The Data Exchange Network Ltd

Update note

Consulting revenue drives FY18 result

Data Centres

17 September 2018

The Data Exchange Network Ltd (DXN) is an early stage company in the process of building two co-location modular data centres in Melbourne and Sydney to tap into perceived increasing demand for cloud services. The company listed on April 11, 2018 after raising $16m at $0.20/share. The proceeds of the offer are being used to develop a data centre in each of Sydney and Melbourne, as well as fund head office/administration expenses and working capital. These two facilities are on track to be live by Q4 CY18. The company reported FY18 revenues of $2.0m, with this predominantly derived from its contract and manufacturing facility in Perth. Gross profit was $0.25m and the operating loss was $4.1m, which was higher than our forecast for an operating loss of $2.8m and due in large part to higher employment costs from contract labour. We expect this to moderate in FY19 due to full time employees replacing contractors. We have adjusted our FY19 earnings forecasts to reflect increased contract and manufacturing revenue but also increased our costs forecasts. We now anticipate a net loss of $2.1m in FY19, versus our previous forecast for a net loss of $0.1m. Our financial model primarily considers the Sydney and Melbourne data centres and generates a DCF valuation of $0.60/share (WACC 12.6%, 2% terminal growth rate).

Business model

The Data Exchange Network is building containerised co-location data centres in leased premises in Sydney and Melbourne. DXN designs, engineers and constructs its own data centre technology with the view to building data centres at a lower capital cost than traditional DC developers. The company has established an engineering and manufacturing facility in Perth to deliver data centre infrastructure to its own operations and to third parties. This facility was the company's main source of revenue in FY18, generating sales of $1.9m and a gross profit of $0.25m. This was ahead of our forecasts for the contracting division. Once the company commences commissioning its modular DCs in Melbourne and Sydney in Q4 CY18, revenue will be derived from manufacturing data centre modules, operating and renting rack space in the co-location data centres and from software licence fees for its monitoring, management and access control system.

FY19 earnings adjustments and valuation

We have adjusted our FY19 forecasts for higher contract revenues (new FY19 revenues $8.7m vs old $8.2m) but gross profit is forecast to lower ($5.2m vs $6.3m previously) due to the lower margins in contracting. We have increased our forecasts for rental and employment costs and this has resulted in a new FY19 forecast for a net loss of $2.1m versus a net loss of $0.1m previously. We have rolled over the financial model for the new financial year and this together with our adjustments has lifted the base case DCF valuation to $0.60/share, (previously $0.53/share). This assumes a longer-term utilisation rate of 90% and monthly revenue of $2,000 per rack, which is comparable to other DC centres in Australia. We have applied a reverse DCF to determine what is implied in the current share price of $0.18. This assumes that free cashflows from 2020-29 will grow at 10.2% per year (vs our forecast for CAGR in FCFs of 32.3% {front loaded from a low base} and the 22% forecast for the sector in Australia).

Earnings estimates

Year end	Revenue (A$m)	EBITDA (A$m)	NPAT (A$m)	EPS (c)	P/E (x)	EV/EBITDA (x)
06/18a	2.0	(4.1)	(5.7)	(5.88)	na	na
06/19e	8.7	(2.1)	(1.8)	(0.86)	na	na
06/20e	23.2	4.9	2.5	1.18	15.25	6.85
06/21e	36.7	12.5	7.9	3.69	4.88	2.15

Source: RaaS Advisory Estimates

Share details

ASX Code	DXN
Share price at 11 Sept	$0.18
Market Capitalisation	$32.8M
Shares on issue	182.31M
Enterprise value	$24.8M
Net cash at June 30	$12.0M
Free float	~58%

Share performance (since listing)

Upside Case

- Board, management and senior advisers experienced in developing tech companies
- Capital light model compared to traditional co-location data centre models
- Modularised and smaller data centres will be critical to 5G mobile and the Internet of Things

Downside Case

- Small player in a market dominated by global players with deep pockets
- Significant data centre capacity coming to market in Q4 18
- Growth of mature centres reverts to CPI

