

AUSTRALIAN

RESEARCH

INDEPENDENT INVESTMENT RESEARCH

Spring FG Limited (ASX: SFL)

Acquisition: Financial Choice

March 2017

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Share price (\$) as at 14 March 2017	0.25
Target price (\$) per share	0.28
Issued capital:	
Ordinary shares (M) - pre acqn	127.0
Options (M)	0.0
Acqn - Financial Choice	2.5
Performance Rights (M)	0.0
Fully Diluted (M)	129.5
Market capitalisation (\$M)	34.3
12-mnth Share Price Lo/Hi (\$)	0.16 / 0.275

Board and Management

Mr Guy Hedley (Non Exec. Chairman)

Mr Keith Cullen (Managing Director)

Mr Chris Kelesis (Executive Director)

Mr Jeffrey Zulman (Non Exec. Director)

Mr Russell Scott (CFO)

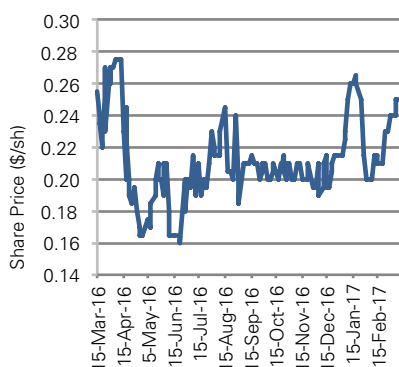
Mr Frank Paul (Head of Advice)

Mr Mitchell Ansiewicz (General Manager)

Major Shareholders (post acqcn)

	%
Keith Cullen	26.8%
Chris Kelesis	15.6%
IFM Pty Ltd <IFM Super Fund>	11.0%
Dam Enterprise Services Pty Ltd	5.6%
Bannaby Investments Pty Ltd	5.0%
Frank Paul	3.9%
Mitchell Ansiewicz	3.8%

Share Price



HIGHLY COMPLEMENTARY ACQUISITION

Spring FG (ASX: SFL) has announced the acquisition of financial service organisation Financial Choice Pty Ltd for a total commitment of \$4.8M. Settlement is due in mid April, 2017. This comprises \$2M cash on settlement, 2.5M SFL shares to be issued at \$0.20 per share (\$0.5M) plus a total of \$2.3M cash comprising two deferred payments: \$1.3M in 6 months time plus a \$1M performance based payment in 18 months time.

This acquisition is projected to increase SFL's earnings (eps) by 49% on a pro forma basis, and meaningfully rebalance its revenue base toward recurring revenues.

Financial Choice has been advising clients for over 20 years on products and strategies to manage client equity portfolios and related investments. Based on "FinTech" technologies, Financial Choice is a leader in creating investment management tools for investors.

KEY POINTS

The Acquisition: SFL will acquire Financial Choice Pty Ltd for \$4.8M, which represents an historic EBITDA multiple of 3.0 times (up to 3.75 times including performance payments).

Financial Choice: Financial Choice was established 20 years ago, and currently has a staff of 6 and with offices in Sydney and Melbourne. The group provides comprehensive advice for retail clients across equities, hybrids, Exchange Traded Funds (ETFs), and fixed interest securities. Financial Choice also provides model portfolio services to optimise client portfolio construction and to meet the financial objectives and risk profile of the clients. Financial Choice currently has 200 SMSF clients with an average portfolio balance (AUM) of \$0.75M; the total SMSF and retail client base is 15,000. The total book consists of \$325M FUA, compared to SFL's FUA of \$525M prior to the acquisition. Financial Choice's revenue base is structured to be 97% recurring (indicating a low risk of loss of clients over the medium term), compared to SFL's 24% recurring revenue structure. The merged businesses will have a projected 34% recurring revenue base, closer to the group's target of 50%. The average SMSF client investment portfolio for Financial Choice at \$0.75M is significantly higher than SFL's \$0.38M. Financial Choice claims to be the lowest cost, automated ("FinTech") equity financial advise organisation in Australia. The company also provides wider investment advice including family budgeting, automated bill payments, and taxation advice.

