DomaCom Ltd

FUM potentially up by $300M

Share Price: A$0.09

ASX: DCL
Sector: Diversified Financials
10 September 2020

DomaCom Ltd (ASX: DCL) is progressing well with respect to the development of its new products. The company completed the acquisition of its first property under the Rent-to-Own (RTO) offering. For the essential worker RTO product, DCL has partnered with a tier 1 community housing provider and is on track to launch the product in Q4 2020. DCL also received confirmation from the Australian Tax Office regarding the downsizer legislation, which is expected to drive the growth of its Senior Equity Release product. More recently, DCL has been pursuing an acquisition of an Australian agribusiness which if successful could potentially add $300M to its FUM.

Resilient business model in the face of COVID-19

Notably, DCL has made all these advancements, including syndication for its RTO product, against the backdrop of the COVID-19 pandemic. In our view, this highlights the resilience and robustness of DCL's business model. Additionally, we believe the impacts of the pandemic, such as higher vacancy risk, lower interest rates and decline in property prices, have the potential to play out in the favour of DCL's business model.

Reiterating valuation of A$0.30 – 0.41 per share

Although FUM of $71.4M as of 30 June 2020 came in below our expectations, the potential addition of $300M to FUM as a result of the recent AAGL acquisition should significantly beat our initial growth forecasts. Accordingly, we reiterate our valuation of A$0.30 – 0.41 per share. As DCL progresses closer to completing the acquisition, we will revisit our valuation and make the appropriate adjustments. Key risks we see at this stage include: (1) M&A integration risk; (2) AAGL not performing to expectations and (3) continuing execution across product innovation and implementation.

Year to June (AUD)	2019A	2020A	2021f	2022f	2023f
Sales (x 1,000)	277.4	394.8	1,934.0	4,527.5	8,130.8
Y/Y growth	94.0%	42.3%	389.9%	134.1%	79.6%
Adj. EBITDA (x 1,000)	-3,228	-3,885	-748	1,819	5,368
Net Profit (x 1,000)	-5,290	-5,815	-1,288	1,105	3,737
Adj. EBITDA Margin (%)	NM	NM	NM	40.2%	66.0%
RoA (%)	NM	NM	NM	15.0%	36.8%
EPS before extr. & amort.	-3.97c	-2.70c	-0.42c	0.33c	1.13c
Adj. EPS	-4.34c	-2.68c	-0.42c	0.33c	1.13c
EV/Sales	54.6x	28.2x	10.7x	4.2x	1.8x
EV/EBITDA	NM	NM	NM	10.6x	2.8x
P/E	NM	NM	NM	26.9x	8.0x

Source: Company, Pitt Street Research

Market Cap. (A$ m)	25.1
# shares outstanding (m)	278.4
# share fully diluted	288.3
Market Cap Ful. Dil. (A$ m)	25.9
Free Float	49.6%
12 months high/low	0.14 / 0.02
Avg. 12M daily volume ('000)	255.8
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

Disclosure: Pitt Street Research directors own stock in DomaCom.

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New acquisition to boost FUM by $300M

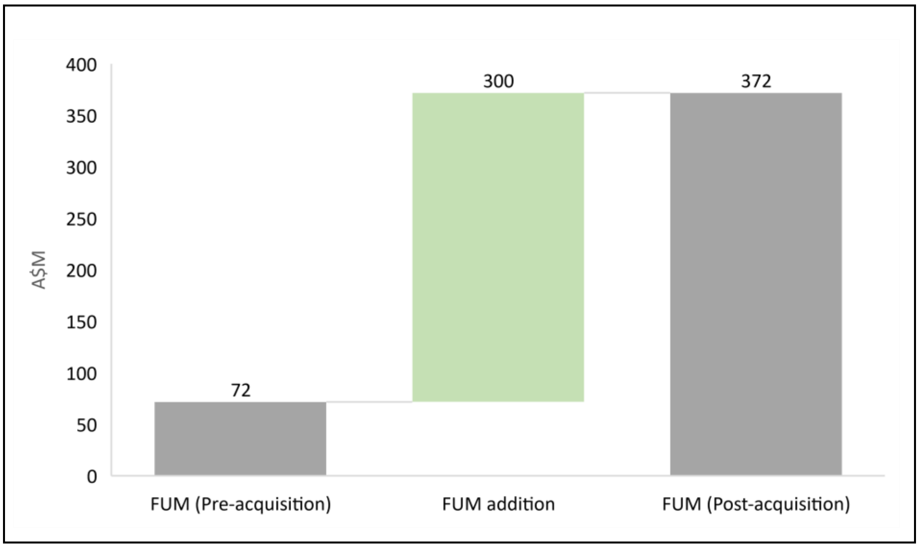
In 1Q21, DCL has entered into a conditional implementation agreement for one of its sub-funds to acquire AustAgri Group Limited (AAGL), an Australian unlisted company with operations spanning dairy, fresh milk, milk powder and infant formula. As consideration for the acquisition, AAGL shareholders will receive one unit in the DCL sub-fund in proportion to the amount of AAGL shares held.

