DomaCom Limited

All its ducks in a row now

Share Price: A$0.08

ASX: DCL
Sector: Diversified Financials
23 Aug 2019

Ready for take off

In June 2019, DomaCom Limited (ASX:DCL) launched its much-awaited Senior Equity Release (SER) product, marking the conclusion of a 7-year development process of receiving the required regulatory approvals. The unique value proposition of this product, allowing homeowners to release equity in their homes without the hassle of relocation, places it at an advantage over alternatives such as downsizing. We believe SER can be a very strong growth driver for DCL and is likely to reward DCL's investors for the long wait.

Investment case

On the back of an ageing Australian population, coupled with rising cost of living, DCL is poised to benefit from the launch of its SER offering. Moreover, the company's FuM from its Fractional Investment platform has also witnessed substantial growth, increasing 25% in 75 days to reach the A$59m mark in July 2019. In our view, the launch of SER, together with the La Trobe facility can significantly contribute towards further expansion in FuM.

Valuation range of A$0.35 – 0.46 per share

We value DomaCom at 35 cents per share base case and 46 cents per share optimistic case using a DCF approach. Our valuation is sensitive to growth in the FuM in line with management's expectations, and hence depends on the successful utilisation of the La Trobe facility and the conversion of the pilot program with the Big-4 bank.

Year to June (AUD)	2017A	2018A	2019A	2020f	2021f
Sales (x 1,000)	93.0	143.0	277.4	869.0	1,934.0
YoY growth		53.7%	94.0%	213.2%	122.6%
EBITDA (x 1,000) Adj.	-5,448	-5,017	-3,228	-2,111	-897
Net Profit (x 1,000)	-6,136	-5,907	-5,290	-2,749	-1,418
Adj. EBITDA Margin (%)	NA	NA	NA	NA	NA
ROA (%)	NM	NM	NM	NM	NM
EPS before extr. & amort.	-5.68c	-5.21c	-3.97c	-1.56c	-0.67c
EPS	-5.68c	-5.00c	-4.34c	-1.56c	-0.67c
DPS	NA	NA	NA	NA	NA
EV/Sales	104.8x	61.1x	56.6x	20.8x	11.2x
EV/EBITDA before extra	-1.8x	-1.7x	-4.9x	-8.6x	-24.1x
P/E before extra	-1.9x	-1.3x	-2.0x	-5.1x	-12.0x
Dividend yield %	NM	NM	NM	NM	NM

Source: Company, Pitt Street Research

Market Cap. (A$ m)	12.9
# shares outstanding (m)	161.8
# share fully diluted	171.7
Market Cap Ful. Dil. (A$ m)	13.7
Free Float	70%
12 months high/low	$0.17 / $0.05
1 / 3 / 12-month performance	-15% /-30% / 8%
Website	domacom.com.au

Source: Company, Pitt Street Research

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

Source: Thomson Eikon, Pitt Street Research

Valuation metrics	
DCF fair valuation range (A$)	0.35 – 0.46
WACC	9.6%
Assumed terminal growth rate	2%

Source: Pitt Street Research

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Analyst: Marc Kennis

Tel: +61 (0)4 3483 8134

marc.kennis@pittstreetresearch.com

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SER holds an edge over downsizing and reverse mortgage in terms of minimal lifestyle impact and transaction costs

Launch of SER unlocks substantial growth potential

After 7 years of work towards gaining the required regulatory approvals, DCL finally launched its Senior Equity Release product in June 2019. The product, a first of its kind in Australia, allows homeowners to release a part of the equity in their house, thereby generating proceeds, which they can use to meet their cost of living expenditures. The greatest advantage of this product over alternatives, such as downsizing, is that it allows the homeowner to continue to maintain their title and residency in the house, even as they release a part of its equity for cash.

Additionally, SER allows for progressive sale of equity in the house, as per the needs of the homeowner. This helps limit the uncertainty around residual equity value in the property, a feature not available in reverse mortgages. In our view, these advantages offered by SER in terms of minimal lifestyle impact and transaction costs as well as limited downside risk, provide it substantial edge over competing products.