Rapidly Expanding industry: The Australian SMSF industry (one of the key industries in which both SFL and Financial Choice operate) continues to show relatively strong growth. For the quarter to September, 2016 (the latest data available from the Australian Taxation Office), the total number of SMSFs increased by 4.5%, in line with the longer term range of 3.7% to 7.6% pa since June 2009. Total assets increased by 7.1% in the September, 2016 quarter. Of the total funds held within SMSFs, 31% was held in equities and 15% in property investments, both in line with the long term average. The outlook for SMSF assets will be impacted by any proposed changes to Federal regulations impacting investor flexibility.

Enhanced Opportunities for Cross Selling: While Financial Choice provides a range of financial services, SFL has more extensive capabilities related to financial management including property, taxation, mortgage and insurance services. We expect SFL to enhance the revenue stream of the merged group over time by cross selling its product suite to the client base of 15,000 retail / SMSF clients acquired through the Financial Choice acquisition.

Capital Position: At 31 December, 2016 SFL had \$1M cash on the balance sheet and Net Assets of \$16.3M. This included Intangibles of \$8.3M. With no debt, SFL was negatively geared. The Current Ratio is almost 3 times. The group has structured itself such that it has a low financial risk, to offset the risks associated with early stage growth. The acquisition of Financial Choice has been structured to spread the cash flow impacts, and for these obligations to be sourced from cash flow generated over the 18 month settlement period.

Valuation: We have revised our target price for SFL from \$0.225 up to **\$0.28** per share recognising the risk adjusted pro forma estimated increase in eps due to this acquisition, and the longer term growth options. On the assumption the acquisition meets all expectations, the associated risk profile would reduce and our valuation would increase to 31 cps.

PROFIT & LOSS (\$M)			
Y/E June	2015 (Act)	2016 (Act)	2017 (Est)
Revenue	9.9	11.7	14.1
EBITDA	2.2	2.9	4.3
Depreciation & Amortisation	0.2	0.4	0.6
Finance Cost	0.1	0.0	0.1
Profit Before Tax	1.9	2.5	3.7
Tax Expense	0.4	0.7	1.1
Net Profit (Underlying)	1.5	1.7	2.6
One-off Items	0.0	-0.1	0.0
Net Profit (Reported)	1.5	1.8	2.6

BALANCE SHEET (\$M)			
Y/E June	2015 (Act)	2016 (Act)	2017 (Est)
Cash and cash equivalent	1.6	1.4	0.7
Trade and other receivables	3.4	4.6	7.0
Inventories and work in progress	0.0	0.0	0.0
Current tax receivables			
Other current assets	0.4	0.3	0.6
Total current assets	5.4	6.3	8.3
Property, plant and equipment	0.5	0.7	1.0
Intangible assets	7.9	8.1	10.3
Research and development			
Total non-current assets	8.3	8.8	11.3
Total Assets	13.8	15.1	19.6
Trade and other payables	1.5	1.7	2.5
Borrowings	0.0	0.0	0.0
Current tax liabilities	0.8	0.8	1.6
Other provisions	0.0	0.4	0.1
Total Current Liabilities	2.4	2.9	4.2
Trade and other payables	0.0	0.0	0.6
Borrowings	0.0	0.0	0.5
Deferred tax			
Provisions	0.5	0.5	0.7
Total Non-Current Liabilities	0.5	0.5	1.8
Net Assets	10.9	11.8	13.6

