PITT STREET RESEARCH

DomaCom Limited

Valuable Fractions of a Huge Pie

Share Price: A$0.115

Valuation range: A$0.35-0.46

ASX: DCL

Sector: Diversified Financials

16 April 2019

Revolutionary Fractional Investing property platform

DomaCom Limited (ASX: DCL), a Melbourne-based property fund manager, has developed fully regulated products that have the potential to revolutionise property investing in Australia. Its unique online fractional investing platform allows investors to invest in only a fraction of a property, enabling them to build a leveraged portfolio of real estate assets.

Equity Release: Ideal for 'asset rich, cash poor' retirees

DCL's new Equity Release product is expected to be launched shortly. It is primarily targeted at baby boomers looking to release equity (capital) from their family homes to fund retirement and for inter-generational wealth transfer.

Strong adoption expected by financial advisors

As DCL's two products add another vital asset class to the toolbox of financial advisors, we expect these products to garner strong market support. DCL is targeting the property segment of Self-Managed Superannuation Funds (SMSFs), valued at A$700bn and the A$500bn retiree home market.

Valuation range of A$0.35-0.46 per share

We value DCL at A$0.35 per share (DCF model) in a very conservative base case (due to lack of historical information) and A$0.46 per share in a scenario in which Funds Under Management growth accelerates in line with management's expectations, i.e. on the back of the new residential property debt facility through La Trobe and potential conversion of the trial with a Big-4 bank into a commercial agreement.

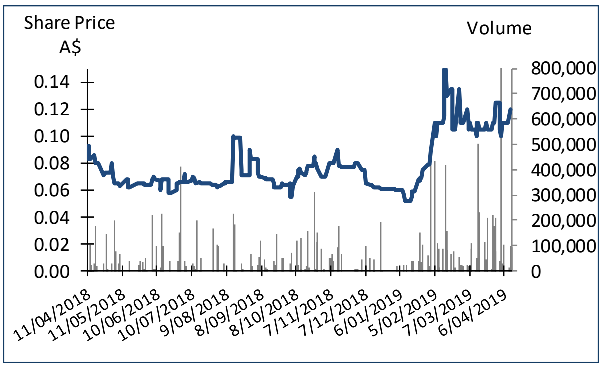
Year to June (AUD)	2017A	2018A	2019f	2020f	2021f
Sales (x 1,000)	93.0	143.0	388.0	825.0	1,934.0
YoY growth		53.7%	171.4%	112.6%	134.4%
EBITDA (x 1,000) Adjusted	-5,448	-5,017	-4,514	-3,342	-2,024
Net Profit (x 1,000)	-6,136	-5,907	-5,151	-3,967	-2,517
Adj. EBITDA Margin (%)	NA	NA	NA	NA	NA
ROA (%)	NM	NM	NM	NM	NM
EPS before extr. & amort.	-5.68c	-5.21c	-3.79c	-2.33c	-1.21c
EPS	-5.68c	-5.00c	-3.79c	-2.33c	-1.21c
DPS	NA	NA	NA	NA	NA
EV/Sales	104.8x	61.1x	48.6x	27.1x	14.2x
EV/EBITDA before extra	-1.8x	-1.7x	-4.2x	-6.7x	-13.6x
P/E before extra	-1.9x	-1.3x	-3.0x	-4.9x	-9.5x
Dividend yield %	NM	NM	NM	NM	NM

Source: Company, Pitt Street Research

Market Cap. (A$ m)	16.6
# shares outstanding (m)	144.7
# share fully diluted	155
Market Cap Ful. Dil. (A$ m)	17.8
Free Float	66.9%
12 months high/low (A$)	0.15 / 0.05
1 / 3 / 12-month performance	20.0% / 60.0% / 37.9%
Website	www.domacom.com

Source: Company, Pitt Street Research

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



Source: Thomson Reuters, Pitt Street Research

Valuation metrics	
Fair valuation (A$) per share	0.35
WACC	9.8%
Assumed terminal growth rate	2.0%

Source: Pitt Street Research

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Please note Pitt Street Research and/or its associates hold stock in Domacom as of the date of this report.

Profit & Loss (A$ '000)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Sales Revenue	**93.0**	**143.0**	**388.0**	**825.0**	**1,934.0**	**3,936.8**	**6,852.0**
Operating expenses	-5,541.0	-5,160.1	-4,902.1	-4,166.8	-3,958.4	-4,037.6	-4,118.4
Adjusted EBITDA	**-5,447.9**	**-5,017.1**	**-4,514.1**	**-3,341.8**	**-2,024.4**	**-100.8**	**2,733.6**
Depn & Amort	-663.6	-665.6	-571.7	-472.7	-372.6	-271.3	-168.8
Adjusted EBIT	**-6,111.5**	**-5,682.8**	**-5,085.8**	**-3,814.5**	**-2,397.1**	**-372.1**	**2,564.9**
Net Interest	-24.9	-313.0	-65.7	-152.4	-120.0	36.0	44.8
Profit before tax (before exceptionals)	**-6,136.4**	**-5,995.8**	**-5,151.5**	**-3,966.9**	**-2,517.1**	**-336.2**	**2,609.7**
Tax expense	0.0	0.0	0.0	0.0	0.0	0.0	-717.7
Abnormals + Minorities	0.0	324.5	0.0	0.0	0.0	0.0	0.0
NPAT	**-6,136.4**	**-5,671.3**	**-5,151.5**	**-3,966.9**	**-2,517.1**	**-336.2**	**1,892.0**

Cash Flow (A$ '000)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Profit after tax	-6,136.4	-5,671.3	-5,151.5	-3,966.9	-2,517.1	-336.2	1,892.0
Depreciation	663.6	665.7	571.7	472.7	372.6	271.3	168.8
Change in trade and other receivables	288.6	463.8	229.3	-26.8	-77.8	-117.3	-66.2
Change in trade payables	-82.8	-145.9	-95.7	87.9	229.0	173.1	129.7
Other operating activities	849.6	797.3	898.8	793.1	824.7	798.5	780.2
Operating cashflow	**-4,417.5**	**-3,890.4**	**-3,547.3**	**-2,640.0**	**-1,168.6**	**789.5**	**2,904.4**
Capex (- asset sales)	-889.1	-617.2	-600.3	-496.4	-391.3	-284.9	-177.2
Other investing activities	44.3	27.4	12.1	42.9	75.2	83.7	92.5
Investing cashflow	**-844.8**	**-589.8**	**-588.2**	**-453.5**	**-316.0**	**-201.2**	**-84.7**
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Equity raised (repurchased)	6,227.8	150.0	3,839.6	5,250.0	5,000.0	0.0	0.0
Debt drawdown (repaid)	0.0	2,429.0	2,350.0	0.0	-2,950.0	0.0	0.0
Other financing activities	-6.3	-0.9	0.0	0.0	0.0	0.0	0.0
Net change in cash	959.3	-1,902.1	2,054.1	2,156.5	565.4	588.3	2,819.7
Cash at End Period	2,705.5	803.4	2,857.5	5,014.0	5,579.3	6,167.7	8,987.4
Net Debt (Cash)	-2,705.5	751.4	1,047.3	-1,109.2	-4,624.6	-5,212.9	-8,032.6

Balance Sheet (A$ '000)	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Cash	2,705.5	803.4	2,857.5	5,014.0	5,579.3	6,167.7	8,987.4
Total Assets	6,637.6	3,943.3	5,355.9	7,122.0	7,343.0	7,621.4	10,074.9
Total Debt	0.0	1,554.8	3,904.8	3,904.8	954.8	954.8	954.8
Total Liabilities	757.3	2,519.4	4,773.7	4,861.7	2,140.7	2,313.8	2,443.5
Shareholders' Funds	5,880.4	1,423.9	582.1	2,260.3	5,202.3	5,307.6	7,631.5

Ratios	2017A	2018A	2019f	2020f	2021f	2022f	2023f
Net Debt/Equity (%)	-46.0%	52.8%	179.9%	-49.1%	-88.9%	-98.2%	-105.3%
Interest Cover (x)	NM	NM	NM	NM	NM	NM	NM
Return on Equity (%)	NM	NM	NM	NM	NM	NM	29.2%

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Introducing DomaCom Limited

DomaCom Limited (ASX: DCL) is a Melbourne-based, ASX-listed operator of investment platforms. DCL's fractional investing platform enables retail investors to part-own real estate. DCL is the first registered operator in Australia that provides an online platform for fractional investing in property. The company operates through the DomaCom Fund, a registered Managed Investment Scheme (MIS). Through this, DCL provides a structured investment vehicle that is a combination of a managed fund and an online crowdfunding platform. The company's platform supports online property listings, real estate trading, unit registry, and book build processing for existing properties and proposed developments. DCL earns revenue by providing management and platform services to the DomaCom Fund. Currently, DCL offers only one product – Fractional Investing. It has already received the required regulatory approval to launch Equity Release, that will compete against the reverse mortgage product for retirees but allows the release of equity in the home to be funded by the large SMSF market.

