PITT STREET RESEARCH

Domacom Ltd.

New products to further bolster FuM growth

Share Price: A$0.048

ASX: DCL
Sector: Diversified Financials
25 June 2020

DomaCom Ltd (ASX: DCL) is back on track with respect to growth of its funds under management (FuM) after a period of subdued activity during Q3 FY20. DCL's FuM registered strong quarterly (~10%) and yearly growth (~37%) and reached A$70.9m as of May 2020. This is a noteworthy development considering that it was achieved against the backdrop of unfavourable economic conditions. We believe that the new product launches in the pipeline will continue to support the growth trajectory of DCL's FuM in future.

Focus on launching four new products in 2020

Management is targeting the launch of four innovative products this year catering to different real estate investment needs. The first transaction of the Rent-to-Own offering is already in progress. The Essential Worker and Equity Mortgage offerings will be launched by Q3 and Q4 CY20 respectively, and the Senior Equity Release product is getting a lot of investor attention, especially from self-funded retirees whose incomes have diminished during the current downturn. DCL is well capitalised to support its products launch plans as it raised A$6m in 2019 and has negotiated an extension of convertible notes worth A$3.6m in May 2020.

Reiterating valuation of A$0.30–0.41 per share

FuM is showing promising growth which leading us to reiterate our previous valuation of A$0.30–0.41 per share based on a DCF approach. We believe that successful product launches and resultant growth in FuM should drive a re-rating of the stock.

Year to June (AUD)	2018A	2019A	2020f	2021f	2022f
Sales (x 1,000)	143.0	277.4	770.0	1,934.0	4,527.5
Y/Y growth	53.7%	94.0%	177.6%	151.2%	134.1%
Adj. EBITDA (x 1,000)	-5,017	-3,228	-2,210	-748	1,819
Net Profit (x 1,000)	-5,907	-5,290	-3,639	-1,288	1,105
Adj. EBITDA Margin (%)	NM	NM	NM	-38.7%	40.2%
RoA (%)	NM	NM	NM	NM	15.0%
EPS before extr. & amort.	-5.21c	-3.97c	-1.79c	-0.47c	0.37c
Adj. EPS	-5.00c	-4.34c	-1.79c	-0.47c	0.37c
EV/Sales	61.1x	54.6x	15.3x	3.9x	1.3x
EV/EBITDA	NM	NM	NM	NM	3.3x
P/E	NM	NM	NM	NM	12.9x

Source: Company, Pitt Street Research

Market Cap. (A$ m)	11.8
# shares outstanding (m)	245.1
# share fully diluted	254.9
Market Cap Ful. Dil. (A$ m)	12.2
Free Float	48.6%
12 months high/low	0.14 / 0.02
Avg. 12M daily volume ('000)	278.6
Website	www.domacom.com.au

Source: Company, Pitt Street Research

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

Source: Refinitiv Eikon, Pitt Street Research

Valuation metrics	
Fair valuation (A$) per share	0.30–0.41
WACC	10.5%
Assumed terminal growth rate	2.5%

Source: Pitt Street Research

Analysts: Marc Kennis, Cheng Ge

Tel: +61 (0)4 3483 8134

marc.kennis@pittstreetresearch.com
cheng.ge@pittstreetresearch.com

Table of Contents

Strong FuM growth a confidence booster

DCL's funds under management (FuM) grew ~10% in the current quarter (Apr–Jun) to reach A$70.9m, compared with A$64.2m as of 31 March 2020. On a y/y basis, FuM grew at a healthy 37% (increased from A$46.9m to A$64.2m in the one-year period ended 31 March 2020) despite a slowdown in FuM growth during Q3 FY20 due to delays in completion of key transactions.

