

DIVERSA LIMITED(DVA) UPDATE

TWO ACQUISITIONS TO PROVIDE QUANTUM BOOST IN SCALE

DIRECTORS

Stuart Korchinski, Chairman
 Mathew Morgan, Non-Executive Director
 Stephen Bizzell, Non-executive Director
 Garry Crole, Non-executive Director

MARKET DATA

ASX Code: DVA
 Current Price: \$0.03
 52 week Share Price Range: \$0.02 - \$0.04
 Market Capitalisation: \$13.6million
 Enterprise Value: \$12.9 million

CAPITAL STRUCTURE

Shares on Issue: 453.7million

FINANCIAL SUMMARY

\$mill	2012-13(A)	2013-14(E)
Operating Revenue	4.5	4.4
EBITDA	-1.4	-1.1
Net Profit	-2.8	-2.3
Net Debt	4.5	-0.7
Shareholders Equity	-0.3	4.9
Total Assets	7.5	7.2

MAJOR SHAREHOLDERS

BCP Nominees 19.77%
 Empshore Pty Ltd 11.19%

SENIOR ANALYST

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KEY POINTS

- Diversa announces two acquisitions; A 100% interest in The Trust Company (Superannuation) Limited for \$2.65 million; and a 30% interest in Tranzact Financial Services Limited for \$2.85 million with an option to acquire the remaining 70%.
- Annualised revenue will exceed \$11 million with EBITDA margin expected to exceed 30% in FY 2016.
- Quantum boost in scale will drive a maiden profit in FY 2015.
- Placement to raise \$3 million with debt facilities in place to complete acquisitions

INVESTMENT PROPOSITION

Diversa is a product manufacturer and integrated services provider to small corporate and industry super funds. With the capability build now completed across the value chain, Diversa is in a position to grow revenue over the next few years as smaller superannuation funds and non-aligned advisers adjust their business models to embrace the changes under FoFA and the Stronger Super reforms.

The two most recently announced acquisitions are transformative and potentially “company making”. The enlarged company will now have the scale to achieve sustained profitability and more effectively deliver its value proposition and grow market share.

Diversa has an experienced management team of superannuation and investment experts and whilst a maiden profit will be achieved in FY15 with a current market capitalisation to FUMA of around 0.5%, there is significant growth potential for longer-term investors as the business model matures.

Event

Diversa has announced that it has entered into two separate agreements to acquire:

- A 100% interest in The Trust Company (Superannuation) Limited for \$2.65 million; and
- A 30% interest in Tranzact Financial Services Limited for \$2.85 million with an option to acquire the remaining 70%.

Both acquisitions are consistent with the Group's growth plans and expected to be earnings accretive before synergies. The acquisitions will be funded by a combination of debt and equity.

Diversa has entered into an agreement with Perpetual Limited (ASX:PPT) to acquire The Trust Company (Superannuation) Limited (TTCSL), which operates a third party superannuation trustee business.

The TTCSL business to be acquired provides third party trustee services to 15 superannuation funds with approximately \$3.1 billion in assets and is expected to have 10 employees on completion of the transaction. Based on the current agreements in place with client funds, the business currently generates approximately \$2.3m of revenue on an annualised basis.

The consideration payable is \$2.65m in cash and the acquisition is expected to settle on or before 1 September 2014.

Diversa has entered into an agreement with Gro-Aust Holdings Limited to acquire 30% of Tranzact Financial Services Pty Limited (TFS) with an option to acquire the remaining 70% subject to certain terms. TFS provides administration, promotion and investment management services to the Smartsave 'Members Choice' superannuation Master Plan, a \$208m fund with approximately 11,000 members. The Fund has a number of investment options including a MySuper option.