DomaCom Fund: Structured vehicle for fractional investing

DCL offers retail investors a platform to build a portfolio of high-yield properties in a low interest environment

DomaCom Fund is an Australian Securities and Investments Commission (ASIC)-registered scheme that allows retail investors to build a portfolio of real estate investments through fractional investing. The fund provides investors with the flexibility to choose a property to invest in and not have to depend on a fund manager's choice. This unique proposition allows the investor to diversify and avoid higher exposure to a single asset at a relatively low cost. DCL's platform facilitates 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 SMSF investors.

Equity Release: Aimed at retirees with property holdings

In November 2018, DCL received regulatory approval for launching Equity Release, a new product involving on the one hand the elderly and on the other hand investors. People who own significant real estate holdings but have limited cash flow can monetise their properties by releasing a part of the equity in their home. This is similar to the reverse mortgage offered by financial institutions, with the difference being that the investors are crowd-funded and take an equity interest in the property rather than debt that accumulates and is owed to one institution. With ~15% of the current Australian population aged over 65 years old, this product offers an ideal opportunity for elderly people to leverage their large real estate holdings. Also, with major banks withdrawing from the reverse mortgage market, there is a significant investment opportunity to be explored.

Business still highly undervalued

DCL is currently valued at only A$18m. One key reason for this low valuation is the incremental costs the firm is undertaking as a result of platform innovation and educating investors. Fractional investing as an investment vehicle is still not being fully explored by retail investors and the concept is in the nascent stage. Similarly, Equity Release will be introduced to the market shortly and will build traction over time. In our opinion, investors do not yet fully acknowledge the potential of disruptive retail financial products based on crowdfunding. We seek a re-rating of DCL based on the company's first-mover advantage in a disruptive niche sector; its consistent growth in

Funds Under Management (FuM), resulting in higher fees; the launch of Equity Release; strong take-up by financial advisors; a white-label deal with the Big Four banks; and lowering of operating costs with the maturing of industry.

Ten reasons to look at DomaCom Limited

1) Rising property prices have made housing unaffordable. Exposure to property means investors with limited resources can rely on fractional investing.
2) DCL has an experienced team that has been at the forefront of fractional property investment for the past three to five years. Management has successfully traversed the initial phase and added over 50 properties to its portfolio.
3) The Equity Release product is unique and DomaCom is the only company to get product approval from ASIC. Competitors will take three to four years to obtain approval due to regulatory hurdles. The product is well suited for older citizens who are asset rich but cash poor.
4) Once a property is purchased and a sub-fund is created, it is usually not terminated until the term expires. The company earns a management fee as a percentage of FuM. This implies the revenue is recurring and provides good visibility to investors.
5) DCL targets end customers as well as financial advisors to sell its products. Most competitors only target end customers. It has products with the approved list of 44 Independent Financial Advisors (IFA), as of November 2018, which represents ~1200 advisors presenting DCL products to their clients.
6) Use of debt in the funding mix through the recent residential property debt facility agreement with La Trobe Financial will be a game changer. Property purchases before March 2018 were mostly done without any debt. Availability of debt for residential property purchases will make DCL's products more lucrative for financial planners as internal leverage will make the investment tax efficient for equity investors.
7) After a court ruling in August 2018, SMSFs are now allowed to invest in DCL's sub-funds (up to 50%) when the tenant of the underlying asset is a related party, such as a family member. The Australian Taxation Office (ATO) did not appeal against this ruling regarding the breach of the sole purpose test. It paves the way for inter-generational wealth management.
8) Banks have withdrawn lending to SMSFs, which means it will be harder to purchase property now. SMSFs looking to leverage property transactions might look at DCL as an alternative.
9) If Labor win the upcoming election, as they are forecasted to do, their stated policy is to ban borrowing within SMSFs which will leave DomaCom as one of the few remaining vehicles for SMSFs to invest in direct property .
10) We believe DCL is currently undervalued. We value the company at A$0.32 per share in our base case scenario, using a long-term DCF calculation approach. We have applied realistic estimates on the increase in FuM across Fractional Investing and Equity Release products.

Fractional Investing: New era in property investment

Fractional investing is a method by which investors collectively raise capital to purchase a high-value asset, such as residential properties, residential developments, land banking, renewable energy assets and rural properties. This gives an individual investor exposure to an asset at a fraction of the total cost.

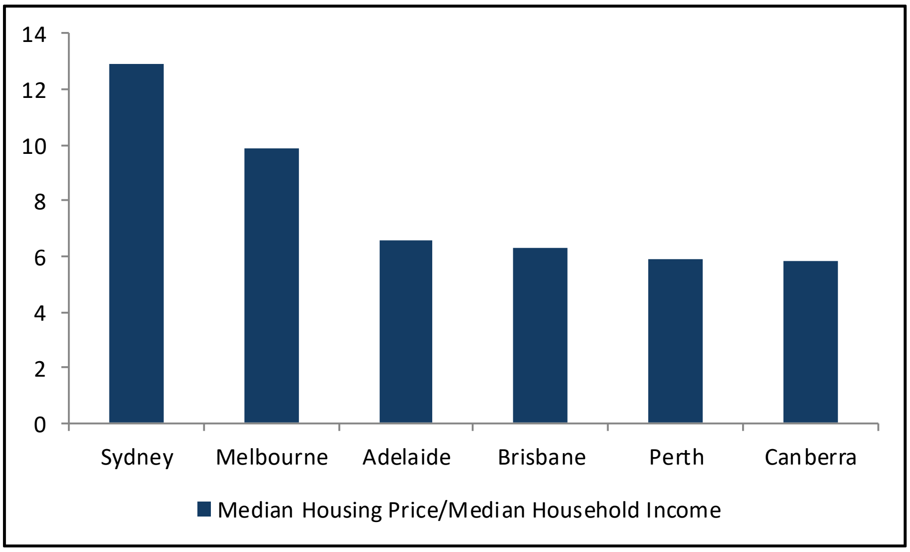
Fractional investment allows investors, who would otherwise not be able to purchase an entire property by themselves, to build exposure to property assets. It also allows investors to diversify their investment portfolio by giving them fractional exposure to different properties. Compared to traditional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

Why fractional investing makes so much sense

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

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 14th Annual Demographia International Housing Affordability Survey conducted in 2018 (Figure 1), the average house price-to-household income ratio is 12.9x in Sydney. Consequently, it is extremely difficult for a person to invest in real estate in an individual capacity. As a result of this, the concept of crowdfunding property investments shows great promise.

Figure 1: Housing Affordability (average house value/annual income)



Source: Demographia Housing Affordability Survey, Pitt Street Research

A boon for financial advisors

Ideal advisory tool for financial advisors

We believe fractional investing will be 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, Australian Real Estate Investment Trusts (AREITs), and traditional syndicates, and have difficulty 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.

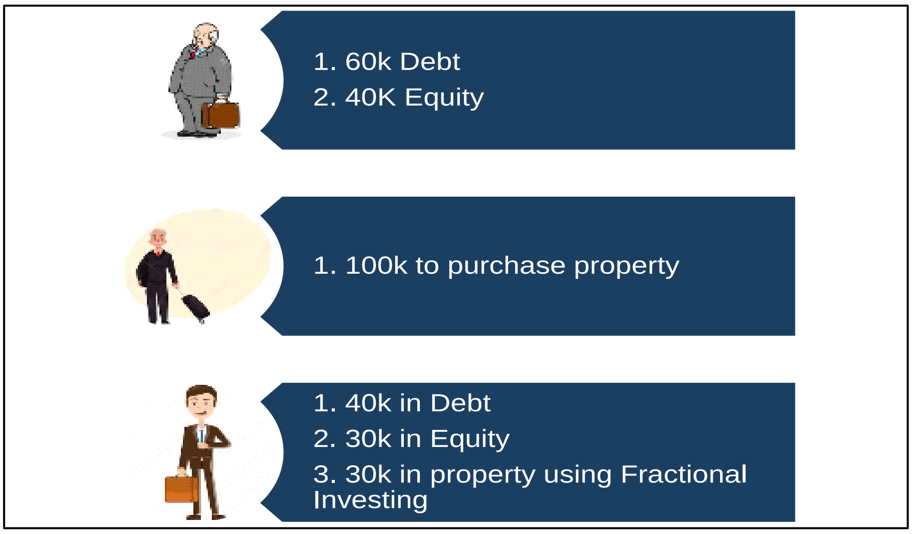
Fractional property investment overcomes all these problems as clients get to choose the property in which they want to invest. DCL conducts due diligence before purchasing a property, which assuages most concerns a financial advisor might have. It reviews the purchase contract, provides legal oversight, conducts property valuation so that investors do not buy an over-priced property, and also carries out property and pest inspections to ensure that the property is in sound condition. Finally, DCL appoints a buyer's agent to negotiate the best possible 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 the Australian Financial Services Licensee (AFSL) can recommend it to their clients. The financial advisor is required to hire a property advisor to select the property based on the investor's requirement and risk profile. Hence, the advisor only recommends the structure and not the underlying property to its clients. Fractional property investing will benefit financial advisors as it will result in increased revenue and client reach (Figure 2). It also protects investors from purchasing over-priced properties.