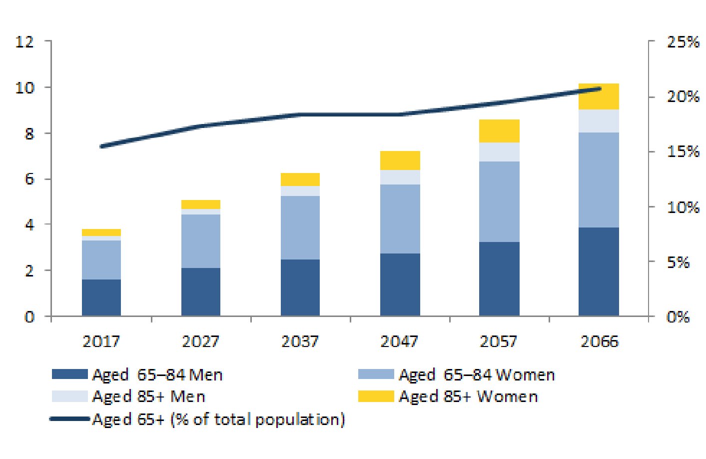
Increasing no. of retirees as well as longevity of life provides a substantial market opportunity to SER

Ageing population and rising cost of living to drive demand

Since SER targets the retired population segment of the economy, the ageing Australian population represents a substantial growth opportunity to the company. Driven by decreasing fertility rates, coupled with increasing life expectancy, the Australian population has witnessed an uptick in its aged population. As per a report released by the Parliamentary Budget Office in February 2019, birth rates in Australia declined sharply from their peak of 3.5 children per woman during the baby boomer phase in early 1960s, to 1.8 in 2019. Additionally, during the same period the average life expectancy also increased from 71 to 83 years.

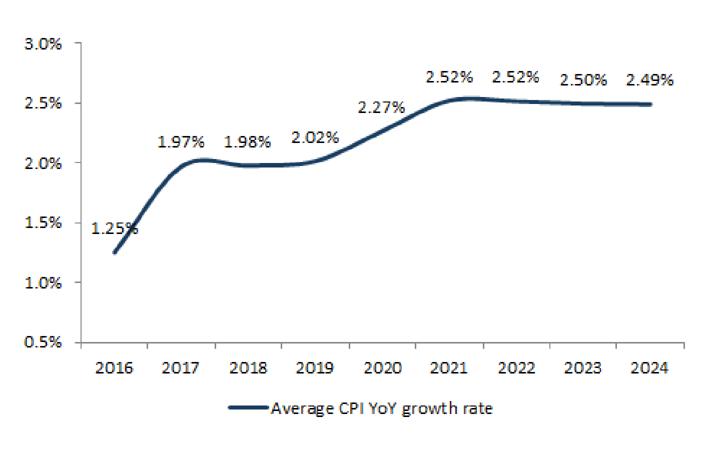
Currently, the Australian population comprises of 3.8m people aged 65+, representing ~15.4% of the total population. In our view, with the retired population expected to grow to more than 5m by 2027 (Figure 1), DCL is well positioned to take advantage of this growth opportunity through its SER offering.

Figure 1: Australia's ageing population (in millions)



Source: ABS, Population Projection 2017 (base) - 2066

Figure 2: IMF forecasts increasing CPI growth rate (YoY)



Source: IMF Forecast, World Economic Forum, April 2019

Furthermore, the current rising trend in the cost of living in Australia is expected to continue in the short-to-medium term, with IMF projecting the

YoY CPI growth rate to increase to 2.52% by 2021 (from 2.02% in 2019), before stabilizing at 2.5% growth rate till 2024 (Figure 2).

Moreover, as a result of longer life spans, senior citizens will need larger sums to meet their predicted, as well as unpredicted, cash requirements. We believe that this represents a lucrative opportunity for DCL to grow through SER.

DCL's go-to-market strategy for SER

DCL markets their new offering directly to financial advisors, who then pitch it to their clients, based on its suitability to their investing needs and capacity. However, for financial advisers to be able to advise their clients on SER, they need to go through an accreditation course. Thus, along with the introduction of their new product, DCL simultaneously launched an advisor accreditation course, which provides financial advisors with all the information necessary to enable them to advise their clients on the product. As of 11 June 2019, there were 19 enrolments under the course, comprising of financial advisors specialising in aged care investing.

Benefits to financial advisors

Financial advisors can pitch the SER to both their investor clients looking for exposure to real estate as well as senior aged clients seeking to release equity in their house

Since SER is a financial product, financial advisors are allowed to advice on it, and can also charge a fee for their advice. Until now, as financial advisors could not advice their clients on real estate products, their portfolios did not have exposure to residential properties. Hence, their clients were deprived of the capital gains offered by the real estate market.

However, with the help of SER, financial advisors can now offer real estate exposure to interested clients, along with the benefit of diversification. Moreover, in addition to capital gains, SER also offers investors a fixed return in the form of rental income, which further incentivises the product for investors.

Furthermore, financial advisors can also use SER to provide additional services to their senior aged clients. Through the SER, financial advisers can offer their senior clients funding in the form of either a lump-sum payment, or a staggered payment schedule, as per their requirements. Moreover, the product requires adviser sign-off for clients to be able to make use of it. In our view, this represents a strong driver for financial advisors, and hence for DCL as well.