Substantial/Institutional Shareholders

Carason Ward Pte Ltd (Dean Coetzee and Tim Desmond) 30.55%, Herdsman Lake Capital (Peter Christie) 7.64%, Macquarie Group 5.04%, Ellerston Capital 4.8%, Smart Investments (Terry Smart) 1.95%

Board of Directors

Douglas Loh	Non-Executive Chairman
Richard Carden	Non-Executive Director
Terry Smart	Non-Executive Director
Peter Christie	Managing Director/CEO

RaaS Advisory contacts

Finola Burke +61 414 354 712
finola.burke@raasgroup.com

Moira Daw +61 418 697 275
moira.daw@raasgroup.com

FY18 results analysis

DXN reported FY18 revenues of $2.0m, gross profit of $0.25m and a net loss of $5.7m. The company had $12.05m in cash at June 30, having raised net $18.68m in April 2018 through a share issue and from convertible notes (which converted to ordinary shares and options on 5 April 2018). Revenues were ahead of our forecasts and due to contracted sales for the manufacture of data centre modules and associated power and cooling infrastructure at the company's Perth manufacturing facility. DXN has noted that since listing, it has secured contracted sales of $3.1m, with $1.1m currently work in progress. Employment costs were higher than we had forecasts due in large part to contract labour, slightly higher administration costs and rental costs. We anticipate that the contract labour will be converted to full time employees in FY19 and that this should assist in containing these costs.

We have set out the FY18 P&L actual versus our forecast in the following exhibit.

Exhibit 1: FY18 result

In A$m unless otherwise stated	FY18 estimated	FY18 actual
Sales	0.2	2.0
COGS	0.1	1.7
Gross profit	**0.1**	**0.3**
Telecoms and technology	0.1	0.2
Marketing	0.0	0.0
Employment	1.6	2.2
Rent	1.1	1.3
Other	0.2	0.5
Operating costs	3.0	4.3
EBITDA	**(2.8)**	**(4.1)**
Depreciation & Amortisation	0.0	1.7
EBIT	(2.8)	(5.8)
Net Interest	(0.0)	(0.0)
Tax	(0.7)	-
NPAT	(2.2)	(5.8)

Source: RaaS estimates, Company data

FY19 Earnings adjustments

We have adjusted our FY19 forecasts to reflect the better than expected sales being generated by the Perth manufacturing facility. This has resulted in our forecasts for revenue increasing to $8.7m from $8.2m previously. The gross profit margin from contracting and manufacturing in FY18 was 15%, but we expect this to improve to 45% in FY19 as the facility improves processes, gains discipline in its sales proposals and benefits from economies of scale across multiple projects. Even so, the manufacturing facility is not expected to enjoy the gross margin levels of the co-location data centres and this has resulted in our GP forecast for FY19 declining to $5.2m from $6.3m.

Our FY19 forecasts have also been adjusted for higher operating costs, largely employment, rent and administration costs which have flowed through from the FY18 result. This has resulted in an increase in operating costs to $7.3m from $6.1m previously. We are now forecasting an EBITDA loss of $2.1m for FY19, compared with EBITDA of $0.4m previously. We anticipate that DXN will end FY19 with $1.6m in net cash after completing the construction and commissioning of its co-location centres in Sydney and Melbourne. Our forecast adjustments for FY19 are set out in the following exhibit.

Exhibit 2: Earnings adjustments to FY19

In A$m unless otherwise stated	FY19 old	FY19 new
Sales	**8.2**	**8.7**
COGS	1.9	3.6
Gross profit	**6.3**	**5.2**
Telecoms and technology	0.7	0.4
Marketing	0.0	0.1
Employment	2.8	3.2
Rent	2.3	2.8
Other	0.2	0.8
Operating costs	**6.1**	**7.3**
EBITDA	**0.4**	**(2.1)**
Depreciation & Amortisation	0.7	0.6
EBIT	(0.3)	(2.7)
Net Interest	(0.1)	(0.1)
Tax	(0.1)	(0.8)
NPAT	**(0.1)**	**(1.8)**

Source: RaaS Estimates

The earnings adjustments in FY19 have had a flow on effect for our forecasts in FY20 and beyond. We took the opportunity to smooth out the take up rate of rack space in the Sydney and Melbourne co-location data centres and are anticipating that DXN's sales team will add 14 racks per month in utilised capacity by H219. This has resulted in a slight slowing of utilisation rate in FY20-21 but a re-alignment in FY22-23. We have also lifted our forecasts for employment and rental costs longer term which has also had the effect of reducing our near-term forecasts. We have factored in additional revenue and costs from the manufacturing facility which has the effect of lowering our EBITDA forecasts from FY21-22. Our revised forecasts are set out below.