DCL expects that the acquisition will lift its FUM by A$300M. Adding this onto their existing FUM of A$72M, it will result in a total FUM of approximately A$372M post-acquisition (Figure 1). We expect this resultant FUM base will help to drive a material uplift in future management fees and revenues of DCL, which should enable the business to attain cashflow breakeven next year.

Whilst the management fee imposed on this sub-fund is undisclosed, the company has noted that the acquisition will deliver at least A$13M in revenue over the five-year term of the sub-fund, which represents an annualised revenue of A$2.6M.

As part of the acquisition, we also note that DCL will seek shareholder approval to issue 100 million DCL shares to AAGL shareholders in recognition of future revenues expected to be received for managing the sub-fund.

Figure 1: FUM bridge pre and post AAGL acquisition



Source: Pitt Street Research, Company Report

Rent-to-Own offering is advancing well

DCL closed its first transaction under RTO which was syndicated during a pandemic

In February 2020, DCL launched the Rent-to-Own (RTO) pilot programme to leverage property developers as a distribution channel. The aim of the product is to use developer's distribution margins to provide discounts to investors while giving equity to tenants each year. The product provides 1% equity per annum to the tenants, helping them to escape the rental cycle.

In July 2020, the company closed its first acquisition under this scheme, having acquired a one-bedroom apartment in the Mason Square development in Melbourne. The apartment was acquired for A$447k, excluding the 10% developer's rebate. The purchase was funded by an initial equity investment of A$249k, plus a loan of A$200k, giving an LVR (loan-to-value ratio) of ~44%. The DCL sub-fund created for this property comprises 261,948 units, with 95% of the units distributed across 15 investors. The remaining 5% are kept in the RTO Tenant Reserve Trust, to be gifted to the tenant over the next five-year period.

DCL is currently finalising its second property to be acquired in Melbourne.

In our view, the fact that the syndication was completed during a pandemic represents both the resilience of the scheme, as well as its pull with investors. Notably, DCL is currently in the process of syndicating more properties, this time in the suburbs of Brunswick in Melbourne and Westmead in Sydney. We believe that with the current pace with which DCL is building its portfolio of RTO properties, it is positioned to see substantial growth in its funds under management (FUM).

Upfront fee model of RTO has substantial cash flow benefits

DCL has deployed a beneficial fee structure for the RTO product, under which it charges an upfront fee of 1%, as well as a recurring fee of 0.66% per annum on gross value of property. This provides the company significant cash flow benefits, by generating cash flow at an earlier point in the timeline, thereby reducing the time to breakeven.

Australian Tax Office confirmation to underpin growth for Senior Equity Release product

On 17 August 2020, DCL received confirmation from the Australian Tax Office (ATO) that a part disposal of a person's home can be made towards a 'downsizer' contribution. This works well for DCL's Senior Equity Release (SER) product, under which 'asset-rich, cash-poor' retirees can sell off a part of the equity in their house, to free up cash to meet their expenditures.

An ATO boost to DCL's Senior Equity Release product

The latest confirmation by the ATO has cleared the path for DCL to seek higher growth for its SER product. People can now release a part of the equity in their house under the SER platform and use those funds to make a downsizer contribution to top up their superannuation fund.

In our view, this is expected to gain 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 SER product is now on the 'Approved Product Groups' list of four financial planning firms.

Focus on introducing new products continues

In addition to the progress made with newly launched products (RTO and SER), DCL continues to work towards launching other new products.

Making headway with the affordable housing offering

The company is partnering with a leading national community housing provider (CHP) for its pilot under the RTO affordable housing programme. The A$25m pilot targets essential workers and is expected to be launched in Q4 2020. DCL plans to leverage the Australian government's affordable housing facility to provide an RTO product for essential workers (e.g., firefighters, teachers, police and medical professionals) on a 25% discounted rent. The company plans to access the low-cost government debt to fund the purchase, with an LVR of 40%.