The consideration payable for the 30% interest is \$2.85m in cash, and the agreement is conditional on Diversa raising sufficient capital to complete the acquisition. The agreement also includes a put and call option in relation to the remaining 70% of TFS, for a consideration of up to \$6.65m as follow

- \$2.85m to exercise the option

- \$1.9m payable 12 months after the exercise of the option (\$0.25m in shares)

- \$1.9m payable 24 months after the exercise of the option (\$0.25m in shares)

The call option is at Diversa's discretion and is exercisable between 1 January 2015 and 30 June 2015. The put option is at the discretion of the vendor and is subject to TFS satisfying key revenue performance hurdles, and is exercisable between 1 July 2015 and 31 December 2015. In the event that Diversa does not exercise its call option by 30 June 2015, the vendor has the option to buyback the 30% interest for the initial consideration amount. Adjustment provisions apply for the deferred consideration payments after the option is exercised if the revenue earned by TFS decreases during the payment periods. The agreement also provides that a minimum return of \$0.7m per annum will be received by Diversa for its 30% interest during the time that it holds a minority interest in TFS.

Analysis and Comment

This announcement is the climax of a program that management has been implementing over the past two years to build Diversa into a significant financial services group providing a comprehensive range of integrated services in the superannuation sector. These acquisitions provide a quantum leap and much needed scale to the company's operations. Moreover, they put Diversa firmly on the pathway towards sustainable profitability.

Diversa has largely built its business, which provides Trustee Services, Fund Administration, Promotion and Product Management and Investment Services, through acquisition. Whilst the individual business units are operating profitably the margins have not been sufficient to cover group overheads, although the gap has been narrowing.

The Trust Company (Superannuation) will boost funds under trusteeship from \$1.1 billion to \$4.1 billion and approximately doubles the number of funds under trusteeship to 31. Tranzact is the Promoter, Administrator and Investment Manager of the \$208m Smartsave Members Choice Superannuation Plan. The addition of this fund will boost the number of insured lives managed by the company from 11K to nearly 19K.

The acquisition of The Trust Company (Superannuation) will double the revenue of the Trustee Services business whilst the 30% interest Tranzact Financial Services will deliver an investment return of \$0.7 million, which will enable the company to report a maiden profit in FY 2015. On a full year basis and assuming 100% ownership of Tranzact Financial Services, the enlarged Diversa will be generating revenues in excess of \$11 million compared with our FY 2014 forecast of \$4.4 million. It is difficult to estimate the sustainable EBITDA margin, however, we believe that a margin above 30% is achievable, especially as synergies emerge after the initial implementation costs have been recovered. The margin in FY 2015 will be somewhat less due to timing issues associated with the completion of the acquisitions and the acquisition and integration costs but the margin should be close to this figure in FY 2016.

The company has undertaken a \$3 million placement to sophisticated investors and fund managers at 2.7c per share, a 10% discount to the 30 day vwap. The placement and a debt facility will be used to fund these acquisitions, however management has left the door open to further equity raisings to minimise the company's exposure to debt. Post the placement, the company will have around 565 million issued shares with a market cap of about \$17 million, at the 3 cents. An objective of the capital raise is to introduce new shareholders and to further broaden the shareholder base.

The Diversa business model has been constructed over the past two years over which time the company has undergone considerable management, operational and financial restructuring to the point where it can, with a high degree of financial and management confidence regarding its capabilities, execute and implement these acquisitions.

Whilst further acquisitions are possible, the business development strategy will now focus more on growing market share in the small superannuation fund space and to cross sell its various product offerings. Diversa's value proposition for small corporate / industry superannuation funds is to offer high levels of service and flexibility. Its competitive advantage lies in a relatively small management team being able to respond quickly and favourably to the needs of these funds who typically face rigid management in the bigger organisations that are more focused on the needs of the large funds.

The company's target market is a relatively small slice of the overall trillion dollar superannuation market. As Diversa currently holds less than 2% share of its \$150 billion to \$200 billion target market, it nonetheless represents a considerably opportunity for the company.

These acquisitions are transformative and potentially company making. The quantum leap in scale will not only enable the company to reach sustainable profitability, it will considerably enhance its competitive position with the resources and capabilities to efficiently service its target market and boost its market share.