Exhibit 3: Earnings adjustments FY19-FY23

Old	FY19	FY20	FY21	FY22	FY23
Revenue	8.2	24.5	37.9	43.9	45.7
EBITDA	0.4	10.9	19.5	22.9	23.3
EBIT	(0.3)	9.5	18.1	21.5	21.8
NPAT	(0.1)	6.6	12.8	15.4	15.8
New	**FY19**	**FY20**	**FY21**	**FY22**	**FY23**
Revenue	8.7	23.2	36.7	49.8	57.0
EBITDA	(2.1)	4.9	12.6	20.2	23.8
EBIT	(2.7)	3.8	11.4	19.1	22.6
NPAT	(1.8)	2.6	8.0	13.5	16.1

Source: RaaS estimates

Key parameters in base assumptions

We have modelled each data centre individually and made some assumptions around software sales and manufacturing revenues and COGS. Our revised forecasts have incorporated increased revenues from the manufacturing facility at a lower margin (as discussed on the previous page). Our assumptions have been derived from examining other operators in the market and from discussions with management.

Our base case assumptions include the key parameters:

- Port Melbourne will have 920 racks commissioned in Q4CY18 and a utilisation rate of 90%* after five years of operation. We previously modelled 90% utilisation at three years but this implied adding 24 racks a month and we have pulled this back to 14 per month. Revenue per rack per month continues to be forecast at $2,000;
- Similarly for Homebush with 960 racks, the utilisation rate is forecast to get to 90% after five years of operation;
- Software sales are forecast to grow from 2 to 4 per year while contracting and manufacturing revenues are forecast to grow to 8% of total revenues longer term;

- Contract (third party) manufacturing to grow at an average rate of ~40% year on year near term (this has been increased from 20-50% previously);
- Electricity costs of 14.5c per KW per hour;
- Manufacturing COGS of 60%;
- We have not included any additional data centres in our base case, which anticipates a peak in EBITDA margin in FY23, as set out in the following Exhibit.
- The growth forecasts are front-loaded with the bulk of the growth forecasted from FY19-FY23. Beyond this we revert to CPI in the absence of additional centres.

*We decided to factor in a 90% base case utilisation rate after studying existing utilisation rates at NextDC, Equinix and Digital Realty (refer to our 4 July 2018 initiation report available at www.raasgroup.com/our-research). DXN's management is of the view that DXN's utilisation rate will be 95% and potentially could go above 100% depending on the module configuration and consumed power density.

DCF Valuation

We have used the discounted cashflow methodology to value DXN, applying a WACC of 12.6%, beta of 1.5 and terminal growth rate of 2.0%, to our base case free cashflows. This derives a valuation of $0.60 a share. It should be noted that our base case forecasts only include the Sydney and Melbourne DCs. At the current share price of $0.20, DXN's 39.3m $0.30 options, which have expiry dates of 30/11/20 and 5/4/21 are out of the money. We have calculated the dilution impact of these in the table below.

We have also given regard to the potential impact IFRS 16 – Changes to leases could have on DXN's DCF valuation when it comes into effect in January 2019. We have assumed that 15% of the rent payments are re-classed as interest payments and adjusted the free cashflows to reflect this. The NPV of rent payments under the lease has been added to net debt and deducted from EV. This together with the in the money options brings the base valuation back to $0.44/share.

Scenario Analyses

We have built an upside case and a downside case into the model to contemplate how different growth parameters impact profitability and the DCF valuation. We have also looked at the impact of additional data centres in Brisbane or Adelaide in early 2020. This assumes a 900-rack data centre in Brisbane or a 400-rack data centre in Adelaide and 90% utilisation rate by December 2022 for our base case.

