DomaCom Ltd

Moving forward at a robust pace

Share Price: A$0.08

ASX: DCL
Sector: Diversified Financials
14 January 2021

DomaCom Ltd (ASX: DCL) continues to make steady progress on new product releases. The company is partnering with BlueCHP, a community housing provider, on an A$250m essential workers affordable housing pilot programme, based on DCL's Rental Property Accelerator product. The product uses developer discounts to accelerate property investment for both investor and tenants. Additionally, DCL has also advanced on the new Shariah-compliant Islamic home finance product by entering into a partnership with Crescent Group.

Retirement Income Review provides validation for senior equity release offering

In November 2020, the Australian Treasurer released its Retirement Income Review report, which highlights the need for focus on post-retirement income stream. The report also emphasises the government's downsizer contributions scheme which retirees can use to access their housing wealth. We believe that any tangible expansion in retirement income will in parallel increases attention on alternative investment strategies such as DCL's senior equity release.

Reiterating valuation of A$0.30–0.40 per share

Given the steady progress on the essential worker program and the Shariah-compliant finance solution, as well as the opportunity provided by the senior equity release offering, we reinstate our previous valuation of A$0.30–0.40 per share based on the DCF approach. We believe that successful product launches and resultant growth in FuM should drive a re-rating of DCL. Key risks we see include: 1) slow increase in FuM; and 2) cyclical risk.

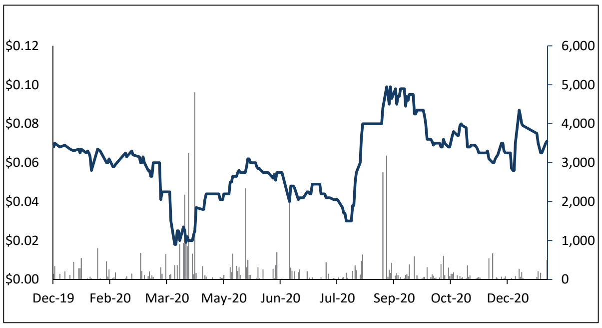
Year to June (AUD)	2019A	2020A	2021f	2022f	2023f
Sales (x 1,000)	277.4	394.8	1,416.6	3,381.7	6,190.4
Y/Y growth	94.0%	42.3%	258.8%	138.7%	83.1%
Adj. EBITDA (x 1,000)	-3,228	-3,582	-2,162	-233	2,503
Net Profit (x 1,000)	-5,290	-5,595	-2,685	-539	1,633
Adj. EBITDA Margin (%)	NM	NM	NM	-6.9%	40.4%
RoA (%)	NM	NM	NM	NM	60.8%
EPS before extr. & amort.	-3.97c	-2.59c	-0.99c	-0.18c	0.55c
Adj. EPS	-4.34c	-2.68c	-0.99c	-0.18c	0.55c
EV/Sales	54.6x	58.4x	19.0x	8.0x	4.1x
EV/EBITDA	NM	NM	NM	NM	10.1x
P/E	NM	NM	NM	NM	16.4x

Source: Company, Pitt Street Research

Market Cap. (A$ m)	22.9
# shares outstanding (m)	305.8
# share fully diluted	314.9
Market Cap Ful. Dil. (A$ m)	23.6
Free Float	76.7%
12 months high/low	0.10 / 0.02
Avg. 12M daily volume ('000)	218.1
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	0.30–0.40
WACC	10.8%
Assumed terminal growth rate	2.5%

Source: Pitt Street Research

Disclosure: Pitt Street Research directors own stock in DomaCom.

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DCL on-track with affordable housing

In November 2020, DCL announced a partnership with BlueCHP on the affordable housing for essential workers scheme. BlueCHP is a tier 1 community housing provider (CHP) in Australia, engaged in developing affordable housing in the states of New South Wales and Queensland. In the past 10 years, BlueCHP has delivered 1,700 affordable homes.

Under this partnership, the two companies plan to work together to channel A$250m in affordable housing in 2021, starting with a pilot project of A$10m. Through DCL's Affordable Property Accelerator (RPA) programme (formerly known as Rent-To-Own), investors will be able to invest in affordable housing properties that are managed by BlueCHP.

The partnership provides benefits to both investors and renters, i.e. the essential workers

BlueCHP is able to secure low-cost loans, with a 40% LTV, which is expected to generate attractive returns for the investors of DomaCom fund. Since the renters are essential workers, it also provides an attractive ethical investment vehicle to superannuation funds.

Moreover, this program provides a two-fold advantage to the renters:

- 25% discount on rent as compared to market price, as funded by the low cost loans available to BlueCHP
- 5% equity in the property over a five year period as part of the RPA programme by DCL

Moving forward on Islamic finance product

Maintaining its momentum on new product releases, in December 2020 DCL entered into a partnership with Crescent Group for the launch of its Islamic home finance solution. Through this product, DCL plans to target the Australian Islamic community to help them obtain Shariah-compliant home financing options.

