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CAPITAL

2020

The Agency Group Australia Ltd

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THE AGENCY GROUP AUSTRALIA LTD

A DISRUPTOR POISED FOR GROWTH

The Agency Group Australia Limited (The Agency) is a disruptor in the Australian real estate industry. It has, in a short space of time, built a nationwide platform which runs lower fixed costs than its peers, pays higher splits to agents and gives the agent autonomy to run the operating model that works for them. The key milestone for The Agency was reaching breakeven and driving economies of scale. This was critical in terms of both not being reliant upon external capital, but also having the creditability to attract more high-end agents. We believe that now this is behind The Agency it is best placed in the sector to drive growth and benefit as conditions improve post the Coronavirus lockdown.

KEY DRIVERS FOR THE AGENCY

- **Building out the platform**. Property Sales and Property Management are the two key profit drivers for The Agency and both dependent upon agent growth. The Agency offers the most flexibility for agents to work how they want to work. With focus on costs and agents looking to maximise revenue across the value chain, The Agency provides the best alternative for each agent to concentrate on their own business.
- **Disrupt and consolidate**. The Agency is a disruptor. The huge changes we will see with regard to operating models post the Coronavirus lockdown will see agents migrate to low overhead, cloud based operating platforms. Smaller players will not survive. The Agency is uniquely placed to capitalise on its model and generate considerable gains from consolidating the market as business models change.
- **What does post Coronavirus real estate look like**. Real Estate is a cyclical business. When we see large moves in prices due to a dislocation such as the current market, any short-term bumps will generally be followed by a rush of activity. Assuming there is no further outbreak in Australia, once the market digests the financial stress from the economic lockdown The Agency should see tailwinds for a number of years.

VALUATION IS COMPELLING

- The Agency has built a nationwide integrated real estate company. It has undertaken some complex acquisitions, raised capital and simplified its own capital structure in the last six months – ensuring that it has the financial strength to trade through a market slowdown. We see its valuation trajectory as significant and based on conservative forecast numbers and given material tailwinds as markets normalise post Coronavirus see the share price reaching 7.1cps over the next 12 months, which is 1.75x the current share price (4.0cps). We calculate a valuation range of between 6.2cps and at the upper end 10 cps.
- From there we see a clear pathway to 12cps in FY22 and 25cps in FY23 – The Agency is a pure growth company extraordinarily well placed to capture high growth in both property sales and property management in a post Coronavirus recovery.

INVESTMENT VIEW

The Agency is a growth company that should appeal to investors that understand property markets, and have a risk appetite to invest in a diverse portfolio of real estate assets at a cyclical low.

Management are highly regarded with a depth of experience across Residential Sales, Projects, Property Management, Mortgages and Conveyancing with a cloud-based platform giving agents the flexibility to work out of an office or on the road. The Agency has dual brands (*The Agency* and *SLP*) which gives agents an option to work with a cost structure that suits their business. This disruptive model should see higher adoption rates as the focus moves to flexible working and higher commission splits.

The stock is attractively priced and significantly undervalued. Catalysts to a re-rating include; faster than expected agent acquisition, the ability to consolidate smaller property management portfolios as smaller players drop out of the market, expense management ensuring that The Agency is the lowest cost operator in the market and finally demonstrating that the model can build on its fixed cost base and drive material profit growth.

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The Agency Australia Ltd

AU1.ASX

Profit & Loss

	FY18	FY19	FY20	FY21	FY22	FY23
A $m	**(A)**	**(A)**	**(F)**	**(F)**	**(F)**	**(F)**
Revenue						
Commissions	10.5	21.2	29.7	31.8	37.8	48.4
Fees	4.1	4.9	5.0	4.8	5.2	5.7
Management Fees	2.1	5.0	8.2	8.2	9.1	10.1
Interest Income	0.0	0.0	0.0	0.0	0.0	0.0
Other Income	0.0	0.2	1.6	1.3	1.3	1.3
Total Revenue	**16.8**	**31.3**	**44.5**	**46.1**	**53.5**	**65.6**
Wages and Salaries	14.6	24.2	30.4	28.4	31.1	34.3
Advertising	0.5	3.5	7.0	6.6	6.3	6.0
Depreciation	0.5	2.3	6.0	5.8	5.6	5.3
Other	5.1	10.7	8.9	7.4	6.5	6.1
Total Expenses	**20.7**	**40.6**	**52.3**	**48.2**	**49.4**	**51.7**
Tax Expense	-0.1	-1.4	-2.3	0.0	0.0	0.0
Net Profit After Tax	**-3.7**	**-7.8**	**-5.5**	**-2.1**	**4.1**	**13.9**
EBIT	**-3.7**	**-8.0**	**-6.2**	**-1.0**	**4.4**	**13.9**
EBITDA	**-3.0**	**-5.6**	**-0.2**	**4.8**	**10.0**	**19.2**

	1H19	2H19	1H20	2H20	1H21	2H21
A $m	**(A)**	**(A)**	**(A)**	**(F)**	**(F)**	**(F)**
Revenue						
Commissions	7.0	14.2	17.5	12.2	14.3	17.5
Fees	2.5	2.4	3.0	2.0	2.3	2.5
Management Fees	0.9	4.1	4.2	4.0	4.0	4.2
Interest Income	0.0	0.0	0.0	0.0	0.0	0.0
Other Income	0.0	0.1	0.9	0.7	0.7	0.7
Total Revenue	**10.5**	**20.8**	**25.6**	**18.8**	**21.3**	**24.8**
Wages and Salaries	9.1	15.0	16.6	13.8	12.9	15.5
Advertising	0.2	3.3	3.6	3.4	3.3	3.3
Depreciation	0.2	2.0	3.0	3.0	2.9	2.9
Other	3.1	7.6	5.0	3.8	3.8	3.6
Total Expenses	**12.6**	**28.0**	**28.2**	**24.0**	**22.9**	**25.3**
Tax Expense	-0.2	-1.3	-0.9	-1.6	-0.5	-0.1
Net Profit After Tax	-2.0	-5.9	-1.7	-3.6	-1.2	-0.3
EBIT	**-1.8**	**-6.2**	**-1.6**	**-4.6**	**-1.0**	**0.1**
EBITDA	**-1.6**	**-4.0**	**1.5**	**-1.6**	**1.9**	**2.9**

