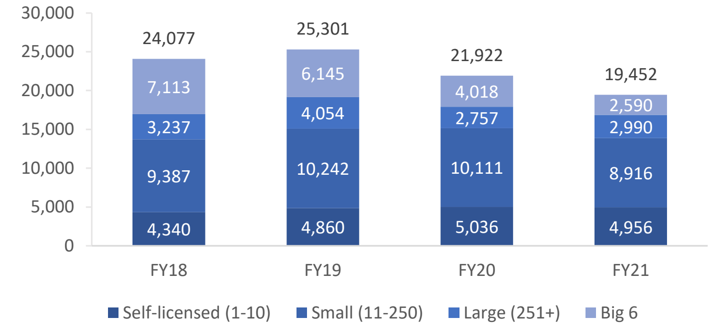
Diverger Limited

Disrupting financial advice

Diverger is well positioned to lead the consolidation of the financial advice industry. New management and the technology partnership with HUB24 should improve the customer proposition, drive revenue growth and increase margins. We launch coverage with a Buy recommendation and a fair value of $2.00 per share, nearly 100% upside.

- **Set to lead industry consolidation:** Increased regulation and conflicted operating models led to the exit of the Big 4 Banks from financial advice. Australia now has 23% fewer licenced financial advisers than in FY19 (Figure 1). The experience of the UK market, which underwent similar reforms in 2012, suggests the Australian advice market may be past the worst. Diverger is the natural market consolidator due to the strength of its customer proposition.
- **New management and HUB24 partnership to drive growth:** HUB24 (HUB.ASX) took a 31% stake in Diverger and commenced a technology development partnership in February 2021. Nathan Jacobsen, a former HUB24 executive, was appointed as CEO at the same time. New management plan to utilise technology to enhance the customer experience and lower the cost of advice – the gameplan that enabled HUB24 to disrupt wealth platforms. The majority of Diverger's competitors lack the capital and skills to follow. Only 11% of Australians over the age of 21 receive financial advice currently.
- **EPS forecast to grow at 22% CAGR:** We forecast EPS will grow at 22% CAGR over the three years to FY24, excluding acquisitions. A strategic priority of management is to triple net revenue over the same period with acquisitions.
- **Fair value of $2.00 per share:** Our DCF derived fair value of $2.00 per share puts the stock on an EV/Net revenue multiple of 2.1x in FY23 which is within the range of recent transactions (Figure 21) versus 1.1x currently.

Figure 1. Number of financial advisers in Australia by licence type



Source: Centrepoint Alliance, Veritas. The Big 6 consists of CBA, Westpac, ANZ, NAB, IOOF, AMP

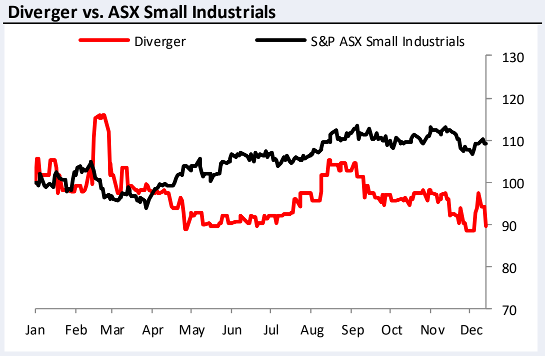
DVR.ASX BUY

Thursday 23 December 2021

Share Price	$1.02
Price Target	$2.00
Valuation Method	DCF
Market capitalisation	38m
Enterprise value	39m
GICS sector	Asset Management & Custody Banks
12 month price range	$1.00 - $1.31
Average monthly t/o	0.3m
Shares in issue	37.6m
Top 20 holders	27.1m
Previous rating	Initiation

Year ended June 30		FY21	FY22E	FY23E	FY24E
Net revenue	$m	27.7	31.6	35.8	40.4
Growth	%	23.5	14.1	13.2	12.9
EBITDA	$m	6.7	7.0	8.3	11.3
Margin	%	24.1	22.2	23.3	28.0
NPAT	$m	3.5	3.8	4.7	6.7
EPS	¢ps	9.7	10.0	12.4	17.6
CFPS	¢ps	17.2	13.0	15.4	21.1
DPS	¢ps	9.0	5.0	6.0	8.0
Franking	%	100	100	100	100
Dividend Yield	%	8.9	4.9	5.9	7.9
PER	x	10.5	10.2	8.2	5.8
Price/Cash Flow	x	5.9	7.8	6.6	4.8
EV/Net revenue	x	1.4	1.2	1.1	1.0
EV/EBITDA	x	5.9	5.6	4.7	3.5
EV/EBITA	x	6.2	5.9	4.9	3.6
EV/EBIT	x	7.3	7.0	5.8	4.1
EV/Capital	x	1.1	1.0	1.0	0.9
Fixed charge cover	x	11.0	12.2	14.8	21.0

Diverger vs. ASX Small Industrials



Source: Factset, Veritas

Diverger is a leading financial advice licensee and provider of technical support services to accounting firms.

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Diverger Ltd

Share Price: $1.02 ps **Valuation: $2.00 ps**

Financial Performance (A$m)

Year ended June 30	FY19	FY20	FY21	FY22E	FY23E	FY24E
Gross Revenue	**59.8**	**69.0**	**91.7**	**108.2**	**125.6**	**145.7**
Payments to advisers	(39.1)	(46.6)	(64.0)	(76.6)	(89.8)	(105.3)
Net Revenue	**20.7**	**22.4**	**27.7**	**31.6**	**35.8**	**40.4**
Operating costs	(14.5)	(18.1)	(21.0)	(24.6)	(27.4)	(29.1)
Normalised EBITDA	**6.3**	**4.3**	**6.7**	**7.0**	**8.3**	**11.3**
Depreciation	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Normalised EBITA	**5.1**	**4.4**	**6.4**	**6.7**	**8.0**	**11.0**
Amortisation	(0.9)	(0.7)	(1.0)	(1.1)	(1.3)	(1.5)
Normalised EBIT	**4.3**	**3.7**	**5.4**	**5.6**	**6.7**	**9.5**
Associate income	0.0	0.0	0.0	0.0	0.0	0.0
Net interest	(0.5)	(0.4)	(0.2)	(0.2)	(0.2)	(0.2)
Normalised Pre-tax Profit	**3.8**	**3.2**	**5.2**	**5.4**	**6.5**	**9.3**
Normalised tax	(1.2)	(0.6)	(1.3)	(1.3)	(1.8)	(2.6)
Profit attributable to minorities	(0.0)	0.3	0.5	0.2	0.0	0.0
Normalised profit to holders	**2.6**	**2.4**	**3.5**	**3.8**	**4.7**	**6.7**
One off items (post-tax)	0.1	(0.4)	(0.7)	(0.3)	(0.3)	(0.3)
Reported profit to holders	**2.7**	**2.1**	**2.8**	**3.5**	**4.4**	**6.5**

Cash Flow Statement (A$m)

