property market without having to acquire an entire house. Instead, they can purchase a fraction of that house using a combination of their deposit and debt (mortgage) with third party investors co-investing alongside them.

### **Baby Boomers looking to release cash**

The Equity Release product is primarily aimed at the market for retiree homes worth around A\$ 500BN, according to Deloitte. We believe Baby Boomers looking for cash without wanting to downsize present a very substantial opportunity for DCL.

### **Targeting 1% of the > A\$ 700BN SMSF funds under management**

The overall share of property within SMSFs assets is 20% (Non-residential real property, residential real property and through LRBA combined), or approximately A\$ 14.5BN. The long term goal for DCL is to get 1% of the Australian SMSFs' funds under management (FUM) on its books, i.e. more than A\$ 7BN. In his previous venture, Praemium (ASX:PPS), DCL CEO Arthur Naoumidis achieved a 4% market share with SMSFs.

To date, without the Equity Release product having been launched yet (expected to start generating FUM in May 2019) and without having been able to introduce debt into the Fractional Investing product yet, the company has generated A\$ 40M in FUM with a further A\$ 20M in the pipeline.

Once the final building block is in place (debt funding), we expect a strong uptick in FUM going forward, driven by strong appetite from financial advisers to offer these products to their client base.

Given the typical 0.88% management fee on FUM and 0.44% on mortgage assets, we believe it will be easy to see the scalability of DCL's model as FUM grows over time.

*Long term target of A\$ 7BN  
funds under management*

*CEO achieved 4% market share  
with SMSFs with Praemium*



## Conclusion: Tremendous opportunity with revolutionary financial products

DCL is currently valued at only A\$ 14.5m. We believe the main reason for this apparent low valuation is the fact that Fractional Investing as an investment tool is not well known by retail investors and the concept is in a nascent stage.

Similarly, the Equity Release product will be introduced to the market shortly and will need to build traction over time.

In other words, DCL's two main products are very new and largely unknown to the vast majority of financial advisers and retail investors.

However, once the disruptive potential of DCL's products is better understood by the market, we anticipate rapid uptake, driving FUM and hence revenues from management fees.

### Near term share price catalysts

- Arrangement with debt providers to introduce debt to the property investments on DCL's platform
- Launch of the Equity Release product, anticipated March/April with initial revenues expected to start in May 2019.

### Key challenges

- We believe DCL's key near term challenge will be to properly educate financial advisers and retail investors on the benefits and opportunities of Fractional Investing and the Equity Release product.
- At the same time, financial advisers will need to be accredited in order to advise their clients on these products.

*Products and their benefits still largely unknown by investors*

*This report serves as an initial introduction to DomaCom and its two main products, Fractional Investing and Equity Release. We will endeavour to publish a more in-depth report shortly, including a full financial model and valuation range, highlighting the financial opportunity for DomaCom and its investors.*

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