Key Metrics

	FY18	FY19	FY20	FY21	FY22	FY23
	(A)	**(A)**	**(F)**	**(F)**	**(F)**	**(F)**
Total Revenue Growth		86%	42%	4%	16%	23%
NPAT Growth		109%	-30%	-61%	-292%	238%
EPS			-0.018	-0.006	0.010	0.033
PE (x)	n/a	n/a	-2.22	-6.65	4.02	1.20
DPS	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Properties Under Management	4,175	4,397	4771	5012	5420	5861

Key Metrics

	1H19	2H19	1H20	2H20	1H21	2H21
	(A)	**(A)**	**(A)**	**(F)**	**(F)**	**(F)**
Total Revenue Growth		99%	23%	-26%	13%	17%
NPAT Growth		200%	-71%	117%	-68%	-73%
EPS			-0.006	-0.012	-0.004	-0.001
PE (x)	n/a	n/a	-7.20	-3.33	-10.30	-44.53
DPS	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Properties Under Management	4,325	4,397	4678	4771	4890	5012

Valuation FY21

Sum of the Parts	**Multiple**	**Low**	**Multiple**	**High**
Rent Roll	3.2x Revenue	26.2	3.5x Revenue	28.7
Mortgage Book	2.1x Revenue	5.1	2.4x Revenue	5.8
Real Estate Agency	6x EBITDA	1.05	1x Revenue	11.5
Less Net Debt		10.4		10.4
Gross Valuation ($m)		22.0		35.6
EFPOWA		356.3		356.3
Valuation Per Share		0.062		0.100

Major Shareholders

Magnolia Equities	52.2	17.5%
Ben Collier	27.1	9.1%
MAK Property	25.7	8.6%
SEMC 2	25.6	8.6%
Daring Investments	24.7	8.3%
Teldar Real Estate Pty Limited	24.3	8.1%
Honan Insurance	7.7	2.6%
Total Shares On Issue	299.0	62.7%

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EXECUTIVE SUMMARY

The Agency began trading on the ASX in December 2016 and at that time it was a modest sized Perth based Real Estate Group. However, it had an integrated model from the get go which provided it with a springboard for national growth.

The Agency operates three divisions:

1. Property Sales - which includes the National Real Estate network of 300 agents under The Agency and SLP brands.

2. Property Management - managing residential and commercial properties on behalf of property owners. The Agency has 4,763 Properties Under Management (PUM) as at 31 March 2020.

3. Ancillary Services which includes Mortgage Financing, Conveyancing and Insurance

These three divisions operate on the Agency's cloud-based platform, and leverage a centralised admin team that manages the entire sale and management process.

Figure 1: Key Financial Metrics

Key Financial Metrics	FY20(F)	FY21(F)	FY22(F)	FY23(F)
Properties Under Management	4771	5012	5420	5861
Gross Commission Income	42.8	47.5	57.3	72.7
Number of Agents	300	368	435	509
EBITDA ($m)	-$0.2	$4.8	$10.0	$19.2
EPS (cps)	-$0.02	-$0.01	$0.01	$0.03

The Agency has now reached the point where it has scale in both its Property Management and Property Sales divisions and is approaching being EBITDA positive. If the impact of the Coronavirus lockdown is not as enduring as we expect then The Agency is already trading EBITDA positive.

The economic lockdown initiated post the outbreak of Coronavirus is seen as a significant negative on the Real Estate industry. The Agency reacted to the lockdown quickly and this has softened any impact that slower economic conditions and a falling property market will have on its underlying earnings.

The Agency's March 2020 quarterly results highlighted that The Agency has been more resilient that expected. Over the March 2020 quarter, PUM increased, The Agency recorded its second highest quarter ever for GCI and there was sound sales momentum into the end of the quarter.

As Australia emerges from the lockdown, in what we expect to be a measured fashion, we believe that The Agency will see a short term slow down which will be shallower than we initially expected and then return to its pre lockdown run rate by 2H21. It should then benefit from material tailwinds out past 2023.

The Agency has seen significant share price falls since it began its integration program and cleaned up its balance sheet.

The share has been weak notwithstanding a materially improving business, a robust platform for growth, material expense savings and success in delivering more new agents to the platform. This underpins The Agency as an attractive proposition for the top tier of Australian residential real estate agents.

Our conservative valuation based on FY2021 numbers is a range of 6.2 cps and 10 cps. From here we see The Agency poised to be a huge beneficiary as market conditions return to normal, as a consolidator in the industry and as an attractive alternative for agents currently operating out of franchised or company owned buisnesses looking to increase their commission splits without material overhead costs.

THE CREATION OF THE AGENCY

The Agency was formed by current Managing Director, Paul Niardone, and started with two business segments - Real Estate and Wealth. The Agency is now the fastest growing nationwide integrated real estate company in Australia.

The Real Estate business kicked off with its core "***Agency***" branded offering, with 30 Agents, integrated with Property Management, mortgages and conveyancing. Given that the Perth real estate market is dominated by private treaty transactions, Agents have a lot more interaction with buyers and sellers pre the consummation of any transaction and they are able to support clients by offering mortgage and conveyancing services in the lead up to a sale.

SLP (SELL LEASE PROPERTY) ACQUISITION - DECEMBER 2017

In December 2017, The Agency acquired Sell Lease Property (SLP). SLP was a subsidiary of ASX listed Company Servtech Global Holdings Ltd (SVT.ASX).

SLP consisted of 50 core Sales Agents based across Australia which generated $8.1m in revenue, a conveyancing business, and a mortgage broking business.

The Agency continues to run SLP as a separate brand which is complementary to the premium Agency branded offering.

SLP Agents have a higher commission structure than the agents that operate under The Agency brand, however, get less in the way of support and pay a higher upfront fee. The platform allows SLP Agents to operate on a cloud-based administration platform that provides support for the Agent across the entire Real Estate transaction.

The plan is to continue to grow the SLP brand going forward. With a focus on overhead fees and the ease by which some agents have been able to transition to working from home, post the economic lockdown this is expected to be of appeal to a number of smaller less profitable agents.

