

# Lighthouse Group

On track for full year expectations

H118 results

First half results from Lighthouse indicate that it is on track to meet market expectations for the full year, while the strength of its business providing financial advice to members of affinity partners was underlined by its success in renewing all eight of the contracts that have come up for renewal this year. This now accounts for 19% of group revenue and there is good scope to increase penetration in this area. Part of the c £5m of cash the group has available for investment is likely to be allocated here.

Year end	Revenue (£m)	PBT (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/16	47.9	1.9	1.13	0.27	29.6	0.8
12/17	54.1	2.5	1.49	0.42	22.4	1.3
12/18e	55.7	2.8	1.61	0.60	20.7	1.8
12/19e	57.5	3.1	1.81	0.70	18.5	2.1

Note: \*EPS are normalised and fully diluted, with tax credits excluded and a standard tax charge applied.

## Operational gearing and growing dividend

H118 results showed total revenue up 5% but, excluding the legacy Communities (Network) division, the increase was 12%. Revenues from the higher-margin affinity business increased 20% and the proportion of customer-derived recurring revenue has increased to more than 50% of the total. Costs were held flat and reduced before share based payments, allowing pre-tax profit and diluted EPS to increase by 12% and 9% respectively. Reflecting the strong balance sheet with no debt, cash of £9.6m and a positive outlook, the interim dividend was increased by 67% to 0.20p.

## Outlook

The market background for a UK financial advice firm such as Lighthouse is favourable given an ageing population, and increased choices and responsibility for pension accumulation and decumulation. Lighthouse is differentiated by its well-established affinity business, and investment in additional staff to develop this opportunity more rapidly could provide attractive returns in due course. Otherwise, Luceo Asset Management should continue to build towards a profitable scale and other in-house solutions for clients may be added where appropriate opportunities are seen. In the near term, Lighthouse reports that the second half has started well, continuing the trends seen in the first six months.

## Valuation: Useful upside following recent correction

Our estimates are only marginally changed with earnings per share marginally increased. With limited changes in estimates, our DCF valuation is unchanged at c 44p, more than 30% above the current share price.

## Financial services

10 September 2018

**Price** 33.4p  
**Market cap** £43m

Net cash (£m) at end June 2018	9.6
Shares in issue	127.7m
Free float (updated July 2018)	80%
Code	LGT
Primary exchange	AIM
Secondary exchange	N/A

## Share price performance



%	1m	3m	12m
Abs	(7.2)	16.8	88.2
Rel (local)	(2.3)	23.3	89.7
52-week high/low		38.7p	16.8p

## Business description

Lighthouse comprises a diverse group of UK financial advice firms serving individuals and businesses. The main focus is on Middle Britain and contracts with 21 affinity groups are an important revenue and profit contributor. Wealth Advisory serves a high net worth client base, while Luceo Asset Management provides an in-house fund offering.

## Next events

FY18 trading update	January 2019
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## H118 results

Lighthouse reported good progress at the interim stage with revenue growth of 5% translating to a 12% increase in pre-tax profit. The recurring element of sales has continued to increase, now accounting for 51% of customer-derived revenue compared with 49% in the same period last year. The strength of the affinity business, including the level of service provided, has also been reaffirmed, with all eight contracts that have come up renewal this year (out of 21) being retained. The relationship with Unison has also been extended to include mortgage and protection advice. Revenue arising from these relationships increased by 20% and accounted for 19% of group and 51% of the National division's revenues respectively.

Key points from the figures are highlighted below, and a profit and loss analysis is shown in Exhibit 1 (comparisons are with H117 unless stated).

- Revenue increased by 5% but, excluding the legacy Communities division where revenue is contracting, growth would have been 12%.
- Average revenue production per adviser increased from £117,000 to £124,000. This compares with £80,000 in H113: compound annual growth was 9.2% over the last five years.
- The gross margin nudged slightly lower (26.8% versus 27.2%) with higher growth in affinity revenue resulting in an increase in introducer payments made to the partner organisations.
- Cost discipline meant that operating expenses before share-based payments were reduced by 3%, allowing underlying EBITDA to increase by 26%. The underlying EBITDA margin increased from 5.1% to 6.1%. Unadjusted EBITDA and pre-tax profit increased by 16% and 12% respectively.
- Fully diluted, adjusted EPS (assumes a full tax charge) increased by 10%.
- The interim dividend has been increased by 67%, reflecting a strong balance sheet position and the board's confidence in the outlook.