Year ended June 30	FY19	FY20	FY21	FY22E	FY23E	FY24E
Normalised EBITDA	**6.3**	**4.3**	**6.7**	**7.0**	**8.3**	**11.3**
Cash net interest	(0.5)	(0.4)	(0.2)	(0.2)	(0.2)	(0.2)
Cash tax (paid)/received	(0.5)	(1.2)	(1.1)	(1.2)	(1.7)	(2.4)
Working capital/other	(3.1)	(0.1)	0.8	(0.6)	(0.5)	(0.6)
Operating Cash Flow	**2.2**	**2.6**	**6.3**	**5.0**	**5.9**	**8.1**
Capex	(0.3)	(0.3)	(0.4)	(1.1)	(2.1)	(3.1)
Free Cash Flow	**1.9**	**2.3**	**5.9**	**3.9**	**3.9**	**5.0**
Disposal/(Acquisition)	(0.2)	(3.7)	2.5	(2.9)	0.0	0.0
Dividends paid to shareholders	(1.0)	(1.2)	(3.1)	(1.7)	(2.1)	(2.4)
Equity Rasied/(Buyback)	(0.1)	(0.1)	(0.1)	0.0	0.0	0.0
Borrowings/(debt repayment)	(1.1)	3.0	(9.2)	0.0	0.0	0.0
Other inc. finance leases	0.7	(3.6)	7.7	(3.1)	(0.3)	(0.3)
Net increase/(decrease) cash	**0.3**	**0.3**	**1.2**	**(0.9)**	**1.5**	**2.3**
Cash at beginning	0.5	0.8	1.1	2.3	1.4	2.9
Cash at end (including bank deposits)	0.8	1.0	2.3	1.4	2.9	5.2

Balance Sheet (A$m)

Year ended June 30	FY19	FY20	FY21	FY22E	FY23E	FY24E
Cash and cash equivalents	0.8	1.0	2.3	1.4	2.9	5.2
Trade and other receivables	2.5	7.1	3.9	4.4	5.2	6.0
Other current assets	2.5	3.7	1.3	1.3	1.3	1.3
Current assets	**5.8**	**11.8**	**7.4**	**7.1**	**9.3**	**12.4**
Plant and equipment	0.1	0.1	0.1	0.1	0.1	0.1
Intangible assets	31.5	44.3	44.2	47.0	47.7	49.2
Right of use	0.0	0.5	0.2	0.2	0.3	0.3
Deferred tax assets	0.9	0.7	1.2	1.2	1.2	1.2
Non current assets	**38.2**	**45.7**	**45.7**	**48.4**	**49.2**	**50.7**
Assets	**44.1**	**57.5**	**53.1**	**55.5**	**58.5**	**63.1**
Trade and other payables	2.3	2.5	3.2	3.6	4.1	4.8
Employee Benefits	1.7	2.5	3.4	3.4	3.4	3.4
Lease Liabilities	0.0	0.6	0.2	0.2	0.2	0.2
Provisions	0.0	0.5	0.0	0.0	0.0	0.0
Borrowings	6.2	9.2	0.0	0.0	0.0	0.0
Deferred tax liabilities	0.5	5.4	5.4	5.4	5.4	5.4
Other Liabilities	1.1	1.2	2.3	2.3	2.3	2.3
Total liabilities	**11.8**	**21.8**	**14.4**	**14.8**	**15.4**	**16.0**
Issued shares	26.4	26.2	29.8	29.8	29.8	29.8
Retained Earnings losses	5.7	5.9	5.3	7.1	9.5	13.5
Reserves	0.0	0.0	0.3	0.3	0.3	0.3
Non-Controlling Interests	0.3	3.5	3.2	3.5	3.5	3.5
Total equity	**32.3**	**35.7**	**38.6**	**40.7**	**43.1**	**47.1**

Directors and Key Management Personnel

		Shares	Holding
Kevin White	Chairman	2.1m	5.5%
Nathan Jacobsen	Managing Director	0.0m	0.1%
Grahame Evans	Executive Director	0.7m	1.8%
Carl Scarella	Non-Executive Director	0.1m	0.4%
Tony McDonald	Non-Executive Director	0.0m	0.0%
Peter Brook	Non-Executive Director	0.0m	0.0%

Major Shareholders

	Shares	Holding
HUB24 Limited	11.9m	31.5%
Greg Hayes	3.9m	10.5%
Pie Funds Management	2.3m	6.2%
Top 20 shareholders	**27.1m**	**72.2%**

Source: Company data, Veritas Securities estimates. Note: FY20 financials have been restated for the disposals made during FY21.

Valuation Metrics

		Valuation
Price Target (ps)	$2.00	97%
Share Price (ps)	$1.02	
FY23E EV/Net revenue (x)	1.1	
Implied FY23 EV/Net revenue (x)	2.1	94%
Implied FY24 EV/Net revenue (x)	1.9	72%
Market Capitalisation (A$m)	38.2	
Enterprise Value (A$m)	39.4	
Shares in issue (m)	37.6	

Valuation Multiples

Year ended June	FY19	FY20	FY21	FY22E	FY23E	FY24E
P/E (x)	13.7	14.3	10.5	10.2	8.2	5.8
Price/Cash Flow (x)	15.9	13.5	5.9	7.8	6.6	4.8
EV/Net Revenue (x)	1.9	1.8	1.4	1.2	1.1	1.0
EV/EBITDA (x)	6.3	9.1	5.9	5.6	4.7	3.5
EV/EBITA (x)	7.7	9.0	6.2	5.9	4.9	3.6
EV/EBIT (x)	9.2	10.7	7.3	7.0	5.8	4.1
Equity FCF yield (%)	5.0	6.0	15.3	10.3	10.1	13.2
Dividend yield (%)	3.0	3.9	8.9	4.9	5.9	7.9
EV/capital (x)	1.0	0.9	1.1	1.0	1.0	0.9
Price to book value (x)	1.1	1.0	1.0	1.0	0.9	0.8

Per Share Data

Year ended June 30	FY19	FY20	FY21	FY22E	FY23E	FY24E
EPS diluted - adjusted (¢ps)	**7.4**	**7.1**	**9.7**	**10.0**	**12.4**	**17.6**
EPS diluted (¢ps)	7.9	6.0	7.7	9.2	11.6	16.8
Cash flow per share (¢ps)	6.4	7.5	17.2	13.0	15.4	21.1
Free cash flow per share (¢ps)	5.5	6.6	16.1	10.3	10.1	13.2
Cash (¢ps)	2.3	2.9	6.2	3.5	7.5	13.5
Net assets (¢ps)	92.9	103.4	106.2	106.2	112.4	122.9
DPS (¢ps)	3.0	4.0	9.0	5.0	6.0	8.0
Franking (%)	100	100	100	100	100	100
Shares on issue - avg. basic (m)	35	35	36	38	38	38
Shares on issue - avg. diluted (m)	35	35	36	38	38	38

Segmental ($Am)

Year ended June 30	FY19	FY20	FY21	FY22E	FY23E	FY24E
Wealth Solutions	48.8	58.5	77.0	92.3	108.2	126.9
Accounting Solutions	11.0	10.5	14.7	15.9	17.4	18.8
Gross revenue	**59.8**	**69.0**	**91.7**	**108.2**	**125.6**	**145.7**
Wealth Solutions	9.8	11.9	13.0	15.7	18.4	21.6
Accounting Solutions	11.0	10.5	14.7	15.9	17.4	18.8
Net revenue	**20.7**	**22.4**	**27.7**	**31.6**	**35.8**	**40.4**
Wealth Solutions EBITA	3.8	2.5	2.8	3.5	4.6	6.5
Accounting Solutions EBITA	3.1	3.9	5.9	5.6	6.4	7.5
Corporate costs EBITA	(1.8)	(1.9)	(2.3)	(2.4)	(3.0)	(3.0)
Underlying EBITA	**5.1**	**4.4**	**6.4**	**6.7**	**8.0**	**11.0**
Normalisations	0.0	(1.8)	(1.3)	(0.4)	(0.4)	(0.4)
Statutory EBITA Continuing	**5.3**	**4.0**	**5.7**	**6.3**	**7.6**	**10.6**
Wealth net revenue growth (% YoY)		22%	9%	21%	17%	17%
Accounting net revenue growth (% YoY)		-4%	40%	8%	9%	8%
Net revenue growth (% YoY)		**8%**	**24%**	**14%**	**13%**	**13%**
Underlying EBITDA margin (%)	**30.3**	**19.3**	**24.1**	**22.2**	**23.3**	**28.0**
Wealth EBITA Margin (%)	39.0	20.6	21.4	22.5	25.0	30.0
Accounting EBITA Margin (%)	28.3	36.9	39.8	35.0	37.0	40.0
Underlying EBITA Margin (%)	**24.7**	**19.6**	**23.0**	**21.2**	**22.5**	**27.2**