TOP LEVEL REAL ESTATE - FEBRUARY 2018

In early 2018, The Agency acquired "Top Level Real Estate". Top Level was founded by Matt Lahood and a cohort of senior Agents who had operated with a great deal of success in the Sydney real estate market for almost two decades. When acquired, Top Level was already licencing "The Agency" brand across NSW, Vic and Qld and had 90 Agents.

The Agency Group entered into, and exercised, an Amended and Restated Option Agreement to acquire all Top Level shares held by the majority shareholders in Top Level Real Estate Pty Ltd (and offer to acquire all other Top Level shares from those shareholders other than the majority shareholders).

In addition to leading agents in key Sydney locations (the Eastern Suburbs, the inner West from Alexandria out to Lilyfield and the North Shore) The Agency also acquired one of the leading Projects teams with extensive networks in both NSW and Queensland.

Upon acquisition, The Agency took on all the agents, a large rent roll and the debt associated with the business which was used to acquire agents and rent rolls.

The acquisition of Top Level immediately gave The Agency geographic reach and the scale to attract more agents, expand its property management portfolio and build out ancillary services to grow annuity revenue streams adjacent to the core property sales and management businesses.

THE AGENCY TODAY

The Agency has now almost completed the integration of these acquisitions, with annualised cost savings of $2.5m to be fully delivered in FY20. These cost savings do not include the savings from initiatives resulting from the Agency's response to the economic lockdown.

After integrating these businesses, The Agency operates three divisions;

1. Property Sales - which includes the National Real Estate network under The Agency (244 Agents) and SLP (56 Agents) brands.

2. Property Management - managing residential and commercial properties on behalf of property owners.

3. Ancillary Services which includes Mortgage Financing, Conveyancing and Insurance.

These three businesses operate on the Agency's cloud-based platform, and leverage a centralised admin team that manages the entire sale and management process.

The Agency's technology platform is outsourced to third party vendors that are specialists in their fields and interlink with one another. It is a fully "plug and play" system which can be updated for new technology seamlessly. This has significantly reduced the amount of capital The Agency has had to allocate on its technology spend, allowing it to operate capital light. Importantly The Agency has the platform to attract new agents and drive down operating expenses - while offering their agents access to best of breed technology.

The Agency is the only nationwide Real Estate Group that runs dual brands. This will become significantly more important in a post lockdown economy with a focus on operating expenses and being able to operate in a flexible workplace. The differences between the two brands are:

The Agency	**SLP**
Premium brand with 9 physical locations	Value brand with virtual presence
Full-service Agent offering • Progressive commission structure • Opportunity for the agents to participate in the value creation from property management, mortgage broking and other ancillary services	SaaS offering • Progressive commission structure • Opportunity for the agents to participate in the value creation from property management, mortgage broking and other ancillary services • Settlement services
Extensive pipeline of new agents across Australia	Technology platform supports the entire property sales and settlement process

Compared to its peers, we can summarise the differences between the Agency, SLP and traditional players in the table below.

Real Estate Models

	Traditional Franchise			THE AGENCY		SLP		Independent Operations	
	Franchisor	Franchisee	Agent	Head Office	Agent	Head Office	Agent	Principal	Agent
Revenue									
Commission	~10%	~40%	~50%	~25%	~75%	~15%	~85%	~40%	~60%
Property Management	✗	100%	✗	✓	Value Option	✓	Value Option	100%	✗
Mortgage	Upfront + Trail	✗	✗	Upfront + Trail	Trail	Upfront + Trail	Trail	✓	✗
Expenses	– Costs borne by Franchisee			– Costs borne by Head office – Agent has an optional desk fee of $6,000 p.a.		– Costs borne by Head office – Agent has $10,000 p.a. member fee, $250 per transaction fee, and IT platform fee of $720 p.a.		– Costs borne by Agent	
Level of Support									
Brand Support	✓	✓	✓	✓	✓	✓	✓	✗	✗
Overhead Support	✗	✓	✓	✗	✓	✗	✓	✗	✗
Add-on Services	✗	✓	✗	✓	✓	✓	✓	✗	✗
Corporate Benefits	✗	✗	✗	✓	✓	✓	✓	✗	✗

The table above highlights a key difference in the different models being operated in the current environment.

Since the Coronavirus induced economic lockdown, many agents have been forced to work from home. Whilst working from home, agents will still be required to maintain their office infrastructure - admin wages, office rental, paying franchise fees etc.

We believe that the huge economic costs from the lockdown will lead a number of agents to reassess their operating model and searching for alternatives such as The Agency that provide brand and operational support whilst giving the underlying agent a lot more control over their operating cost model.

According to Maven Marketing, there are 11,600 real estate agencies in Australia, and around 120,000 real estate agents. With a focus on cost and revenue splits, there is a huge opportunity for The Agency with dual brands and one of the lowest cost, highest Gross Commission Income (GCI) splits to attract new agents.

The Australian real estate model is dominated by franchised based brand networks. A recent report by IBIS calculated that in the residential property market over 50% of revenue is captured by franchised operators.

There has been a trend over recent years to see smaller franchisees joining larger brands for additional support. This has increased market concentration, however based on most recent statistics, the largest players in the market have less than 10% market share.

Franchise models see significant fee leakage away from the underlying agent to the franchisor with multiple layers of administration and costs. The primary alternative for agents has been to establish their own operations, either stand alone or with peers. These models come with higher risks and high fixed costs for the underlying agent.

Franchise models are slow to move because instigating change and flexibility is not that easy in a franchise model as buy-in from the franchisees is required which may take some time.

The Agency model is a viable alternative to operate under a recognised brand but without the cost outlay and fixed costs of establishing a new practice. The Agency provides the agents with exposure to previously leaked fees, yet they get the same level of support.

In addition to the benefits for selling agents to move to The Agency or SLP brands, we also expect agents with small property management portfolios to exit the market given the high costs of management.

The Agency, with almost 5,000 properties on its books, has the scale and administrative support to take on additional properties with limited fixed costs. Smaller groups with manual processes will almost certainly look to divest the cost of their management books - and partner with Groups such as The Agency that can share some economics.