Fractional Investing provides a level of balance/ diversification to an individual's portfolio

Figure 2: Investment allocation with and without fractional investing

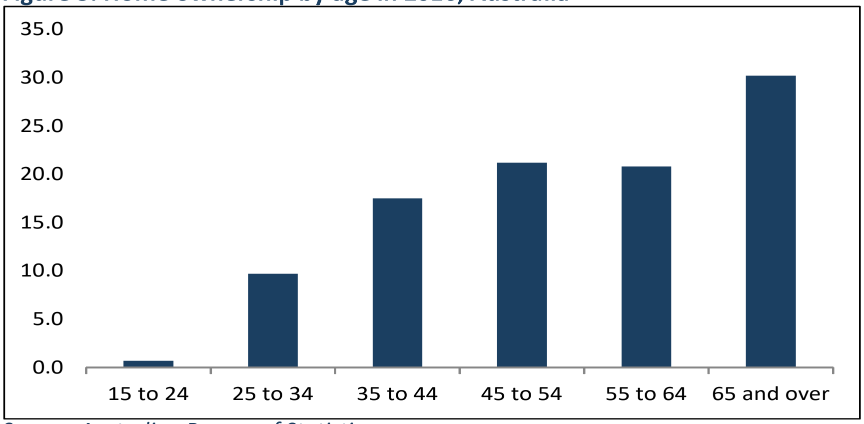


Source: Pitt Street Research

Equity Release: Ideal for 'asset rich, cash poor'

A significant portion of real estate in Australia is held by people over 65 years of age (Figure 3). Thus, the possibility of utilising asset holdings for sustainable and regular income for retirees is very substantial. Reverse Mortgage, the best possible financial instrument which provides this flexibility, accounts for only ~1% of total housing equity, until now. This problem is exacerbated by the fact that the superannuation guarantee only started in the early 1990s, which means that members of the older generations did not have the ability to accumulate their funds into a superannuation account in their early years and hence many do not have sufficient savings. Considering the significant gap in the potential and existing underlying assets, DCL is compensating by launching a parallel but better product – Equity Release.

Figure 3: Home ownership by age in 2016, Australia



Source: Australian Bureau of Statistics

Equity Release will match those looking to obtain cash by releasing equity in their homes with individuals who wish to make investments that are underpinned by those properties. Recently approved by the regulators, DCL's Equity Release product provides an attractive solution to 'asset rich, cash poor' retirees; it gives them control and at the same time unlocks the value of their homes, while allowing them to remain living in them.

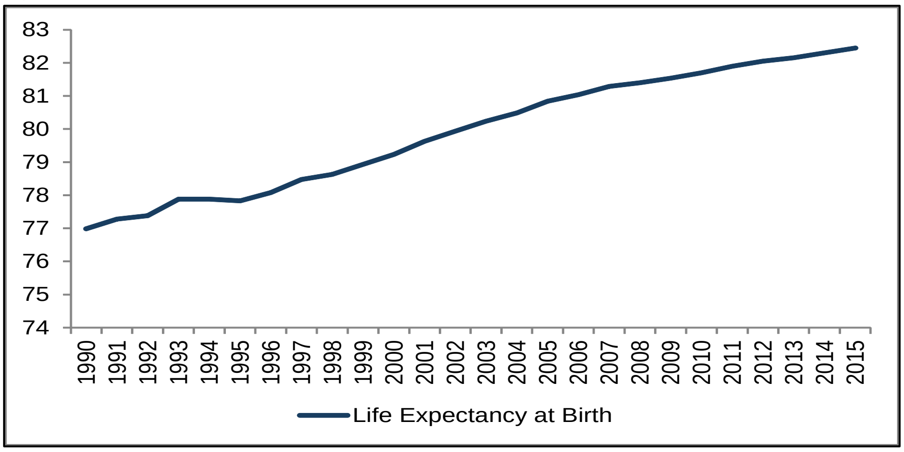
With increasing life expectancy, people will need more capital for retirement

Retirees nowadays live longer and thus need more capital after retirement

Looking at the current demographic situation in Australia (Figure 4), the need and the opportunity for Equity Release has become more apparent. Just like most developed countries, Australia's population is ageing due to low fertility and increased life expectancy; therefore, there are fewer children below 15 and a proportionally larger number of those aged 65 and over.

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

Figure 4: Australia's life expectancy



Source: Australian Institute of Health and Welfare

1. **Australia's ageing population**

   Over the last two decades, the median population of Australia has gone up by 2 years, from 35 years (as at June 30, 1998) to 37 years (as at June 30, 2018). The proportion of population above 65 years old increased from 11.8% in 1994 to 14.7% in 2014. It is projected that by 2061, 25% of the country's population will be above 65 (Figure 7).

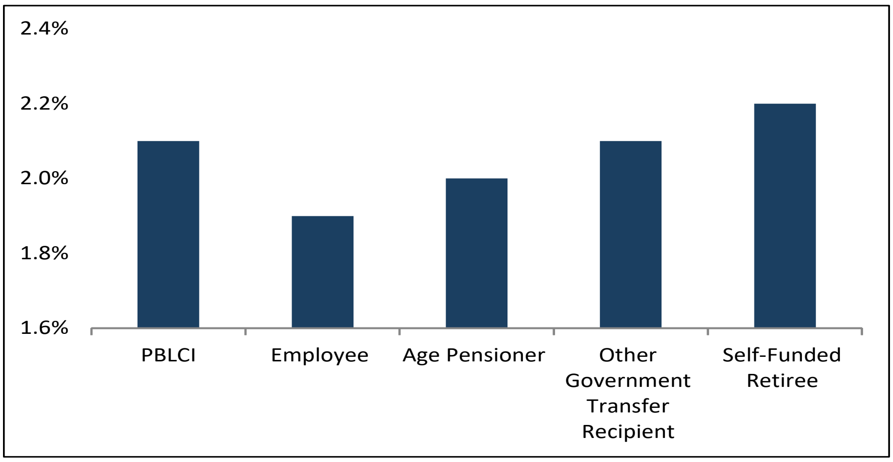
   As Australia's population continues to age, a larger portion will be joining the retiree segment, thereby stimulating the demand for more funds to meet their rising expenditures. Add to that the currently prevailing tighter underwriting standards in the economy, and DCL has the perfect opportunity to leverage its Equity Release offering.

2. **Increasing cost of living**

   The cost of living in Australia has risen, as evidenced by a 1.8% YoY increase in the CPI to 114.1, as of December 2018 (from 112.1 a year ago). Notably, the largest uptick in the Living Cost Indexes (LCI) was observed in the Self-Funded Retiree segment, which grew 2.2% YoY to 113.7. This was closely followed by a 2.1% YoY increase experienced by the Pensioner and Beneficiary Index (PBLCI), which includes the Age Pensioner and Other Government Transfer Recipient Household segments of the economy (Figure 5).

   The segments that were worst hit by the continuously rising costs of living are mostly comprised of retirees and individuals who do not have an independent, growing source of income to support their expenditures. We believe that for these individuals, DCL's Equity Release offering provides a great opportunity to tap into the part of their capital that has been locked up in their most prized asset, their house.

Figure 5: Percentage changes in Living Cost Index for Australian households



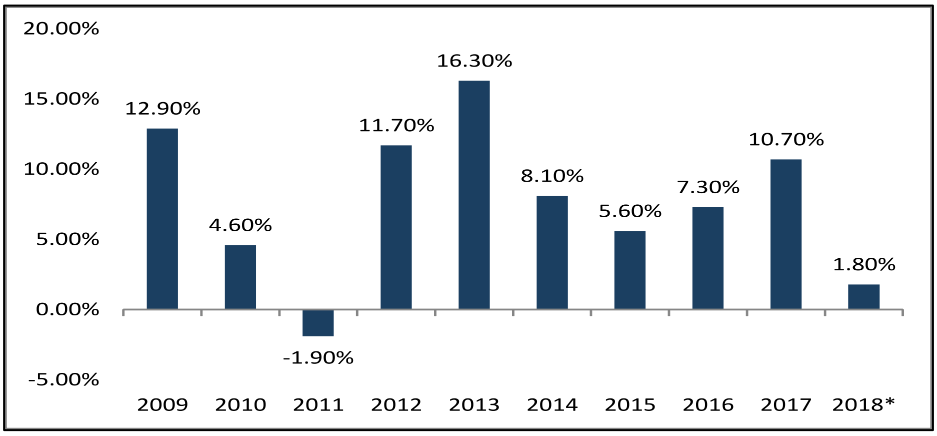
Source: Australian Bureau of Statistics

Equity Release is an ideal investment opportunity for retirees

1. **Volatility in Superfunds Performance**

   Members of superfunds that are invested in the Median Balanced option experienced a negative return of 0.6% in November 2018 (Figure 6). History is witness to other such instances where returns on superfunds turned negative, such as the annual loss of 1.9% in 2011. Such instances bring to the forefront the fact that superfunds, which form the majority of the average Australian's retirement source of income, are just like any other financial investment product and are prone to associated risks. This makes superannuation funds a risky short- to medium-term source of income.