<b>Exhibit 1: H118 P&amp;L summary</b>				
<b>£000s except where stated</b>	<b>H117</b>	<b>H217</b>	<b>H118</b>	<b>Change y-o-y %</b>
<b>Revenue</b>	<b>25,673</b>	<b>28,438</b>	<b>26,876</b>	<b>4.7</b>
Cost of sales	(18,680)	(20,759)	(19,686)	5.4
<b>Gross profit</b>	<b>6,993</b>	<b>7,679</b>	<b>7,190</b>	<b>2.8</b>
Underlying operating expenses	(5,686)	(5,799)	(5,543)	(2.5)
<b>Underlying EBITDA</b>	<b>1,307</b>	<b>1,880</b>	<b>1,647</b>	<b>26.0</b>
Share-based payments	(39)	(346)	(183)	369.2
<b>EBITDA</b>	<b>1,268</b>	<b>1,534</b>	<b>1,464</b>	<b>15.5</b>
Depreciation and amortisation	(137)	(137)	(178)	29.9
<b>Operating profit</b>	<b>1,131</b>	<b>1,397</b>	<b>1,286</b>	<b>13.7</b>
Finance income	1	2	7	600.0
Finance costs	(7)	(3)	(29)	314.3
<b>Profit before taxation</b>	<b>1,125</b>	<b>1,396</b>	<b>1,264</b>	<b>12.4</b>
Taxation	0	200	0	
<b>Earnings</b>	<b>1,125</b>	<b>1,596</b>	<b>1,264</b>	<b>12.4</b>
Basic EPS (p)	0.88	1.25	0.99	12.4
Dil EPS (p)	0.83	1.15	0.91	8.8
Adjusted EPS (p)	0.71	0.88	0.80	12.7
<b>Dil adjusted EPS (p)</b>	<b>0.67</b>	<b>0.81</b>	<b>0.73</b>	<b>9.6</b>
<b>Dividend (p)</b>	<b>0.12</b>	<b>0.30</b>	<b>0.20</b>	<b>66.7</b>
Source: Lighthouse, Edison Investment Research				

The next table shows the segmental analysis of revenue and profit for the period. In the revenue analysis, the contrast between the National division (including the affinity business) and the gradual contraction of the Communities division (previously Network) is clear, while revenue growth in the Wealth Advisory division, serving high net worth clients, was strong at over 16%. Early-stage

growth in the Luceo Asset Management business explains the rapid growth in Other segments revenue.

<b>Exhibit 2: H118 segmental analysis</b>				
<b>£000s</b>	<b>H117</b>	<b>H217</b>	<b>H118</b>	<b>Change y-o-y %</b>
<b>Revenue</b>				
National	9,248	10,592	10,064	8.8
Communities	11,774	12,678	11,295	(4.1)
Wealth Advisory	4,598	5,054	5,349	16.3
Other segments	53	113	168	217.0
<b>Total revenue</b>	<b>25,673</b>	<b>28,437</b>	<b>26,876</b>	<b>4.7</b>
<b>Profit</b>				
National	2,537	2,862	2,531	(0.2)
Communities	1,191	1,800	1,263	6.0
Wealth Advisory	380	286	394	3.7
Other segments	(177)	(256)	(160)	(9.6)
<b>Total segmental profit</b>	<b>3,931</b>	<b>4,692</b>	<b>4,028</b>	<b>2.5</b>
Indirect operating expenses	(2,624)	(2,812)	(2,381)	(9.3)
<b>Underlying EBITDA</b>	<b>1,307</b>	<b>1,880</b>	<b>1,647</b>	<b>26.0</b>
Share-based payments	(39)	(346)	(183)	369.2
<b>EBITDA</b>	<b>1,268</b>	<b>1,534</b>	<b>1,464</b>	<b>15.5</b>
Source: Lighthouse, Edison Investment Research				

Turning to segmental profits (now presented excluding indirect operating costs), the contribution from National was maintained. The result was held back by the fact that the prior year period benefited from a £0.11m credit relating to past regulatory fees and the current year bore the cost of further investment in the division's infrastructure. The division still has the highest segmental profit margin at 25% compared with 11% for Communities and 7% for Wealth Advisory. Although Communities' revenue declined as some members moved to being directly regulated, profit increased versus H117 as risks have been reduced and the advisers who have left have tended to be less profitable. Wealth Advisory profitability in recent periods has been affected by investment in the Lighthouse Pensions Trust (LPT) automatic enrolment offering, which now has nearly 6,000 members. A strategic review of this business is now underway as part of a wider exercise to focus on the key growth areas for the group. We assume that while costs may arise from implementing the results of the review, there could also be valuable ongoing savings (for example, EBITDA losses relating to LPT for FY16 and FY17 were over £0.5m a year). The loss in Other segments reflects uncovered costs in Luceo Asset Management. The AUM of the five risk-profiled funds of funds here increased from £37m to £53m during the period, with one fund reaching the break-even level of c £20m. The fee rate is 75bp, of which Lighthouse retains 23bp with the balance paid to the investment manager, Octopus and the ACD, FundRock, as part of cost of sales. At current rates of asset accumulation, the company indicates that the business is likely to move into profitability during 2019. Finally, in this table we note that indirect costs, not allocated to divisions, were 9% lower reflecting continued focus on operational efficiencies.

