



Residential sales collapse hurts Domain

Company/ASX Code	Domain Holdings Australia Limited/ DHG
AGM date	Monday 11 November 2019
Time and location	Doltone House, Darling Island, Ground Floor, 48 Pirrama Road, Pyrmont
Registry	Link Market Services Limited
Webcast	Yes
Poll or show of hands	Poll on all items
Monitor	Donald Adams assisted by Allan Goldin
Pre AGM Meeting?	Yes, with Chair Nick Falloon; Diana Eilert, Independent Director and Chair, People and Culture Committee; and Jolanta Masojada, Investor Relations

Item 1	Consideration of accounts and reports
ASA Vote	No vote required

Domain had a tough year in the 2019 financial year (FY19) due to a decline in the housing market. This was particularly severe in Sydney and Melbourne where auctions were down 25% and 28% respectively. Nevertheless, the company held its own. Other significant changes were the arrival of a new CEO, Jason Pellegrino, in August 2018 and the transfer of the majority share from Fairfax to Nine Entertainment in December 2018.

Governance and culture

The directors of Domain were all elected last year following its listing in November 2017. At the coming AGM, Nick Falloon and Geoff Kleemann are standing for re-election to start rolling elections to the Board so that there will not need to be an election for the total Board in the future.

The Board has only three independent directors out of seven, and the Chair, Mr Falloon is not independent. This breaches the ASA standards that a majority of directors should be independent and that the Chair should be independent. Domain has designated Geoff Kleemann as senior independent director to take the chair should Nick Falloon be conflicted.

The Board Committees at Domain are chaired by independent directors and a majority of the members of each committee are independent. Geoff Kleemann chairs the Audit and Risk Committee and also the Nomination Committee. The People and Culture Committee is chaired by the independent director Diana Eilert.

The whole company is 48% female and the Executive Leadership Team, following the appointment of YY Kim as Director – Strategy & Development in July 2019, is now 30% female. Domain has set an objective that by 2020 all levels will be at least 40% female.

Financial performance

Since Domain has been a listed entity for just less than two years the Summary table below shows limited history with the 2018 pro-forma full year data. The large decline in statutory net profit after tax (NPAT) is caused in part by a \$178.8m write-down of Goodwill created when Fairfax assets were sold into the new venture in 2017. Goodwill is now around a billion dollars. Trading results in FY19 varied by business.

Residential

The digital Residential business is the heart of the company. Revenue at \$173.3m was 52% of total revenue, and up 0.5% on 2018. This was achieved by increasing yield on listings by 12% to offset the decline caused by the fall in the housing market.

Domain claims listing parity with the market leader REA Group with some 95% of listed properties appearing on both websites. REA reported Australian residential revenue in 2019 of \$555m, up 8% from 2018. REA is more evenly spread across the country than Domain which is strongest in areas hit the most by the housing downturn, Sydney and Melbourne.

REA gets many more views than Domain and has been around longer. This means that more of REA's listings are upsold to premium levels. REA also charges more than Domain for premium listings in some areas. Domain has three levels of premium listings – silver, gold and platinum and increased premium listings in FY19 supported the 12% increase in yield noted above.

Domain is aiming to use its relationship with the Nine network to spread its impact across Australia. They are a major sponsor of *The Block*, and a new show called *Your Domain*.

Media, Developers and CRE

Revenue fell by 12.9%. This would have been larger were it not for strong growth for commercialrealestate.com.au (CRE), the commercial real estate web services.

Agent Services and Consumer Solutions

Domain sees these two businesses as having high potential for the future growth, and that they are more than competitive with REA Group in these areas.

Agent Services, which provides real estate agents with digital tools, had a revenue increase of 15.1%. Consumer Solutions provides house purchasers with online access to tools to find home loans and insurance. Revenue was up 10% but earnings before interest tax depreciation and amortisation (EBITDA) was disappointingly down \$4.5m to \$(7.2)m.

Print

Domain's print business is profitable, but revenue fell about 30% as did EBITDA. While the future of Print is gloomy it is seen as having additional value as a marketing tool for Domain.

Summary

(As at FYE)	2019	2018 pro forma
NPAT (\$m)	(137.6)	(6.2)
UPAT (\$m)	37.4	52.9
Share price (\$)	3.18	3.22
Dividend (cents)	6	8
TSR (%)	1.2	na
EPS (cents)	6.4	9.2
CEO total remuneration, actual (\$m, part year)	1.698	na

Item 2	Adoption of Remuneration Report
ASA Vote	Against

Summary of ASA Position

The remuneration report is clear and comprehensive, showing details of the packages for the Key Management Personnel (KMP). Apart from the directors, Domain claims only two executive KMP, the CEO and CFO. It seems unlikely that these were the only executives responsible for planning, directing and controlling the affairs of the company.

The table below shows full-year pro forma figures for the CEO, Jason Pellegrino. He started at Domain on 27 August 2018 and served for 84% of a year.

