

Date of issue

23.02.10

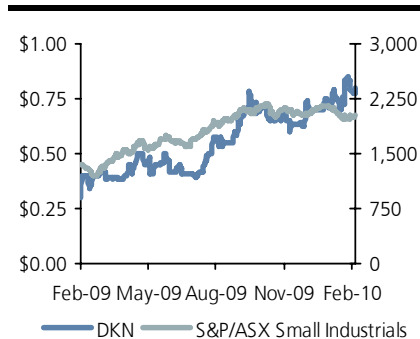
Company Update

INVESTMENT DATA

Share Price	\$0.83
Issued Capital	
Ordinary Shares	142.0
Options/Other	0.0
Fully Diluted	142.0
Market Capitalisation	\$117.8m
52 Week Low/High	\$0.33/ \$0.85
Price Target (12 months)	\$0.90

Top 20 shareholders as at 21 August 2009 hold 80.5% of total shares on issue

Year end Jun	09a	10f	11f	12f
Revenue	\$m 24.1	28.0	31.9	35.0
EBITDA	\$m 10.6	11.9	14.0	15.5
EBIT	\$m 10.1	11.4	13.4	15.0
NPAT	\$m 6.2	7.5	9.3	10.5
EPS adj	¢ 4.4	5.3	6.5	7.4
EPS growth	% -34.3	20.5	22.6	13.8
DPS	¢ 3.9	4.4	5.4	6.1
Yield	% 4.7	5.3	6.5	7.4
Franking	% 100	0	0	0
P/E	x 18.9	15.7	12.8	11.2
EV/EBITDA	x 11.0	9.9	8.4	7.5



DKN Financial Group (DKN)

Buy

Leveraging growth

DKN's core business is to provide financial service solutions to wealth management practices. The group earns profits by 'clipping-the-ticket' on funds under administration (FUA), and in turn providing access to platforms, products, and other ancillary services. The group also has equity interests in 8 financial planning businesses and the Lonsdale Financial Group, a dealer group that supports 108 practices, with a view to increasing FUA. DKN's profitability is therefore highly leveraged to attaining increased FUA, either through positive investment returns or inflows of new funds. Given an improved economic environment, the group is well placed to lever this into future profitability.

Normalised EPS up 17.6%

DKN reported a normalised net profit of \$3.9m, a 25.2% increase over the prior corresponding period (PCP). EPS increased 17.6% to 2.6 cents and the group delivered an unfranked interim dividend of 2.0 cents. Free operating cash flow increased from \$1.1m in 1H09 to \$6.3m in 1H10, leaving the group with a net debt position of \$2.6m.

The result was bolstered by strong results in Platform Solutions, supported by higher funds under administration and good cost control, and a return to profitability of the core Lonsdale business (excluding internal platform fees). Product Solutions result was impaired by lower FUA, we estimate down almost ~10% against the PCP, and the equity and loans business delivered a flat result, impaired by a negative contribution from one of the equity positions.

EPS growth of 20.5% in FY10 and 22.6% in FY11

DKN's profitability is largely beholden to the profitability of the Platform and Product business, which accounts for the lions share of earnings. The remaining businesses are largely retained in order to facilitate the process of growing this FUA. Given FUA finished the year at \$7.75bn and received net inflows of \$0.3bn in 1H10, we are comfortable with our forecasts of achieving FUM of \$8.2bn at closing year end. This implies an average FUM of \$8.0bn in 2H10.

Factoring in this result we have made some minor adjustments to our earnings. Following these adjustments, DKN offers EPS growth of 20.5% in the current period and 22.6% in FY11, once again highlighting the degree of operating leverage from the groups Platform and Product Solutions divisions in particular, should market conditions continue to improve.

Buy Recommendation retained

We have increased our DCF valuation from \$0.84 to \$0.90, using a WACC of 13.0% and a terminal growth rate of 2.5%. At \$0.90, this valuation implies a reasonably hefty PE ratio of 17.3x in FY10 and a more reasonable 13.8x in FY11. This compares to peers Count Financial (ASX code: COU) currently on a comparable 15.1x in FY10 and 13.1x in FY11 and WHG Group (ASX code: WHG) on a miserly 8.8x in FY10 and 7.6x in FY11. We would point out that 77.5% of WHG's EBIT comes from its accounting operation of which DKN does not have an exposure. Interestingly enough, COU owns 7.1% of DKN purchasing its last \$3.0m share at \$0.80. We retain our Buy recommendation.