Our upside case assumes the following parameters:

- $2,300 per month recurring revenue per rack, 99% utilisation rate 3 years from commencement;
- 10 software licence sales a year longer term,
- 50-75% revenue growth near term for the contracting and manufacturing business,
- Electricity costs of 13c per KW hour
- Manufacturing COGS of 65%.

Our downside case assumes the following parameters:

- $1,350 per month recurring revenue per rack, 80% utilisation rate 3.5 years from commencement;
- No software sales long term;
- 10-30% revenue growth near term for the contracting and manufacturing business;
- Electricity costs of 19c per KW hour
- Manufacturing COGS of 75%.

The DCF impact of each of these scenarios is set out below. These fully diluted valuations include the dilution effect of DXN's options and impact of IFRS 16.

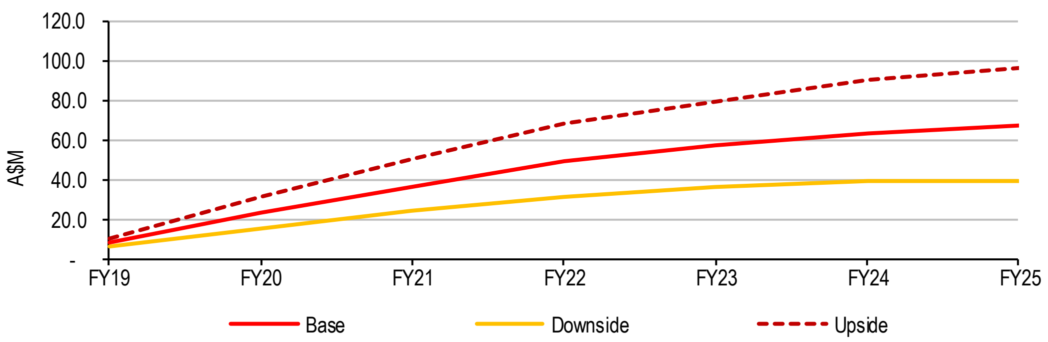
Exhibit 4: DCF Valuation by Scenario

Scenarios	Current shares	Fully diluted*
Base case valuation	$0.60	$0.44
Downside case	$(0.03)	$(0.06)
Upside case	$1.20	$0.90
Base case with Adelaide	$0.76	$0.56
Base case with Brisbane	$0.85	$0.63
Base case with Adelaide and Brisbane	$1.01	$0.75

Source: RaaS Advisory * fully diluted for out of the money options and IFRS 16 impact

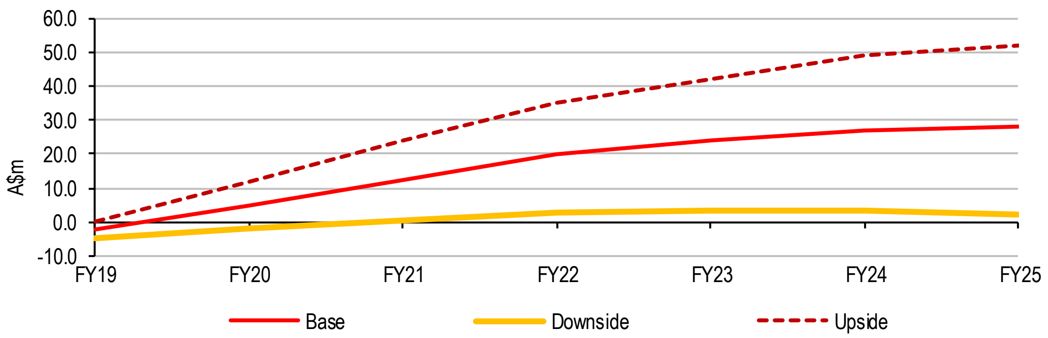
We set out below, the base, upside and downside scenarios on both revenues and EBITDA. These exclude the prospect of Adelaide and Brisbane.

