One to Watch

Prime Financial Group

Meeting with CEO Simon Madder

13th February 2024

Venn Brown sat down with Simon Madder, CEO of Prime Financial, to discuss the business's outlook, financial performance, staffing challenges and growth strategies.

Company overview: Prime Financial is an advice, capital and asset management firm. With 160 staff, the company has four main business lines:

1. wealth management;
2. accounting & business advisory;
3. capital & corporate finance capital, and
4. self managed super funds (SMSF).

The business turned over $34 million in revenue in FY23 and has around $1.1 billion of client funds under advisement.

Focus on organic growth: Prime has an impressive history of delivering top-line growth of ~20%. Growth has primarily been achieved organically by growing its client base in conjunction with its share of wallet from existing clients.

Investing for growth: Prime has historically delivered EBITDA margins of around 30%. This dropped to 26% in FY23 as the business grew staffing to position it to deliver future growth. Long term, management expects margins to return to the 30% range as it focuses on expanding its higher-margin business lines.

Staff retention: As is the story across financial services, staff retention is an ongoing challenge. Prime reports that turnover is below the industry average, with the accounting business seeing the biggest turnover. Management reports that 45% of the company is owned by staff, which helps with retention and attracting new talent. Prime uses a combination of on- and off-shore staff to better manage its cost base.

Ambitious but achievable growth targets: Prime is targeting FY25 revenue of $50 million, doubling to $100 million 3-5 years beyond that. Management expects growth to be largely organic and a combination of new and existing customers from across all business lines. With a payout ratio of around 70%, this growth should continue the dividend growth of the last few years, which has averaged almost 50% a year since FY20.

Prime Financial Group

ASX:PFG

Sector	Investment Services
Date	12-Feb-24
Share price	$0.245
52-week range	$0.20 / $0.27
Market cap	$53.3m
Free float	-
Dividend (FY23)	$0.015
Yield	6%

Year-end 30 June	FY20	FY21	FY22	FY23
Revenue	$22m	$22m	$26m	$34m
EBITDA	$6.2m	$7.1m	$8.4m	$8.8m
EBIT	$4.1m	$5.3m	$6.8m	$7.0m
Net profit	$2.1m	$3.1m	$3.8m	$4.4m
Earnings per share	$0.01	$0.02	$0.02	$0.02
Operating cash flow	$3.7m	$5.5m	$6.1m	$4.2m
Free cash flow	$3.0m	$4.5m	$4.2m	$1.5m
Cash & equiv	$0.1m	$0.1m	$0.1m	$1.0m
Net debt	$13.4m	$9.9m	$7.0m	$10.3m
Net debt / EBITDA	2.2	1.4	0.8	1.2
Dividend per share	$0.00	$0.01	$0.01	$0.02
ROA	4.7%	6.3%	7.4%	7.4%
ROE	6.8%	8.5%	9.5%	10.1%

3-year Price Chart

Analysts

Andrew Wilkinson awilkinson@vennbrown.com

Thanks for being with us here today, Simon. First, can you give us a brief overview of Prime Financial?

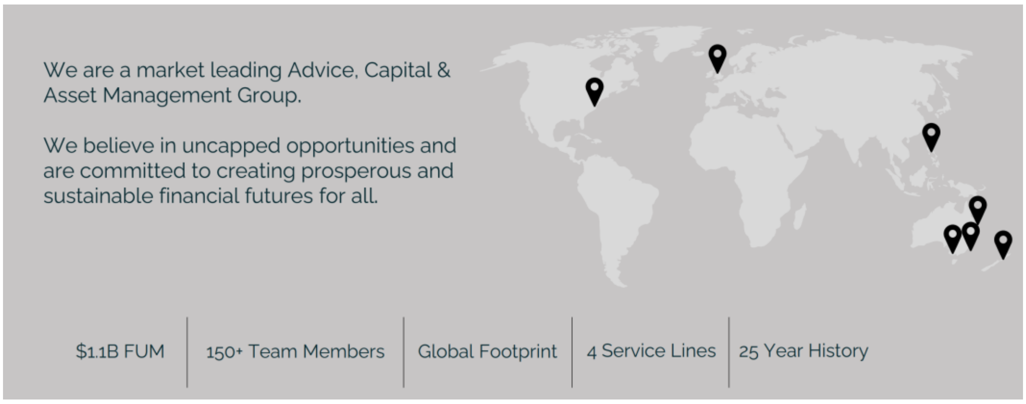
Prime Financial is an advice, capital and asset management firm. We've got almost 160 staff and operate in four key areas in the advice space:

1. wealth management;
2. accounting & business advisory;
3. capital & corporate finance capital, and
4. self managed super funds (SMSF).

We currently manage around $1.1 billion for clients within the wealth management space.

Last year, we turned over about $34 million with an EBITDA margin of around 26%, although most years, it's closer to 30%. The business is growing well, driven by strong organic growth across all four service lines, and over the last two years, we've delivered organic growth of about 18 to 20%.

Figure 1: Prime Financial operates four business lines with $1.1 billion under advisement



Source: Prime Financial

Is this growth coming from new or existing customers?

It's a combination of both. We grew across all four service lines, but they grew in probably three different ways:

1. existing partners in the business, finding new clients;
2. cross-selling more services or delivering more value to the existing customer base and;
3. rolling out new service lines.

Organic growth is our core. Last year, we made our first acquisition in six years, and it was in the SMSF space.

Where we really seek to differentiate our business is in the professional services space, where we work hard to capture a greater share of wallet from our ideal customers. These are typically emerging companies or businesses, larger family groups or wholesale investors to who we try to provide a more complete experience. I think how we, as a team, bring that together into a wholly connected and integrated advice offering is unique.

Another key point of differentiation for us is that 45% of the company is staff owned. We've got a unique ownership model allowing any team member, from graduates to senior management, to own equity after being with the firm for twelve months. Although we're quite a small listed company, we can make equity available to attract talent and given our pace of growth, the equity is quite attractive.

Figure 2: Prime employees own 45% of the company's shares

Source: Prime Financial

Can you give us a breakdown of your different customer segments?

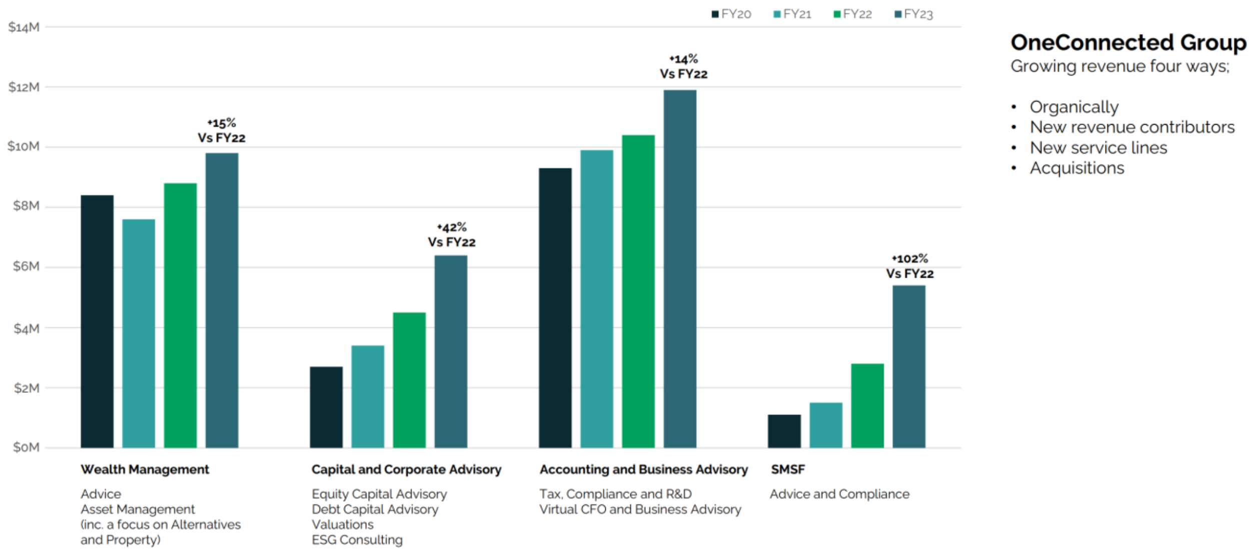
Our customers are slightly different across the overall business.