Balance Sheet Ratios

Year ended June 30	FY19	FY20	FY21	FY22E	FY23E	FY24E
EBITDA growth (% YoY)	55.2	-31.1	54.8	4.7	19.0	35.6
EBIT growth (% YoY0	20.7	-13.5	47.1	3.4	20.3	41.1
EPS growth (% YoY)	-0.7	-4.8	36.7	3.1	24.1	42.4
Net cash/(debt) ($ m)	-5.4	-8.7	2.0	1.1	2.6	5.0
Fixed charge cover (x)	11.0	5.5	11.0	12.2	14.8	21.0

Contents

Supporting advisers and accountants

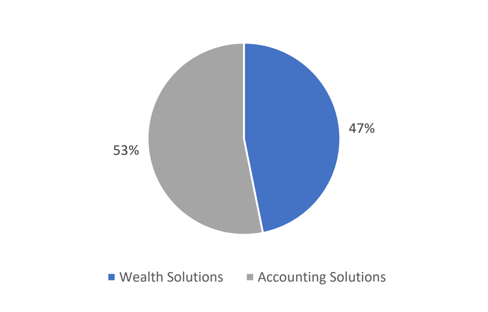
Diverger provides support to financial advisers and accountants via its Wealth and Accounting Solutions divisions.

The Wealth Solutions division operates a number of financial advice licensees. A licensee holds an Australian Financial Services Licence (AFSL) granted by ASIC which permits members, called Authorised Representatives or more simply advisers, to provide financial advice often under the brand of the licensee. Dealer groups typically do not employ advisers. Instead, they offer support and training to advisory practices. Without the scale and expertise of the licensee it is challenging for advisory practices to be compliant with regulations and profitable.

The Accounting Solutions segment provides training and an outsourced helpdesk to small and mid-tier accounting firms in order to keep them up to date with the changing regulations.

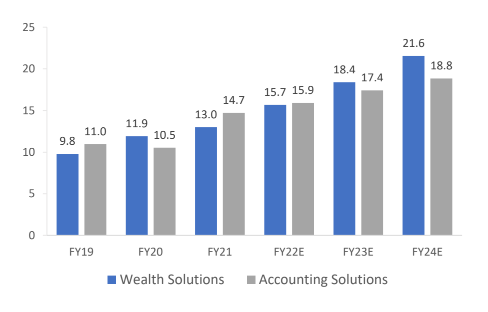
Net revenue, defined as operating revenue from continuing operations less the revenue share of advisers and cost recoveries, is a key metric for the business. Wealth Solutions comprised of 47% of group net revenues in FY21 with the remainder in Accounting Solutions (Figure 2). We expect Wealth Solutions to be the growth engine of the group over the near term (Figure 3).

Figure 2: Net revenue by segment in FY21 (%)



Source: Company data

Figure 3: Net revenue by segment ($m)

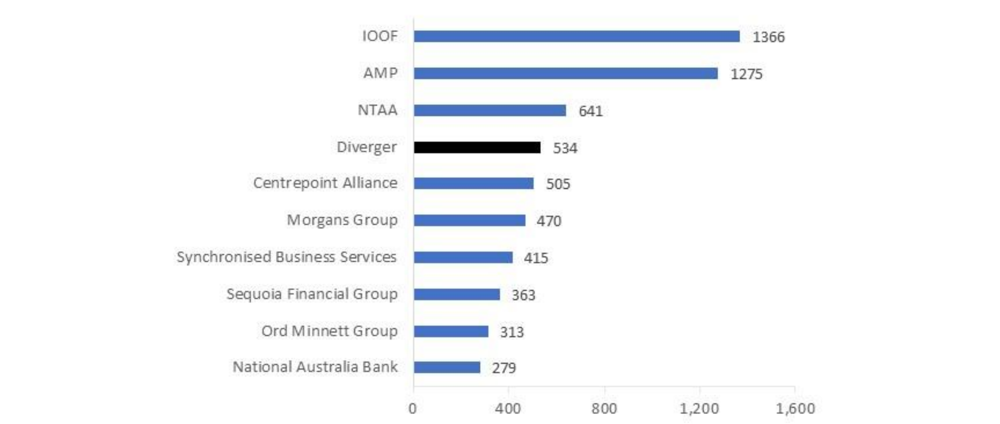


Source: Veritas estimates, Company data

Wealth Solutions

Diverger's Wealth Solutions division acts as the licensee for 534 Authorised Representatives under the GPS Wealth, Merit Wealth, Paragem (acquired 1 February 2021) and SMSF Expert brands making it the fourth largest group in Australia by licenced adviser numbers as of October 2021 (Figure 4).

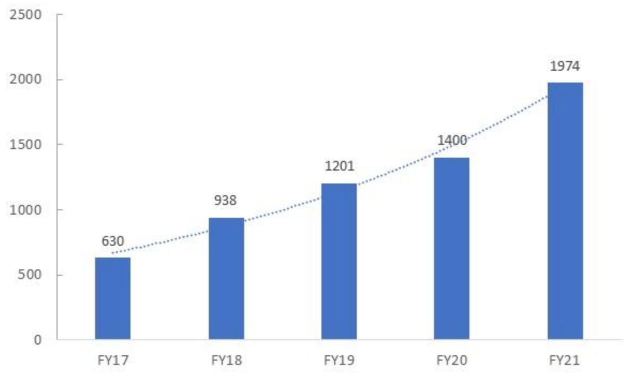
Figure 4: The top ten financial advice licensees by number of advisers as of October 2021



Source: Wealth Data, Money Management, Veritas

The segment also has a $2bn managed portfolio available to advisers known as CARE. The fund has seen sustained 25% CAGR funds under management from FY17 to FY21 (Figure 5).

Figure 5: CARE Funds under Management ($m)



Source: Company data, Veritas

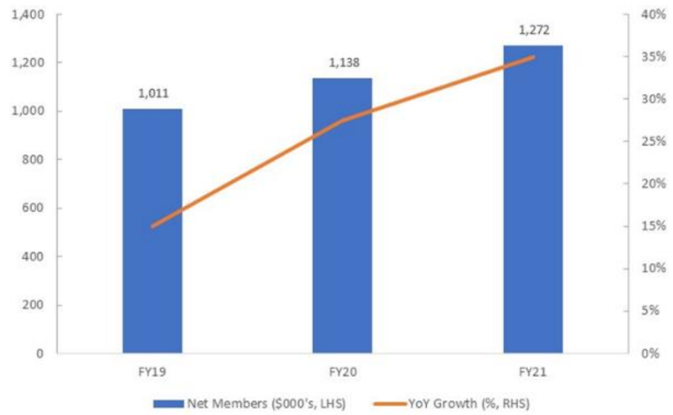
Accounting Solutions

Diverger provides Accounting Solutions to circa 3,000 accounting firms nationwide under the brands:

- Knowledge Shop – a subscription-based service allowing member firms access to a technical support desk, professional development training, technical newsletters and an online bank of electronic precedents.
- Taxbytes – a provider of training for accountants and lawyers on aspects of taxation law.
- TaxBanter – a provider of online and face to face training on aspects of taxation. 60% owned by Diverger.