Partnership with a tier 1 community housing provider expected to provide scalability

This product offers scalability to DCL in expanding its FUM. If the pilot is successful, the company has the potential to extend the offering across all Australian CHPs. The incentive for CHPs is that they get access to equity for their houses in the form of investors of DCL's sub-funds. Concurrently, the sub-fund investors benefit from low vacancy risk associated with the security of the tenant's employment.

On track to launch Equity Mortgage product in 2021

Another major product in the pipeline is the Equity Mortgage product. Earlier this year, DCL announced its plans to launch a Shariah-compliant product targeting the Australian Islamic community. This product will provide a method to obtain leverage for people wishing to become homeowners. As per the 2016 census, ~604k Australians are Islamic, making up 2.6% of the total population.

DCL is currently engaged in developing the unique legal structures required for this product and is working towards obtaining the global Islamic compliance verification. The product is expected to be operational in 2021. This product can later be extended to non-Islamic markets as well.

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, in our view.

Business impacts of COVID-19 have the potential to foster growth for DCL

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. On the other hand, business impacts that the pandemic has had on a macro level could play to DCL's benefit.

As per the data released by the Australian Bureau of Statistics, the seasonally adjusted unemployment rate in Australia ticked-up to 7.5% in July 2020 – the highest since November 1988. Moreover, driven by lockdowns, there has been a shift in living arrangements. Australians are moving back to their parents' homes, taking on more housemates or delaying plans to move or buy property, thereby increasing the vacancy risk.

In our view, the hedge against vacancy risk provided by DCL's RTO product should help boost adoption among investors. By gifting equity to the tenant, the product promotes tenant stickiness and reduces the risk of vacancy.

High interest in SER product from self-funded retirees

Besides high vacancy risk, historically low interest rates on term deposits and slashing of dividends due to COVID-19, have left self-funded retirees in crisis. This has resulted in increased interest in the SER product as self-funded retirees struggle with reduced income and 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.

Building strong funding pipeline

DCL is in a comfortable position with respect to near-term funding. It had already raised A$6m via an equity placement in 2019. Further, it reduced its capital requirements for 2020 by A$3.6m through a 12-month extension of its convertible notes.

Though the company has sufficient funding to execute its near-term growth plans, it is taking steps to raise further cash for medium-term growth. At the extraordinary general meeting held in July 2020, DCL refreshed its ability to raise capital under the ASX listing rule 7.1. Further, in September 2020, DCL has entered into a placement agreement with FQC Fintech 2 Pty Ltd to raise approximately A$2M, with AAGL agreeing to underwrite a further A$1.6M. This combined A$3.6M equity injection will strengthen DCL's balance sheet and place the business on a sound financial footing.

Given that DCL has already proven its ability to raise cash, as evidenced by four private placements completed in 2019–2020, we believe that it is capable to raise further capital from the market when required.

Reiterating valuation range of A$0.30 – 0.41

Although FUM of $71.4M as of 30 June 2020 came in below our expectations, the potential addition of $300M to FUM as a result of the recent AAGL acquisition should significantly beat our initial growth forecasts.

At this stage, we reiterate our valuation of A$0.30 – 0.41 per share. As DCL progresses closer to completing the acquisition, we will then revisit our valuation and make the appropriate adjustments.

Furthermore, we believe the steady progress with respect to new product launches and the resilience of DCL's business model provide confidence in the company's long-term growth potential.

Finally, we expect that the new product launches, greater awareness of its products among advisors and investors, as well as the potential acceleration in FUM growth, should support a re-rating of the stock.

Conclusion: Growing at a steady pace with new product launches in the pipeline

The robust pace at which DCL is progressing with new product launches, as well as their growing acceptability in the market, e.g. RTO, provides confidence in the resilience of the company's business model. Moreover, DCL's flagship crowdfunding platform continues to register strong growth in FUM, confirming the strength of the underlying business.

Further, the turbulence created by the pandemic in the capital markets, coupled with historically low interest rates, could drive investors to seek new investment opportunities. We believe the unique value propositions offered by DCL's fractional investing products (diversity in real estate portfolios, reduced vacancy risk, etc.) offer great investment vehicles to retail investors. We continue to hold the view that the upside potential of the stock will 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 to ramp 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 will make it difficult for DCL to break 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.

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