



# DKN FINANCIAL GROUP LTD(DKN)

RESEARCH

TOLHURST

<b>Last Price</b> \$0.88	<b>Price Target</b> \$1.29	<b>Sector</b> Diversified Financials	<b>Risk Rating</b> <b>MEDIUM</b>	<b>Short term &lt;12m</b> <b>ACCUMULATE BUY</b>	<b>Long Term &gt;12m</b>
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<b>Company update</b>	Earnings Downgrade
<b>Recommendation Change</b>	No Change
<b>Target Price Change</b>	Decreased to \$1.29 (from \$1.43)
<b>Forecast Change</b>	Decreased EPS forecasts by c6%

## Market Stats

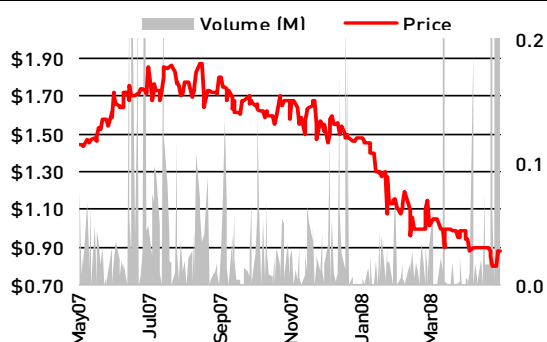
Market Capitalisation	\$m	127
12 Month Price Range		\$0.78 - \$1.97
Monthly Turnover	\$m	10.4
Monthly Volume	#m	12.3
% of SOI traded per month	%	8.5

Fundamentals		2008P *	2009E	2010E	2011E
Net Profit	\$m	11.7	13.3	15.7	18.4
EPS	¢	7.5	8.4	10.0	11.7
EPS Growth	%	n/a	12.7	18.4	16.9
PE	x	11.8	10.4	8.8	7.5
DPS	¢	6.5	7.5	9.0	10.5
Yield	%	7.4	8.5	10.2	11.9
Franking	%	100	100	100	100
P/CF	x	12.2	9.6	8.2	7.0
EV/EBITDA	x	8.4	6.9	5.8	5.0
ROE	%	7.6	8.5	9.9	11.3

TNL adjusted NPAT from continuing operations and excluding abnormal items  
EPS reported on a fully diluted basis  
\* Pro-forma reflects 12 month contribution of Lonsdale and Wrap (effective 1 July 2007)

Forecast Returns	% Return- 12 months
Forecast Price Appreciation	46.6
FY08 Pro-forma Dividend Yield	7.4
Total Forecast Return	53.4

## Share Price Chart 1 Year



## Market weakness offsets continued inflows

### Event

DKN has lowered its 2H08 profit guidance from \$5.9 million to \$5.3 million on the back of ongoing volatility in equity markets. This follows an initial c6% reduction in 2H08 guidance which the company provided with its interim result in February. DKN maintained its 2H08 dividend guidance of 3.5 cps.

The company also reported 3Q08 fund inflows of \$141 million, taking total inflows to date in FY08 to \$683 million. However this solid operating performance was well and truly masked by weakness in equity markets. DKN indicated that market weakness has resulted in a 10% reduction in FuA and now anticipates FuA of \$8.35 billion at year end (previously \$9.0 billion).

### Impact

Our key takeaway from the earnings downgrade was that DKN's underlying operations are performing well in an increasingly difficult business environment. Given the increased level of equity market volatility and string of downgrades from listed peers, we have attempted to be conservative with our outlook. We are reducing our EPS forecast by a further 6% following on from our 10 - 15% reduction in February.

It is worth noting that the extent of the previous decrease was largely due to our 10 - 15% EPS upgrade in November 2007 following the merger. This upgrade was based on the assumption that the existing buoyant equity market conditions would continue and DKN would receive additional margin uplift from its increased scale.