Diverger has grown Accounting Solutions subscribers at 8% CAGR over the two years to FY21 (Figure 6). COVID-19 caused margins to increase in FY21 because of the forced cancellation of face-to-face training sessions. We expect this to unwind as restrictions ease.

Figure 6: Accounting Solutions net members (LHS) and growth (% YoY, RHS)



Source: Company data, Veritas

Regulation has upended the advice industry

Educational reforms in 2017 and the Royal Commission into 'Misconduct in the Banking, Superannuation and Financial Service Industry' in 2019 were catalysts for the Big 4 banks leaving the industry and an exodus of advisers.

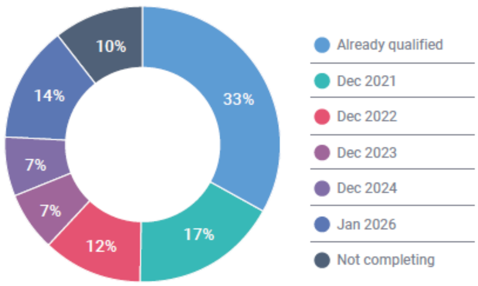
Enhanced educational standards

In 2017 in a possible attempt to stave off a Royal Commission the Turnbull government created the Financial Adviser Standards and Ethics Authority (FASEA) which introduced more stringent educational requirements for financial advisers including:

- Holding a bachelor or greater qualification in financial planning on or before 1 January 2026.
- Completion of Financial Adviser Standard & Ethics Authority (FASEA) exam on or before 1 January 2022. This has been extended until 30 September 2022 for those that have failed the exam twice. Around 80% of active advisers had passed the exam as of November 2021 (link).
- Participation in a professional year.

Many advisers left the industry due to lacking the ability or inclination to achieve these educational standards. Only one third of advisers fully met the FASEA education criteria as of 2020 (Figure 7). Whilst FASEA was disbanded in December 2020, its oversight function was rolled into ASIC and policy function moved to the Treasury.

Figure 7: When advisers expect to meet FASEA education standard



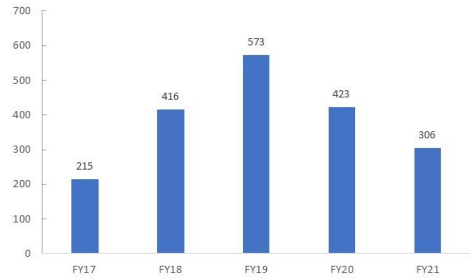
Source: Adviser Rating 2020 Financial Advice Landscape Survey, Veritas

There are signs that the government's stance on adviser education is beginning to soften. On 16 December 2021 the Treasury proposed exempting advisers with at least a decade's work experience from the need to obtain a degree – mirroring an election campaign promise made by the federal Labor opposition a week earlier.

Another consequence of regulatory change has been a shift in adviser composition – away from limited and toward full authorised representatives. Limited Authorised Representatives (AR's) are accountants authorised to give advice on self managed superannuation funds. Full ARs are authorised to provide comprehensive advice.

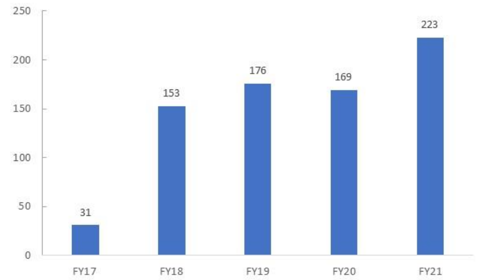
Diverger, Like the rest of the industry, has seen a significant decline in the number of limited AR's since FY19 (Figure 8). The number of Full AR's at Diverger has remained steady since FY18 when the acquisition of Paragem (72 Full ARs in February 2021) is considered. The impact of the decline in limited AR's has been softened by considerably lower revenue per adviser at $4k vs. $28k for Full ARs on average.

Figure 8: Diverger Limited Authorised Representatives



Source: Company data

Figure 9: Diverger Full Authorised Representatives



Source: Veritas estimates, Company data

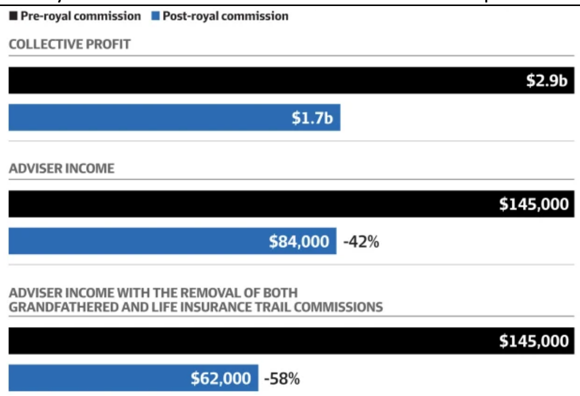
The end of trailing commissions

Prior to the Royal Commission, advice licensees acted predominantly as the distribution arms of banks and/or funds management groups that would generate most of their revenues from the commission on selling financial products.

The incentive for advisers to sell more profitable financial products over those better suited to clients was considered by the Royal Commission to be a conflict of interest. In order to prevent poor consumer outcomes, the Commission recommended the banning of trailing (or grandfathered) commissions to advisers and licences from the sale of financial products (excluding insurance). This became law in January 2021 and was phased out following the publication of the Commission's recommendations in 2019.

Whilst the grandfathered commissions were replaced with direct fees – advisers charging clients an advice fee and licensees charging advisers a licencing fee – the value of the fees was typically less than the commissions under the old model. The change triggered an estimated 40% decline in the industry profit pool according to KPMG (Figure 10).

Figure 10: Impact of the Royal Commission on the licensee and adviser profitability



Source: KPMG, Advisor Ratings

Rising costs of advice

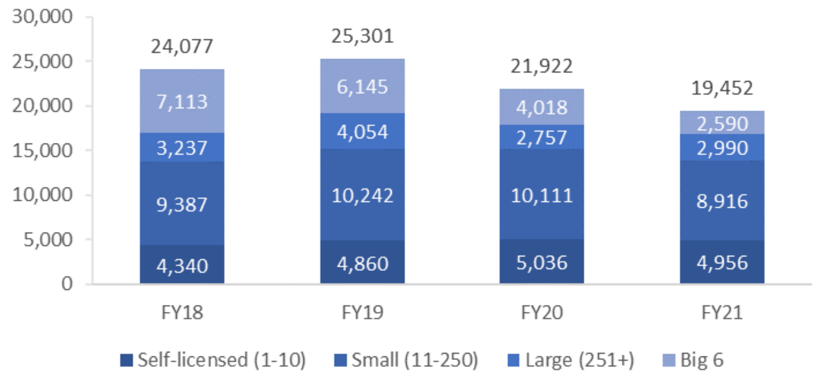
Regulatory changes have increased the cost of advice by 16% in 2020 according to research conducted by KPMG and published in the AFR. The average cost to provide comprehensive financial advice to consumers in 2020 was $5,335 per client, exceeding the average price paid for that advice of $3,660.

The exodus of advisers

The consequence of regulatory change and rising costs is an exodus of advisers. Total adviser numbers declined from a peak of 25,000 to c19,000 currently. Before the Royal Commission the Big 6 (CBA, NAB, Westpac, ANZ, AMP and IOOF) had 7,113 advisors. This stood at 2,590 by FY21 (Figure 11):

- Commonwealth Bank shut down much of its financial advice operations during 2019 and closed its last advice subsidiary on 30 Nov 2021.
- NAB sold their MLC financial advice subsidiaries to IOOF on 1 June 2021 for $1.4bn.
- Westpac exited financial advice on 30 June 2019.
- ANZ sold its financial advice businesses to IOOF in October 2017.