Continued growth in Funds under Management

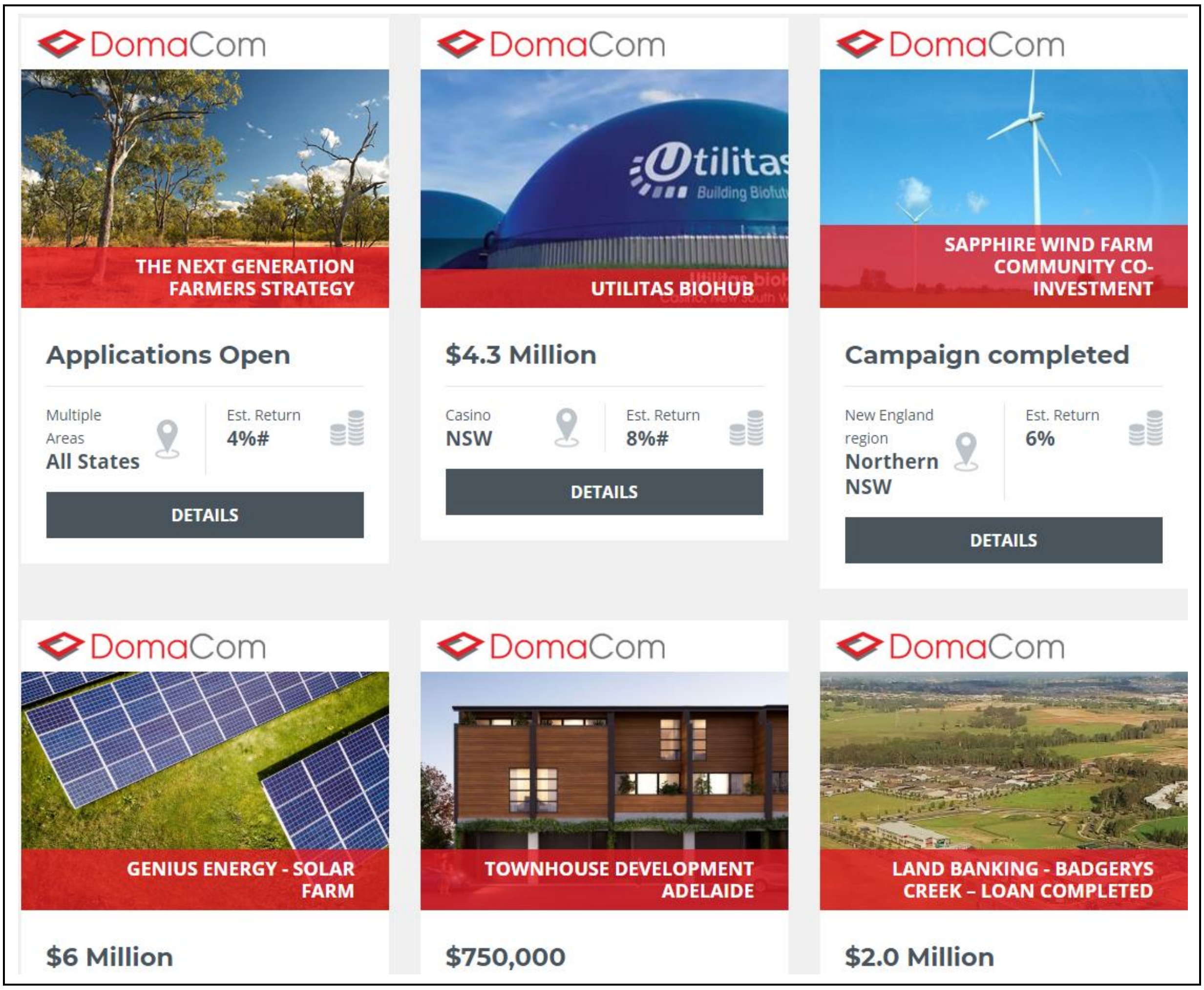
A major revenue driver for DCL is its Funds under Management (FuM), as the company derives revenues from the fees earned on investment management services provided to the DomaCom fund. Notably, the company's FuM reached the A$59m mark in July 2019, representing growth of 48% from 31 January 2019.