1. Wealth management mainly deals with high-net-worth individuals, family groups and wholesale investors. They are often looking for something a bit differentiated, whether a total asset management solution or specific investments, the alternatives and property space is where we've tended to differentiate.
2. In the capital and asset management space, we focus on emerging companies. There are businesses in startup mode through to those turning over $50 to a $100 million, all the way through to family groups that might be interested in seeing a differentiated asset or investment opportunity and who might also own their own business that one day they will want to sell.
   Our corporate finance offering provides both equity and debt solutions to companies that typically have an enterprise value of between $10 million and $300 million. The majority of our work is probably in the $50 to $150 million range.
   We do everything from helping them identify acquisitions to raising capital, selling businesses, and providing debt advisory services. We also have an ESG consulting offering.
3. The accounting business is particularly good at looking after clients with R&D tax claims. We do that for about 600 companies, half onshore and half offshore. We're very good at working with those more innovative and aspirational businesses that might be developing interesting new products. We do a lot of work in the biotech life sciences and technology space there.
   We also look after more traditional businesses in terms of business advisory, accounting and tax.
4. Our SMSF business has two components: the first is advising our own SMSF clients while fulfilling the administration, tax and compliance requirements. The second component is a white-label service we provide to 200 different accountants and financial advisors. Most advisors don't have the in-house expertise to deal with the SMSF requirements. We provide the labour, talent and software to administer these

funds as a white-labelled service under their brand. We ensure that we and the clients both make a margin.

What you'll typically see across all our businesses is advice paired with a capital solution.

Figure 3: Prime Financial has delivered double-digit growth across all business lines



Source: Prime Financial

What's the share of domestic versus international revenue?

Currently, over 99% of our revenue is Australian-based. We do have a team member in Christchurch [New Zealand], and in the past 6 to 12 months, we've seen an increase in work conducted overseas. This shift began with the recruitment of a professional who was previously in New York and is now based in Sydney, maintaining US-based relationships, particularly in tech advisory. This is part of our strategy to elevate the level of service we provide to our customers.

While we don't have a physical office in the US, we are actively expanding our client base there, as well as in Europe. In Europe, our focus is on the corporate finance division, exploring niches like sports mergers and acquisitions and equity debt solutions. Our aim is to find unique niches where we can expand and differentiate ourselves in the global market.