Key changes are illustrated in the table below:

	Old Forecasts			New Forecasts		
	FY08P	FY09F	FY10F	FY08P	FY09F	FY10F
FuA (\$b)	9.0	10.3	11.7	8.4	9.7	11.1
NPAT (\$m)	12.3	14.1	16.6	11.7	13.3	15.7
EPS (cps)	7.8	9.0	10.6	7.5	8.4	10.0
DPS (cps)	6.5	7.5	9.0	6.5	7.5	9.0
DCF (\$)		1.70			1.63	
Rel Value (\$)		1.16			0.94	
Price Target (\$)		1.43			1.29	

## Recommendation and Valuation

Our price target has decreased to \$1.29 ps (from \$1.43 ps), underpinned by the sector's de-rating adversely affecting our relative valuation. Combining this with our forecast FY08 pro-forma dividend yield of 7.4% equates to a total forecast 12-month shareholder return of 53.4%. While this would usually justify a Buy recommendation, we are maintaining our Short-Term Accumulate recommendation to reflect the increased market volatility making investors less willing to invest in small, illiquid stocks.

We view the acquisition of LFG and Wrap favourably given the clear benefits to DKN (scale), Lonsdale (scale and increased service offering) and Zurich (distribution). In addition, we retain our favourable view of DKN's model, management and recent track record. However, we believe it will be fighting against some increasingly difficult sector-wide headwinds. We need to see some equity market stability before we upgrade to a Short-Term Buy.



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RESEARCH

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Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$0.88	\$1.29	Diversified Financials	MEDIUM	ACCUMULATE BUY	

## TNL forecasts for DKN on a merged basis

Profit and Loss				
Y/e June 30	2008p	2009e	2010e	2011e
Total Revenue	32.2	35.2	39.2	43.2
EBITDA	16.3	20.0	23.5	27.2
Depreciation	-0.1	-0.1	-0.1	-0.1
Amortisation *	0.0	0.0	0.0	0.0
EBIT	16.2	19.9	23.4	27.1
Net Interest Expense	0.6	-0.9	-0.9	-0.9
Pre-tax profit	16.8	19.0	22.5	26.3
Tax	-5.0	-5.7	-6.7	-7.9
min. int/pref divs	0.0	0.0	0.0	0.0
TNL adj net profit	11.7	13.3	15.7	18.4
Abnormals	-2.1	0.0	0.0	0.0
Reported Profit After Tax	9.6	13.3	15.7	18.4

TNL adjusted NPAT from continuing operations and excludes abnormals p = pro-forma

Cashflow				
Y/e June 30	2008p	2009e	2010e	2011e
Reported pre-tax profit	16.8	19.0	22.5	26.3
Depn and amortisation	0.1	0.1	0.1	0.1
Tax paid	-5.0	-5.7	-6.7	-7.9
(inc)/dec in wk'q cap	0.6	-0.2	-0.3	-0.3
Other	-2.1	0.0	0.0	0.0
Operating cashflow	10.4	13.2	15.6	18.2
Capex	-0.1	-0.1	-0.1	-0.1
Acquisitions/investments	-2.0	-2.5	-2.5	-2.5
Asset Sales	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Investing cashflow	-2.1	-2.6	-2.6	-2.6
Equity raised	0.0	0.0	0.0	0.0
Dividends paid	-7.8	-11.0	-12.3	-13.7
Net change in borrowings	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
Financing cashflow	-7.8	-11.0	-12.3	-13.7
Net change in cash	0.5	-0.4	0.7	1.9

Balance sheet				
Y/e June 30	2008p	2009e	2010e	2011e
Cash	8.7	8.9	10.4	12.5
Receivables	5.4	5.7	6.3	6.9
Investments	0.0	0.0	0.0	0.0
Other	0.3	0.3	0.3	0.3
Current assets	14.4	15.0	17.1	19.7
Receivables	0.0	0.0	0.0	0.0
PPE	0.2	0.2	0.2	0.2
Investments	15.9	18.4	20.9	23.4
Intangibles	147.2	147.2	147.2	147.2
Other	3.4	3.4	3.4	3.4
Non-current assets	166.7	169.2	171.7	174.2
Total assets	181.1	184.2	188.8	194.0
Current acc. Payable	3.0	3.2	3.5	3.8
Current borrowings	0.0	0.0	0.0	0.0
Other current liabilities	0.5	0.5	0.5	0.6
Total current liabilities	3.5	3.7	4.1	4.4
NC borrowings	18.8	19.6	20.5	20.7
Other nc liabilities	3.6	3.5	3.5	3.8
Total nc. Liabilities	22.4	23.1	24.0	24.6
Total Liabilities	25.9	26.8	28.0	29.0