Business Overview

Diversa's business model is focussed on providing products and services across the superannuation value chain to individuals and intermediaries (retail and wholesale channels). The target market is large and continuing to grow with the value of targeted industry funds estimated at \$20b and adviser led private label funds at \$55b. Across all service offerings the market opportunity is estimated at between \$150 billion and \$200 billion. Currently, Diversa has FUTMA of around \$1.7b. The business model specifically caters for the new and emerging regulatory environment under FoFA and the Stronger Super reforms. The integrated nature of the products and services offered has the potential to deliver multiple revenue streams. Diversa has three established revenue generating divisions:

Superannuation Services – Diversa, prior to the acquisitions, currently provides superannuation (including insurance) administration and promotion services to the following funds:

- Progress Superannuation Fund (\$45m fund with approximately 1,900 members);
- Law Employees Superannuation Fund (\$80m fund with approximately 3,800 members);
- Managed Australian Retirement Fund (\$42m fund with approximately 3,500 members);
- Transport Industry Superannuation Fund (\$103m fund with approximately 7,400 members);

Group Life and Salary Continuance risk products are provided to individuals and SMSF trustees directly and to employer groups. Overall, the superannuation services business is currently servicing about 16,000 members. Total funds under administration and promotion are about \$332m with around 8,000 lives insured.

Trustee Services - Diversa acts as superannuation trustee using its Registrable Superannuation Entity Licence (RSE) for a range of master trusts, corporate and insurance only superannuation funds. Currently, Diversa provides services to 16 funds with total funds under trusteeship of \$1.1b.

Funds Management and Investment Services – Diversa provides investment management services to the Managed Australian Retirement Fund (MARF) and the Law Employees Superannuation Fund (LESF) and is expected to further develop this business over time.

Business Drivers and Growth Profile

The key business drivers for Diversa are the FoFA and Stronger Super reforms and the strong industry growth with superannuation contributions set to rise to 12% of salary by 2019. The current lack of direct competition due to the increasing regulatory barriers to entry and with no competitor building a similar total fund product offering, Diversa is in a strong position to take full advantage of the financial services industry reforms.

FoFA is driving non-aligned advisers to re-engineer their revenue streams as volume related payments and soft dollars are gradually being eliminated. This is forcing intermediaries to re-focus on insurance sales and fee-for-service advice or vertically integrate to have more margin discretion by owning or partnering with a product manufacturer/promoter such as Diversa to source an RSE trustee service to enable and transition of existing superannuation business arrangements into a private label structure where an adviser also acts as a fund promoter. At a market level, the trend for independent financial advisers to move from multiple white label platforms to a private label structure is real and will continue in a post FoFA environment in part because existing platforms have sought to own adviser clients or have introduced narrow remuneration frameworks.

The shared services/products model operated by Diversa enables advice businesses and sub-scale superannuation funds to reduce establishment costs for and gain immediate access to new products and services. They are then able to focus on their core advice services of advice and by owning part of the value chain (as promoter), are replacing lost revenue due to the FoFA and other regulatory reforms.

The Stronger Super requirements are placing increased pressure on all superannuation funds to deliver better quality products and services to their members for lower fees. This is forcing promoters of smaller funds to merge with others or alter their business models to address the new superannuation requirements. The growing demand for superannuation products is also forcing non-superannuation product providers to provide a superannuation equivalent on a private or white label basis. Intermediaries and fund promoters have to either deploy resources to deliver competitive superannuation products or access product manufacturing capability (trustee, administration, investment management and insurance) in order to provide a superannuation product.

These industry trends provide a significant opportunity for Diversa to grow its superannuation business by: acquiring promotion/administration/investment management rights to smaller superannuation funds; taking on trusteeship; offering administration and promotion services to target superannuation funds on an outsourced basis placing it in a position to assume trusteeship should the trustee elect to exit; and aggregating Diversa Superannuation with other funds which provide a non-intermediated client base open for scaled and personal advice, and that augment existing investment management, insurance and administration service revenue. Diversa's current offering to smaller superannuation funds/employers and ability to build/distribute products under its own name will become increasingly valuable in the future and should not be underestimated.

Having now established the capability and the infrastructure, Diversa is in a position to handle significantly higher volumes with marginal outlays given that its overheads are relatively fixed. Trustee and investment management services are particularly scalable which benefits both internal and external products. As the Group's revenue is largely determined by a percentage of FUTMA and member numbers to a lesser extent, organic growth will be derived as client businesses grow and new clients are added. Diversa can also expand the range of services offered to existing clients and build scale through selective acquisitions.

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