Figure 6: Calendar Year Returns on median balanced options



*Note: * Only includes data until November 2018*

Source: Superratings.com

2. Shrinking benefits paid to pensioners

Effective from January 2017, the Australian government increased the taper rate on assets (which determines how much of the pension payment is made on a fortnightly basis) from A$1.5 to A$3.0 on every $1,000 above the threshold limit. As a result of these sweeping changes made by the government in order to determine the eligibility of the pensioners, the reliance of retirees on pension transfers has reduced dramatically. In the same year, the age limit for a retiree to qualify to receive the pension payment was also increased to 65 years and six months of age. As the government plans on increasing this limit by six months every two years, the eligibility threshold for receiving the pension benefits is set to reach 67 years old by 2023. This will drive retirees to seek other sources of income to make up for the loss caused by the abovementioned changes in the legislature. It is expected that Equity Release will provide the required platform for retirees to earn higher yields from their property holdings.

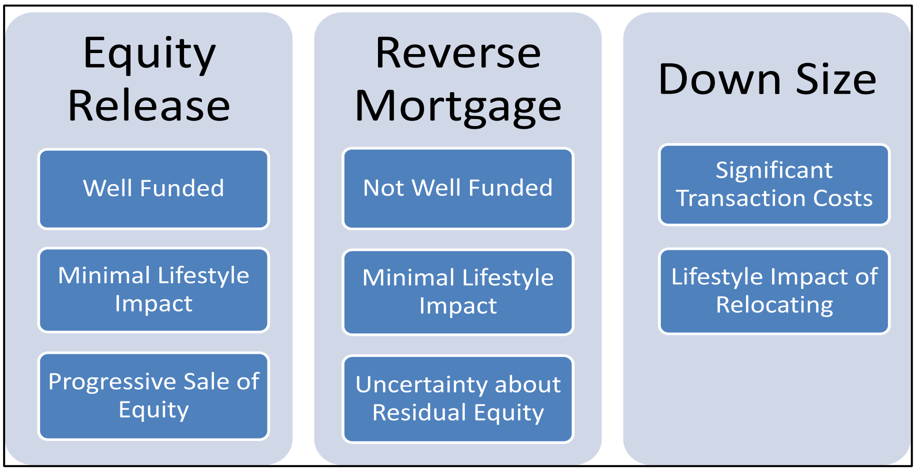
3. Relatively superior products

Compared to some other financial products for retirees that allow them to benefit from real estate holdings, i.e. reverse mortgages and downsizing, Equity Release has inherent benefits. DCL's product is not only well funded but progressive equity sale means that both the owner and investor have enough scope to judge the return before committing any more capital/holding. Comparatively, other options have fundamental complications (Figure 7):

a. Reverse mortgages: These are debt products, secured over a property, that release equity to the owners. The loan can be taken as a lump sum, an income stream, or a line of credit. There are no regular repayments in this case. In Australia, reverse mortgage includes a no-negative-equity guarantee. Although this protects against negative equity, there is no certainty regarding the value of the residual equity at the end of the contract.

b. Downsizing: This refers to selling the current house and moving to a smaller house, which frees up some cash from the transactions in consideration. However, it means a change in lifestyle and a significant transaction cost for the property owner.

Figure 7: Comparison of different funding sources of elderly Australians



Source: Company, Pitt Street Research

Equity release deed

An equity release deed has no negative guarantee, which means that the borrower would never end up owning more than the market value of the house

An equity release deed is an agreement between a property owner and a custodian in which the property owner sells an interest in his/her property to the custodian for an agreed amount. The supplementary Product Disclosure Statement (PDS) will contain relevant information for investors, such as the value of the property, the proposed interest DCL will acquire, the notional rent, the associated expenses, a property description, and the risks associated with the investment. The deed allows investors to receive a fixed income from the service fee paid by the property owner. As this notional rent is disclosed in the supplementary PDS, investors are not subject to vacancy risk, and because the amounts are fixed in advance, there is certainty of yield. Generally, the base service fee rate is 5.4% of the payout amount, while 4% of the service fee goes to paying investors a notional rent.

The fixed fee is paid through releasing additional interest in the property, usually every five years, to the DomaCom fund. This allows existing unit holders to increase their holdings in the sub-fund. If the property owner's interests in the underlying property are extinguished over time, the Equity Release Administrator (ERA) has to pay rent to the investors until the deed is terminated. This payment is made from the longevity reserve that is built up over the time of the investment.

The underlying asset in this case is still held in the name of the property owner; however, as a co-owner of the property, investors will share certain expenses with the owner – such as property maintenance and insurance costs – in proportion to their share of the property; this will be deducted from investor returns.

If a property is valued at A$400,000 at the time of acquisition and the property owner wants to release 25% equity in the property, the payout to the property owner will be as follows:

Equity Released Amount = amount purchased by investors = $137,000
Payout Amount = Amount paid to property owner = A$400,000 x 0.25 = $100,000
Service Fee Reserve = Equity Release Amount – Payout Amount = $137,000 - $100,000 = $37,000
Service Fee = Equity Release Amount x Service Fee Rate = A$137,000 x 5.4% = $7,400
Notional Rent Paid to Investors = Equity Release Amount x Notional Rent Rate = A$137,000 x 4.0% = $5,480

At the time of settlement, the sub-fund pays A$100,000 to the property owner in lieu of 25% equity in the property. A further $37,000 is kept for the owner in the Service Fee Reserve to pay the $7,400 annual service fees for the 5 years; out of this, A$5,480 is paid to investors as notional rent with the balance being used to pay fund and property management fees and costs.

DCL Advantage

DCL has developed a unique trading platform through which investors can buy and sell units in the various sub-funds (individual properties). 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, the unique proposition of this trading platform is enhanced liquidity and a higher attraction for property investors.

Facilitates secondary trading in property investments

First-mover advantage

While the Australian property investment market has attracted many financial service providers, DCL is the first company in Australia to introduce crowdfunding to this asset class. 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 related to DCL's products, we expect any potential competitor will need at least two years to develop a similar offering.

Moreover, DCL has a substantial head start in obtaining regulatory approval for its trading platform, which will likely result in it being a market maker. Currently, it takes three to four years for a company to obtain this approval, which places DCL way ahead of any potential peers.

Head start of 2–4 years on any potential competitor

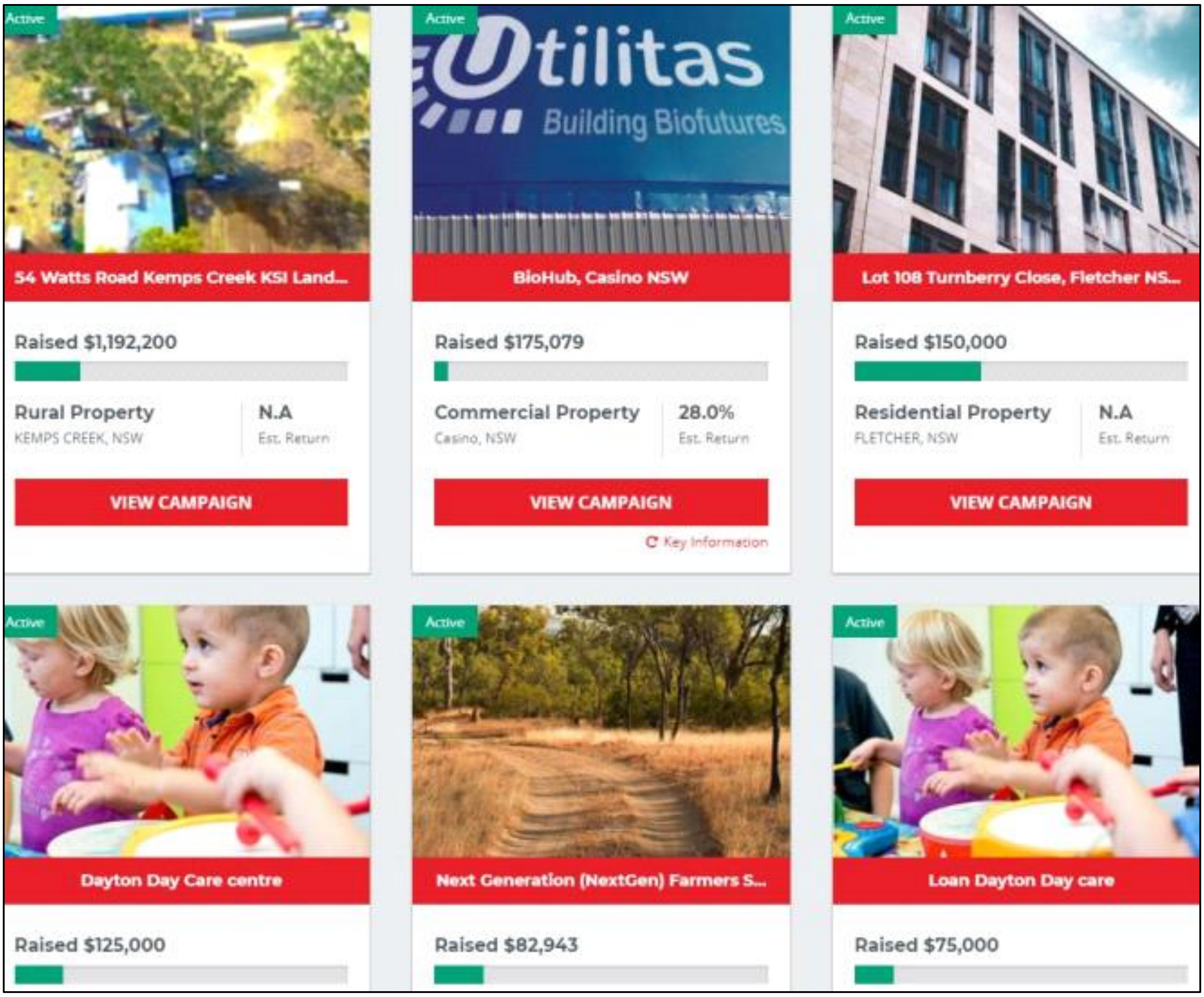
Investing Platform: DCL's unique proposition

DCL has acquired an Australian Financial Services License that authorizes it to create a market for its sub-funds. The platform (Figure 8) is provided by DCL and uses an online technology solution. Apart from making the process of fractional investing transparent, it provides a secondary market for such investments.