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Half Year Results Review

DKN reported a normalised net profit of \$3.9m for the 1H10, 25.2% higher than the PCP. The result benefited from organic growth and solid cost control particular in Lonsdale Financial Group, noting that while market conditions and ending FUM improved considerably from \$6.6bn in 1H09 to \$7.8bn in 1H10, average funds under management (FUM) over the period actually declined from \$7.60bn in 1H09 to \$7.25bn in 1H10, intimating a solid base for the 2H10 result. The group reported normalised EPS of 2.6 cents, up 17.6% and delivered an interim dividend of 2.0 cents per share unfranked, owing to significant deductions post the Lonsdale trasation which has resulted in no tax payments 2008, 2009 and 2010. Free operating cash flow, which includes dividends from minority interests, increased from \$1.1m in 1H09 to \$6.3m in 1H10.

Table 1 - DKN Half Year Results Summary

	1H09	1H10	% Change	1H10f	% diff
Revenue	12.4	13.5	9.0%	14.4	6.7%
EBITDA	4.7	5.7	20.9%	5.5	-3.5%
Margin	37.6%	41.8%		38.1%	
Depreciation and amortisation	0.2	0.2	-1.6%	0.2	0.0%
EBIT	4.4	5.4	22.2%	5.3	-1.9%
Pre-tax profit	4.4	5.4	22.2%	5.3	-1.9%
Tax	1.3	1.5	15.2%	1.6	6.7%
Normalised net profit	3.1	3.9	25.2%	3.7	-5.1%
Reported net profit	-14.7	3.9	n/a	3.7	-5.1%
Diluted EPS (CPS)	2.2	2.6	17.6%	2.6	0.0%
Dividends (DPS)	0.0	2.0	n/a	2.0	0.0%
Payout ratio	n/a	77.2%		76.4%	
Operating Free Cash Flow	1.1	6.3	460.6%		
Net Cash	1.9	2.6	36.8%		

Divisional Detail

- Platform Solutions** - Revenues in the platform business increased 5.1% to \$8.2m in the 1H10 and EBIT increased 6.3% to \$6.8m. Although total average FUM actually decreased 4.6% over the period, we understand that the platform FUM (mainly comprising BT Wrap and AustChoice) did increase over the period, noting that platform solutions takes a clip over the platform FUA. What is interesting, although perhaps not surprising, is that the \$0.4m increase in revenue appears to have flowed through to the EBIT line in its entirety, noting the operational leverage of this division.
- Product Solutions** - Revenues in the product business declined 20.5% to \$0.8m and EBIT in turn fell 39.1% to \$0.4m. This is largely a result of the flight to cash that occurred during the 1H09, thus a materially higher average product FUA, and also Cash Managed Trust withdrawals in the 1H10 as investors transfer funds back into the market.
- Acquisition and Succession (Equity and Loans)** - EBIT contribution from DKN's equity and loans business flattened across the period delivering \$0.4m. We understand the division, which encompasses 8 minority positions, was impacted by a negative contribution from one of the equity positions of approximately \$0.1m. We also anticipate that this group will benefit from the improved market conditions in 2H10.
- Lonsdale Financial Group** - Lonsdale delivered a materially higher result at the revenue line up 32.1% and delivered a positive contribution of \$0.1m in 1H10. We note that management stripped out a \$1.3m internal platform fee in 1H09, bringing the divisions comparable 1H09 result into negative territory, with an EBIT contribution in 1H09 of -\$0.6m).

Table 2 - DKN Divisional Detail, Historical Performance

Revenue	1H09	2H09	FY09	1H10	2H10f	FY10f
Platform Solutions	7.8	7.1	14.9	8.2	9.1	17.3
Product Solutions	1.0	1.1	2.1	0.8	0.8	1.7
Equity and Loans	0.5	0.4	0.8	0.5	0.5	1.0
Lonsdale	2.8	3.0	5.8	3.7	4.1	7.7
Unallocated	0.4	0.1	0.5	0.3	0.0	0.3
Total	12.4	11.7	24.1	13.6	14.4	28.0
EBIT						
Platform Solutions	6.4	3.4	9.8	6.8	7.5	14.3
Product Solutions	0.7	0.8	1.5	0.4	0.4	0.8
Equity and Loans	0.4	0.4	0.8	0.4	0.4	0.8
Lonsdale	-0.6	2.8	2.2	0.1	0.2	0.2
Unallocated	-2.5	-1.7	-4.2	-2.3	-2.5	-4.8
Total	4.4	5.6	10.1	5.4	6.0	11.4
PBT margins						
Platform Solutions	82.6%	47.2%	65.7%	82.8%	82.8%	82.8%
Product Solutions	66.0%	76.7%	71.5%	50.5%	50.5%	50.5%
Equity and Loans	86.6%	95.5%	90.6%	78.2%	77.3%	77.7%
Lonsdale	-20.6%	92.7%	38.6%	1.5%	4.9%	2.0%