DCL's FuM growth in the current quarter is attributable to the following investments:

FuM growth in tough times exhibits robustness of business model

– **DFS Pooled Mortgage Sub-Fund** – This sub-fund allows direct mortgage investments to be included in the models that DCL delivers to financial advisers across multiple platforms. This investment delivers interest rates of 7–9% by investing in loans secured against property. The average loan-to-value ratio (LVR) is currently less than 55%.
– **Badgery's Creek Land Banking** – This is DCL's fourth land banking investment in the Badgerys Creek locality and it includes both equity and debt syndications. The property to be purchased is a farmland that is set to gain via capital appreciation as Sydney's second airport is slated to be constructed in the area.
– **Rent-to-Own (RTO)** – DCL's first RTO property syndication is in progress – property due diligence is currently being conducted. The first property is a A$447,000 apartment in a Melbourne inner-city suburb, with the developer's distribution margin being split between investors and tenants. The key feature of this product is that the tenant will acquire ownership interest in the sub-fund that owns the apartment by simply paying rent as usual and looking after the property.

DCL's FuM growth is impressive, considering that this was achieved against the backdrop of the COVID-19 pandemic. Going forward, it is expected that FuM growth for the next 12 months will be predominantly driven by the RTO product. As mentioned above, DCL's first RTO property syndication is well underway with property due diligence currently being conducted. We think this first property transaction provides a solid foundation for DCL to secure more property transactions in the near term, which in turn will benefit the growth of FuM. Moreover, we believe FuM will continue to grow driven by the company's other new products.

Continued focus on new products introductions

DCL is focussing on launching four products, which are currently in different stages of development.

DCL is targeting four product launches in CY2020

– **Equity Mortgage:** A Shariah-compliant product targeting the Australian Islamic community, which is prohibited from borrowing money for interest. The company is targeting a launch in Q4 CY20 and this product will provide a method to obtain leverage for people wishing to become homeowners.
– **RTO:** In February 2020, DCL launched the RTO pilot program to leverage property developers as a distribution channel. The first transaction is expected to close in Q2 CY20. This product uses developer's distribution margins to provide discounts to investors while giving equity to tenants each year. The management fee structure will likely be adjusted to reflect a larger upfront fee to DCL.

– **Essential Worker:** The product leverages the Australian government's affordable housing lending facility to deliver an RTO product for essential workers (e.g. firefighters, teachers, police and medical professionals) on a 25% discounted rent. This is expected to be an attractive product due to the low vacancy risk associated with the security of the tenants' employment and is expected to be launched by Q3 CY20.
– **Senior Equity Release (SER):** This product helps retirees in need of an income stream by selling off a portion of equity in their houses. It has gained traction in the current market downturn with self-funded retirees becoming increasingly concerned about their recurring income levels. DCL is currently going through the process of adviser accreditation and the product is now on the 'Approved Product Groups' list of four financial planning firms.

In our view, the planned product launches along with DCL's flagship fractional investing/crowdfunding platform will go a long way in establishing the credibility of the company in the real estate investing space.

Largely positive impact of COVID-19 pandemic

The ongoing COVID-19 crisis has had a minimal impact on DCL's operations, as it is largely a cloud-based business and most employees are effectively working from home. Further, all sales conferences and physical meetings have been transitioned to phone or virtual meetings and this has worked well for the financial planning industry. This is also expected to lead to savings on marketing costs for DCL.

High interest in SER product due to COVID-19-related market volatility

The impact on property fund operations has been minimal as most properties are not leveraged, leading to minimal vacancy risks. Additionally, the company usually has internal rent reserves to cover 3–4 months of rent in case of vacancies.

Besides operational benefits, the current market downturn has resulted in increased interest in the SER product as many self-funded retirees struggle with reduced income and may potentially plan to sell a fraction of their houses. DCL's SER is the only financial product in the Australian market that allows retirees to top up their superannuation fund by selling a fraction of their houses.

Sufficient capital to fund near-term growth plans

DCL is in a comfortable position with respect to near-term funding. It already raised A$6m via equity shares in 2019. Further, it reduced its capital requirements for 2020 by A$3.6m through a 12-month extension of its convertible notes – for which it has agreed to pay A$300,000 plus goods and services tax, along with a revised nominal conversion price of 10 cents. The funds were acquired in 2018 by issuing convertible securities to Thundering Herd Fund No. 1 (A$2.95m) and Thundering Herd Pty Ltd (A$650,000).