The unit holders in the sub-funds can trade their units on DCL's platform. DCL acts as a principal buyer and seller of these units by buying from unit holders who want to sell and then selling to investors who want to buy. This means a prospective investor is likely to benefit from liquidity in an asset (real estate) that is mainly illiquid. The platform provides better control to investors. DCL buys units when it finds a corresponding buyer in the market; hence, the trade is contingent on liquidity provided by investors.

The platform also allows investors to trade in a range of assets that are not available to retail clients because these assets are high-ticket purchases. Investors can access detailed information online about any property, e.g. its condition, age, and type, as well as the location of the underlying property. Such clarity and ease of access improves transparency.

Figure 8: DCL's Fractional Investing platform



Source: Company

Generating revenue from funds management

Traditional funds management revenue model

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 (over gross property value).

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.

DomaCom Fund: Facilitating Fractional Investing and Equity Release

DCL operates through a registered investment scheme, DomaCom Fund, which allows investors to purchase a fractional interest in an underlying asset. Through this fund, DCL provides a structured investment vehicle that is a combination of a managed fund and a crowdfunding process. This fund facilitates the purchase of an asset on behalf of all the investors.

DomaCom Fund is a managed investment scheme structure that provides the benefits of scalability and liquidity

An investor can invest in the following asset classes:

1. Real estate (commercial, retail, rural, industrial, etc.);
2. Loans secured against a mortgage with a 60% Loan-To-Value (LTV) ratio; and
3. Other special opportunities where the underlying asset is a debt or equity security.

How the process of investing through crowdfunding works

DCL follows a systematic process for fractional investing that is easy, efficient and transparent:

Step 1: Once an investor's funds are cleared, an investor can participate in a campaign (process of raising capital) of choice.

Step 2: When a campaign receives enough responses, DCL purchases the underlying asset on behalf of the investors. It results in the creation of a sub-fund, wherein investors are allotted units according to the ratio of their investments to the total capital raised. As an investor in the sub-fund, one is entitled to the fractional share of the net income too, in case the underlying asset earns an income. When the asset is sold off, proceeds from the sale are also distributed in the same proportion to unit holders.

Before purchasing any property, DCL subjects the property to an independent pre-purchase valuation

Step 3: Once the property is purchased, DCL appoints a licensed real estate agent as a property manager. The manager is responsible for procuring tenants, collecting rent, managing lease expiries, etc. A predetermined amount can be spent by property managers on repair and maintenance of the property. If the manager wants to exceed this amount for any reason, he/she needs to get DCL's approval.

Step 4: Investments in the sub-fund can only be cashed out when it is terminated. The duration of a sub-fund varies and depends on a host of factors, primarily on the underlying asset. The investor is made well aware of the term of the sub-fund, which is specified in the campaign.

The underlying assets are held by a sub-fund. To invest in a sub-fund, a user needs to create an account in the cash pool with DCL. The cash pool serves to indicate commitment from the investor and assures the trustee of the same. The cash pool is held by the custodian who is nominated by the trustee. Currently, ANZ is the trustee for DCL, and this will be reviewed periodically.

Illiquidity of the sub-fund is a limitation. However, this is expected to be mitigated by DCL, which has the license to make a market for these funds. DCL is expected to allow unit holders to trade their units in a sub-fund. It will buy and sell units from time to time. Currently, it does not have any obligation to do so.

Adding debt to funding mix will be a game changer for DCL

LTV is likely to be capped at 30–40% as the property is required to be positively geared

In order to introduce leverage to its property investments, DCL has arranged a residential property debt facility with La Trobe Financial to be used in conjunction with equity. Investors will be able to invest in properties with a co-investment from this debt provider, thereby creating leverage for equity investors.

As in the case of the purchase of any other asset, adding debt increases the magnitude of gains as well as losses. If the property increases in value, investors' gains are amplified; if the property decreases in value, losses are amplified too.

For example, a property is valued at A$600,000 at the time of acquisition and an interest-only loan of A$200,000 is used to fund this acquisition. If after a year, the property is valued at $650,000, the value of equity will increase by: Increase in Equity (%) = Gain in Equity / Initial Investment = A$50,000/A$400,000 = 12.5%

Similarly, if at the end of the year the property is valued at A$550,000, it will result in a loss of 12.5%. Had the entire amount been funded by equity, the corresponding profit and loss would have been 8.33%.

We believe that adding debt to the funding mix will be a game changer for DCL, given that this mixed financing structure resembles the traditional way to invest in property, i.e. through a combination of debt and equity. Consequently, we expect that financial advisors will be in a much better position to advise on fractional investing to their clients once debt is introduced.

Future of Financial Advice (FOFA)

DomaCom complies with regulations on responsible investing

The government's 2012 introduction of the FOFA legislation greatly transformed the financial planning industry while acting as a driving force for DCL. Under the new legislation, financial advisors are allowed to charge their clients a fee but cannot receive any compensation from product providers; consequently, advisors need to have a strong value proposition to interest clients in investing. Furthermore, in Australia, financial advisors are prohibited from advising on real estate, which deprives clients of the benefits of capital gains the industry has to offer.

Fractional investing converts property into a financial product, allowing financial advisors to expand their portfolios to include real estate in their suite of offerings, which in turn supports DCL's further growth.

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

DCL deploys multiple go-to-market channels

DCL has been channelling all its resources into developing a robust, multilayer approach to reach its target audience. Currently, it leverages three major partners:

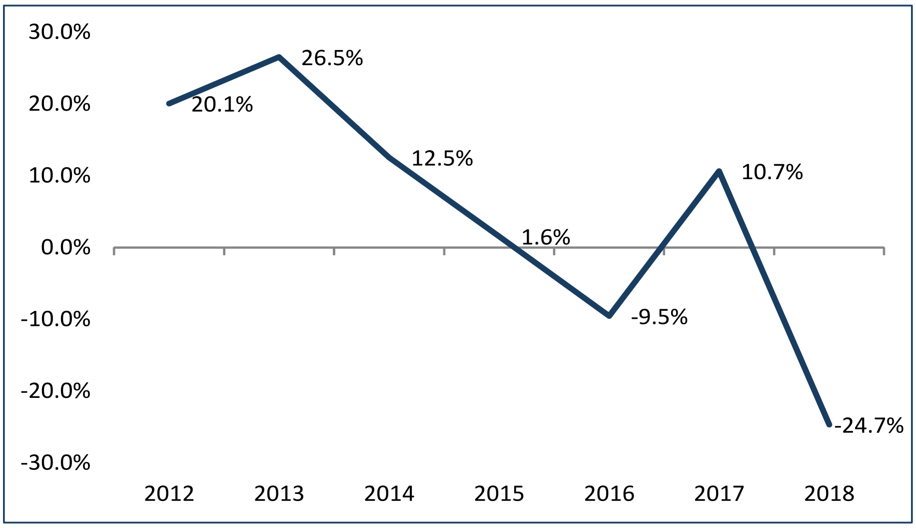
1. **Financial Advisors:** As DCL's product offerings are compliant with the FOFA norms introduced by the government, as of November 2018, the company has been able to present its fractional investment offering to the approved list of 44 Independent Financial Advisors (IFAs), representing a fleet of 1200 advisors.

   CEO, Arthur Naoumidis, has leveraged the client relationships he formed while serving as the CEO of Praemium to further expand DCL's network of financial advisors. Naoumidis founded Praemium (ASX:PPS) in 2001 in order to introduce IT solutions to the investment administration industry. He grew the business to serve a portfolio of 500 client firms, including financial planners, stockbrokers, and SMSF administrators.

2. **Affinity Groups:** DCL partners with developers and other project sponsors who need capital to fund ongoing projects or are looking for a regulated vehicle to hold the investment. The current liquidity crunch in the property investment sector in Australia, brought on by stricter lending standards employed by the Australian Prudential Regulation Authority (APRA) for investment housing loans, has resulted in property developers witnessing a slowdown in sales (Figure 9). Notably, even with the current substantial 24.7% YoY decrease in the total dwelling units approved, the housing boom witnessed by the country in the past few years has left developers with a sizable inventory (Figure 9). As per the 2017 study conducted by the Australian National University[1], the country had a cumulative oversupply of 164,000 dwellings as of August 2017 (with a 2011 base year). Partnering with DCL ensures property developers enjoy the benefit of marketing property to a wider audience right from the construction stage of a development. DomaCom gets investors to invest fractionally in the development project, thus providing the much-needed capital.