Figure 11: The total number of Authorised Representatives by licensee in Australia



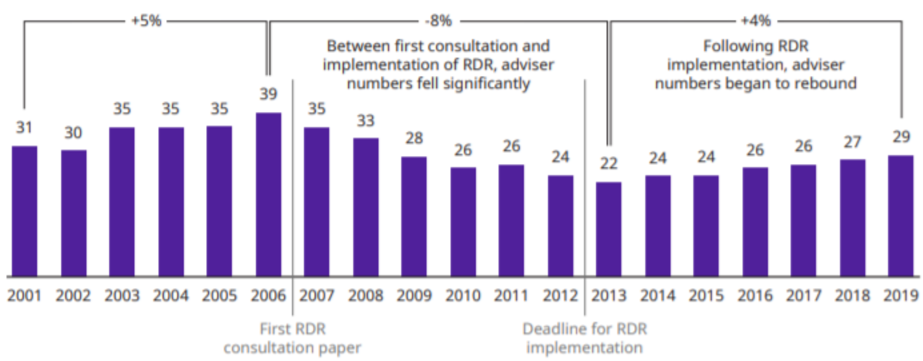
Source: KPMG, Advisor Ratings, Veritas research

UK precedent suggests the Australian advice market may be past the worst

The current situation of financial advice in Australia has parallels to the UK. The UK regulators began consulting on a retail distribution review (RDR) in 2006 which took effect in 2012. The RDR reforms included enhanced educational standards for advisers and a ban on commissions to advisers for selling investment products – very similar to the Australian Royal Commission reforms.

Like Australia, adviser numbers in the UK declined as the industry responded to the reforms and the major British banks exited advice after receiving large fines for mis-selling financial products. Growth in advisers and industry revenues bottomed when the RDR rules took effect (Figure 12). Over the six years following implementation of RDR the total revenue of advice firms UK grew by more than 50% and the banks re-entered the market using digital offerings according to Oliver Wyman. The trailing commission ban took effect in Australia on 1 January 2021 meaning we could be past the worst.

Figure 12: Number of financial advisers in the UK (thousands)



Source: Oliver Wyman 'Future of Financial Advice – The Australian Renaissance'

Diverger is profitable despite industry pressures

Diverger is unique among advice firms for its profit growth in a challenging environment which we attribute to the diversification provided by its training businesses; a relatively low-cost base and the high level of service provided by its licensees.

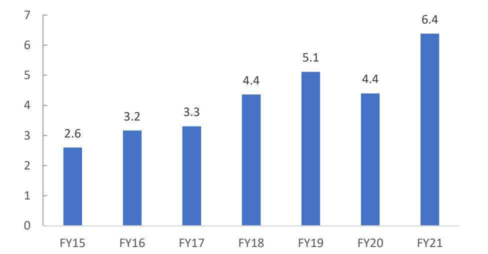
Financial Statements lodged with ASIC show many of the largest advice licensees were loss making during FY20 (Figure 13). Diverger has grown underlying EBITA from continuing operations at 16% CAGR since FY15 (Figure 14).

Figure 13: The profitability of selected large advice licensees in FY20 ($m)

Licensee	Parent	Advisers	Pre-tax profit/(loss)	Retained earnings
Garvan	NAB/IOOF	276	-23.0	-108.2
Financial Wisdom	CBA	N/A	-13.5	-81.7
Australian Unity	Australian Unity	172	-6.9	-57.2
Affinia	TAL	185	-1.4	-26.2
Fortnum	Private	205	-0.4	-1.1
Count Financial	Countplus	268	0.3	-35.9
Lonsdale	IOOF	185	1.5	-2.8
Matrix	Clearview	119	1.7	-1.6
Millennium3	IOOF	265	2.2	-32.4

Source: ASIC, Countplus, Adviser Ratings, Veritas Research

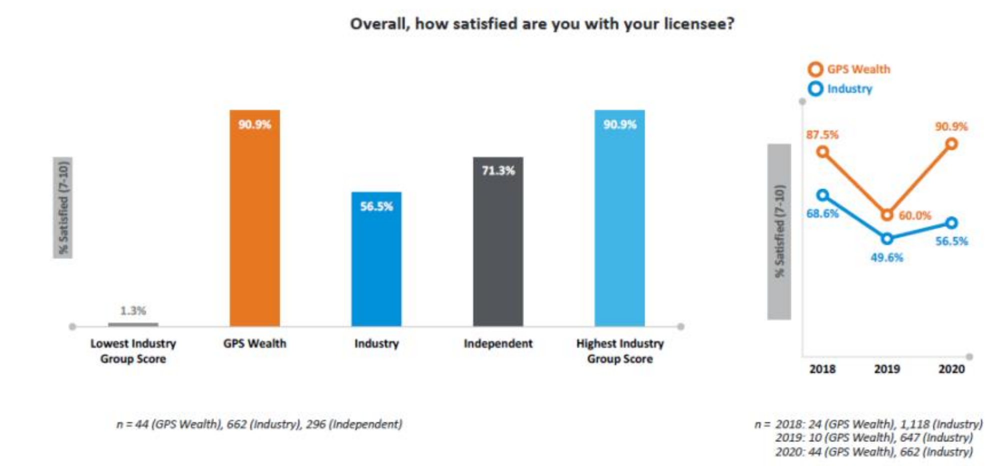
Figure 14: Diverger underlying EBITA from continuing operations ($m)



Source: Veritas estimates, Company data

Diverger's licensee, GPS Wealth, has consistently achieve higher satisfaction scores in adviser survey for the past three years and received the highest adviser satisfaction rating in the market in 2020 (Figure 15).

Figure 15: Adviser satisfaction score for Diverger licensee GPS Wealth



Source: Core Data, Company data, Veritas research

Transforming earnings potential

Diverger was at a fork in the road at its FY19 results. The company had grown underling EBITA per share at a creditable 12% CAGR over the preceding four years yet the shares were stuck in a holding pattern with the market capitalisation at a nil premium to book value. The company's purpose wasn't clear. Was it a roll-up of advice licensees, accounting firms or accountant support firms? How could it differentiate from the thousands of other license providers?

The board conducted a strategic review to transform the company's earnings potential and clarify its purpose. The conclusion was to divest non-core assets; embark on a technology led strategy to improve the customer experience in partnership with HUB24 and refresh the board.

Diverger changed its name from Easton Investments (ASX code EAS) on 23 Nov 2021 to underline its divergence from the conflicted and broken advice models of the past. The ambition is nothing short of transforming the customer experience of advice in a similar fashion to how HUB24 and Netwealth transformed the investment administration platform landscape.

Divestment of non-core assets

A key outcome of the strategic review was to focus the business on its two core verticals – providing licensee services in the Wealth Solutions segment and educational services in the Accounting Solutions segment. To this end Diverger made $6.9m of divestments during FY21, the proceeds of which were used to reduce debt to zero in FY21 from $9.2m in FY20. Divestments included:

- **First Financial** – a 25% interest for $3m completed in August 2020. A financial advice practice with its own AFSL. This was the only disposal that was not management's choice. The majority shareholder exercised an option to acquire Diverger's interest.
- **EWA Finance** – stake reduced from 70% to 10% for an immaterial consideration.
- **Hayes Knight (NSW) Pty Ltd** – a 33% interest for $2.45m completed in September 2020. An accounting practice majority owned by outgoing managing director Greg Hayes.
- **Law Central** – a 100% interest for $0.15m completed in December 2021. An online shop for company incorporations and other legal templates.
- **Panthercorp** – a 100% interest for $1.8m completed in January 2021. A similar business to Law Central.