Reiterating valuation range of A$0.30–0.41

DCL's FuM growth in the past year and concrete plans for new product launches in 2020 provide confidence in Domacom's long-term growth potential. Consequently, we reiterate our valuation (conducted in March 2020) of A$0.30–0.41 per share based on the DCF approach (Figure 1 and Figure 2). We believe that the new product launches, greater awareness of DCL's products among advisors and investors as well as the resultant growth in FuM may support a re-rating of the stock. Figure 3 shows our sensitivity analysis based on varying discount rate and terminal growth rate.

Figure 1: Base Case value using DCF

Valuation (AUD)	
Present value of FCF	12,318,704
Present value of Terminal FCF	65,210,607
Enterprise Value	**77,529,311**
Net debt (cash)	(401,548)
Minority interest	-
Employee entitlements	391,022
Equity value (AUD)	77,539,837
Diluted shares	254,943,815
Implied price (A$)	**0.304**
Current price (A$)	**0.048**
Upside (%)	533.6%

Figure 2: Bull Case value using DCF

Valuation (AUD)	
Present value of FCF	16,484,683
Present value of Terminal FCF	88,453,970
Enterprise Value	**104,938,653**
Net debt (cash)	(401,548)
Minority interest	-
Employee entitlements	391,022
Equity value (AUD)	104,949,179
Diluted shares	254,943,815
Implied price (A$)	**0.412**
Current price (A$)	**0.048**
Upside (%)	757.6%

Source: Pitt Street Research

Figure 3: DCF using various WACCs

Sensitivity Analysis									
WACC	10.5%								
Terminal Growth Rate	2.50%	Change in WACC							
Implied Price (A$)	0.30	*10.0%*	*10.2%*	*10.3%*	*10.5%*	*10.8%*	*11.0%*	*11.2%*	*11.4%*
Change in Terminal Growth Rate	*1.75%*	0.31	0.30	0.29	0.28	0.27	0.26	0.25	0.24
	2.00%	0.32	0.31	0.30	0.29	0.28	0.27	0.26	0.25
	2.25%	0.33	0.31	0.31	0.30	0.28	0.27	0.27	0.26
	2.50%	0.34	0.32	0.32	**0.30**	0.29	0.28	0.27	0.26
	2.75%	0.35	0.33	0.33	0.31	0.30	0.29	0.28	0.27
	3.00%	0.36	0.34	0.34	0.32	0.31	0.30	0.29	0.28
	3.25%	0.37	0.36	0.35	0.33	0.32	0.31	0.30	0.28

Source: Pitt Street Research

Conclusion: On the right track

The strong FuM growth registered by the company is likely to be sustained in the future, driven by the launch of innovative products targeting specific real estate investment needs. In these times of turbulence in capital markets and the real estate sector, we believe fractional investing products and products that ease the financial burden of retirees (e.g. through SER) are great investment vehicles for retail investors. We continue to hold the view that the upside potential for the stock may unlock with growing awareness and acceptance of DCL's products among potential investors.

Risks

We see two main risks related to DCL's investment thesis.

– Slow increase in FuM: While FuM growth has been impressive in the past year, there have been phases when the company witnessed subdued growth in FuM. The company needs to continue ramping up its FuM, so that it can spread its fixed costs over a larger number of projects. In order to do this, it needs to educate investors on the operational features and benefits of crowdfunding platforms, which will require investment. Any setback or delay in FuM growth may cause delays for DCL in breaking even.
– Cyclical risk: In the past 2–3 years, the property market across Australian cities has witnessed an uptick, followed by a sharp downturn in the beginning of 2019. This volatility in property prices can dampen investor sentiment and they may want to stay away from this sector for some time.

Analyst Certification

Marc Kennis, lead analyst on this report, has been covering the Semiconductor sector as an analyst since 1997.

– Marc obtained an MSc in Economics from Tilburg University, Netherlands, in 1996 and a post graduate degree in investment analysis in 2001.
– Since 1996, he has worked for a variety of brokers and banks in the Netherlands, including ING and Rabobank, where his main focus has been on the Technology sector, including the Semiconductor sector.
– After moving to Sydney in 2014, he worked for several Sydney-based brokers before setting up TMT Analytics Pty Ltd, an issuer-sponsored equities research firm.
– In July 2016, with Stuart Roberts, Marc co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Technology companies.