Exhibit 5: Revenues by scenario analyses (base, upside, downside ex Adelaide and Brisbane)



Source: RaaS Advisory

Exhibit 6: EBITDA by scenario analyses (base, upside, downside ex Adelaide and Brisbane)



Source: RaaS Advisory

Exhibit 7: Financial Summary

The Data Exchange Network (DXN)					
Profit and Loss (A$m)					
Y/E 30 June	**FY18F**	**FY19F**	**FY20F**	**FY21F**	**FY22F**
Revenue	2.0	8.7	23.2	36.7	49.8
EBITDA	(4.1)	(2.1)	4.9	12.5	20.1
Depn	(0.0)	(0.6)	(1.1)	(1.1)	(1.1)
Amort	(1.7)	(0.0)	(0.0)	(0.0)	(0.0)
EBIT	(5.8)	(2.7)	3.7	11.4	19.0
Interest	0.0	0.1	(0.1)	(0.0)	0.1
Tax	0.0	0.8	(1.1)	(3.4)	(5.7)
Minorities	0.0	0.0	0.0	0.0	0.0
Equity accounted assoc	0.0	0.0	0.0	0.0	0.0
NPAT pre significant items	(5.7)	(1.8)	2.5	7.9	13.4
Significant items	0.0	0.0	0.0	0.0	0.0
NPAT (reported)	**(5.7)**	**(1.8)**	**2.5**	**7.9**	**13.4**
Cash flow (A$m)					
Y/E 30 June	**FY18F**	**FY19F**	**FY20F**	**FY21F**	**FY22F**
EBITDA	(4.1)	(2.1)	4.9	12.5	20.1
Interest	0.0	0.1	(0.1)	(0.0)	0.1
Tax	0.0	0.0	(1.1)	(3.4)	(5.7)
Working capital changes	(1.5)	0.9	(1.3)	(1.5)	(1.5)
Operating cash flow	(5.6)	(1.1)	2.4	7.5	13.0
Mtce capex	(0.4)	(0.6)	(1.2)	(1.1)	(1.1)
Free cash flow	(6.0)	(1.7)	1.2	6.4	11.8
Growth capex	(0.2)	(12.0)	0.0	0.0	0.0
Acquisitions/Disposals	(0.0)	0.0	0.0	0.0	0.0
Other	(1.2)	0.0	0.0	0.0	0.0
Cash flow pre financing	(7.5)	(13.7)	1.2	6.4	11.8
Equity	17.7	0.0	0.0	0.0	0.0
Debt	0.0	0.0	0.0	0.0	0.0
Dividends paid	0.0	0.0	0.0	0.0	0.0
Net cash flow for year	10.2	(13.7)	1.2	6.4	11.8
Balance sheet (A$m)					
Y/E 30 June	**FY18F**	**FY19F**	**FY20F**	**FY21F**	**FY22F**
Cash	12.0	0.3	1.5	7.9	19.8
Accounts receivable	1.2	1.4	3.8	6.1	8.2
Inventory	0.2	0.0	0.0	0.0	0.0
Other current assets	0.7	0.7	0.7	0.7	0.7
Total current assets	*14.2*	*2.5*	*6.1*	*14.7*	*28.7*
PPE	0.4	11.2	11.2	11.3	11.3
Goodwill	0.0	0.0	0.0	0.0	0.0
Investments	0.0	0.0	0.0	0.0	0.0
Deferred tax asset	0.0	0.8	0.8	0.8	0.8
Other assets	1.1	1.1	1.1	1.1	1.1
Total non current assets	*1.4*	*13.1*	*13.1*	*13.1*	*13.1*
Total Assets	15.6	15.5	19.2	27.9	41.9
Accounts payable	0.9	0.6	1.7	2.4	3.0
Short term debt	0.0	2.0	2.0	2.0	2.0
Tax payable	0.0	0.0	0.0	0.0	0.0
Other current liabilities	0.2	0.2	0.2	0.2	0.2
Total current liabilities	*1.1*	*2.8*	*3.9*	*4.6*	*5.2*
Long term debt	0.0	0.0	0.0	0.0	0.0
Other non current liabs	0.0	0.0	0.0	0.0	0.0
Total long term liabilities	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*
Total Liabilities	1.1	2.8	3.9	4.6	5.2
Net Assets	**14.6**	**12.8**	**15.3**	**23.3**	**36.6**
Share capital	20.1	20.1	20.1	20.1	20.1
Accumulated profits/losses	(5.7)	(7.6)	(5.0)	2.9	16.2
Reserves	0.3	0.3	0.3	0.3	0.3
Minorities	0.0	0.0	0.0	0.0	0.0
Total Shareholder funds	**14.7**	**12.9**	**15.4**	**23.3**	**36.7**