The HUB24 partnership

During the review Diverger's board entered discussions with HUB24. On 21 December 2020 the companies reached an agreement which included:

- **HUB24 acquiring up to 40% of Diverger** by way of a off-market proportional takeover offer for one in three fully paid ordinary shares of Diverger (11.4 million shares at the maximum acceptance) at $1.20 per share which was recommended by the Diverger board.
- **A special dividend of $0.05 per share** to Diverger shareholders.
- **A technology partnership and distribution arrangement between Diverger and HUB24,** with the intention of Easton becoming a leading provider of re-imagined support services and solutions for financial advisers, licensees and accountants by benefiting from technology built by HUB24 to be paid for by Diverger issuing 1.7 million options at an exercise price of $1.20 exercisable over two years to HUB24.
- **The acquisition of Paragem from HUB24** for a consideration of $4.0 million to be satisfied by the issue of 3.33 million Diverger shares (9.7% of shares outstanding) at a price of $1.20 each. Paragem was a financial advice licensee owned by HUB24 with Nathan Jacobsen as managing director.

- **The appointment of Nathan Jacobsen as managing director** and HUB24 having the right to nominate two directors to the board which occurred in February 2021.

HUB24's offer closed on 2 February 2021. At the end of the process, it held 31.5% of all Diverger shares on issue which implied 75% of Diverger shareholders accepted HUB's offer.

Refreshing the board

Greg Hayes, Diverger's Managing Director of six years, announced his resignation on February 2020 effective at the October AGM. Rodney Green, the company's longest serving director (since 2012) announced his resignation at the same time.

Nathan Jacobsen, former managing director of Paragem, was appointed Managing Director of Diverger and Tony McDonald, co-founder and former Managing Director of SFG Australia/Snowball Group and a non-executive director of HUB24, was appointed a non-executive director of Diverger on 1 February 2021.

Nathan and Tony have successful track records in growing advice businesses. Nathan was a senior executive for ten years at Perpetual Private where he implemented a digital enablement model which was a significant new driver of growth.

Tony McDonald co founded Snowball Group which grew from being a start-up in 2000 to one of Australia's largest independent wealth management firms. The company merged with Shadforth Group to become SFG Australia (in a deal that valued the company at c$280m) in 2012. IOOF acquired SFG for c$600m in 2014.

Taking a leaf out of the HUB24 playbook

New management are employing a new strategy: the development and deployment of technology for advisers to deliver a better advice experience at a lower cost. This is the same formula used by HUB24 to disrupt the wealth platform industry.

HUB24 has generated a 14x share price return over the past decade driven by the popularity of its portfolio administration platform which is used by advisers to manage client investments and gives clients access to up-to-date reporting on investment holdings and performance.

Diverger is well positioned to repeat HUB24's success in advice due to access to resources, client focused independence and the ability to build the killer app enabled by the HUB24 partnership.

Superior access to resources

Post-transaction Diverger is HUB24's vehicle for democratising advice via technology. The smaller end of the market is also unlikely to be able to match Diverger and HUB24's access to capital – 60% of licensees are privately owned with between one and ten advisers.

If HUB24's growth continues it will have better access to capital than any other player in the advice industry. Today HUB24 has a market capitalisation of $1.9bn, making it similarly sized to the two largest advice licensees by adviser numbers: IOOF with a $2.3bn market capitalisation and AMP with $3bn.

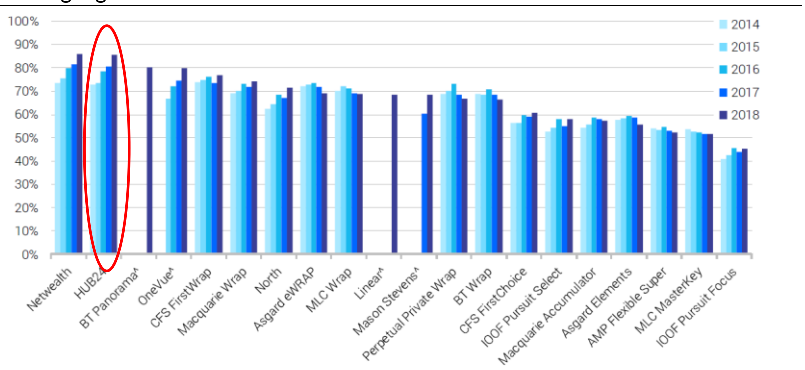
HUB24 has increased Funds Under Administration from $5.5bn in June 2017 to $41.4bn in June 2021 and the number of advisers on its platform from 917 at June 2017 to 3,063 at June 2021 (Figure 17). The growth has been reflected in its share price, which has increased 452% over the past five years versus IOOF which has declined by 57% and AMP has declined by 82%.

The share price declines of AMP and IOOF put pressure on the management to divest assets and increase cash returns to shareholders which reduce the likelihood they will invest sufficiently to develop the technology that HUB24 and Diverger aspire to.

Client focused independence

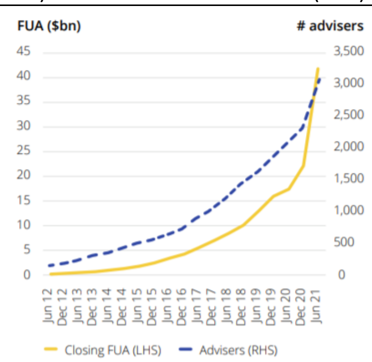
HUB24 has delivered higher rates of funds under administration (FUA) and profit growth than the industry by following the simple formula: investing in technology to deliver a superior customer experience (Figure 16); driving bigger net inflows than competitors (Figure 17); funding the acquisition of more assets to put on the platform.

Figure 16: Adviser ratings of investment administration platform functionality - HUB24 highlighted



Source: Investment Trends, Platform Competitive Analysis and Benchmarking Report December 2018

Figure 17: HUB24 funds under administration ($bn, LHS) versus number of advisers (RHS)



Source: Company data, Veritas research

One of the reasons HUB24 has been so successful was that its competitors were hamstrung by their own conflicted operating models. For example, AMP owned the financial product, the advice practice and the platform. Advisers were forced to use the AMP platform which provided the company with scant incentive to build a good one. It should be no surprise then the integrated players IOOF, MLC (previously owned by NAB) and AMP had the platforms with the lowest user satisfaction scores (Figure 16).

Conflicted operating models are inversely correlated to the customer experience. HUB24 and Diverger are both among the largest independent players in their respective markets (Figure 4) with leading overall customer satisfaction scores (Figure 15).

Building the killer app

Making advice affordable using technology has the potential to increase the number of Australians receiving advice by 9x. Diverger is unique in planning to do just that.

The HUB24 platform is an integral part of client portfolio administration for many advisers in the same way that Diverger's license and support tools are essential in the provision of advice. HUB24's growth came from how it used a platform to replace spreadsheets, emails and other manual processes in the investment administration process. While the benefits of this seem obvious in retrospect HUB24 were able to execute on the opportunity more effectively than other platforms by having a well funded development team and management that were focused on this goal.