In Exhibit 3, we summarise the eight affinity partner contract renewals announced year to date, together with the extension of the Unison contract. The renewals involved full tender processes and Lighthouse indicates that its partners pay close attention to service levels delivered when considering proposals. So far, the business has not lost a renewal tender, which is attributed to the extensive experience the group has in this sector and the infrastructure it has established to support service delivery.

**Exhibit 3: Lighthouse affinity partners new contract and renewals 2018 year to date**

Organisation	Membership	Renewals/new contract	Notes
<b>Education</b>			
Association of School and College Leaders (ASCL)	Over 19,000	3 yrs from 1 Sep 2018	Union
<b>Healthcare professionals</b>			
FosterTalk	c 20,000	3 yrs from 1 May 2018	Not for profit company
Royal College of Nursing (via RCN Xtra)	c 435,000	3 yrs from 1 Mar 2018	Union
<b>Public services</b>			
Public and Commercial Services (PCS)	c 200,000	3 yrs from 1 Jun 2018	Union
<b>Multiple sectors</b>			
Unison	Over 1,300,000	Extends coverage to mortgage advice 30 Jan 2018	Union
Prospect	142,000	3 yrs from 1 Jun 2018	Union
<b>Corporate and collectives</b>			
GFTU	c 260,000	2 yrs from 1 Mar 2018	General Federation of Trade Unions
Parliament Hill	Over 2,500,000	2 yrs from 1 Mar 2018	Benefit management for over 90 UK-based membership associations
Money Advice Service	N/A	1 yr from 15 Apr 2018	Govt. funded company with the objective of improving public understanding/management of financial affairs

Source: Lighthouse, TUC, affinity partner websites, Edison Investment Research

## Outlook

We discussed the industry background and outlook for Lighthouse in our [initiation note](#) published in July this year. Key points included:

- Progressive ageing of the UK population, partly driven by greater longevity, is likely to feed into a growing requirement for advice on saving and drawing down funds for retirement.
- There is a substantial affluent and mass-affluent population.
- The shift from defined benefit to defined contribution pensions, together with the pension freedoms introduced in 2015, has increased the complexity of choices individuals face.
- Lighthouse strategy is focused on realising the opportunity provided by the affinity relationships it has established, achieving steady growth in wealth management and attracting additional funds into the Luceo Asset Management activity.

Lighthouse indicates that trading in the second half has started well, with adviser activity levels remaining good. The group has a positive view on achieving market expectations for the full year.

In discussing strategy, Lighthouse highlighted that it may now be appropriate to support development of the affinity business by investing some of its available cash (approximately £5m after regulatory requirements out of the £9.6m reported at the end of H118). Spending would be directed to recruiting additional field staff to liaise with partners and financial advisers to service rising client numbers. The ability to establish closer relations with partners should help generate additional fruitful leads from the six million individual members of the existing affinity organisations, while increased volume would require more advisers to service the new clients arising. Another use of cash could be to develop in-house specialist services or products to meet client needs. Acquisitions would also be considered where appropriate to achieve this, while management notes that prevailing pricing in the purchase of financial advisory firms has been generally unattractive in recent years so this seems less likely as a route for development.

In the next section, we discuss the modest changes we have made to our estimates.

## Financials

The adjustments to our revenue, profit and earnings estimates are limited, with modest changes in the mix to reflect the first half results and to allow for changes in the format of divisional disclosure. PBT and EPS for both years are marginally higher. Ahead of further announcements, we have not allowed for any changes resulting from the current review of the LPT or a step-up in investment to support the affinity business in increasing its penetration of the membership base.

We have increased our dividend estimates following the significant increase in the interim payment. Based on a 40/60 split between interim and final we have assumed a final payment of 0.40p, giving 0.60p for FY18. On our estimates, dividend cover would be c 2.6x for both forecast years.