Share price (14 September 2018)					**A$**	**0.18**
Interim (A$m)	**H119F**	**H219F**	**H120F**	**H220F**	**H121F**	**H221F**
Revenue	2.8	5.9	10.2	13.1	16.2	20.5
EBITDA	(2.1)	(0.0)	1.7	3.2	5.0	7.5
EBIT	(2.1)	(0.6)	1.1	2.6	4.4	7.0
NPAT (normalised)	(1.4)	(0.4)	0.7	1.8	3.1	4.9
Minorities	0.0	0.0	0.0	0.0	0.0	0.0
NPAT (reported)	(1.4)	(0.4)	0.7	1.8	3.1	4.9
EPS (normalised)	n/a	(2.8)	(0.8)	(0.2)	0.4	1.0
EPS (reported)	n/a	(2.8)	(0.8)	(0.2)	0.4	1.0
Dividend (cps)	0.0	0.0	0.0	0.0	0.0	0.0
Imputation	30.0	30.0	30.0	30.0	30.0	30.0
Operating cash flow	(0.6)	(5.0)	(0.5)	(0.6)	0.6	1.8
Free Cash flow	(0.4)	(4.5)	11.6	(0.1)	1.2	2.3
Divisions	**H119F**	**H219F**	**H120F**	**H220F**	**H121F**	**H221F**
Port Melbourne	0.3	1.7	1.9	2.8	3.9	5.6
Homebush	0.3	1.7	2.0	2.9	4.0	5.8
Adelaide	0.0	0.0	0.0	0.0	0.0	0.0
Brisbane	0.0	0.0	0.0	0.0	0.0	0.0
Software	0.1	0.1	0.1	0.1	0.2	0.2
Contract Mfg	2.0	2.4	6.1	7.3	8.1	8.9
Total Revenue	2.8	5.9	10.2	13.1	16.2	20.5
COGS	1.4	2.2	4.5	5.6	6.5	7.8
Telecommunications	0.1	0.3	0.3	0.5	0.7	1.0
Marketing	0.0	0.1	0.1	0.1	0.1	0.2
Rent	1.4	1.4	1.4	1.5	1.5	1.6
Employment	1.6	1.6	1.6	1.7	1.8	1.9
Other costs	0.3	0.3	0.3	0.3	0.3	0.3
Total Costs	4.8	5.8	8.4	9.8	11.1	12.8
EBITDA	(2.0)	0.1	1.8	3.3	5.1	7.7
Margins, Leverage, Returns		**FY18F**	**FY19F**	**FY20F**	**FY21F**	**FY22F**
EBITDA		n/a	(24.1%)	20.9%	34.1%	40.4%
EBIT		n/a	(31.2%)	16.0%	31.0%	38.1%
NPAT pre significant items		n/a	(21.1%)	10.9%	21.6%	26.8%
Net Debt (Cash)		12.0	- 1.7	- 0.5	5.9	17.8
Net debt/EBITDA (x)	(x)	n/a	n/a	- 0.096	0.475	0.883
ND/ND+Equity (%)	(%)	n/a	11.6%	2.9%	(34.1%)	(93.8%)
EBIT interest cover (x)	(x)	n/a	n/a	0.0	0.0	- 0.0
ROA		n/a	(17.5%)	21.4%	48.3%	54.4%
ROE			(13.4%)	17.9%	40.9%	44.5%
ROIC		0.0%	(16.3%)	(1508.6%)	75.7%	56.8%
NTA (per share)		0.08	0.07	0.08	0.13	0.20
Working capital		0.6	0.9	2.2	3.7	5.2
WC/Sales (%)		**28.2%**	**9.8%**	**9.3%**	**10.1%**	**10.5%**
Revenue growth		n/a	340.8%	165.7%	57.8%	35.8%
EBIT growth pa		n/a	n/a	(236.1%)	206.3%	66.9%
Pricing		**FY18F**	**FY19F**	**FY20F**	**FY21F**	**FY22F**
No of shares (y/e)	(m)	182	182	182	182	182
Weighted Av Dil Shares	(m)	98	182	182	182	182
EPS Reported	cps	(5.88)	(0.86)	1.18	3.69	6.22
EPS Normalised/Diluted	cps	(5.88)	(1.01)	1.39	4.35	7.32
EPS growth (norm/dil)		n/a	n/a	-237%	213%	68%
DPS	cps	-	-	-	-	-
DPS Growth		n/a	n/a	n/a	n/a	n/a
Dividend yield		0.0%	0.0%	0.0%	0.0%	0.0%
Dividend imputation		30	30	30	30	30
PE (x)		-	-	15.3	4.9	2.9
PE market		15.2	15.2	15.2	15.2	15.2
Premium/(discount)			(100.0%)	0.3%	(67.9%)	(81.0%)
EV/EBITDA		(5.1)	(16.4)	6.8	2.1	0.7
FCF/Share	cps	(2.8)	(0.3)	1.9	4.8	7.7
Price/FCF share		(6.4)	(66.7)	9.3	3.8	2.3
Free Cash flow Yield		(15.7%)	(1.5%)	10.7%	26.5%	43.0%