The Agency noted in its March 2020 quarterly update that it is already seeing small players looking to migrate sub scale property management portfolios on to the Agency's platform.

We are of the very strong view that going forward larger players will consolidate the industry as operational costs are ratcheted lower and scale becomes important. The Agency has placed itself to be a consolidator and a beneficiary as conditions return to normal.

FINANCIAL OVERVIEW

The Agency has now reached the point where it has scale in both its Property Management and Sales divisions and is EBITDA positive.

The economic lockdown initiated post the outbreak of Coronavirus has had a significant negative impact on the Real Estate industry. The Agency reacted to the lockdown quickly and this has softened the impact that slower economic conditions and a falling property market will have on its underlying earnings.

Since the lockdown, The Agency has made the following changes to its business to reduce costs;

- Reducing non-sales staff hours and cutting wages
- Closed a non-essential office
- Cut subscriptions
- Received an extension from its bankers to refinance existing facilities

The Agency's March 2020 quarterly highlighted that the real estate industry has been more resilient than expected. Over the March 2020 quarter, PUM increased, The Agency recorded its second highest quarter ever for GCI and there was sound sales activity right into the end of the quarter.

As Australia emerges from the lockdown, in what we expect to be a measured fashion, we believe that The Agency will see a short term slow down which will be shallower than we initially expected and return to its pre lockdown run rate in 2H21.

The Agency breaks down its operating divisions into Property Sales, Property Management and Ancillary Services.

PROPERTY SALES

Since the formation of The Agency and following the acquisition of Top Level in 2018, it derives the majority of its commission income in its premium "*Agency*" brand in WA and NSW which remain its two primary markets.

The Agency has 300 agents in 9 locations across Australia. Agents under The Agency banner generate around 90% of Exchanges and Gross Commission Income (GCI) for the Group.

Of the total GCI generated, around 75% is retained by the agent, and 25% goes to the Agency. This model remunerates agents with a higher split than almost any other model. Franchise operators generally pay 50% back to the agent and Independent Operators may pay up to 60% back to the agent.

The Agency had seen its GCI growing very strongly pre the lockdown due to a buoyant property market and successful recruitment drive of high-quality agents.

One of the key drivers of growth going forward is expected to be recruitment of high-quality agents. We expect that The Agency will put on 6 agents per month out to FY23. Whilst there will always be churn of agents, given the Agency's commission splits it is more likely that agents coming on board will be high quality. Any agents that it loses as a result of soft economic conditions are like to be underperforming. Going forward the quality of the underlying agents should increase through natural selection as weaker agents leave the industry.

Given the strong brand penetration The Agency has seen in Eastern States and leading position in WA, we should see agents moving post the lockdown to The Agency to reduce their own overheads and increase margins. After two months of working from home, and the likely new paradigm for people to spend more time working from home we expect a number of Agents to look to reduce fixed costs and move to a higher commission structure model. The Agency has the most attractive model for Agents and this should augment agent growth numbers.

The Agency's March quarter numbers which included The January holiday period and the slowdown induced by Coronavirus restrictions saw only a modest impact on GCI for the quarter.

We do anticipate that the June quarter will be slower given the full impact of the Coronvirus lockdown in April and a gradual easing of the restrictive conditions. This could see GCI halving for the final quarter of the year. We see this as a worst-case scenario.

April trading is likely to be the worst month of the year given the lockdown. There has been evidence of The Agency completing some large sales towards the end of April and in early May and this may underwrite a better quarter than we expected.

In NSW, open homes were allowed from the middle of May 2020 which should be a strong catalyst to soften the dip we are seeing in sales. Based on speaking with agents, it appears that although sales are down as much as 50%, listings are only down as much as 20%. The softening of the lockdown laws, and returns to auctions and open homes should see this gap close. We are still a little early in to see if this will in fact be the case.

As a result, we expect a material drop in commission revenues for the second half of 2020. It is difficult to forecast the exact impact given that we have not seen a lockdown of this magnitude since the Spanish Flu 100 years ago, following World War I.

We believe that the next 2 halves will be critical for the Agency. If auctions are up and running by the middle of May 2020, that gives six weeks of activity before 30 June. As conditions get back to whatever the new normal is, economic stress from the enforced lockdown will ensure that there will be a number of property owners that will be looking to sell and this should see activity jump materially.

In NSW, high end market - Eastern suburbs and the North Shore where The Agency is over represented, has not been as impacted as the low end of the market. We have seen that higher value properties always tend to trade by private treaty - rather than auctions. The inability to hold auctions therefore has not had the same impact on these key markets for the Agency. It is the auction market that has taken the greatest hit leaving WA and the high end of NSW still heavily impacted, but not as badly as other geographies.

On a geographic basis, WA agents represent about 25% of Agency GCI. With the WA market reducing lockdown restrictions faster than the rest of Australia, the greater resilience of the WA market coupled with transactions in the WA market being conducted via private treaty, The Agency should be significantly more insulated from the downturn in the property market than the Eastern states.

Addressing the drop in property prices, we do not believe that any drop will have a material impact on volumes as soon as restrictions are eased.

Other periods where we have seen large price retreats, we have not necessarily seen commensurate falls in volumes. If anything, we expect that there will be a number of owners of both residential and investment properties forced to sell which we believe will be positive for higher quality agents.

Where we could be a little bullish with our forecasts is if there is a second lockdown due to a spike in Covid-19 infections in the second half of the year. People are becoming used to working from home and practising social distancing so this would not be as disruptive as the March / April period.

PROPERTY MANAGEMENT

The Agency had 4,737 Properties Under Management (PUM) as at 31 March 2020. Of these properties, around 22% are located in WA and the remainder in the Eastern states.

The Property Management division is the largest single asset in The Agency Group and underpins their ability to attract external capital (debt or equity) and provides an annuity styled revenue stream from which to build out the commission-based Property Sales division. Currently, The Agency owns a rent roll valued at approximately $23.5m.

NSW has the largest PUM numbers and we expect this to grow as more agents come on board. In its March 20 quarterly report, The Agency highlighted that it was seeing smaller agencies going to The Agency to get them to take on their rent rolls. The Agency has a scale position and is able to absorb these smaller players at very little incremental cost.