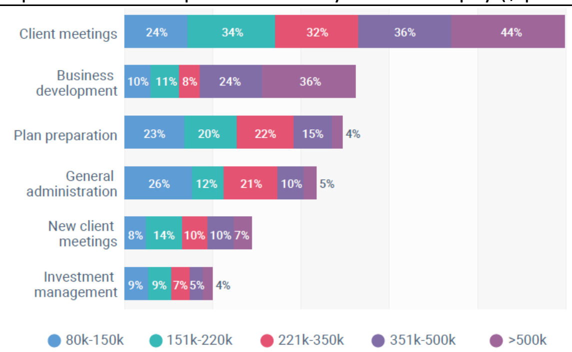
The technology situation in advice today is similar to the investment administration platform market ten years ago: the opportunity for technology to transform the advice process is obvious but no-one has built the killer app. Diverger with support from HUB24 are unique in planning to do just that.

The primary objective for the partnership with HUB24 is to develop and deploy technology solutions that will improve operational efficiency and client engagement for advice practices. The tools developed will automate many manual adviser workflows to reduce the overall cost of advice and increase the size of the addressable market.

Only 11% of Australians over the age of 21 receive financial advice out of the 40% of population that can afford it according to the 2020 Australian Financial Advice Landscape report by Adviser Ratings. Making advice affordable for all therefore has the potential to increase the number of people accessing advice by 9x. This is particularly important as the total pool of non-advised investments and superannuation assets in Australia is $3,648bn and $2,049bn respectively versus $962bn funds under advice according to Oliver Wyman. Millennials are set to inherit $3.5 trillion over the 2020-2040 period - the biggest inter-generational transfer of wealth in history, according to the study.

The potential productivity benefits to advisers of employing technology are demonstrated by the lowest paid advisers spending nearly half their time on general administration and plan preparation versus less than 10% of their time for the highest paid (Figure 18). This is the kind of transformation that Diverger plans to enable with the HUB24 partnership.

Figure 18: Adviser proportion of time spent on tasks by take home pay ($ per adviser per year)



Source: VBP practice efficiency survey (2021), Veritas research

Earnings to inflect

Diverger management outlined four strategic priorities at FY21 results:

- To triple group net revenue in three years (by FY24).
- To grow the Accounting Solutions client base by 40% over three years.
- To grow the underlying EBITA margin in Wealth Solutions to 40% by FY25 versus 21% in FY21 by investing in advice systems, processes and leveraging the technology partnership with HUB24.
- Become the leading non-institutional provider of services to self-licenced and licenced advisers.

Whilst we view these strategic priorities as achievable, we do not include acquisitions in our forecasts as the timing and quantum is unknown.

They key elements of our forecasts include:

Net Revenue: to grow organically from $27.7m in FY21 to $40.4m in FY24 driven by Wealth Solutions growing from $13.0m in FY21 to $21.6m in FY24.

Wealth Solutions: EBITA margin to rise from 21% in FY21 to 30% in FY24 driven by productivity benefits from the HUB24 partnership and leverage over fixed costs. This is below management's aspiration for 40% by FY25.

Accounting Solutions: EBITA margin to drop to 35% in FY22 versus 40% in FY21 due to the loss of some one-off benefits such as JobKeeper and the cost of face-to-face lessons. EBITA margin levels should return to current levels by FY24 as the segment continues to grow its client base.

JobKeeper: Diverger received $0.4m of JobKeeper subsidies in FY21 which we expect not to recur in FY22, providing a drag on profit growth in the year.

Normalised pre-tax profit: to nearly double from $5.2m in FY21 to $9.3m in FY24.

Normalised diluted EPS: to increase from 9.7 cps in FY21 to 17.6c by FY24

Acquiring the remainder of TaxBanter: There is an option in place for Diverger to buy the 40% stake in TaxBanter that it doesn't already own, exercisable from January 2022 for an estimated $2.85m. We expect the option will be exercised. We estimate that the transaction will be 11% EPS accretive in FY23 due to the elimination of profits attributable to non-controlling interests.

Buyback: Whilst a buyback of up to 3.76m shares (10% of the total shares on issue) over the December 2021 to December 2022 period is authorised we do not forecast any share buy-backs will occur. We believe the buyback authorisation is in place to give the company flexibility to respond to changes in capital market conditions. This reduces downside risk for the shares, in our opinion.

Capex: to rise from $0.4m in FY21 to $3.1m by FY24 as the company invests in technology.

Cash: to increase from $2.3m in FY21 to $6.5m in FY24 without borrowings or equity issuance and excluding acquisitions other than the TaxBanter option exercise.

Experienced and entrepeneurial managment

Kevin White has held executive roles at Diverger for 8 years, and is a substantial shareholder.

Kevin White has been chairman of Diverger for the past six years. Prior to Diverger, Kevin founded and was Managing Director of Crowe Horwath Australasia Limited (formerly WHK Group) for 15 years. His leadership led the group to becoming the fifth largest accounting group in Australia at the time. White was appointed Managing Director of Diverger in mid 2013 and chairman in 2015. Kevin is currently a substantial shareholder, with 2.1m shares (5.5% of total).

Nathan Jacobsen joined Diverger in early 2021 through the HUB24 transaction.

Nathan Jacobsen was appointed Managing Director during February 2021, after previously working as managing director of Paragem Limited within HUB24. Nathan has an extensive record of transforming businesses. He spent 10 years in various management roles at Perpetual Private where he was responsible for digital enablement of advisers. After that he served as Group Executive of Advice & Technology Solutions at HUB24 and the Managing Director of HUB's advice AFSL Paragem.

Grahame Evans, executive director, co-founded GPS Wealth.

Executive Director, Grahame Evans joined the Diverger board in August 2017. Grahame has held executive roles across the financial services industry including CEO Investments for Tower Australia, Managing Director at AMP Consulting and Group Managing Director at Centrepoint Wealth. In more recent times, he is the Executive Chairman of Easton Wealth and Managing Director of GPS Wealth. Grahame, along with the two founders of GPS Wealth, was responsible for taking it from a start-up to a $20m valuation in 5 years. Grahame also currently holds a board position at ASX Listed DomaCom (ASX: DCL).

Carl Scarcella, NED, helped co-found a successful advice business.

Carl Scarcella joined the company in May 2014, and has formed a key member of the Diverger board. Carl co-founded Snowball Group Limited in 2000, an independent, integrated advice business providing various financial services. Scarcella was COO and Company Secretary of Snowball Group Limited from its inception through to its listing on the ASX in 2001. In 2011, it merged with the Shadforth Group to become SFG Australia Limited, a wealth management business with a market capitalisation of over $500 million. Following this, Carl co-founded T&C Consulting Services, in which he is currently a director.

Tony McDonald, NED, joined Diverger through HUB24's nomination.

Anthony (Tony) McDonald became a NED in February 2021 following nomination from HUB24 to join the board at Diverger, under the terms of the Transaction Implementation Deed entered into with HUB24. Tony, along with Carl, co-founded Snowball Group Limited, which when acquired had $4.7bn in funds under advice. Tony held a directorship at the Investments Funds Association of Australia (now Financial Services Council), URB Investments Ltd and 8IP Emerging Companies Ltd. Tony remains a non-executive director at HUB24.

Peter Brook is the newest addition to the board and brings a wealth of experience from senior roles at prominent Australian wealth management firms.

Peter Brook, the newest member of Diverger's board, was appointed on 20 December 2021. Peter has extensive experience in the wealth management industry as former chairman of Xplore Wealth Limited (acquired by HUB24 in March 2021) and the former Managing Director of Pillar Administration. Peter improved the profitability of Pillar prior to its sale to Mercer for $35m in December 2016. Prior roles included being the Group Financial Controller of MLC (2000-2005) and an Executive Director of Challenger Financial Services Group (2006-2008).