Source: RaaS Advisory

FINANCIAL SERVICES GUIDE

RaaS Advisory Pty Ltd

ABN 99 614 783 363

Corporate Authorised Representative, number 1248415

of

BR SECURITIES AUSTRALIA PTY LTD

ABN 92 168 734 530

AFSL 456663

Effective Date: 11th May 2017

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Contact Details, BR and RaaS

BR Head Office: Level 2, 129 Robertson Street, Fortitude Valley QLD, 4006

RaaS. 20 Halls Road Arcadia, NSW 2159

P: +61 414 354712

E: finola.burke@raasgroup.com

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What Financial Services are we authorised to provide? RaaS is authorised to

- provide general advice to retail and wholesale clients in relation to
    - Securities
- deal on behalf of retail and wholesale clients in relation to
    - Securities

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Our general advice service

Please note that any advice given by RaaS is general advice, as the information or advice given will not take into account your particular objectives, financial situation or needs. You should, before acting on the advice, consider the appropriateness of the advice, having regard to your objectives, financial situation and needs. If our advice relates to the acquisition, or possible acquisition, of a particular financial product you should read any relevant Prospectus, Product Disclosure Statement or like instrument. As we only provide general advice we will not be providing a Statement of Advice.

We will provide you with recommendations on securities

Our dealing service

RaaS can arrange for you to invest in securities by firstly sending you the offer document and then assisting you fill out the application from if needed.

How are we paid?

RaaS earns a fee from companies for providing a research report and/or a financial model on the company, for dealing in its securities or for assisting in raising capital. You don’t pay anything.

Associations and Relationships

BR, RaaS, its directors and related parties have no associations or relationships with any product issuers other than when advising retail clients to invest in managed funds when the managers of these funds may also be clients of BR. RaaS’s representatives may from time to time deal in or otherwise have a financial interest in financial products recommended to you but any material ownership will be disclosed to you when relevant advice is provided.

Complaints

If you have a complaint about our service you should

- contact your Adviser and tell them about your complaint, the adviser will follow our internal dispute resolution policy, including sending you a copy of the policy if required

- BR is a member of the Financial Ombudsman Service, our external dispute resolution provider.

Financial Ombudsman Service GPO Box 3 Melbourne VIC 3001 Telephone: 1300 78 08 08 Email: nfo@fos.org.au

Professional Indemnity Insurance

BR has in place Professional Indemnity Insurance which satisfies the requirements for compensation under s912B of the Corporations Act and that covers our authorized representatives.