FuM have grown substantially driven in part by DCL's diverse investment property portfolio and the Big-4 bank pilot program

Through its diverse portfolio of investment properties (Figure 3), such as residential and commercial properties, wind and solar farms, and land banking, DCL casts a wide net to engage various types of retail investors. In our view, this provides an advantage to DCL especially with the current transition towards ESG (Environmental, Societal and Governance) investing in Australia. Case in point, the latest campaign closed by DCL was for a utility-scale wind farm – the Sapphire Wind Farm project, which raised A$1.8m through community crowd funding from ~100 investors. Notably, this was the first Australian large-scale crowd funding for investment in a wind farm. The campaign, which required a minimum investment of

A$1,250, will provide investors a yield of 6% p.a., paid quarterly over 9.5 years. Following the success of this project the infrastructure partner CWP Renewables are looking to repeat the community co-investment on two up and coming wind farms and discussions are continuing with other players in the renewable energy space.

Figure 3: DomaCom's diverse investment property portfolio



Source: Company

La Trobe facility to fuel expansion

The La Trobe facility is set to further drive growth in FuM by adding debt to the property investment transactions

In April 2019, DCL secured a A$50m property funding facility with La Trobe financial, a premium non-bank specialising in credit and wealth management. The facility allows the investors at DomaCom's fractional investing platform to add debt to their investments, thereby gaining the benefits of cost of capital. The facility provides ~60% leverage to the investors and SMSFs, at a rate of 5.99% p.a.

Valuation

At the time of our initiation on DCL, we had determined that the discounted cash flow (DCF) calculation would be the appropriate parameter to gauge the value of the company. In our view, the underlying value of the business lies in its ability to scale up the business operations.

Our DCF model yields a 9.6% WACC for DCL (risk-free rate of 2.7%, a beta of 1.1, and an equity risk premium of 7.7%). Applying this discount rate to our free cash flow projections through FY2028E and using a terminal growth rate of 2.0%, DCL yields a value of A$0.35 per share (Figure 4). Our bull case calculation results in a valuation of A$0.46 (Figure 5). This implies a substantial upside from the current share price.

Figure 4: Base Case value using DCF

Valuation (AUD)	
Present value of FCF	5,416,842
Present value of Terminal FCF	51,006,929
Enterprise Value	**56,423,771**
Net debt (cash)	(660,551)
Minority interest	-
Employee entitlements	391,022
Equity value (AUD)	56,693,300
Share outstanding (for 2019, '000)	161,318
Implied price (AUD cents)	35.1
Adjusted Current price (AUD cents)	8.0
Upside (%)	339.3%

Figure 5: Bull Case value using DCF

Valuation (AUD)	
Present value of FCF	7,397,651
Present value of Terminal FCF	66,882,387
Enterprise Value	**74,280,037**
Net debt (cash)	(660,551)
Minority interest	-
Provisions	391,022
Equity value (AUD)	74,549,566
Share outstanding (for 2019, '000)	161,318
Implied price (AUD cents)	46.2
Adjusted Current price (AUD cents)	8.0
Upside (%)	477.7%

Source: Pitt Street Research

Even though there is execution risk associated with the successful roll out of SER, we believe that as the company matures and approaches EBITDA breakeven, there will be room for lower discount rates, which would translate into higher share price values (Figure 6).

Figure 6: DCF using various WACCs

Sensitivity Analysis										
WACC		**9.6%**								
Terminal Growth Rate		**2.00%**				**Change in WACC**				
Implied Price (AUD cents)		**35.0**	*8.9%*	*9.1%*	*9.4%*	*9.6%*	*9.9%*	*10.1%*	*10.4%*	*10.6%*
		1.25%	37.1	35.3	33.6	32.0	30.5	29.1	27.8	26.6
		1.50%	38.3	36.4	34.6	32.9	31.4	29.9	28.6	27.3
		1.75%	39.6	37.6	35.7	33.9	32.3	30.8	29.4	28.0
Change in Terminal Growth Rate		*2.00%*	41.0	38.9	36.9	**35.0**	33.3	31.7	30.2	28.8
		2.25%	42.5	40.2	38.1	36.2	34.4	32.7	31.1	29.6
		2.50%	44.1	41.7	39.5	37.4	35.5	33.7	32.1	30.5
		2.75%	45.9	43.3	40.9	38.7	36.7	34.8	33.1	31.5

Source: Pitt Street Research

Reiterating target range of A$0.35–0.46 per share

In our view, DCL has substantial room for growth, underpinned by the launch of SER, as well as the availability of financial support from the La Trobe facility. Moreover, the unique nature of the company's online fractional investing platform in itself provides significant upside potential to DCL, as evidenced by the substantial expansion in the FuM in the first six months of CY 2019.

Given DCL's strong business performance in FY 2019, coupled with the launch of the new product, we reiterate our valuation range of A$0.35–0.46 per share.

Please see www.pittstreetresearch.com for our initiating coverage, including risk factors for DCL.

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