3. **Intermediaries:** DCL intends to partner with various institutions, i.e. banks and other financial intermediaries, in order to leverage its distribution and network reach to gain further market share for retail investors who have limited resources but who are looking to invest in property. For example, DCL has an exclusive distribution agreement with Prodigy Network to expose Australian investors to New York City projects. Prodigy Network, founded in 2003, invests in multi-family, office, retail and hospitality projects.

Figure 9: Total Historical Dwelling Approvals



Source: Australian Bureau of Statistics

Big Four bank trial may result in white-label deal

In February 2019, DCL announced the start of a 6-month pilot project with one of the Big Four banks in Australia to trial DCL's Fractional Investing platform within the bank. Through this program, DCL expects to utilise the bank's dealer network to gain traction with retail investors looking for both opportunities in real estate as well as debt-style investment options.

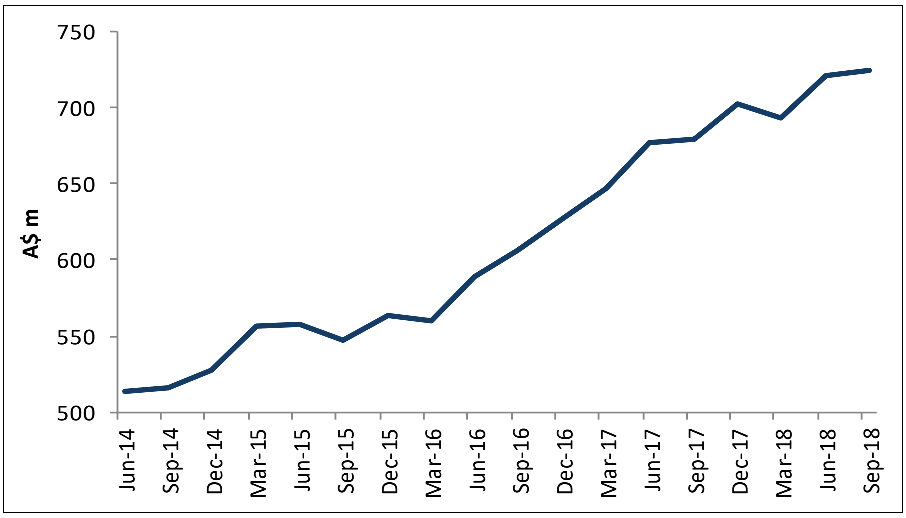
"Intel Inside" model with bank could present a major revenue opportunity

If successful, this trial could lead to the bank rolling out DCL's platform 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 the bank in what is expected to 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 platform.

The Opportunity: SMSF investments in property

Assets managed by SMSFs in Australia grew 6.7% YoY to A$724.7bn as of September 2018 (Figure 10). SMSFs have largely remained bereft of the benefits of real estate investments, primarily due to the aggravations associated with setting up a Limited Recourse Borrowing Arrangement (LRBA), coupled with the current restrictions on lending.

Figure 10: SMSF asset allocation as of September 2018



Source: Australian Taxation office, Pitt Street Research

In the last 25 years, the Australian residential property sector has spiked by 412%; however, due to the inability of the SMSFs to enter into leveraged property transactions, this segment of investors has not been able to benefit from the growth in real estate (Figure 11).

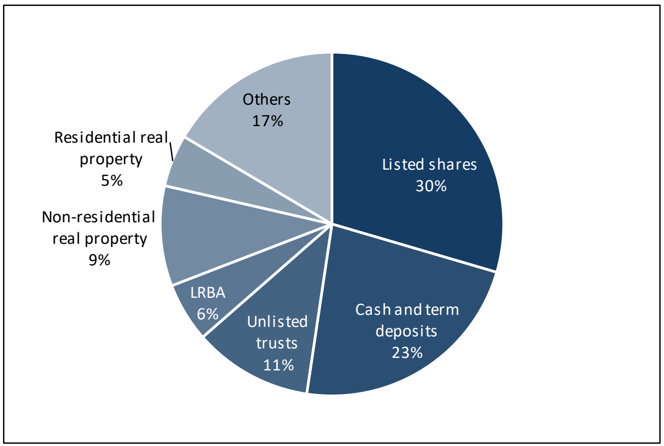
Court ruling enables inter-generational wealth management

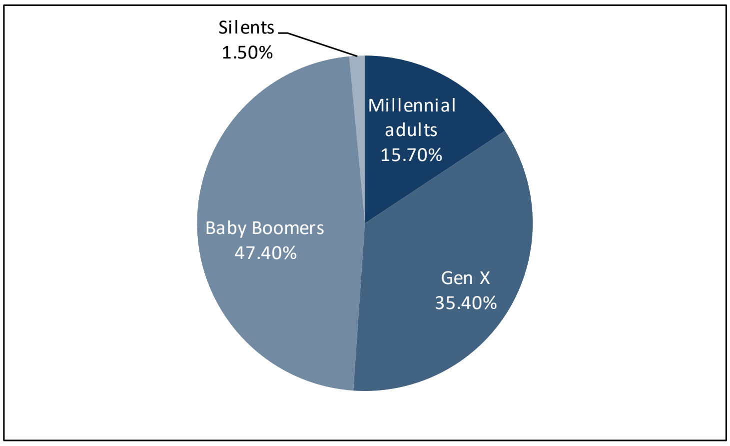
Furthermore, following a Full Federal Court ruling in August 2018, SMSFs are now allowed to invest in DCL's sub-funds up to 50% when the tenant of the underlying asset is a related party (i.e. a family member). This ruling, which did not receive any further appeal from the Australian Tax Office (ATO) 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-time home owners

In addition to the very substantial market for SMSF investments, fractional investing can be an ideal way for first-time 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 by co-investing (Figure 11).

Figure 11: SMSF asset allocation per September 2018 and SMSFs' Member Age Demographic





Source: Australian Taxation office, Pitt Street Research

Baby boomers looking to convert equity to 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 that want cash without wanting to downsize present a very substantial opportunity for DCL.

Targeting 1% of the > A$700bn SMSF funds under management

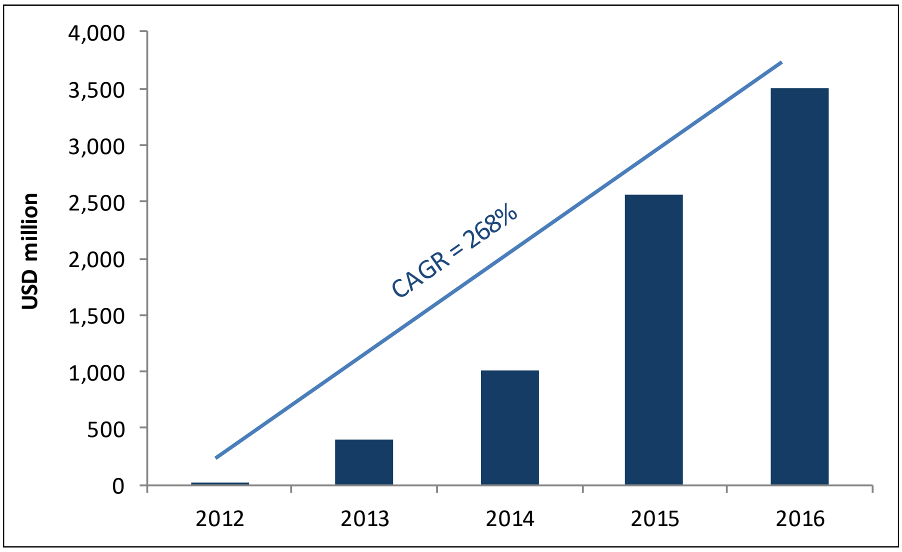
The overall share of property within SMSFs' assets is 20% (non-residential real property; residential real property; and through Limited Recourse Borrowing Arrangements (LRBA) combined) or approximately A$14.5bn. The long-term goal for DCL is to get 1% of the Australian SMSFs' FuM on its books, i.e. 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 (which is expected to start generating FuM in May 2019) and without having been able to introduce debt into the fractional investment product as yet, the company has generated A$44m in FuM with a further A$20m in the pipeline.

With residential property debt facility from La Trobe in place (debt funding), we expect a robust uptick in FuM going forward, driven by strong appetite from financial advisors 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.

Comparable Products

The global real estate industry is one the fastest-growing global crowdfunding industries. Even though it is in the nascent stage, the growth rate has been extremely high – transaction value has increased ~200x between 2012 and 2016 (Figure 12).

Figure 12: Global real estate crowdfunding market size



Source: CrowdfundUP, Pitt Street Research

North America leads in the number of transactions with ~55% market share, followed by Europe at ~42%. There are over 100 property crowdfunding platforms in the US and the UK, such as RealtyMogul, Fundrise, Property Partner, Property Crowd, The House Crowd, and Property Moose. Even in France, where the real estate crowdfunding industry is just finding its feet, the transaction volume increased 53% to reach €68m in 2016.