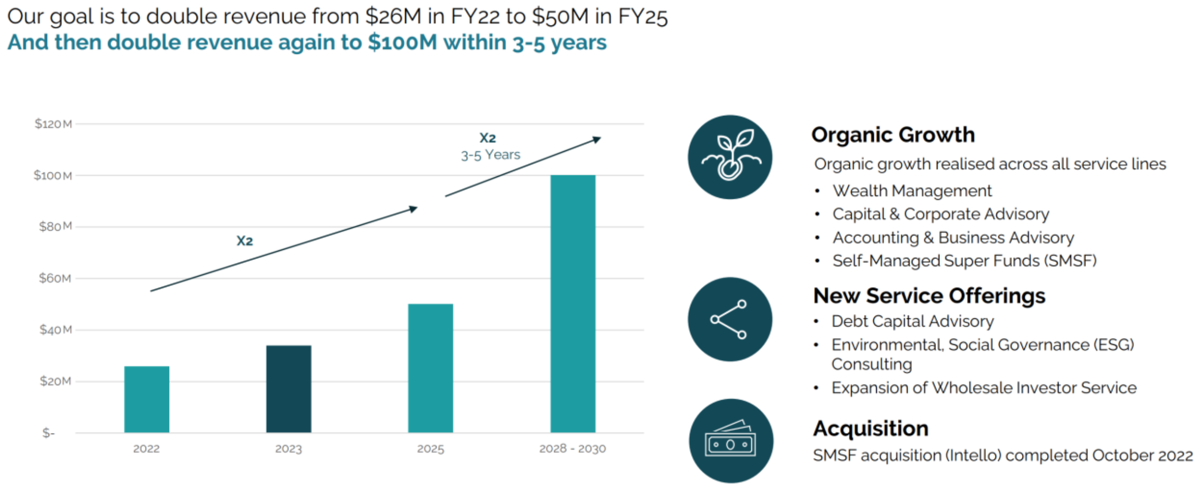
Where do you see your biggest growth opportunities?

In the past five to six years, we've focused on organic growth, initially offering wealth management, accounting & business advisory services and later expanding into self-managed super funds (SMSF) and corporate finance. A key growth strategy has been the cross-delivery of these services to our existing customer base. We've been successful in rolling out new services under a unified business and brand, emphasising customer-centric solutions.

In the second half of FY23, we launched a debt capital advisory division, which we expect to ramp up quickly. Another growth area is our ESG consulting service, aimed at assisting companies in the supply chain of larger businesses with their impact reporting and helping listed companies like ours develop ESG policies.

We're also expanding our wholesale investor platform, seeing significant potential in alternative asset investments and property, especially given the housing shortage. This expansion is part of our revenue growth strategy, where we turned over $26 million in FY22 and are targeting $50 million by FY25. Our aim is to double this again, reaching $100 million by FY28 to FY30.

Figure 4: Prime is targeting to double revenue to $50 million in FY25



Source: Prime Financial

Our unique position in the market allows us to develop intellectual property through specialised advice, which we leverage to create new products. This approach differentiates us and drives our growth.

For the past five to six years we've been very much focused on organic growth driven by two core services: wealth management, and accounting and business advisory. Five years ago, we launched our SMSF business, which we've continued to build out along with our corporate finance division. The cross-delivery of additional services to our existing customer base is a big part of our growth and I see all four service lines continuing to grow.

Figure 5: Growth will come from a combination of revenue growth and margin expansion

Source: Prime Financial

How critical are acquisitions to your growth strategy?

Acquisitions are complementary to our core organic growth strategy. Our preference is to primarily expand existing service lines, develop new ones, and attract industry talent who wish to join us and own equity. This organic growth model is less capital-intensive.

While we have one or two items on our roadmap that might be more efficiently achieved through acquisitions, these won't be so significant as to stretch our balance sheet. Overall, acquisitions are expected to contribute around 10 to 20% of our future growth, with the majority, 70 to 80%, coming from organic expansion.

Can you explain the rational behind the Altor Capital acquisition you announced yesterday? How does it fit within your strategy and your existing businesses?

We are really excited to have completed the acquisition of Altor Capital. which allows Prime to launch new products in the burgeoning alternative asset management space. Altor has an established business model with a team of 7, and annualised revenue of $1.8 million. By plugging this business into Prime's integrated offering, Prime can build out a diversified alternative asset management business under its Wealth Management offering, offering new investment opportunities for wealth management clients, while also providing potential funding solutions for Prime's Capital clients.

This acquisition plays into our strategy of wanting to double group revenue between FY22 and FY25 to $50 million, through organic and inorganic activity, enhancing our capability across Advice, Capital & Asset Management for our Business and Wealth segment clients.

Do you see an opportunity in terms of the number of retiring accountants and financial advisors who don't have an exit strategy?