Cash Flow and Balance Sheet

DKN delivered solid operating free cash flow increasing from \$1.1m in 1H09 to 6.3m in 1H10, including dividends from minority interests. However, the quality of this cash flow is weak with the 1H10 result being inflated by the inclusion of a tax refund of \$2.8m. Historically, the business appears to generate a better cash conversion in the second half. The group maintains a solid balance sheet with net cash of \$2.6m on the balance sheet.

Register movements

DKN announced on the 4 Feb 2010, that Count Financial (ASX code: COU) has taken a 5.0% equity position in DKN and on 22 Feb 2010 increased that equity position to 7.1%. COU's initial 7.1m shares were acquired at 70.1 cents per share or a total cost of \$5.0m and second block of 3.0m shares were acquired at 80.0 cents per share or a total cost of \$2.4m.

COU is the largest independently owned network of franchise accountants and advisers with a franchise network of over ~420 offices, 860 authorised representatives with over \$10bn in funds under advice.

We suspect COU is likely to be interested in DKN's distribution business and its ability to attract new financial firms to its network and the groups \$7.7bn in funds under advice. However, it must be noted that the two largest positions on DKN's register (Zurich Financial Services - 31% and IOOF Holdings - 19%) account for 50% of the entire register. We would therefore suggest that at current levels, a scrip-for-scrip offer would only be considered and would obviously need support from the underlying financial planning network (Lonsdale, etc) which may be difficult to negotiate.

DKN Financial Group (DKN) As at 23/02/2010 **Recommendation:** Buy Share price: \$ 0.83 Market cap (\$m): \$117.8m

Income Statement					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Revenue	\$24.9m	\$24.1m	\$28.0m	\$31.9m	\$35.0m
EBITDA	13.6	10.6	11.9	14.0	15.5
Depreciation and amortisation	0.3	0.5	0.6	0.6	0.6
EBIT	13.3	10.1	11.4	13.4	15.0
Net interest	-1.2	-1.2	-0.8	-0.4	-0.3
Pre-tax profit	12.1	8.8	10.6	13.0	14.7
Tax	-3.5	-2.6	-3.0	-3.7	-4.2
Normalised net profit	8.6	6.2	7.5	9.3	10.5
Non-recurring items	-2.1	-17.7	0.0	0.0	0.0
Reported net profit	6.5	-11.5	7.5	9.3	10.5

Cashflow					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Reconciliation					
Net Profit	\$6.5m	-\$11.5m	\$7.5m	\$9.3m	\$10.5m
Depreciation/Amortisation	0.30	0.51	0.57	0.56	0.55
Change in working capital	-1.55	-1.45	-0.33	-0.52	-0.40
Other	-2.59	19.80	-0.80	-0.92	-1.01
Net operating cashflow	2.71	7.32	6.97	8.38	9.63

Investing cashflow					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Capex	-0.89	-0.14	-0.50	-0.52	-0.53
Sale/purchase of PPE	-27.97	-0.14	-0.50	-0.52	-0.53
Dividends from Minorities	1.23	0.74	0.90	1.03	1.13
Other	1.04	1.50	0.00	0.00	0.00
Net investing cash flow	-26.74	0.60	0.40	0.52	0.60

Financing activities					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Issue of shares	25.71	-5.27	0.00	0.00	0.00
Net borrowings	16.00	-2.60	0.00	-5.00	-2.00
Dividends paid	-4.15	-4.86	-6.27	-7.66	-8.68
Net financing cash flow	37.56	-12.72	-6.27	-12.66	-10.68
Net change in cash held	13.53	-4.80	1.10	-3.77	-0.45

Balance Sheet					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Assets					
Cash assets	\$16.8m	\$11.5m	\$12.6m	\$8.8m	\$8.4m
Receivables	4.56	6.38	7.41	8.42	9.24
Other	0.42	0.34	0.39	0.45	0.49
Total current assets	21.74	18.19	20.37	17.67	18.08
Property, Plant and equipment	1.18	1.11	1.04	0.99	0.97
Intangible assets	146.93	135.08	135.08	135.08	135.08
Other	18.86	12.51	12.42	12.31	12.19
Total non-current assets	166.97	148.70	148.53	148.38	148.24
Total assets	188.71	166.89	168.91	166.05	166.32