### Exhibit 4: Estimate revisions

	Revenue (£m)			PBT (£m)			EPS (p)			Dividend (p)		
	Old	New	% chg	Old	New	% chg	Old	New	% chg	Old	New	% chg
2018e	55.2	55.7	0.8	2.7	2.8	0.4	1.60	1.61	0.0	0.50	0.60	20.0
2019e	56.6	57.5	1.7	3.0	3.1	2.7	1.79	1.81	1.1	0.55	0.70	27.3

Source: Edison Investment Research

The balance sheet remains debt free and cash at the end of June stood at £9.6m compared with £8.7m at the end of 2017 and £8.1m at the end of H117. Lighthouse indicates that roughly half the cash is required to underpin regulatory requirements, leaving £5m available for group use, as noted above.

## Valuation

We have updated our peer group table in Exhibit 5. This includes a broad selection of companies including financial advice companies, discretionary fund managers and wealth managers (which we have grouped separately). While each has different characteristics, we believe they are companies investors interested in the area of financial advice and retail investment may consider. Compared with what we have labelled the adviser/DFM average, Lighthouse trades on a lower or similar P/E rating for this year and next, while the traditional wealth managers trade on lower prospective multiples in most cases and on average.

### Exhibit 5: Peer group comparison

	Market capital (£m)	P/E current year (x)	P/E following year (x)	Trailing yield (%)
<b>Lighthouse Group</b>	<b>42</b>	<b>20.6</b>	<b>18.3</b>	<b>1.3</b>
AFH	157	21.2	14.7	1.2
Frenkel Topping	23	15.8	12.5	4.7
Harwood Wealth	102	23.2	18.3	2.2
Mattioli Woods	225	22.1	19.5	2.0
Mortgage Advice Bureau	332	25.1	21.5	3.3
St James's Place	5,865	23.7	19.5	4.8
Tatton	153	24.2	20.0	2.4
Tavistock Investments	17	40.6	10.5	-
<b>Adviser/DFM average</b>		<b>24.5</b>	<b>18.0</b>	<b>2.9</b>
Brewin Dolphin	985	15.8	14.0	4.7
Brooks Macdonald	296	20.5	17.1	2.3
Charles Stanley	188	17.3	12.7	3.0
Quilter	2,569	12.6	13.4	5.9
Rathbones	1,399	17.7	15.9	2.6
<b>Wealth manager average</b>		<b>16.8</b>	<b>14.6</b>	<b>3.7</b>

Source: Bloomberg, Edison Investment Research

Our discounted cash flow valuation factors in the estimates detailed in the financial summary (Exhibit 7) and, assuming long-term growth of 3% and a discount rate of 9%, gives a valuation of c 44p (unchanged).

Finally, we include a price performance table. This shows that Lighthouse has enjoyed the strongest performance in the peer group over 12 months and year to date as the market gave recognition to a modest rating and attractive investment case.

<b>Exhibit 6: Recent share price performance (%)</b>					
<b>Period</b>	<b>One month</b>	<b>Three months</b>	<b>12 months</b>	<b>From 12-month high</b>	<b>Year to date</b>
<b>Lighthouse Group</b>	<b>-3.5</b>	<b>10.1</b>	<b>84.8</b>	<b>-19.0</b>	<b>68.2</b>
AFH	23.9	20.3	66.0	0.0	49.5
Frenkel Topping	-9.1	-38.8	-42.3	-48.9	-44.4
Harwood Wealth	-3.0	-1.5	6.6	-9.7	-8.5
Mattioli Woods	9.6	7.5	-0.3	-0.6	12.1
Mortgage Advice Bureau	11.5	5.9	49.4	-9.0	17.1
St James's Place	-4.2	-7.1	-3.0	-13.4	-9.6
Tatton	11.8	25.7	53.1	-2.1	43.5
Tavistock Investments	-11.0	6.6	-2.3	-23.5	0.0
<b>Average</b>	<b>2.9</b>	<b>3.2</b>	<b>23.6</b>	<b>-14.0</b>	<b>14.2</b>
Brewin Dolphin	-3.3	-6.5	-1.3	-13.0	-10.9
Brooks Macdonald	20.0	8.1	0.6	-4.9	16.4
Charles Stanley	1.4	7.2	-12.9	-13.5	-3.6
Quilter	-0.2	N/A	N/A	-8.4	N/A
Rathbones	5.1	1.4	1.1	-9.8	-0.7
<b>Average</b>	<b>4.6</b>	<b>2.6</b>	<b>-3.1</b>	<b>-9.9</b>	<b>0.3</b>
Source: Bloomberg					