In Australia, there are few property-investing platforms in the marketplace that compete with DCL's platform. Even though they are based on the concept of fractional ownership, none of them is as operationally competent as DCL, in our view. BrickX, Homesafe and CoVESTA are some of the platforms.

1. **BrickX** uses experts in the property market to search for properties with prospects of good returns. It then purchases these properties and divides them into 10,000 equal shares called Bricks. Investors can then buy and sell these bricks on the BrickX platform. Investors get their proportion of monthly rent and on liquidation of the property, receive their share of capital gains. BrickX charges a 1.75% transaction fee to buy and sell bricks online. BrickX mainly targets direct retail investors while DCL channels both retail investors as well as financial planners. BrickX does not allow investors to choose a property outside its catalogue, while DCL permits investors to choose any property.

If this property gets the requisite funding, DCL purchases it subject to completing successful due diligence on the property. DCL also provides fractional investing in debt while BrickX does not. DomaCom also has a license for Equity Release, which primarily targets senior citizens.

2. **Homesafe** also offers a wealth release product, somewhat like DCL's Equity Release product. In this product, a property owner sells a share of the future sale value of a home to Homesafe for an upfront lump sum. The amount of cash received is determined by the future share of the property Homesafe will be entitled to. The cash received is less than the face value of the share sold as the property owner receives valuable entitlements. Unlike DCL's product, valuable entitlements like rent, etc. are factored into the equity that is sold to Homesafe. Unlike DCL, Homesafe does not receive any notional rent. Homesafe's only entitlement is its share once the property is liquidated. Also, unlike Homesafe DCL investors get a chance to increase their stake in the property at a later stage.
3. **Household Capital** is a recently established specialist retirement funding provider that provides long term access to home equity. Using this home equity as collateral, retirees can get a home loan, which can be used to top up their Super fund, refinance an existing mortgage, provide aged care or for lifestyle choices. Retirees don't actually sell part of their home, as is the case with DCL's Equity Release solution. So there will remain a loan repayment obligation on the part of the retiree.

Going Global

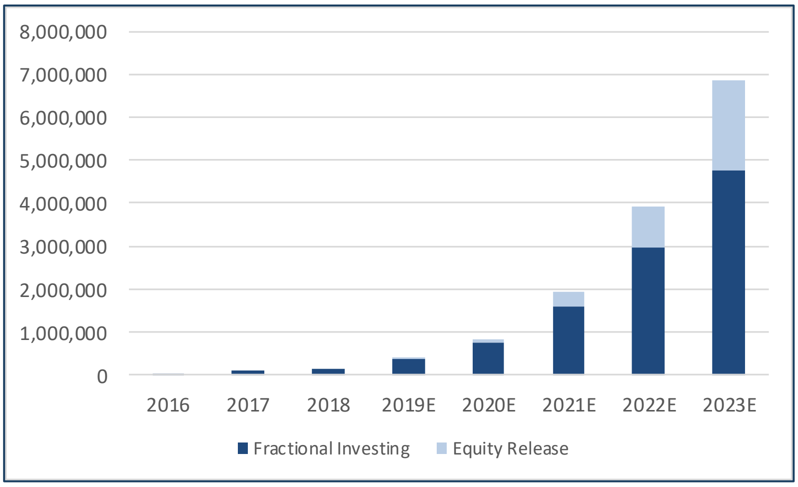
DCL is currently looking to prove that its business model is scalable by capturing a significant share in the Australian market. It intends to then venture out into related international markets that have well defined regulations for real estate crowdfunding operations, i.e. Europe, North America, Japan and Singapore. It plans to collaborate with existing players in those markets and licence them for its property product rather than exposing itself to unknown market dynamics. Success in the Australian market will make it relatively easier for DCL to attract partners in international geographies.

Financial Performance — DCL growth will be driven by expansion of Funds under Management

Recurring revenue – A key factor

DCL has a recurring income stream through its distinctive property crowdfunding platform. Its revenue is determined by the gross Funds under Management (FuM). To accelerate growth and scale-up operations, DCL has been consistently adding new features to its offerings. Consequently, it has been pushing to add leverage to the campaign, giving it the impetus to expand its balance sheet and take initiative toward incremental property purchases. Similarly, DCL has achieved all the necessary regulatory approvals for the Equity Release product. These are expected to support DCL in expanding FuM by a Compound Annual Growth Rate (CAGR) of 89% over FY2018-2023E in our base case and consequently grow the revenue base by a CAGR of more than 100% over the same period (Figure 13).

Figure 13: Revenue distribution through FY2023E



Source: Pitt Street Research

Considering the imminent launch of the Equity Release product, we expect it to have incremental traction in the next couple of years. As investors become educated about the new product, including its features and benefits, the FuM will expand exponentially. Consequently, in our model the Equity Release segment will make a substantial contribution to the consolidated revenue by FY 2023E (Figure 14).

Figure 14: Consolidated revenue break-up

Revenue Contribution (%)	2017	2018	2019E	2020E	2021E	2022E	2023E
Fractional Investing	100.0%	100.0%	96.4%	90.7%	81.9%	75.1%	69.4%
Equity Release	0.0%	0.0%	3.6%	9.3%	18.1%	24.9%	30.6%

Source: Pitt Street Research

Breakeven will take some time

DCL posted a loss of A$6.1m and A$5.7m in FY17 and FY18 respectively. Leverage introduction is expected to support more campaign and property purchases, resulting in FuM growth. We expect revenues from the Fractional Investing segment will increase at a CAGR of 101% over FY2018-2023E (Figure 15).

Figure 15: Fractional Investing revenue growth

Revenue Model (AUD, Year end June)	2016	2017	2018	2019E	2020E	2021E	2022E	2023E
Fractional Investing								
Revenue	20,642	93,045	142,981	374,000	748,000	1,584,000	2,956,800	4,752,000
% of FuM	*0.41%*	*0.41%*	*0.41%*	*0.88%*	*0.88%*	*0.88%*	*0.88%*	*0.88%*
Y-o-Y growth		*350.8%*	*53.7%*	*161.6%*	*100.0%*	*111.8%*	*86.7%*	*60.7%*
FuM (AUD million)	5	23	35	50	120	240	432	648
Y-o-Y growth		*350.8%*	*53.7%*	*42.9%*	*140.0%*	*100.0%*	*80.0%*	*50.0%*
Average FuM		14	29	43	85	180	336	540

Source: Pitt Street Research

In our conservative base case scenario, revenues from the Equity Release segment are expected to still grow strongly over FY2018-2023E (Figure 16).

Figure 16: Equity Release revenue growth

Revenue Model (AUD, Year end June)	2019E	2020E	2021E	2022E	2023E
Equity Release					
Revenue	14,000	77,000	350,000	980,000	2,100,000
% of FuM	*1.4%*	*1.4%*	*1.4%*	*1.4%*	*1.4%*
Y-o-Y growth	*NA*	*450.0%*	*354.5%*	*180.0%*	*114.3%*
FuM (AUD million)	1	10	40	100	200
Y-o-Y growth		*900.0%*	*300.0%*	*150.0%*	*100.0%*
Average FuM	1	6	25	70	150

Source: Pitt Street Research

Liquidity crunch

Consecutive years of losses (since inception) have resulted in depleted financial resources for DCL. Considering that operations are in their nascent stage, management has to create additional reserves for marketing expenses in order to educate investors and promote the platform. Given that the company will not be able to generate enough cash flow to fund growth through internal accruals, equity dilution will become necessary. We have modelled a systematic equity dilution over the next three years along with an uptick in total debt.

Figure 17: Balance Sheet Ratios

Balance Sheet Ratios (%)	2017	2018	2019E	2020E	2021E	2022E	2023E
Total Cash / Total Assets	40.8%	20.4%	53.4%	70.4%	76.0%	80.9%	89.2%
Total Liabilities / Total Assets	11.4%	63.9%	89.1%	68.3%	29.2%	30.4%	24.3%

Source: Pitt Street Research

Valuation

Considering that DCL is one of the only listed companies present in the niche crowdfunding property space, the underlying value of the business lies in its ability to scale up business operations. Hence, the true value of its business can best be gauged from a Discounted Cash Flow (DCF) calculation over a long-term period. We have also refrained from using relative valuation, given the limited relevant public peers and the fact that most of them are making a loss operationally.

Some investors might make the mistake of comparing DCL with real estate fund management companies, but DCL deserves premium valuation over them as it offers a unique combination of fund management and a Software as a Service (SaaS) platform.

Our DCF model yields a 9.8% Weighted Average Cost of Capital (WACC) for DCL (with a 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 18). Our bull case calculation results in a valuation of A$0.46 (Appendix). This implies a substantial upside from the current share price.