Cheng Ge is an equities research analyst at Pitt Street Research.

- Cheng obtained a B.Com in Finance and LL.B from University of New South Wales, in 2013, and has passed all three levels of the CFA Program.
- Prior to joining Pitt Street Research, he has worked for several financial services firms in Sydney, where his focus was on financial advice.
- He joined Pitt Street Research in January 2020.

Please refer to www.pittstreetresearch.com for our initiating coverage report on DCL.

General advice warning, Disclaimer & Disclosures

Terms & Conditions

The information contained herein ("Content") has been prepared and issued by Pitt Street Research Pty Ltd ACN 626365615 ("Pitt Street Research"), an Authorised Representative (no: 1265112) of BR Securities Australia Pty Ltd. ABN 92 168 734 530, AFSL 456663. All intellectual property relating to the Content vests with Pitt Street Research unless otherwise noted.

Disclaimer

Pitt Street Research provides this financial advice as an honest and reasonable opinion held at a point in time about an investment's risk profile and merit and the information is provided by the Pitt Street Research in good faith. The views of the adviser(s) do not necessarily reflect the views of the AFS Licensee. Pitt Street Research has no obligation to update the opinion unless Pitt Street Research is currently contracted to provide such an updated opinion. Pitt Street Research does not warrant the accuracy of any information it sources from others. All statements as to future matters are not guaranteed to be accurate and any statements as to past performance do not represent future performance.

Assessment of risk can be subjective. Portfolios of equity investments need to be well diversified and the risk appropriate for the investor. Equity investments in a listed or unlisted company yet to achieve a profit or with an equity value less than $50 million should collectively be a small component of an individual investor's equity portfolio, with smaller individual investment sizes than otherwise. Investors are responsible for their own investment decisions, unless a contract stipulates otherwise.

Pitt Street Research does not stand behind the capital value or performance of any investment. Subject to any terms implied by law and which cannot be excluded, Pitt Street Research shall not be liable for any errors, omissions, defects or misrepresentations in the information (including by reasons of negligence, negligent misstatement or otherwise) or for any loss or damage (whether direct or indirect) suffered by persons who use or rely on the information. If any law prohibits the exclusion of such liability, Pitt Street Research limits its liability to the re-supply of the Information, provided that such limitation is permitted by law and is fair and reasonable.

General advice warning

The Content has been prepared for general information purposes only and is not (and cannot be construed or relied upon as) personal advice nor as an offer to buy/sell/subscribe to any of the financial products mentioned herein. No investment objectives, financial circumstances or needs of any individual have been taken into consideration in the preparation of the Content.

Financial products are complex, entail risk of loss, may rise and fall, and are impacted by a range of market and economic factors, and you should always obtain professional advice to ensure trading or investing in such products is suitable for your circumstances, and ensure you obtain, read and understand any applicable offer document.

Disclosures

Pitt Street Research has been commissioned to prepare the Content. From time to time, Pitt Street Research representatives or associates may hold interests, transact or hold directorships in, or perform paid services for, companies mentioned herein. Pitt Street Research and its associates, officers, directors and employees, may, from time to time hold securities in the companies referred to herein and may trade in those securities as principal, and in a manner which may be contrary to recommendations mentioned in this document.

Pitt Street Research receives fees from the company referred to in this document, for research services and other financial services or advice we may provide to that company. The analyst has received assistance from the company in preparing this document. The company has provided the analyst with communication with senior management and information on the company and industry. As part of due diligence, the analyst has independently and critically reviewed the assistance and information provided by the company to form the opinions expressed in the report. Diligent care has been taken by the analyst to maintain an honest and fair objectivity in writing this report and making the recommendation. Where Pitt Street Research has been commissioned to prepare Content and receives fees for its preparation, please note that NO part of the fee, compensation or employee remuneration paid will either directly or indirectly impact the Content provided.