Certainly, this presents an opportunity, but our approach is not based on a typical succession or 'tuck-in' model. We focus on professionals who recognise the challenges of small business ownership in professional services and are more inclined towards client advisory and having control over their destiny.

In terms of acquisitions, we prefer these professionals to integrate under our brand and become owners of the overall business. This approach is more about mutual growth acceleration and leveraging each party's strengths rather than just succession planning. We aim to create a sense of community and shared growth, supported by our systems and structures, including a shared services model with team members across various functions like accounting, finance, IT, HR, and operations.

While we have experimented with minority equity interests and acquiring 50% stakes in businesses, this hasn't always aligned with our growth objectives, as it limited our control over business levers. Our acquisitions are selective and not predominantly 'tuck-in' types.

For instance, our 2022 transaction in the SMSF space involved acquiring a business whose owners were not active in the day-to-day operations. We compensated them over a 12-month period and enhanced the roles of existing team members, promoting them and making them owners of the overall business. This strategy of empowering team members and providing ownership opportunities aligns with our vision for future growth.

How much of your growth will come from international opportunities?

The international aspect of our growth is still an emerging sector for us. We might initiate two or three new engagements in the US or European markets. As we expand internationally, our strategy involves making long-term decisions with a typical outlook of five to seven years.

When exploring new areas of interest or ventures complementary to our existing services, we aim for each new initiative to generate three to five million in revenue within three to five years. Our disciplined expansion approach focuses on how new ventures can complement our current customer base. For instance, our corporate finance division, which started from nothing five years ago, now generates approximately six million in revenue. Similarly, the SMSF division has shown significant growth. While we acknowledge that not every venture is successful, our track record shows that we more often succeed in these endeavours. This disciplined, long-term approach to domestic and international expansion is integral to our growth strategy.

What are the biggest risks to your growth targets?

The biggest risks to our growth targets are primarily related to the timing of corporate finance transactions and managing our human resources.

About 80% of our revenue is recurring, mainly from the SMSF, accounting, and wealth management divisions. However, in our corporate finance division, the main challenge is the unpredictability of when transactions will close. While we are gaining more engagements each year and expanding this part of our business, the timing of deal closures and the receipt of success fees (from activities like selling a business or raising capital) is uncertain. This presents a risk more to the timing of revenue recognition rather than to the opportunity or potential for future growth.

Secondly, as a service-oriented business, our people are our most significant asset. Ensuring that we have sufficient growth opportunities for our staff, an effective ownership structure for team members to participate in, and maintaining a positive work environment are critical. We dedicate considerable attention to these aspects, recognising their importance in our overall business strategy and success.

What is your customer churn?

Our customer channel is characterised by a strong focus on client relationships and support, a proven successful strategy, especially during challenging times like COVID.

Our 80% recurring revenue reflects our low customer churn. While I don't have a specific figure to share, the high percentage of recurring revenue clearly shows that most of our clients return each year. This is particularly true for our wealth management, SMSF, and accounting services. In corporate finance, which typically involves term-based engagements, we still maintain strong client relationships.

Over the past 12 months, all four service lines have experienced growth ranging from 14% to 102%, indicating that we are consistently gaining market share and adding more clients than we are losing. This growth is a testament to our effective client engagement and retention strategies. Currently, customer retention is not a significant concern for us, as our results speak to our strong client relationships and the trust we have built in the market.

Given the high employment rate within financial markets, how are you finding staff retention and turnover?

Staff turnover is challenging, particularly in our accounting division. This seems to be an industry-wide issue, and from comparisons with larger peers, we've noticed similar trends.

Post-COVID, we've seen a decrease in the number of accountants returning to Australia, which has affected our staffing. To address this, we've employed a mix of onshore and offshore team members, with about 30 to 35% of our team based in the Philippines and India. This strategy helps us maintain access to talent despite local shortages.