As per the legal structures of Islamic finance, Muslims are prohibited from paying or receiving interest, and as a result they are not able to access generic home financing solutions. However, in partnering with Crescent Group, DCL aims to provide a solution to Australian Muslims that allows them to use leverage for purchasing a home while staying within the legal structures of Islamic finance. Notably, Crescent Group is an Australia-based provider of innovative Islamic finance solutions, including Islamic super and investment fund.

Crescent Group partnership to provide upside potential to DCL's new Islamic home finance product

Through this partnership, DCL will be able to obtain Shariah certification for its product, which is expected to be operational on the company's fractional investment platform by Q3 2021. Moreover, the opportunity to leverage on Crescent Group's relationship with the Australian Muslim community as well as its global Islamic network provides upside potential to DCL's new product.

As per a recent report by DinarStandard, Australia has a significant opportunity for Islamic finance, supported by an estimated Muslim population of 771k in 2020. The report notes that homeownership in the community is 15%, substantially less than the 66% national average. Moreover, the report finds that 95% of Muslims view their religion as an important aspect of their identity, which translates to need for Shariah-compliant financing solutions. This is also reflected in the A$56bn size of Shariah-compliant superannuation funds. In our view, this investment community provides a significant growth opportunity to DCL's new product which is designed specifically to cater to the unique demands of this cohort.

Retirement Income Review report offers insight into the opportunity in the sector

On 20 November 2020, the Australian Treasurer's office released their final report on the 'Retirement Income Review'. The review highlighted the need for improving the understanding of the retirement income system among Australians by dealing with the misconceptions and low financial literacy. The Australian retirement income system is built around three pillars: a) Age pension scheme; b) Compulsory superannuation; and c) Voluntary savings (including home ownership).

The review included following key findings:

The Australian Treasurer's report sheds light on need for a steady post-retirement income source

– **The Australian old-age dependency ratio is expected to worsen over the next decade**. Australia has an ageing population, with the proportion of people over 65 years expected to rise from 16.1% in 2020 to 22% in 2060 (Figure 1). Concurrently, the dependency ratio (# of working age people to retirees) has also fallen from 7.3 in 1974-75 to 4.5 in 2014-15 and is expected to further decline to 3.2 in 2060. Moreover due to COVID-19, the net overseas migration is also expected to fall during 2019-21. As a result of this, coupled with the improvement in longevity and life expectancy, people are expected to require more funds in their retirement to maintain their standards of living.

Figure 1: Actual and projected number of Australians aged 65 and over

	Number (millions)					Portion of population (per cent)				
	1980	2000	2020	2040	2060	1980	2000	2020	2040	2060
Aged 65 and over	1.4	2.4	4.2	6.7	9.3	9.6	12.4	16.1	19.7	22
Aged 75 and over	0.5	1.1	1.8	3.7	5.1	3.4	5.6	7	10.8	12.2
Aged 85 and over	0.1	0.3	0.5	1.2	2.1	0.7	1.3	2	3.6	4.9

Source: Retirement Income Review report, July 2020

– **Many current retirees spent the majority of their working life without compulsory superannuation**. The Superannuation Guarantee (SG) was introduced by the Australian government in 1992[1]. As a result of this low SG coverage, people need to start relying on other sources for their retirement income.

– **The current system is too complex for retirees to understand the options available to them**. This calls for greater role of financial advisers so that they can advise their clients on the various alternative strategies available to them to maximise their retirement income and investment returns.

Impact on Senior Equity Release offering

We believe as the focus on post-retirement income increases, the interest in various alternative financial planning strategies is bound to rise in tandem. In August 2020, the ATO provided clarification on the downsizer contribution which was also included in the 'Retirement Income Review' report.

Below are the key benefits of the downsizer contributions:

– There is no maximum age limit – only a minimum age limit of 65 years or older.

[1] See 'Superannuation in Australia: a timeline' by APRA; https://www.apra.gov.au/superannuation-australia-a-timeline

- No requirement for a work test.
- Unlike with Non-concessional contributions, downsizer contributions can be made regardless of the size of the member's superannuation fund balance. The non-concessional contributions cannot be made to superannuation funds with balances of A$1.6m or more.
- In order to make a downsizer contribution, the person does not need to purchase a new house as a replacement.
- The contribution to the superannuation fund does not have to be made from the proceeds of the house sale. This means that if a person has the amount saved in another bank account, then after the whole/partial sale of their residence, they can use the funds in this bank account to transfer to their super.
- In case of co-ownership of the residence, the downsizer contribution does not need to be divided in the same proportion as that of the ownership of the house. This means that even with unequal ownership in the house, both the owners can make contributions of up to A$300,000 to their superannuation fund.

Benefits of downsizer contribution to drive adoption of SER

We believe these benefits should drive the interest in DCL's senior equity release (SER) offering. SER allows retirees to free-up equity in their house to meet financial needs even as they continue to live in their residence. Through the downsizer contribution mechanism, members can make contributions of up to maximum of A$300,000 or proceeds from the sale of the house towards their superannuation fund.

Benefits of SER to the financial advisers

As per BDO[2], Australia is expected to witness the largest intergenerational wealth transfer over the next two decades. An estimated A$3.5tr of wealth is expected to be transferred from the Baby Boomers generation. We believe this provides a significant opportunity to financial advisors.