Liabilities					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Payables	3.82	4.06	4.82	5.36	5.82
Borrowings	2.60	3.20	3.20	3.20	3.20
Other	2.09	1.11	1.11	1.11	1.11
Total current liabilities	8.51	8.37	9.13	9.67	10.13
Borrowings	13.40	10.20	10.20	5.20	3.20
Other	0.86	4.07	4.07	4.07	4.07
Total non-current liabilities	14.26	14.27	14.27	9.27	7.27
Total liabilities	22.77	22.64	23.39	18.93	17.39
Net assets	165.94	144.25	145.51	147.12	148.93

Equity					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Contributed equity	175.80	170.77	170.77	170.77	170.77
Retained earnings	-9.86	-26.52	-25.25	-23.65	-21.84
Total equity	165.94	144.25	145.51	147.12	148.93

Shares on Issue					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Shares on issue	144.4	138.1	141.9	141.9	141.9
Weighted avg diluted shares	129.5	140.3	141.4	142.4	142.4

Valuation Data					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
Normalised net profit	\$8.6m	\$6.2m	\$7.5m	\$9.3m	\$10.5m
Normalised EPS *	6.7c	4.4c	5.3c	6.5c	7.4c
EPS growth	-1.5%	-34.3%	20.5%	22.6%	13.8%
P/E ratio	12.4x	18.9x	15.7x	12.8x	11.2x
DPS	4.5c	3.9c	4.4c	5.4c	6.1c
Yield	5.4%	4.7%	5.3%	6.5%	7.4%
Franking	100%	100%	100%	100%	100%
OpCFPS (exl. abnormals)	2.1c	5.2c	4.9c	5.9c	6.8c
Price/OpCFPS	39.7x	15.9x	16.8x	14.1x	12.3x
EV/EBITDA	8.8x	11.0x	9.9x	8.4x	7.5x

* Historical and forecast EPS on fully diluted basis

Profitability & Leverage Ratios					
Year end June 30	FY08A	FY09A	FY10F	FY11F	FY12F
EBITDA Margin	55%	44%	43%	44%	44%
EBIT Margin	53%	42%	41%	42%	43%
NPBT	49%	37%	38%	41%	42%
NPAT	35%	26%	27%	29%	30%
Return on assets	4.6%	3.7%	4.5%	5.6%	6.3%
Assets to equity	1.1x	1.1x	1.2x	1.2x	1.1x
Return on equity	5.2%	4.3%	5.2%	6.3%	7.0%
Dividend cover	1.5x	1.1x	1.2x	1.2x	1.2x
Effective tax rate	28.7%	29.8%	28.7%	28.7%	28.7%
Net debt/(cash)	-\$0.8m	\$1.9m	\$0.8m	-\$0.4m	-\$2.0m
Net debt/equity	-0.5%	1.3%	0.6%	-0.3%	-1.3%

Assets Under Management					
	FY08A	FY09A	FY10F	FY11F	FY12F
AUM	\$8.1bn	\$6.8bn	\$8.2bn	\$9.3bn	\$10.2bn
AUM Growth	136%	-15%	20%	14%	10%

Valuation			
		\$m	\$/share
WACC = 12.5%	Operations	124.6	0.89
Terminal growth rate = 2.50%	Net Cash	1.9	0.01
Target debt-to-equity = 30.0%	Total	126.5	0.90

Other				
Company	FY08A	FY09A	FY10F	FY11F
Count Financial (ASX code: COU)	14.9x	17.1x	15.1x	13.1x
WHK Group (ASX code: WHG)	8.7x	10.6x	8.8x	7.6x
Average	11.8x	13.8x	12.0x	10.4x
DKN Financial (ASX code: DKN)	12.4x	18.9x	15.7x	12.8x

Business Description

DKN is a financial services solutions provider to financial planning practices in Australia. The company derives its core profits through recurring margins on funds under administration in platforms and product, and profit contributions through DKN's equity positions in a portfolio of financial planning practices. Following DKN's merger with Lonsdale and Wrap, the new entity comprises over 300 financial planning practices (95 practice licensed under the Lonsdale Dealer Group, 100 practices supporting Wrap under their own licences and 150 practices from the existing DKN network). The group also has six minority interests in financial planning businesses.

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