Our staff turnover rate in the last 12 months was between 12 and 14%. However, it was notably higher in the accounting division, around 30%. We're aware of this issue and understand that it's more an industry-wide challenge than something specific to our company. Although this understanding doesn't necessarily make the problem easier to solve, it's an important factor to consider in our staffing strategy.

And how have you found the wage inflation situation?

Addressing wage inflation is a significant focus for us. We're committed to ensuring that our team members, especially top talent, are compensated as well as, if not better than, what they might receive elsewhere in the industry. This approach requires us to grow our firm rapidly and effectively.

One of our key strengths in attracting and retaining talent lies in our remuneration structure. Beyond offering industry-comparable base salaries and short-term incentives tied to firm growth, our unique advantage is in our ownership structure. We provide opportunities for team members to become business owners, creating an asset beyond their base salary and cash incentives.

To manage wage inflation, it's crucial to match market rates while being strategic about our overall resourcing and retention models. By ensuring our staff are motivated and find additional ways to add value for our customers, we can achieve greater organic growth than the industry average. This, in turn, enables us to sustainably offer competitive or superior compensation.

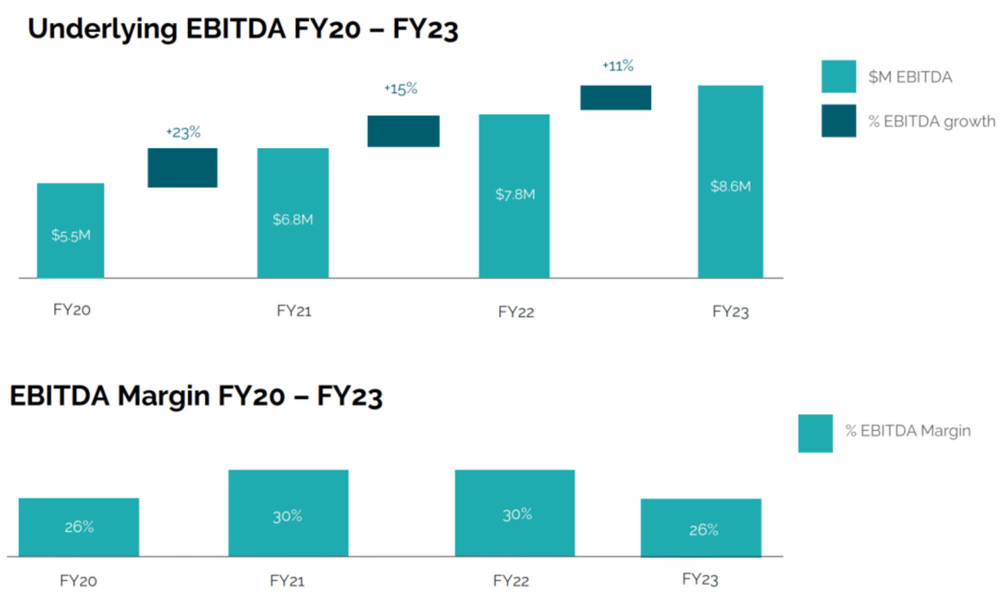
Can you provide some colour around your margins and the recent contraction?

Over the last four to five years, we've worked diligently to achieve an EBITDA margin of approximately 26 to 30%. This process involves balancing the reinvestment in new services, where new team members typically take six to nine months to start contributing positively to earnings.

In the last half of FY23, as we introduced three new key service areas, our EBITDA margin dipped from 30% to 26%. This is part of a strategic investment for future growth, with the goal of returning to a 30% margin in the next year or two.

Regarding our different service lines, they each have varying margins. The wealth division operates at around a 30% EBITDA margin, and the accounting division is slightly higher at about 35%. The SMSF division currently stands at 15% to 20%. The corporate finance division's margin fluctuates more significantly, ranging between 20% and 40%, depending on when transactions are completed. This results in an overall average EBITDA margin for the business of between 26 to 30%.