Agents are incentivised to bring properties on to the Agency's rent roll and grow PUM as The Agency has a unique remuneration model.

For each property the agent brings on they can elect to either receive one weeks rent up front. Or the agent can elect to participate in the Agency's "futures" program where if properties remain on the rent roll for over three years the agent can collect a multiple of up to one year's management fee.

The Agency offers one of the only models in the market where the underlying agent participates in the upside from building the rent roll.

The Agency has around 8% of its property management division in commercial properties where there has been higher arrears rates. We are monitoring this position and will be interested to see the fallout post the Coronavirus induced lockdown. Given its small size, we do not expect the harsher conditions experienced in commercial properties to have a material impact on profitability or valuation.

From a financial modelling point of view, we are expecting;

- PUM to continue to grow at a similar rate we saw pre Covid economic lockdown, notwithstanding that The Agency is seeing smaller players looking to exit the business, and more properties coming back into the pool given the stress in the short term rental market (Air BNB and Stayz etc);
- Rental prices falling 5% in WA and 12.5% in the Eastern States;
- Occupancy rates falling from ~95% we saw pre-Coronavirus lockdown to ~87% over the next half

The Agency stated in its March 2020 quarterly result that due to Government support packages there have been limited requests for rent relief – which has amounted to less than 10% across the book. Only 4% of the property management book have been identified as having financial hardship and receiving rent reductions.

We can conclude from this early data that there is expected to be limited impact on the book. Our forecasts look conservative if anything given the strong position The Agency is in with regard to property management which should see better than market growth as the lockdown is lifted.

Our central thesis being that the big scale players will be the consolidators does imply that The Agency should be able to add significant value through investing in its property management business over the next three years. For this reason, we believe that the value of the rent roll still should carry a value of 3.5x revenue.

ANCILLIARY SERVICES

Ancillary Services revenue consists primarily of trail commissions from the mortgage book and conveyancing revenue. The majority of this fee income is generated in the WA business where the nature of private treaty sales lend itself to offering products to buyers and sellers when the property is on the market.

We expect the revenue from the mortgage book which sits at approx. $1,000,000 per half to remain stable and pick up again in the second half of the year.

Conveyancing income should take a hit with a significant slowdown in exchanges in April and May, which again should begin to pick up in the second half of the year.

The Mortgage division is an important valuation driver, if we do see turnover increasing in WA as expected this may see any short-term drop in activity turn around in the second half of the year.

The Agency makes a nominal amount from desk and sales fees from agents that operate on its platform, however this is more of a cost recovery exercise than a profit driver.

EXPENSE MANAGEMENT

The Agency pays more commission to its agents than any of the large national realtors. It offsets this by running a lean cost structure.

Because The Agency it is a relatively new group, it has been able to partner with cloud based service providers and provide its agents with a flexible working platform enabling them to work from one of the "hub" offices, on the road or from home. This has given them a huge benefit in the Coronavirus lockdown, allowing the team to transition smoothly to work from home.

Prior to Coronavirus, The Agency had initiated a company-wide cost reduction program to deliver scale benefits from operating one platform across the Group. In 1H20, wage savings of $678k were delivered as part of targeted total cost savings of $2.5m this year.

Post Coronavirus, The Agency has made the following additional changes to its business to reduce costs;

- Reducing non-sales staff hours and cutting wages
- Closed a non-essential office
- Cut subscriptions
- Received an extension from its bankers to refinance existing facilities

Running through the expense line, the biggest cost is clearly staff costs. The Agency has done all it can to this point to run as lean as possible whilst providing high quality support to its front line.

Any increase in staff costs is driven by the success in the hiring strategy from the sale teams. Given the percentages that each agent gets from attributable GCI, once the company reaches scale (which it has) the fixed costs are covered, the net contribution from each new agent they hire will hit the bottom line. This also means that in times of stress, such as the current environment, if agents are not generating business then they are not getting paid.

The Agency advised in their March 2020 quarterly update that they have engaged BDO to review the business and identify further cost savings. This is another smart initiative and should further strengthen the operating model.

PROFIT CONTRIBUTION

The Agency generated EBITDA of $500k for the half year to 31 December 2019 and added a further $200k and cashflow was positive in the challenging March quarter which was unaudited illustrating that they are now at scale.

The Agency does not have the fixed cost infrastructure of its peers and this should insulate them from any prolonged downturn in the residential property market.

Moving to EBITDA and Cashflow positive is a benefit right across the business – particularly in reducing the cost of capital and giving new agents and marque hiring's the confidence to bring their business across.

This is a pivotal point for the company and based on the numbers they have released to date, including success in building both their agents and PUM in very difficult market conditions should propel them forward to be a leader in the post Coronavirus market.

GIBRALTAR CAPITAL

CAPITAL STRUCTURE

The Agency has recently undertaken a process to clean up its capital structure.

Due to a successful entitlement offer in October 2019, The Agency has over $4.5m cash at bank and a strong shareholder register dominated by key management personell and key financial backers such as Magnolia Capital and Honan Insurance.

At the same time as the entitlement offer, The Agency did a $1.2m placement and converted $5.8m debt to equity and extended their facility with Macquarie Bank.

Following the capital raising, The Agency has approx 302m ordinary shares on issue and 107m options with a 6.5c strike price and December 2020 expiry.

The top 6 shareholders own 60% of the company. Over time we expect this to dilute.

Major Shareholders		
Magnolia Equities	52.2	17.5%
Ben Collier	27.1	9.1%
MAK Property	25.7	8.6%
SEMC 2	25.6	8.6%
Daring Investments	24.7	8.3%
Teldar Real Estate Pty Limited	24.3	8.1%
Honan Insurance	7.7	2.6%
Total Shares On Issue	299.0	62.7%

Until the entitlement offer was undertaken and the balance sheet cleaned up with the conversion of debt to equity, The Agency has complexities inits capital structure which was not attractive to instituional shareholders.

With a cleaner balance sheet, the business reaching scale and huge opportunities fro growth over the medium term we believe that The Agency is now a compelling growth story and holds great appeal for astute investors looking to participate in the upside in the real eatate industry post coronavirus.