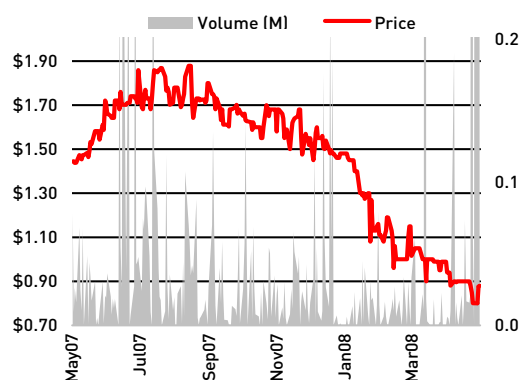
Shareholders funds	155.2	157.4	160.8	165.0
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Valuation data				
Y/e June 30	2008p	2009e	2010e	2011e
Net profit adj (\$m)	11.7	13.3	15.7	18.4
EPS (c) **	7.5	8.4	10.0	11.7
EPS growth (%) **	n/a	12.7	18.4	16.9
P/E ratio (x)	11.8	10.4	8.8	7.5
PEG ratio	n/a	0.8	0.5	0.4
Lynch ratio	n/a	2.0	3.2	3.8
CFPS (c)	7.2	9.2	10.8	12.6
Price/CF (x)	12.2	9.6	8.2	7.0
DPS (c) ordinary	6.5	7.5	9.0	10.5
Franking (%)	100	100	100	100
Yield (%)	7.4	8.5	10.2	11.9
EV/EBITDA (x)	8.4	6.9	5.8	5.0
EV/EBIT (x)	8.5	6.9	5.9	5.0
Net Debt/Equity (%)	6.6	6.8	6.3	5.0
Tax Rate (%)	30.0	30.0	30.0	30.0

\*\* Historical and forecast EPS on fully diluted basis

Profitability ratios				
Y/e June 30	2008p	2009e	2010e	2011e
EBITDA/Net sales (%)	54.3	62.7	66.7	70.9
EBIT/Net sales (%)	63.6	67.4	71.4	75.3
Return on assets (%)	6.6	7.3	8.4	9.6
Return on equity (%)	7.6	8.5	9.9	11.3
Dividend cover (x)	1.1	1.1	1.1	1.1

## Share Price Chart



Segmentals				
Y/e June 30	2008p	2009e	2010e	2011e
Revenue (\$m)				
Platform Solutions	19.5	20.8	23.6	26.6
Product Solutions	2.7	2.9	3.2	3.4
LFG Associate Fees	7.8	8.2	8.5	8.5
Total Sales	30.0	31.9	35.2	38.5
Equity Investments ***	2.2	3.3	4.0	4.8
Other	0.0	0.0	0.0	0.0
Total Revenue	32.2	35.2	39.2	43.2
FuA (\$b)				
Platform Solutions	7.2	8.4	9.7	11.1
Product Solutions	1.1	1.2	1.3	1.4
Total FuA	8.3	9.6	11.0	12.5

\*\*\* From FY09 we assume \$2.5 million pa used to acquire stakes with ROI and organic growth of 15% pa



Last Price	Price Target	Sector	Risk Rating	Short term <12m	Long Term >12m
\$0.88	\$1.29	Diversified Financials	<b>MEDIUM</b>	<b>ACCUMULATE BUY</b>	

### Tolhurst's Recommendation and Risk Rating system:

Recommendations are assessments of each Tolhurst Analyst's view of potential total returns over Short Term and/or Long Term time horizons. A Short Term time horizon is less than 12 months; a Long Term time horizon is greater than 12 months.

Expected total Return is measured as (capital gain (or loss) + dividend)/purchase price

We have divided our recommendations into four main categories:

**Buy:** Expected Total Return more than 20%

**Accumulate:** Expected Total Return between 5% - 20%

**Hold:** Expected Total Return between -5% and 5%

**Sell:** Expected Total Return less than -5%

### Risk Ratings:

Risk is a subjective assessment of overall risk within a company including price volatility and earnings variability, external liquidity, and size.

We divide our risk into three categories:

**High:** Company typically has high price volatility and earnings variability, low external liquidity and has a small market capitalisation.

**Medium:** Company typically has moderate price volatility and earnings variability, external liquidity and a medium size market capitalisation.

**Low:** Company typically has low price volatility and earnings variability, high external liquidity and is a large size market capitalisation.

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This report has been reviewed by peers within the research department.