Figure 6: The rollout of three new service lines saw margins dip to 26% in FY23



Source: Prime Financial

Where will margins be when you hit your hundred million dollar revenue target?

We're targeting a long-term and sustainable EBITDA margin of around 30%. This is because some of the new areas we're exploring are expected to yield higher EBITDA margins than our current average of 25 to 30%. As these areas grow, they will constitute a more significant portion of our overall turnover, contributing to a healthier margin overall.

These targets are supported by industry comparisons. For instance, I recently examined a research report on MA Financial, a peer in our sector known for its substantial asset management component. According to this report, they achieve around a 36% EBITDA margin. This benchmark indicates the potential within our industry and suggests that certain aspects of our business could align with these higher-margin areas. As such, our goal is not only to maintain a margin of 26% to 30% but to enhance it to 30% or more as we diversify and grow our service offerings.

What do you think are the most common misunderstandings about your business?

The most common misconceptions stem from our evolution over the past 25 years. Initially, we started by partnering with accountants for wealth management, eventually holding minority equity interests in some of these firms. About five to six years ago, we shifted focus, moving away from wealth management joint ventures and selling our minority interests to reposition ourselves as a unified capital and asset management business with one brand and three core locations, serving a growing high net worth investor base.

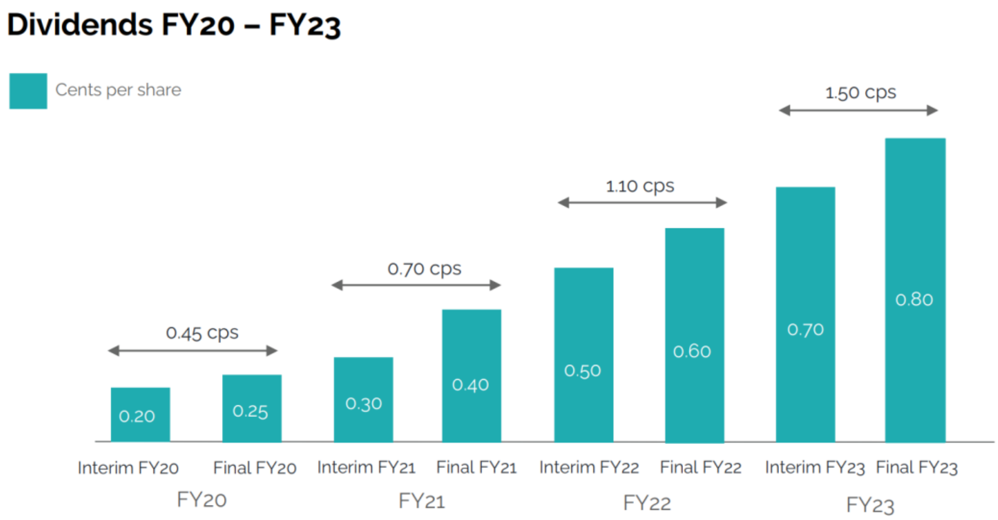
Since this repositioning, we've achieved a compound annual growth rate of 20 to 39% across our five key metrics. However, some challenges persist. Firstly, our relatively small market cap, which ranges between $40 and $50 million, can be perceived as a limitation. While 45% of our company is owned by key management and staff, this can lead to concerns about share liquidity.

Another factor is that we haven't actively promoted the business until recently, feeling that a solid five-year track record was necessary to legitimately showcase our business. Now, with that track record established, we're more actively communicating our strengths and achievements.

We've consistently delivered on our commitments over the past five years, and I believe the current issue is one of scale and relevance. In today's market, where small and micro caps have declined by 30 to 40%, we stand out with potential for strategic acquisitions, a policy of paying out 70% of our earnings as dividends, and growth while trading at below double-digit multiples on historical earnings.

Our recent engagements with micro and small-cap managers have been promising, indicating growing awareness and interest in our stock. This increased awareness, coupled with the realisation that there's accessible entry into our stock, presents an opportunity to reassess our valuation.