CEO rem. framework	Target* \$m	% of Total	Max. Opportunity \$m	% of Total
Fixed Remuneration	1.200	36%	1.200	33%
STI - Cash	0.720	21%	0.960	27%
LTI – Options	1.440**	43%	1.440	40%
Total	3.360	100%	3.600	100%

The amounts in the table above are the statutory amounts that are envisaged in the design of the remuneration plan. *Target remuneration is sometimes called budgeted remuneration and is what the company expects to award the CEO in an ordinary year, with deferred amounts subject to hurdles in subsequent years before vesting. **No specific target is given for long-term incentive (LTI).

LTI is in the form of options, not performance rights. Mr Pellegrino will have to pay \$3.1606 to exercise each option, the volume weighted average Price (VWAP) of Domain shares at the time of award. A total of 1,515,789 options were awarded to him based on an allocation price of \$0.90, equal to 30% of the exercise price. We used a Black Scholes model and found that this is a reasonable value. If total shareholder return (TSR) grows at a 10% compound average growth rate (CAGR) over the period to 30 June 2021, then 20% of the options will become exercisable. It will take a CAGR of 25% for 100% of the options to be exercisable.

To achieve a 10% CAGR would require a share price about \$4.00 (depending on dividends) in 2021. Each option would be worth about \$0.84 (\$4.00 less \$3.16) and at a 20% exercisable level the LTI would be then worth approximately \$255,000. A higher CAGR would yield a lot more because of the increase in the share price coupled with the increase in the number becoming exercisable.

Short-term incentive (STI) is all paid in cash, and 70% depends on achieving revenue and EBITDA targets. The other 30% is individually assigned goals and awarded at the discretion of the Board. In FY19 there was zero payment for revenue and EBITDA performance, and 100% payment for the individual goals.

We will vote undirected proxies **against** the remuneration report for the following reasons:

1. STI awards are paid fully in cash but the ASA expects a minimum of 50% deferred equity.
2. ASA would hope that companies would have a gateway, in this case they don't. It is disappointing to note that when the financial component of the STI is not achieved, the two KMP's still received 100% of the non-financial component of the bonus.
3. LTI compensation is determined over only three years. Our standard is at least four, preferably five years for performance measurement for LTI.
4. The ASA approves the use of absolute TSR as a performance hurdle for LTI, but it should determine less than 50% of the award with other performance hurdles, such as relative TSR, ROE, etc.
5. There is no transparency about non-financial criteria used for the STI award.
6. There was no clear disclosure of the reasoning behind the LTI option allocation price of 30% of VWAP.

The ASA Voting Intentions report last year said that the vote this year could be very different unless there were some improvements in the remuneration scheme. We note that Domain have indicated that the People and Culture Committee will review the LTI option plan in FY20.

Item 3	Re-election of Nick Falloon as a Director
ASA Vote	For

Summary of ASA Position

Nick Falloon was chair of Fairfax and is now Deputy Chair of Nine Entertainment. He has been the Chair of Domain since it listed in November 2017. Mr Falloon has 30 years of experience in the media level having been CEO at different times of both PBL and Ten Network Holdings. He holds 101,239 shares in Domain. For 109 days in FY18 and FY19 he was Executive Chair of Domain while a new CEO was sought. He is undoubtedly highly qualified for this position.

We are troubled, however, by the fact that Mr Falloon is not independent due to him being Deputy Chair of Nine Entertainment Co. Holdings, the 59.4% controlling shareholder in Domain. This has been mitigated by the appointment of Geoff Kleemann, an independent director, as to act as chair where Mr Falloon may have a conflict. Further, there is a standard item on the Board agenda for independent directors to have a discussion and all Board committees are chaired by independent directors.

Accordingly, we will vote all undirected proxies in favour of his re-election.

Item 4	Re-election of Geoff Kleemann as a Director
ASA Vote	For

Summary of ASA Position

Geoff Kleemann has been on the Domain Board since listing in November 2017. He is a Chartered Accountant who started his career at Deloitte. He spent about 20 years as a senior executive in listed companies. He was CFO for Crown, PBL, Woolworths and Pioneer. He is a director of the NSW Telco Authority, and has been a director at Asciano, Broadspectrum and Investa.

He is the senior independent director on the Domain Board and, as noted above, acts as Chair on occasion.

We will vote all undirected proxies in favour of his re-election.

Item 5	Issue of LTI Options to Jason Pellegrino under the Executive Incentive Plan
ASA Vote	For

Summary of ASA Position

This resolution is for the issue of 1,600,000 options with a strike price of \$3.0169. For any of the options to be exercised certain hurdles for CAGR in TSR have to be met.

ASA voted against the overall remuneration report however, we still believe that the CEO should be incentivised and awarded for out-performance. Additionally, we are hopeful that the overall remuneration structure will be corrected prior to the exercise date. For this reason, we will be voting our undirected proxies in favour.

The individuals involved in the preparation of this voting intention have shareholdings in this company.

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