CASHFLOW (\$M)			
Y/E June	2015 (Act)	2016 (Act)	2017 (Est)
Receipts from customers	9.3	12.2	13.8
Payments to suppliers and employees	-8.5	-10.8	-11.7
Income tax paid	-0.9	-0.9	-0.8
One off and non recurring items	-0.9	0.0	0.0
Net interest (paid) / received	0.0	0.1	-0.1
Net Cash from Operation Activities	-1.0	0.6	1.3
Payments for acquisitions	-3.5	0.0	0.0
Payments for PP&E	-0.1	-0.9	-0.6
Payments for intangible assets	0.0	0.0	-2.3
Payments for product development	0.0	0.0	0.0
Proceeds on disposals and sales	0.0	0.0	0.0
Net Cash from Investing	-3.6	-0.9	-2.9
Proceeds from borrowings	0.0	0.0	0.0
Repayments of borrowings	-0.8	0.4	0.2
Dividends paid to shareholders	-1.2	-1.1	-1.2
Proceeds from share issue	7.1	0.7	1.0
Net Cash from Financing	5.1	0.1	-0.6
Cash at Beginning of the Year	0.8	1.6	2.3
FX Effect	0.0	0.0	0.0
Net Change in Cash	0.9	-0.2	-2.0
Cash at End	1.6	1.4	0.3

Ratios			
Y/E June	2015 (Act)	2016 (Act)	2017 (Est)
Profitability Ratios			
EBITDA margin (%)	22.6%	24.6%	30.7%
Net profit margin (%) (underlying)	15.7%	14.3%	18.7%
ROA (%)	11.2%	11.0%	13.4%
ROE (%)	14.2%	14.2%	19.3%
Diluted EPS (underlying)	10.3	11.1	17.5
DPS	2.6	1.0	1.0
Liquidity & Debt Ratios			
Net Debt to Equity (%)	-14.9%	-11.7%	-1.5%
Current Ratio (x)	2.3	2.2	2.0

FINANCIAL CHOICE ACQUISITION

- ◆ The acquisition of Financial Choice is expected to be meaningfully value accretive for SFL. The acquisition will also establish longer term revenue growth opportunities, reduce the company's risk profile, and add highly experienced wealth managers to the existing team.
- ◆ The acquisition has been structured to spread the financial risks and obligations so that it can be partly funded by available cash reserves plus future cash generation. The expected total cost of the acquisition is \$4.8M comprising:
 - \$2M cash on settlement
 - 2.5M new shares issued at 20 cps (\$0.5M)
 - Deferred payment of \$1.3M (6 month deferment)
 - Performance payment of \$1.0M (18 month deferment)
- ◆ SFL has made several acquisitions since its establishment, with each expanding the group's capabilities, professional staff, client base and depth of services.
- ◆ Financial Choice is a significant acquisition. The total client base of Financial Choice is circa seven times larger than SFL's current client base, with each SMSF client holding double the assets (at \$0.75M) compared to SFL's clients. Financial Choice, based on 2016 accounts, has far higher NPAT profit margin than SFL, at 46% compared to 14%.
- ◆ Importantly, with 94% recurring revenue compared to SFL's 24%, the acquisition and consolidation of Financial Choice will reduce the risk profile of the merged group with 34% of revenue locked in over the medium term through obligated (eg, contracted) payments from clients.
- ◆ The following table summarises the key metrics of SFL, of Financial Choice, and the merged entity.

Operational and Financial Comparison			
	SFL	FC	Pro Forma
AUM (\$M)	525	325	850
SMSF - Average Assets (\$M)	0.38	0.75	0.50
Recurring Revenue (\$M)	2.82	1.74	4.50
Recurring Revenue (% total)	24	97	34
SMSF Clients (#)	430	200	630
Total Clients (#)	2,100	15,000	17,100
Shares on Issue (M)	127.0	-	129.5
EPS (cps)	1.3	-	1.9

Note:

SFL = Spring FG Limited

FC = Financial Choice Pty Ltd

Pro forma = estimated merged group based on historic data

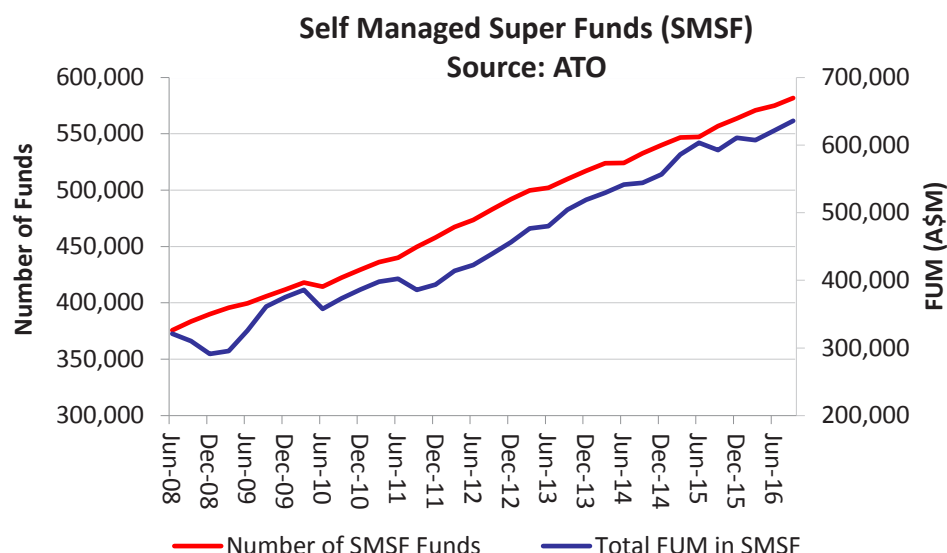
ACQUISITION IMPACT ON SFL

- ◆ The acquisition of Financial Choice is a game changer for SFL, providing the merged group several meaningful growth options and a reduced risk compared to SFL's current profile.
- ◆ Based on client base, Financial Choice is circa seven times larger than SFL. On the more relevant metric of profitability, Financial Choice generates (based on historic 2016 data) a profit after tax half that of SFL - indicating the relative size of this acquisition and hence the profit upside available to SFL from this acquisition. With only a modest number of shares being issued through the acquisition, pro forma eps is forecast to increase by 49% assuming debt is not increased, ie that the deferred payments are sourced internally from cash flow generation over the next 18 months.
- ◆ Assets Under Management (AUM) are projected to increase significantly from \$525M to \$850M. With 15,000 clients acquired, compared to SFL's current client base of 2,100, there is significant scope to offer the acquired Financial choice clients a more extensive and broad range of financial services, based on SFL's existing product suite.

- ◆ SFL has a comprehensive product range spanning financial management, equity portfolio management, property acquisition and management, taxation advice, insurance, lifestyle planning, investment strategies, and related services. This comprehensive suite of products can be marketed to the acquired client base from Financial Choice, providing the scope to drive value accretive revenue growth over the longer term.
- ◆ The technology base of SFL is scalable, meaning that it can support revenue growth while sustaining only a marginal increase in costs. The company should benefit from the eventual onboarding of Financial Choice's client base to its current technology platform over time. It has not at this stage been determined the nature or timing of the merger of the technology platforms that support both the legacy and the acquired companies.
- ◆ The client base of Financial Choice (15,000 clients) is almost evenly split between retail clients and SMSF clients, providing both personal and general advice. The client base consists of a broad spectrum of profiles, from young to old and from small account balances to large portfolios. This diverse client base will add to SFL's existing client base, enhancing scale and momentum for the merged group and providing opportunities to offer SFL's product suite to these new clients.
- ◆ A significant number of Financial Choice's clients reside on various adviser network platforms, meaning that they are also clients of third party advice companies. SFL will attempt to migrate these clients to their own direct platforms (including OnePath and 24/7), enhancing the value of each client to SFL providing revenue momentum through this process.
- ◆ The founder, Russell Metcraft, and key staff of Financial Choice will be employed by SFL, adding their experience, skills and customer contacts to the existing competencies of SFL.
- ◆ For SFL shareholders, there is expected to be value accretion from the arbitrage between the private valuation and public valuation, as the value of the business increases from the low PE used to value the acquisition to the higher PE used by the market after the merger.
- ◆ Acquiring Financial Choice will not only increase SFL's recurring revenue, it will also broaden the nature of the client base, broadening the nature of advice from property and SMSF to a wider spectrum of financial advice. In addition, the Financial Choice client base has a greater exposure to alternative investment securities including Exchange Traded Funds (ETFs). SFL will acquire experience in these alternative assets which can then be marketed to the merged group's client base. These aspects of the merger are expected to reduce the risk profile of SFL.
- ◆ Assuming this acquisition delivers the expected benefits, this will give SFL the scale and reputation to initiate further acquisitions, accelerating the revenue growth opportunities.
- ◆ In our view, SFL has several growth opportunities available from the acquisition of Financial Choice - both on a pro forma basis and from longer term revenue growth options.