DEBT REFINANCING

The Agency has $13m of long term debt with Macquarie Bank which it is currently in the process of refinancing. The value of this loan is materially less than the value of the assets owned by the Agency.

To fund the Agency's rapid growth, they took on debt to get the business to scale. A large part of the debt was incurred by Top Level prior to the merger of the two groups to fund the purchase of the rent roll and other acquisitions. This debt has been with Macquarie Bank and post the merger The Agency has been keen to refinance the debt given some of the legacy conditions around the terms negotiated by Top Level prior to the merger.

In addition to the 4,763 property rent roll, The Agency has a ~$1.1bn mortgage book. Both of these assets generate annuity revenue streams with a largely fixed cost base. These assets have a look through market valuation, and there is a very liquid secondary market for both rent rolls and mortgage books.

The Agency announced to the ASX on 11 May that it had now entered into an agreement with Macquarie Bank in relation to the repayment of its primary bank debt by the Company on or before 30 September 2020. Given the attributable value of its financial assets, which is well in excess of the level of debt, the likelihood it will be in a position to grow these through consolidating smaller players and natural market growth we expect that The Agency will have no difficulty in refinancing its debt facility by 30 September.

GIBRALTAR CAPITAL

VALUATION METHODOLOGY

The Agency has seen share price weakness since it began its integration program, and cleaned up its balance sheet.

The share price falls have been a materially improving business, a robust platform for growth with further cost savings and the strategy delivering more new agents to the platform that the business which is an attractive proposition for the top tier of Australian residential real estate agents.

There are a number of ways to value a growth company such as The Agency, but given the transparent valuation of key assets on the balance sheet a sum of the parts valuation is going to be most accurate.

We have calculated a valuation range to indicate where the business could trade depending upon how asset valuations hold up following the Coronavirus lockdown.

Our calculated valuation range based on FY2021 is 6.2 cps – 10.0 cps.

We attribute a valuation within this range of 7.1cps which is 1.75x the current share price (4.0 cps). The valuation is as per the table below;

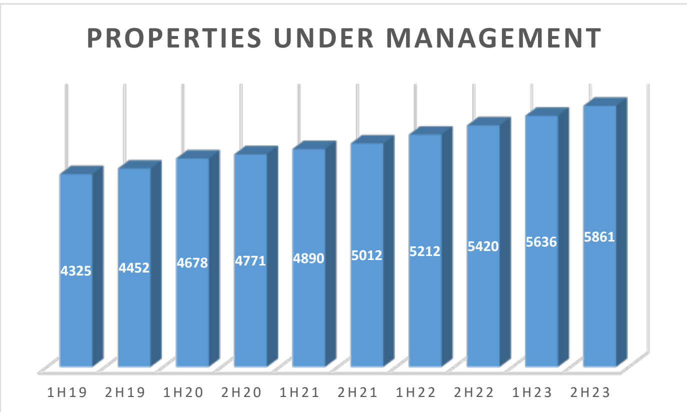
Valuation	FY21			
Sum of the Parts	**Multiple**	**Low**	**Multiple**	**High**
Rent Roll	3.2x Revenue	26.2	3.5x Revenue	28.7
Mortgage Book	2.1x Revenue	5.1	2.4x Revenue	5.8
Real Estate Agency	6x EBITDA	1.05	1x Revenue	11.5
Less Net Debt		10.4		10.4
Gross Valuation ($m)		22.0		35.6
EFPOWA		356.3		356.3
Valuation Per Share		0.062		0.100

PROPERTY MANAGEMENT

The largest driver of the value is the Property Management division.

Properties Under Management are expected to increase at between 5% to 8% per half out to FY23. The reason for the strong growth rates are due to;

- Consolidation of smaller players which we are already seeing;
- Organic growth – which we expect to be material given the attractive incentive program that The Agency offers its team to refer properties into the book;
- Increased properties coming into the pool from the short term rental / tourist accomodation market; and
- Newly recruited agents bringing their books across with them



Revenue growth from the book is expected to be relatively stable, albeit with a drop over the next 12 months as vacancy rates increase and rents fall.

We expect headline rents to fall by 10% over the next 12 months across the book before recovering in line with inflation out to 2023.

Vacancy rates to drop to 87% this year before recovering back up to 94% by 2H23.

The net result is that we expect the addition of new properties to largely offset falls from increrased vacancy rates and rental drops. This should begin to reverse in FY22 where we expect very strong growth as The Agency adds new properties and benefits from tailwinds from a growing back book and increased rents.

We expect revenue from Property Management jumping from $8.2m to $9.1m in FY22 which sees the value of the book at a 3.5x multiple increasing from $24.5m to $27.3m.

We use a low end multiple of 3.2x revenue in the event The Agency were a forced seller for some reason. Based on how the business is currently tracking we see this as extremely unlikely.

That puts the value of the Property Management business alone worth 7.6cps or almost double the current share price.

MORTGAGE DIVISION

The mortgage book valued at ~$5m generates a trail in the order of 40bps which equates to $2m per year. Mortgage books trade at or around 2.4x revenue. Again this is a liquid asset, and whilst not a material driver of the valuation of the business going forward it is a bankable asset and will grow, particularly in the WA market.

We have used a low end valuation multiple of 2.1x revenue in the event The Agency were a forced seller which we believe is unlikely given current market conditions.

PROPERTY SALES DIVISION

To attribute a low end valuation to the sales business we have stripped out the Property Management and Mortgage divisions from Group EBITDA, including allocating 10% of Group expenses to the running of these businesses.

Based on the Net EBITDA number, we calculate we give it a 6x multiple which is in line with comparable, profitable micro cap growth businesses. If market conditions continue to improve and The Agency builds on its success attracting new agents we expect mutiple expansion to drive the valuation to over 25cps by FY23.

We have used EBITDA as we believe that cashflow contribution is a primary driver of valuation.

However, we also acknowledge that The Agency has over 300 agents across its network generating strong Gross Commission Income numbers and that the business has a great deal of strategic value. If we look at an upper end of what that value may trade for then we calculate the value at 1 x net revenue from the sales team.