Figure 18: Base Case value using DCF

DCF start date	30/Jun/19
Valuation date	15/Apr/19
Risk free rate of Return (Rf)	2.7%
Equity premium (Rp)	7.7%
Beta	1.10
Cost of Equity	11.1%
Weight of Equity	82.0%
Cost of debt	5.0%
Tax rate	27.5%
After tax cost of debt	3.6%
Weight of Debt	18.0%
WACC	9.73%
Terminal Growth rate	2.0%

Valuation (AUD)	
Present value of FCF	311,654
Present value of Terminal FCF	53,575,145
Enterprise Value	**53,886,799**
Net debt (cash)	(1,109,203)
Minority interest	-
Employee entitlements	294,586
Equity value (AUD)	54,701,416
Share outstanding (for 2019, '000)	155,000
Implied price (AUD cents)	35.3
Adjusted Current price (AUD cents)	11.5
Upside (%)	206.9%

Source: Pitt Street Research

Even though there is execution risk associated with DCL's strategy, as the company matures and approaches EBITDA breakeven (by FY2022E), there will be room for lower discount rates, which will translate into higher share price values (Figure 19).

Figure 19: DCF using various WACCs

Sensitivity Analysis									
WACC	9.8%								
Terminal Growth Rate	2.00%	Change in WACC							
Implied Price (AUD cents)	35.0	*9.0%*	*9.3%*	*9.5%*	*9.77%*	*10.0%*	*10.3%*	*10.5%*	*10.8%*
	1.25%	37.3	35.3	33.5	31.7	30.1	28.6	27.2	25.8
	1.50%	38.6	36.5	34.6	32.8	31.1	29.5	28.0	26.6
	1.75%	40.0	37.8	35.7	33.8	32.1	30.4	28.9	27.4
Change in Terminal Growth Rate	*2.00%*	41.5	39.1	37.0	**35.0**	33.1	31.4	29.8	28.2
	2.25%	43.1	40.6	38.3	36.2	34.3	32.4	30.7	29.1
	2.50%	44.8	42.2	39.8	37.5	35.5	33.5	31.7	30.1
	2.75%	46.6	43.8	41.3	38.9	36.7	34.7	32.8	31.1

Source: Pitt Street Research

Please see figure 21 in Appendix for DCL's valuation in our Bull case scenario.

Re-rating DomaCom Limited

DCL's stock is currently trading below our base case valuation. We have outlined a number of factors that may result in a re-rating of DCL going forward:

– DCL has approval for Equity Release, which provides it with a competitive edge as there are regulatory hurdles in obtaining this approval. Clients and financial advisors have a latent demand for this product as it can be used for inter-generational wealth planning.

– The availability of leverage for property purchases will make DCL's products more lucrative to financial planners as internal leverage will make the investment tax efficient. Property purchases prior to March 2018 were made without any debt.

– Banks have withdrawn lending to self-managed superfunds. This will make it difficult to purchase property and give a boost to fractional investing. DCL is a viable option for SMSFs looking to leverage property transactions.

– Labor winning and delivering on their promise to ban SMSFs from borrowing. This will position DCL as one of the few, if not only, ways for SMSFs to invest in direct property.

Further, DCL has an experienced management team (Figure 20) capable of steering the company through to the growth stage. Grahame Evans, the chairman, has over 30 years of experience in financial services. CEO Arthur Naoumidis has over 20 years of experience in consulting and has worked in financial services for several years. Ross Laidlaw, COO, has over 25 years of experience in financial services operations.

Figure 20: DCL's Proficient Management Team

	Name and Designation	Profile
	Grahame D Evans **Chairman**	• Grahame Evans has worked in the field of financial services for over 30 years. • He has held several executive roles, including CEO of Investments for Tower Australia, Managing Director, and AMP Consulting and Group Managing Director of Centrepoint Wealth.
	Arthur Naoumidis **Director & CEO**	• Arthur Naoumidis has 20 years' experience in IT consulting. He spent five years at JB Were and BNP Paribas building and operating investment administration systems and businesses. • The founder of Praemium, he grew it to a business administering A$43bn. He launched Australia's first online Separately Managed Account (SMA) platform in partnership with Blackrock Australia.
	Ross A Laidlaw **Executive Director & COO**	• Ross has been a director since February 2015; he manages DomaCom's operations. He is a qualified CA and Fellow of the Financial Services Institute of Australasia. • Ross has over 25 years of experience in financial services, and his strength lies in growing start-ups or green field developments and nurturing them into fully fledged and profitable businesses.

Source: Company, Pitt Street Research

Risks

We see three main risks related to DCL's investment thesis:

1) Liquidity risk: DCL has been in a loss for FY17 and FY18 and the company will require funds to maintain daily operations. Raising funds on favourable terms (both debt and equity) will be key for DCL.
2) Slow increase in FuM: Increase in FuM has been below investor expectations. The company needs 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 delay in FuM growth will make it difficult for DCL to break even.
3) Cyclical risk: In the past two to three years, the commercial property market across Australian cities has witnessed an uptick. Any downturn in property prices can dampen investor sentiments and result in a lower-than-expected increase in FuM.

Conclusion: Growth opportunities abound

DCL has a scalable business operation, an experienced management team, and a latent demand for its products. It has received approval for Equity Release and in H2 2019, this product will start adding to the company's top line. DCL sells its products directly to end customers, as well as through financial intermediaries, while its competitors mainly sell directly to end customers. Rising demand for its products, increasing FuM, and better operational efficiencies are expected to contribute to a potential re-rating of the stock. Based on our base and bull case DCF calculation, we have set a fair value range of A$0.35–0.46.

SWOT Analysis

Strengths:

- It has a good distribution network with financial advisors. Around 1,200 advisors advise on DCL products to their clients. Competitors are largely restricted to selling directly to customers.
- The Fractional Investing Platform, which allows investors to buy and sell property just like stocks, brings liquidity to an otherwise illiquid market.
- DCL has already obtained approval from ASIC for the Equity Release product. There are regulatory hurdles and competitors would take up to three to four years to obtain the same licence.
- CEO Arthur Naoumidis has ~30 years of experience in IT and finance. He previously founded Praemium and grew it to over 500 clients.

Weaknesses:

- The company is currently facing an operating loss due to less than satisfactory growth in FuM and will need additional capital (at favorable rates) to fund its growth.

Opportunities:

- There is a latent demand for fractional investing that allows small investors to gain exposure to property, which otherwise is a high-ticket purchase. Financial advisors can better allocate their clients' portfolios with meaningful exposure to debt, equity, and property.
- Equity Release will provide senior citizens with better alternatives to reverse mortgages and downsizing. The product will interest investors as well as it does not suffer from the uncertain residual value problem like reverse mortgages.

Threats:

- A possible property market meltdown could dampen investor sentiments and put a brake on increase in funds under management.
- There is a plethora of other fractional investing players in the market. Investors may prefer competing products which will have an adverse impact on DomaCom.

Appendix

1. What is a Campaign?

It is the process of raising capital for the purpose of fractional investing. An investor can indicate preference for investing by placing a bid for the underlying asset through the Fractional Investing Platform. If a campaign receives the requisite number of investors, then DCL seeks to purchase the asset or make the loan. When the asset is purchased, a sub-fund is created and the investor is issued units in proportion to the total funds raised.

2. How are sub-funds segregated?

The investment performance of a sub-fund depends on the performance of the underlying asset of that sub-fund alone, and it is not impacted by the performance of other sub-funds. It means the net income or the proceeds from the sale of assets of a sub-fund will not be used to offset the losses or settle the liabilities of another sub-fund. Investors in a sub-fund will receive the net income of a sub-fund and sales proceeds on termination of the sub-fund in proportion to their investment.

3. Finer details of adding debt to the fund

a) The responsibility to comply with the gearing policy lies with the trustee. The gearing policy does not allow capitalizing interest expenses and all loans to a sub-fund have limited recourse to the underlying asset of that sub-fund. The purpose of a non-recourse debt is to shield the performance of one sub-fund from another. If an asset fails to fulfil its debt obligations, it cannot be compensated for by other sub-funds. The trustee ensures that the interest cover of a credit facility is compliant with the norms at the time of entry. The minimum interest cover ratio at an individual credit facility level, and at a sub-fund level, is 1x income, including cash reserves.

b) Once the target of the crowdfunding campaign is achieved, DCL takes that property offer to the lender, asking them to fund the remaining amount of the property (LVR of 50%). Once the lender agrees, the sub-fund for that property is put on the exchange, the money that the retail investors have provided through crowdfunding is redeemed, and the investors are assigned units in the sub-fund in return.

4. Bull Case valuation

Figure 21: Bull case value using DCF

Next FY End	30/Jun/19
Valuation date	15/Apr/19
Risk free rate of Return (Rf)	2.7%
Equity premium (Rp)	7.7%
Beta	1.10
Cost of Equity	11.1%
Weight of Equity	82.0%
Cost of debt	5.0%
Tax rate	27.5%
After tax cost of debt	3.6%
Weight of Debt	18.0%
WACC	9.73%
Terminal Growth rate	2.0%

Valuation (AUD)	
Present value of FCF	2,972,537
Present value of Terminal FCF	68,050,090
Enterprise Value	**71,022,627**
Net debt (cash)	(1,109,203)
Minority interest	-
Provisions	294,586
Equity value (AUD)	71,837,245
Share outstanding (for 2019, '000)	155,000
Implied price (AUD cents)	46.3
Adjusted Current price (AUD cents)	11.5
Upside (%)	303.0%

Source: Pitt Street Research

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