Hurdle Rate Unit Trust

February 2024 – Centrepoint Alliance (ASX:CAF)

Centrepoint Alliance (ASX:CAF) is an Australian financial services business providing licensing in both financial and credit advice along with a managed portfolios business and support services such as assistance with Xplan implementation (Financial Planning software. Centrepoint is a business I have been following for many years, having owned it myself in the past when it was a net-net. Back then it was paying significant amounts of cash to legacy clients claiming remediation for fee-for-no-service complaints. This was slated to stop imminently and on an ex-claims basis the business was trading on a low-single digit multiple despites having more than the market cap in cash. Suffice to say it was a huge success, with an IRR of 97%, although I was not so successful having booked no such profits. Nevertheless, the thesis has changed today so the question is… what has made the trust make an investment after such a run?

In the time since Centrepoint has acquired several businesses including Enzumo in 2020, ClearView Advice in 2021 and the more recent Financial Advice Matters (FAM) in late 2023. Firstly, Enzumo was acquired for cash consideration of $1.5m and generated $2.5m and $0.7m of revenue and EBITDA in the first year respectively. ClearView was much more transformational at a total consideration of $15.2m ($12m in shares) but has appeared to of paid off with particularly strong improvement in profits, and more importantly ROE since this acquisition with EPS growing from 1.28cps to 3.23cps and pre-tax ROE from 13% to 21% over a 2-year period. Just recently it has purchased FAM for a price of $10m (20% deferred depending on EBIT of >$1.5m). Of note here is that prior to this deal Centrepoint only had 5 salaried advisers, which is interesting given the trend in preference for salaried advisers at other peer firms as well.

As can be seen they have been highly successful at purchasing and integrating acquisitions, but of particular importance is the broadening service suite for the prospects of future organic growth. It's likely that this would come from initiatives such as managed accounts and their credit services rather than growth in advisers, which is more likely to occur through consolidation in my view (that being said, the group has had some success adding an additional ~1% of advisors in 2023 whereas the industry was down ~1% in the same period).

Financially, the group has a consolidated exposure to adviser revenue through it's accounts, though it's merely a passthrough. You should view licensee revenue as the gross profit within the accounts as a result. After taking out goodwill, Deferred taxes, and cash, the net tangible asset position of the business is in the negative, which reflects the capital light nature of the group. This is due to the group's activities as a licensee where they bill the client directly and then pay advisers in effect pushing the working capital onto the authorised representative. As you would expect the expense lines are predominately staff related, which makes sense as a services business. For reference, rightsizing the headcount post the ClearView acquisition was their focus, and they did a good job of it.

Insider ownership in the business is not especially large with the only real participant being Mr Alexander Beard with ~3% who recently stood down as director. But the group has a number of interesting shareholders including a 20% shareholding by **COG Financial Services (ASX:COG)** and 6% by our holding in **Sequoia Financial Group (ASX:SEQ)**. However, with the existence and failure of a prior bid at $0.325 in August 2022 from Diverger, given the increase business value since it may be difficult to envision a scenario where Centrepoint gets acquired for anything near the current price. If we use the relative valuation of Diverger's bid from Count, it will imply a takeout price of $0.41 for Centrepoint or 34% above the current price.

Lastly, it is worth noting the substantial revenue and capital losses of $28.1m and $37.2m respectively in addition to the $11.7m in franking credits which may be of value to prospective acquirers, particularly in the same industry and given their excess cash balance. Approaching this from an absolute valuation I see Centrepoint as trading at an earnings yield of 12% and pays just about all of this out to shareholders as a fully franked dividend. This would imply a first-year dividend yield of ~17%, meaning we need little in the way of earnings growth or even multiple expansion to achieve our 25% hurdle rate.