This increases the valuation to $11.5m. With The Agency recruiting at the rate that it is, we expect strong growth at both the EBITDA and GCI lines and see material uplift out to FY23.

VALUATION UPLIFT

The gross value of the business comes to $25m based on current forecasts. Even though this has been negatively impacted by the Coronavirus related economic slowdown, we expect the underlying business to build on the momentum it has generated since inception.

If it attracts quality agents to its high commission split model and can keep its overheads low The Agency should have huge momentum as conditions normalise post Coronavirus.

The Agency will have property prices, rents, vacancy rates and the highest rate of agent growth in the country pushing the valuation up to $48m (12cps) in FY22 and $100m 25cps) in FY23.

This puts The Agency clearly in the company of growth stocks and huge upside from current prices if the business keeps on its current trajectory.

RESIDENTIAL PROPERTY MARKET ANALYSIS

The Government lockdown post the onset of Coronavirus in Australia has had a huge impact on the Australian economy. The Government reacted quickly by announcing stimulus measures, however the lockdown is much further reaching than the stimulus offered and already there has been a huge jump in unemployment and wages have taken a huge hit.

Based on research undertaken by the University of NSW there has been a material drop in clearance rates, house price falls are already evident and there is a great deal of stress in the rental market.

Property prices are definitely an important determinant for the profitability of real estate agencies, however there are many others. Given that prices impact the sales, management and mortgage divisions of The Agency, we have undertaken an examination of the market as a key input in our valuation model.

MARKET UPDATE

Property prices have been on a steady rise in Australia since the 1970's. The two times where unemployment rose over 10% (peaking at 11.2% in 1993) the market pulled back and flattened out, but resumed its upward trajectory.

Even in the Global Financial Crisis which saw asset prices collapse around the world, Australia was relatively immune due to the economic strength from the mining boom, fiscal and monetary stimulus and a strong labour market where unemployment did not stay above 6% for any extended period.

This time it is different.

We believe that the property market is driven by six key metrics;

1. Income Growth (-ve)
2. Population Growth (-ve);
3. The Unemployment Rate (-ve);
4. Interest Rates (+ve);
5. Inflation (-ve); and
6. Supply (-ve)

We have included an indicator on which way we expect each metric to impact the residential property market. There would be very few times in history when 5 of the 6 indicators in the market are all negative. And you could argue that given the anecdotal evidence we have seen from the lockdown to date these metrics have all moved to be materially negative.

We analyse the drivers of the property market as follows;

Income Growth

We are unlikely to see any income growth in Australia for many years. Tourism, Retail, Health, Hospitality and Non-Essential services have now been closed two months. There is still no certainty as to when these will re-open.

Between 1994 to 2018 income in Australia rose by around 60%. This has been a material contributor to growth in residential property prices.

Given the lockdown, and the huge growth in unemployment we expect incomes to fall by circa 20%, particularly in the locked down sectors.

If you consider that executives have cut their salaries by anywhere between 20% to 100%, regardless of when this lockdown ends there is the chance that Covid-19 re-emerges (keeping affected sector wages and staffing most likely made up of casual or part time) and massive knock on impacts into other sectors 10% is conservative.

On the flip side, the mining sector looks in good shape, retailers are being swamped by people staying at home (and finding refuge from their lockdown in the supermarket) and technology companies are seeing much stronger growth.

Any rebound is probably 2 years away.

Population Growth

Population growth has never been a problem for Australia. Australia has relied on immigration since we opened up our borders post World War II. Since 1980, migrants have accounted for between 40% - 60% of population growth in Australia.

Between the Great Depression and World War II Australia essentially took in no migrants. Following World War II, Migration has been the backbone of population growth in Australia which has fuelled the residential property market. Interestingly, the recessions in 1975 and 1993 saw low levels of migration due to lack of employment opportunities.

This time, not only do we have the highest unemployment rate since the Great Depression, but we have closed our borders to both migration, students and international travel. These restrictions are likely to remain in force for at least twelve months. In fact, we believe that the state borders will remain closed to all but essential services for the remainder of this calendar year.

The good news is that even though migration dipped in 1975 and 1993, they bounced back quickly.

Unemployment Rate

The unemployment rate was lauded in the Global Financial Crisis as the primary reason Australia's property market did not fall by as much as other G20 countries.

Based on the anecdotal data we have seen to date it is likely that there are over 2.5 million Australians out of work since the lockdown came into effect. This would push the unemployment rate to close to 10%. This is a reality we have never seen in Australia.

If we then couple this with an increasingly casual and part time workforce post the Lockdown then this number is likely conservative.

With an underemployment rate / unemployment rate sitting that high there will be a huge impact on residential property prices.

The Australian Government stimulus package will plug a bit of the gap but we will need a material increase in full time employment to see any meaningful increase in residential property prices.

Lending Interest Rate

Interest rates are already at record lows. The major banks are unable to pass on any material rate cuts. Lower lending rates will do little to offset falls caused by other leading factors.

The moratorium that the banks are giving home loan customers will largely just delay the inevitable.

The process that the major banks will have to go through to foreclose on defaulting borrowers will take the six-month moratorium, plus up to 90 days after that plus a negotiation period with borrowers. That could be twelve months all up.

More highly leveraged borrowers will try and sell earlier, before the bulk of properties hit the market at the end of this year, early next year. The banks are not giving interest forgiveness, just kicking the can down the road. This could put pressure on property prices for at least twelve months.

Inflation

Given the lack of inflation from the unprecedented stimulus package emanating from the GFC it is extremely unlikely there will be any inflation in Australia for the foreseeable future.

Deflation is a stark reality.

Supply

The other factor which will further put pressure on the property market is the tourism ban which will likely see up to 100,000 properties come off short term rental websites such as Airbnb into the rental pool. These are listings for entire dwellings, not just a room or share accommodation.

Based on property data, before the impact of Covid-19, increased vacancies coming off short term rental sites could double the number of vacant properties across Australia.

HOW DOES THIS TRANSLATE BACK TO THE AGENCY?

The success of The Agency is more leveraged to agent growth, exchange numbers and the consistent earnings of the Property Management division than property prices.

However, because The Agency operates in the residential property market it is still an important sentiment factor.