SMSF - STRONG GROWTH INDUSTRY

- ◆ Both SFL and Financial Choice have a significant exposure to the Self Managed Superannuation Fund sector, through the assets of their client bases.
- ◆ In Australia, the SMSF sector has grown by 7% in the quarter to September, 2016. This is in line with the long term growth experienced by the sector. The total value of listed and unlisted shares in client portfolios is approx \$200B, with an additional \$100B in property assets.
- ◆ There are 582,000 SMSF schemes operating in Australia, representing an annual growth of 4.5%. The total number of SMSF members also increased by over 4.5% in the year to September, 2016. This exceeds the population growth of Australia, indicating that the sector is penetrating deeper into the working population.
- ◆ The following chart highlights the long term growth in Funds Under Management (FUM) within the SMSF sector, with consistent growth ahead of inflation and population growth over the period from June 2008.



VALUATION

- ◆ We have revised our target price up to **\$0.28** per share from the \$0.225 per share in our initiation of coverage report dated December, 2016. This valuation is conservative due to the normal risk factors that are related to an acquisition. We expect the share price to more closely reflect our valuation as the market recognises the significance of this acquisition and the growth opportunities it creates. Our valuation increases to circa **31 cps** if the acquisition risks are discounted, and Financial Choice delivers on expectations.
- ◆ The valuation is based on the company's revenue growth guidance over the years 2017 to 2020 of 15% pa. We also note that SFL has indicated that profit margins should increase as the business model matures. SFL reported a profit of \$1.6M on revenue of \$11.6M in 2016.
- ◆ We have forecast a merged entity profit of \$2.63M in 2017 on a pro forma (ie, not reported) basis. This assumes the acquisition merges smoothly into the existing operations, and no benefit in 2017 from other growth opportunities. This profit figure equates to 2.03 cps. With a full year of the acquisition, SFL's reported profit in 2018 is expected to reflect organic growth in excess of the industry growth rate of 4.5% - 5.0%, plus the ongoing Financial Choice merger benefits. While we have forecast 1 cps dividend in 2017, there is clearly scope to exceed this forecast.
- ◆ The forecasts are tabulated below. Note that, with the acquisition of Financial Choice yet to be reflected in audited accounts, we have remained conservative with our forecasts.

Forecast Financials (merged entity; pro forma 2017)

	2017
Merged Revenue (\$M)	14.1
NPAT (\$M)	2.63
Earnings (EPS)	2.03
Dividends (dps)	1.00

(source: IIR)

SFL is trading on more favourable valuation metrics than its competitors:

Peer Comparison	SFL	Centerpoint	Fiducian	Clearview Wealth
Market Cap (\$M)	29.8	111	128	89.2
NPAT Multiple (x)	12.3	26.1	19.4	32.6
FY16 Div Yld (%)	5.3%	3.1%	3.4%	3.9%

(source: SFL)

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