Figure 7: Since FY20, Prime has grown its dividend by an average annual rate of 49%



Source: Prime Financial

What do you wish the investors better understood about your business?

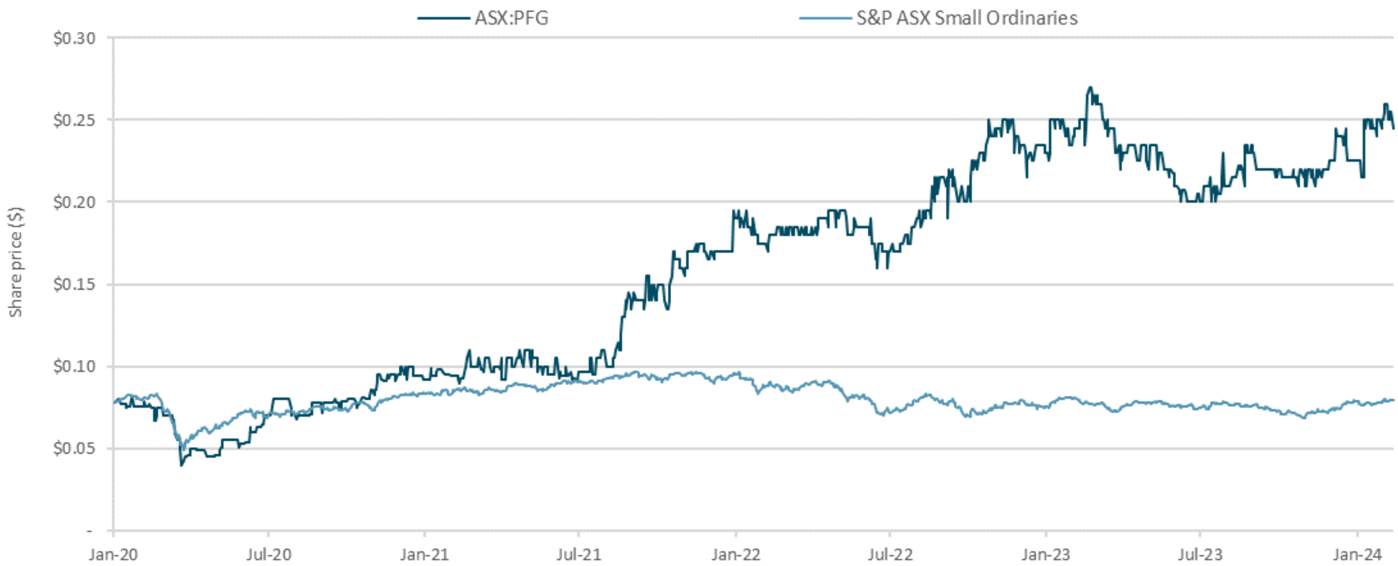
I wish investors better understood Prime's unique position and potential in the financial services space. We often find ourselves grouped with various business models, but our focus on advice and capital sets us apart. This combination is quite distinct, and over 25 years, including during times like the GFC and COVID, we've seen the consistent need for quality advice and investment opportunities.

Our approach is to identify growing segments and support our clients, thereby building a differentiated and robust business. We aim to consistently do more for our customers than our competitors. One key aspect I'd like investors to appreciate more is our strong operating cash flow. This enables us to pay regular dividends, which have been increasing over the past five years, while still having a considerable growth runway ahead of us. There's no direct comparable peer in our market, which presents a unique opportunity.

We envision growing into a business with a market cap of $250 to $300 million. With the ability to double revenue every three to five years, we are well-positioned for significant scaling. However, the greatest asset we have is our team. We've successfully maintained and grown our team, which I believe is central to our ongoing and future success.

It's an exciting time for us, as we have clearly defined our value proposition in a lucrative space. The current valuations may not fully reflect our past growth or future potential, which I believe is a crucial point for investors to understand.

Share price performance



Source: Factset

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