The leading indicators are pointing to a fall in prices in the residential property market for at least twelve months, anywhere between 10% - 30%.

Leverage rates in Australia were also at record levels - never before in history have personal debt levels been so high. This has been driven by rising incomes, a growing population, buoyant tourism industry (Airbnb) and a burgeoning second tier lending market.

Since the Coronavirus induced economic lockdown there has been a material slowing in the Australian and global economies, there has been a massive increase in unemployment even more so under-employment and many businesses are yet to re-open.

The likely impact of this will be felt for some time. Organisations and people have adapted quickly. Working from home is second nature, dealing with a thousand distractions in the background is commonplace, we survived the toilet paper shortage of 2020 and working through Zoom and Microsoft Teams has been seamless.

In terms of the Australian property market,

- There are scores of commercial properties vacant, the true extent of how far commercial properties will fall (particularly retail and office) will not be known until people are able to return to work and Government support for affected parties is lifted. This is likely to be twelve months away;
- The residential rental market has seen vacancies rise immediately post the lockdown. It is not just the traditional residential renting market, but also the huge number of properties coming into the rental pool as Airbnb and other short-term rentals that have relied on short term renters from the tourism market vend their properties back into the traditional residential renting pool;
- We believe that the residential market is likely to remain under pressure for some time as the Government has limited recourse that can be taken against for renters, borrowers and banks. This will likely play out for another twelve months until Government support is withdrawn.
- Ultimately – beds and sheds are going to hold up the best

In the residential market, the damage is nowhere near as severe as the commercial market. Properties are still transacting; people are still paying their rent and lender from Commonwealth Bank and NAB to smaller independent property research groups believe that prices will come off by~15% up to 30%. This compares with other cycles. According to CoreLogic annual sales fell by;

- 39% in 1987 after the Black Monday stock market crash
- 22% in the 1997 Asian Financial Crisis
- 34% in the 2001 Tech Wreck; and
- 23% in the 2008 GFC

and Australia locked down its borders early enough that it looks as though we will be through the worst of the lockdown and back to more normal, yet restricted, conditions by the end of May 2020.

For groups such as The Agency, this is not the end of the world. Once social distancing restrictions are relaxed, open homes can be conducted and people start getting back to work the market will improve.

In conclusion, falling prices and the huge increase in unemployment / underemployment that we are expecting will eventually push volumes higher, push people into the rental market and lead to agents moving to operating models that cater to higher profit splits and lower operating costs.

As a result, we see The Agency being a medium-term beneficiary and do not believe that falling property prices will have a negative long-term impact on their business.

GIBRALTAR CAPITAL

BOARD AND MANAGEMENT TEAM

The Management team is one of the most experienced in the market. Founder and Managing Director, Paul Niardone, has laid the foundation for the business and built a resilient and fast-growing operation in Perth with the challenge of bringing this across to the Eastern States with a new brand, and with a completely differentiated operating model.

Matt Lahood was leading a large cohort of agents at a NSW centric firm that ran a dual franchise and company owned model. Matt and a core group of leading agents left to build their own business and were able to operate and build The Agency brand in the Eastern states. This gave The Agency immediate scale, a leading development business and a foothold to expand up the East Coast.

Importantly, both Paul and Matt have come from traditional models which they felt were not contemporary enough to attract top agents. The advent of cloud-based technology has disrupted all industries and The Agency has been a first mover to build a cloud-based model, where the agents can share in the upside for business they generate right across the business. Thomas McGlynn has been a critical element of the team to ensure the hiring run rate of agents is maintained - particularly as the market slows.

On the operational side of the business, Andrew Jensen has decades of experience running real estate groups and is critical to bed down acquisitions and oversee the integration of the various segments of the business in addition to his background as a CFO.

Maria Carlino has run large scale rent rolls and has positioned the group well to survive the slowdown related to Covid-19 in addition to integrating smaller players that may look to migrate to a more robust platform.

Senior Management Profiles

Paul Niardone - Managing Director

Previously Executive Director and founder of Professional Public Relations (WA), the largest PR and communications firm in WA until he sold the business to WPP. Experience in marketing and strategic planning for clients in both Government and the private sector and over 15 years' experience with public companies.

Matt Lahood - Chief Executive Officer (The Agency)

More than 30 years in real estate sales; 2,000+ property sales worth over $2bn. Previously Director of Sales for McGrath Real Estate, responsible for market entry strategies and management of 22 company owned offices and more than 250 people.

Thomas McGlynn - Director of Sales

Armed with close to 15 years of experience, Thomas has conducted over 4,000 auctions and run thousands of training and one-on-one coaching sessions. It is the rare combination of hands-on sales experience, general management and auctioneering that make Thomas a trusted and dependable leader at The Agency.

Maria Carlino - Director of Property Management

Over 27 years of real estate experience in key markets incl. Sydney, Brisbane and the Gold Coast. Previous senior roles at RUN Property, Ray White and McGrath Real Estate where she was responsible for the management and growth strategies of the rental portfolio and team across all company owned offices.

Andrew Jensen - Chief Operating Officer

Andrew, formerly CFO of Ray White, has extensive knowledge in the management of all aspects of finance with strong commercial, strategic, M&A, and change management experience. He has financially led companies engaged in various fields including real estate and ancillary services sectors globally. Fellow of IPA and member of the AICD.

Arjan van Ameyde - Chief Financial Officer

Arjan has over 25 years' experience in senior finance roles in listed companies and SME. He has previously founded short-term lending and insurance businesses and established the treasury for a listed multinational group. Most recently he was Chief Operating Officer/Chief Financial Officer (Australia and UK) of ASX listed Ensurance Limited (ASX: ENA).

Board of Directors Profiles

Paul Niardone - Managing Director

See Senior Management Profiles

Matt Lahood - Chief Executive Officer (Real Estate)

See Senior Management Profiles

Adam Davey - Non-Executive Director

Adam is Director, Private Clients and Institutional at Canaccord Genuity. His expertise spans over 25 years and includes capital raising (both private and public), mergers and acquisitions, ASX listings, asset sales and purchases, transaction due diligence and director duties.

Andrew Jensen - Interim Executive Chairman

See Senior Management Profiles

GIBRALTAR CAPITAL

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