Fair value of $2 per share

Our DCF derived value for Diverger Limited is $2.00 per share (Figure 19). The primary assumptions of the DCF include revenue growth fading to 1%, a terminal EBITDA margin of 28% which is lower than management's long term aspiration for c40%, terminal capex to deprecation of 1.0x and a WACC of 10% to reflect the higher risk of the industry due to the changing of the landscape after the Royal Commission.

Figure 19: DCF valuation for Diverger Limited

Year end June	Units	FY22	FY23	FY24	FY25	FY26	FY27	FY28	FY29	FY30	FY31	TV
Net revenue	$m	31.6	35.8	40.4	45.3	47.6	49.9	50.9	52.0	53.0	54.1	54.6
Revenue growth	*%*	*14.1*	*13.2*	*12.9*	*12.1*	*5.0*	*5.0*	*2.0*	*2.0*	*2.0*	*2.0*	*1.0*
EBITDA	$m	7.0	8.3	11.3	13.7	13.8	14.5	14.6	14.8	14.8	15.1	15.3
EBITDA margin	*%*	*22.2*	*23.3*	*28.0*	*30.2*	*29.0*	*29.0*	*28.7*	*28.5*	*28.0*	*28.0*	*28.0*
EBIT	$m	5.2	6.3	9.1	11.5	11.4	12.0	12.1	12.2	12.2	12.4	12.6
Tax rate	*%*	*25*	*28*	*28*	*28*	*30*	*30*	*30*	*30*	*30*	*30*	*30*
NOPAT	**$m**	**3.9**	**4.6**	**6.6**	**8.3**	**8.0**	**8.4**	**8.4**	**8.5**	**8.5**	**8.7**	**8.8**
DA	$m	1.8	2.0	2.2	2.2	2.4	2.5	2.5	2.6	2.6	2.7	2.7
Margin	*%*	*5.7*	*5.6*	*5.5*	*4.9*	*5.0*	*5.0*	*5.0*	*5.0*	*5.0*	*5.0*	*5.0*
Working capital	$m	-0.2	-0.1	-0.2	-0.2	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0
Capex	$m	-1.1	-2.1	-3.1	-3.1	-3.8	-4.0	-4.1	-3.4	-2.6	-2.7	-2.7
Capex/D&A	*x*	*0.6*	*1.0*	*1.4*	*1.4*	*1.6*	*1.6*	*1.6*	*1.3*	*1.0*	*1.0*	*1.0*
FCF	**$m**	**4.5**	**4.4**	**5.6**	**7.3**	**6.5**	**6.8**	**6.9**	**7.7**	**8.5**	**8.7**	**8.8**
Discount factor	%	91%	83%	75%	68%	62%	56%	51%	47%	42%	39%	
NPV of FCF	**$m**	**4.1**	**3.6**	**4.2**	**5.0**	**4.0**	**3.8**	**3.5**	**3.6**	**3.6**	**3.3**	

Item	Units	Value
NPV of the forecast period	$m	38.8
NPV of terminal value	$m	37.6
NPV of cash flows	**$m**	**76.4**
Add: net cash	$m	2.0
Less: non controlling interests	$m	-3.2
Fair value of equity	**$m**	**75.2**
Fair value of equity per share	**$ps**	**2.00**
Share count	m	38

Item	Units	Value
WACC	%	10.0
Terminal growth	%	1.0
Terminal EBITDA margin	%	28.0
Terminal value nominal	$m	97
Terminal EV/Revenue	x	1.8
Terminal EV/EBITDA	x	6.4

Source: Veritas estimates

A 34% EV/EBITDA discount to peers in FY24

Diverger trades on an EV/EBITDA multiple of 3.5x in FY24 a 75% discount to the peer average including wealth platforms (HUB24, Netwealth and Praemium) and a 34% discount to the peer average excluding platforms.

Figure 20: Diverger peer valuation

Stock	Code	Price	Mkt Cap	EV	EV/Net revenue (x)				EV/EBITDA(x)				Revenue Growth (%)			
		LC$	LC$m	LC$m	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E	FY21	FY22E	FY23E	FY24E
Diverger	DVR-ASX	1.02	38	39	1.4	1.2	1.1	1.0	5.9	5.6	4.7	3.5	23.5	14.1	13.2	12.9
Countplus	CUP-ASX	0.94	107	100	1.2	1.2	1.1	1.0	7.1	7.0	5.9	5.4	-2.5	6.2	6.8	4.8
Centrepoint Alliance	CAF-ASX	0.26	50	39	1.4	1.0			12.7	4.9			-4.1	47.0		
Sequoia Financial Group	SEQ-ASX	0.68	90	59	1.1				5.1	4.4			55.4			
Insignia Financial	IFL-ASX	3.56	2,312	1,295	1.7	0.9	0.9	0.9	5.3	3.6	3.3	3.0	31.2	92.6	-0.5	1.6
AMP	AMP-ASX	0.94	3,070	3,151	1.4	1.5	1.6	1.6	8.6	7.4	7.5	7.6	328.5	-7.1	-6.8	-0.3
HUB24	HUB-ASX	27.82	1,909	1,865	17.3	10.5	7.8	6.8	51.5	29.0	21.0	17.6	-2.2	65.1	33.9	15.6
Netwealth Group	NWL-ASX	17.18	4,189	4,123	29.0	23.2	19.7	16.4	52.0	43.4	36.6	29.5	14.6	25.0	17.8	20.1
Praemium	PPS-ASX	1.44	731	721	11.1	8.7	7.6	6.4	51.5	34.3	26.6	21.6	28.2	27.6	15.1	18.0
Peer average (ex platforms)					**1.4**	**1.1**	**1.2**	**1.2**	**7.8**	**5.5**	**5.6**	**5.3**	**81.7**	**34.7**	**-0.2**	**2.0**
Peer average					**8.0**	**6.7**	**6.4**	**5.5**	**24.2**	**16.8**	**16.8**	**14.1**	**56.1**	**36.6**	**11.1**	**10.0**

Source: FactSet consensus as of market close on 22 December 2021, Veritas estimates. Note: AMP enterprise value excludes Bank liabilities, Centrepoint FY21 results exclude Clearview acquisition and FY22 valuation is based on guidance

Our $2.00 per share fair value puts Diverger on an EV/net revenue multiple of 1.9x and an EV/EBITDA multiple of 6.8x in FY24. The fair EV/net revenue multiple of 1.9x is within the range of recent transactions (Figure 21).

Figure 21: Recent transactions in the Australian financial advice sector

Transaction date	Target	Acquirer	EV/Net revenue (x)	Enterprise value ($m)	Net revenue ($m)	Year ending
Dec 21	Crestone Wealth Management	LGT Group	4.4	475	109	Jun 20
Aug 21	Clearview Advice (CVW.ASX)	Centrepoint Alliance (CAF.ASX)	1.2	15	13	Jun 21
Jul 21	Sentry Group	WTL Financial Group (WTL.ASX)	2.0	7	4	Jun 21
Aug 20	MLC Wealth (NAB.ASX)	Insignia Financial (IFL.ASX)	1.7	1,440	744	Sep 20
Average			**2.3**			

Source: Companies, Veritas research

Diverger in partnership with HUB24 is well positioned to lead the consolidation of the financial advice industry. New management and new technology should transform the customer proposition and improve profitability. We initiate coverage with a Buy recommendation and a fair value of $2.00 per share, nearly 100% upside.

RATING

BUY – anticipated stock return is greater than 10%

SELL – anticipated stock return is less than -10%

HOLD – anticipated stock return is between -10% and +10%

SPECULATIVE – high risk with stock price likely to fluctuate by 50% or more

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