**Exhibit 7: Financial summary**

Year end 31 December (£000s)	2015	2016	2017	2018e	2019e
<b>Profit and loss</b>					
National	16,074	15,717	19,840	21,368	23,184
Communities	23,978	23,780	24,452	23,181	22,181
Wealth Advisory	8,829	8,422	9,652	10,714	11,410
Other segments	0	0	166	409	731
Total revenue	48,881	47,919	54,111	55,672	57,506
Cost of sales	(34,057)	(33,452)	(39,439)	(40,625)	(41,551)
Gross profit	14,824	14,467	14,672	15,046	15,955
Underlying expenses	(13,214)	(12,180)	(11,485)	(11,530)	(12,146)
Underlying EBITDA	1,610	2,287	3,187	3,516	3,809
Share based payment	0	(79)	(385)	(385)	(385)
EBITDA	1,610	2,208	2,802	3,131	3,424
Depreciation and amortisation	(552)	(299)	(274)	(352)	(334)
Operating profit	1,058	1,909	2,528	2,779	3,091
Finance income	14	11	3	14	15
Finance costs	(206)	(27)	(10)	(32)	0
Profit before taxation	866	1,893	2,521	2,761	3,106
Taxation	0	750	200	0	(590)
Non-controlling interest	0	0	0	0	0
Earnings	866	2,643	2,721	2,761	2,516
Adjusted earnings	866	1,514	2,036	2,236	2,516
Basic EPS (p)	0.68	2.07	2.13	2.16	1.97
Dil EPS (p)	0.68	1.97	1.98	1.98	1.81
Adjusted EPS (p)	0.68	1.19	1.59	1.75	1.97
Dil adjusted EPS (p)	0.68	1.13	1.49	1.61	1.81
Dividends (p)	0.24	0.27	0.42	0.60	0.70
Dividend cover - dil adjusted EPS (x)	2.8	4.2	3.5	2.7	2.6
EBITDA margin (%)	3.3	4.6	5.2	5.6	6.0
Return on equity - adj earnings (%)	13.8	19.5	19.7	17.3	16.5
<b>Balance sheet</b>					
Non-current assets	6,555	7,220	7,478	7,594	7,610
Intangible assets	5,284	5,230	5,131	5,231	5,229
Property, plant & equipment	1,271	1,240	1,397	1,412	1,431
Available for sale investment	0	0	0	0	0
Deferred tax asset	0	750	950	950	950
Current assets	21,655	17,505	16,920	17,601	19,579
Trade and other receivables	13,266	9,004	8,187	8,423	9,051
Cash and cash equivalents	8,389	8,501	8,733	9,178	10,529
Total assets	28,210	24,725	24,398	25,194	27,189
Current liabilities	17,254	12,307	11,635	10,150	10,148
Borrowings	34	34	0	0	0
Trade and other payables	10,629	9,268	8,789	8,450	8,448
Provisions	6,591	3,005	2,846	1,700	1,700
Non-current liabilities	4,395	3,454	1,076	850	750
Borrowings	439	405	0	0	0
Provisions	3,956	3,049	1,076	850	750
Total liabilities	21,649	15,761	12,711	11,000	10,898
Net assets	6,561	8,964	11,687	14,194	16,291
<b>Cash flow</b>					
Operating profit	1,058	1,909	2,528	2,779	3,091
Depreciation and amortisation	552	299	274	352	334
Share-based payments	0	79	385	385	385
Change in receivables, payables	(2,415)	2,901	338	(575)	(629)
Change in provisions	2,270	(4,493)	(2,132)	(1,372)	(100)
Finance costs paid	(404)	(27)	(10)	(32)	0
Income taxes refunded/paid	0	0	0	0	(590)
Net cash flow from operating activities	1,061	668	1,383	1,537	2,490
Purchase of PPE	(119)	(126)	(307)	(243)	(200)
Purchase of intangibles	(69)	(88)	(25)	(225)	(150)
Finance income received	14	11	3	14	15
Net cash flow from investing activities	(174)	(203)	(329)	(454)	(335)
Dividends paid	(255)	(319)	(383)	(638)	(805)
Change in loans	(1,307)	(34)	(439)	0	0
Net cash flow from financing activities	(1,562)	(353)	(822)	(638)	(805)
Change in cash	(675)	112	232	445	1,351
Change in loans/other	1,505	34	439	0	0
Change in net cash	830	146	671	445	1,351
Closing net cash	7,916	8,062	8,733	9,178	10,529

Source: Lighthouse Group, Edison Investment Research

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