The Retirement Income Review report states that for most households aged 65 and over, the family house is the main asset. With a large portion of the wealth tied into this traditionally illiquid asset, financial advisors can help their senior clients unlock the equity in their home through equity release products such as reverse mortgage and home reversion.

SER can help financial advisors on intergenerational wealth transfer

Through home reversion products, such as DCL's SER offering, financial advisors can aid their clients in intergenerational wealth transfer. Furthermore, SER helps financial advisors to convert their retired clients, which are mostly passive, into active clients, thereby generating more revenue for their firm. This also helps advisors in creating intergenerational relationships with their clients, providing business expansion opportunities.

Equity release market in Australia has upside potential

There is a need for harmony between the public and private sector equity release offerings in Australia. While the government Pension Loans Scheme does provide a post retirement income stream, people need more options to release value from their homes and this is where private sector comes in.

[2] See 'With wealth transfer on the rise, why has planning taken a back seat?'; https://www.bdo.com.au/en-au/insights/private-wealth/articles/wealth-transfer-planning-taken-a-back-seat#:~:text=The%20largest%20intergenerational%20wealth%20transfer,the%20Baby%20Boomer%20generation1.

As per the Retirement Income Review, the private market for home equity release in Australia is still relatively small. The report also highlighted the significant opportunity in this market presented by the 1.9m homes owned by people aged 65 and over in 2017-18.

UK provides an important case study for the growth in the equity release market. Driven by market innovation and favourable policy initiatives, such as high inheritance tax of 40%, the equity release market in the UK has seen tremendous growth. As per the market monitor report by Key Group, during 2015–19, the value of equity release plans in the UK grew at a CAGR of 15%, reaching GBP3.4bn in 2019. At the same time, the number of equity release plans also increased at a CAGR of 14% during 2015–19, with 45,598 plans sold in 2019. We believe that if a similar acceptance of the product is witnessed in Australia, it would provide substantial upside potential to DCL's SER product.

Reiterating valuation range of A$0.30–0.40

In our view, the steady progress with respect to new product launches, such as RPA and Islamic home finance product, provides confidence in the company's long-term growth potential. Consequently, we reiterate our valuation of A$0.30–0.40 per share based on the DCF approach (Figure 2 and Figure 3). Moreover, we believe that as the attention towards equity release products increases among retirees and financial advisors, the acceptance of SER should also increase, thereby supporting a re-rating of the stock. Figure 4 shows our sensitivity analysis based on varying discount rates and terminal growth rates.

Figure 2: Base-case value using DCF

Valuation (AUD)	
Present value of FCF	12,827,474
Present value of Terminal FCF	83,532,106
Enterprise Value	**96,359,580**
Net debt (cash)	1,250,710
Minority interest	-
Employee entitlements	331,447
Equity value (AUD)	94,777,423
Diluted shares	314,943,814
Implied price (A$)	**0.30**
Current price (A$)	**0.08**
Upside (%)	301.2%

Figure 3: Bull-case value using DCF

Valuation (AUD)	
Present value of FCF	16,944,174
Present value of Terminal FCF	111,349,422
Enterprise Value	**128,293,596**
Net debt (cash)	1,250,710
Minority interest	-
Employee entitlements	331,447
Equity value (AUD)	126,711,439
Diluted shares	314,943,814
Implied price (A$)	**0.40**
Current price (A$)	**0.08**
Upside (%)	436.4%

Source: Pitt Street Research

Figure 4: DCF using various WACCs

Sensitivity Analysis									
WACC	10.8%								
Terminal Growth Rate	2.50%				Change in WACC				
Implied Price (A$)	0.30	10.0%	10.2%	10.5%	10.8%	10.8%	11.0%	11.2%	11.4%
	1.75%	0.32	0.31	0.29	0.28	0.28	0.27	0.26	0.25
	2.00%	0.33	0.31	0.30	0.29	0.28	0.27	0.27	0.26
	2.25%	0.34	0.32	0.31	0.29	0.29	0.28	0.27	0.26
Change in Terminal Growth Rate	2.50%	0.35	0.33	0.32	**0.30**	0.30	0.29	0.28	0.27
	2.75%	0.36	0.34	0.33	0.31	0.31	0.30	0.29	0.28
	3.00%	0.37	0.36	0.34	0.32	0.32	0.31	0.30	0.29
	3.25%	0.39	0.37	0.35	0.33	0.33	0.32	0.30	0.29

Source: Pitt Street Research

Conclusion: Formative years marked with steady growth

DCL has been consistently recording growth in its Funds under Management (FuM), even in the pandemic, confirming the resilience of its business model. The company's FuM stood at A$75.6m in December 2020. Additionally, if the acquisition of AusAgri is completed, it is expected to give a A$300m boost to the FuM, thereby driving management fees income.

Notably, this growth has been achieved in DCL's formative years with the company steadily introducing new products, such as the Shariah-compliant Equity Mortgage product and the RPA. In our view, as these new products reach the market and begin to gain end market attention, it could further boost the FuM, thereby driving a re-rating of the stock.

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 has been covering a range of sectors 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.
– Before 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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