



Lighthouse Group: Profiting from the right advice

The cash-rich financial advisory group offers prospects for accelerated profit growth, improving cash flow performance, a progressive dividend policy and consolidation opportunities, too

Lighthouse (Aim:LGT)

Ticker	LGT
Current price (p)	29
Target price (p)	40
Market cap (£m)	37
52-week high (p)	29.6
52-week low (p)	13
Net cash (£m)	8.7
Shares in issue (m)	127.7
Financial year-end	31 Dec
Next event	2018 half-year pre-close trading update Jul 2018
Company website	lighthousegroup.plc.uk

Lighthouse Group share price



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Simon Thompson's view:

Lighthouse (LGT) has forced analysts to raise their earnings estimates three times since the autumn – an upgrade cycle that looks far from over – as a raft of contract awards this year highlights. As the preferred financial adviser to large organisations, trade unions and affinity groups which have between them well over 6m members, Lighthouse has created an enviable and highly profitable distribution pipeline for its team of advisers, and one that's being significantly under-valued by investors. Rated on nine times next year's operating profit to its enterprise value, and with the risk to earnings skewed heavily to the upside, the rating discount to larger rivals is worth exploiting.

Bull points

- Fast growing affinity-based national adviser to more than 6m individuals.
- High recurring revenues.
- Nascent asset management division could break even this year.
- Potential consolidation opportunities for auto-enrolment business.
- Progressive dividend policy.
- Relatively fixed overheads and above-average operational leverage.
- Investment in new products supports material upside to future profits.
- Legacy balance sheet provisions unwinding.

Bear points

- UK economic uncertainty.
- Additional regulatory requirements post Mifid II and GDPR.
- Professional indemnity market tight.

“Lighthouse provides financial advice to more than 6m members and employees of large organisations”

Financial services group **Lighthouse (LGT)** has a market cap of £37m and has been listed on London’s Alternative Investment Market since 2000. It had a turbulent passage post the 2008 global financial crisis when the board had to address potential liabilities arising out of the historic trading of certain subsidiaries, and the balance sheet was hit by a hefty write-down of the intangible assets acquired after Lighthouse merged with listed rival Sumus in 2008. But all of that is in the past – Lighthouse has successfully restructured its operations, and the level of its legacy provisioning has fallen markedly. Moreover, there is a growth angle as the management team has invested heavily to turn the business into the “Go to” financial adviser for “Middle Britain” to capitalise on the opportunities that have opened up following the introduction of the Retail Distribution Review (RDR) in 2013.

Lighthouse main operating structure

National/Affinity

- Lighthouse Financial Advice (LFA), a national advisory business focused on providing appropriate financial advice and solutions to the market area termed “Middle Britain”, servicing affinity partners through self-employed advisers.
- Advisers use the Lighthouse Financial Advice (LFA) brand.
- Higher margins and more support/direction from senior management.
- Affinity-based proposition.

Wealth Management

- Highly-skilled advisers operating under LighthouseCarrwood (incorporating Lighthouse Group Employee Benefits) and LighthouseWealth brands.
- Employed and self-employed advisers provide independent, specialist advice on investments, pensions and employee benefits, mainly through professional and other affinity and employer relationships, to high net worth individuals and corporate clients.
- Instrumental in addressing service provision gaps inherent within the workplace solutions and auto-enrolment markets.

Communities/Network

- Lighthouse Advisory Services, a network offering support services to self-employed advisers.
- High quality advisers operating either as self-employed sole traders or within Appointed Representative firms and using their own brands.
- Lighthouse provides regulatory cover, risk management, professional indemnity insurance and income collection and processing services.

Operating from three principal locations – London, Stockport, and Woodingdean near Brighton – Lighthouse has built unique distribution channels through contractual arrangements with affinity partners and accountancy groups, while reducing its reliance on the traditional network business. The strategy is paying off as Lighthouse is now a leading adviser in the affinity arena, providing financial advice to more than 6m employees of large organisations, trade unions and members of affinity groups. UNISON, UNITE and the Royal College of Nursing are among the 21 affinity partners who have appointed Lighthouse as their preferred financial adviser.

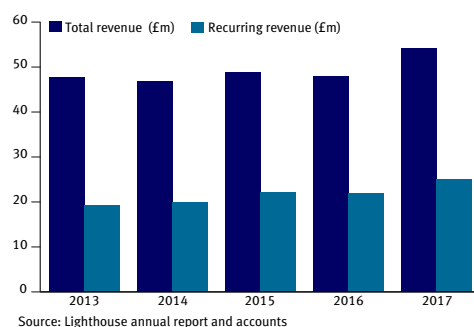
It's very profitable business as growth from affinity-sourced business was the key driver behind last year's eye-catching financial performance: Lighthouse lifted its pre-tax profits by a third to £2.5m on 13 per cent higher revenues of £54m, all of which was organic; and its team of financial advisers generated average revenue of £122,000 each, a record level and 23 per cent higher than in 2016.

Lighthouse (LGT)

Ord Price: 29p			Market Value: £37m	
Touch: 28.2-29p			12-Month High: 29.6p Low: 13p	
Discount Yield: 1.7%			PE Ratio: 16	
Net Asset Value: 9.1p*			Net Cash: £8.7m	
Year to 31 Dec	Revenue (£m)	Pre-tax profit (£m)	Earnings per share (p)	Dividend per share (p)
2014	46.8	0.56	0.44	0.18
2015	48.8	0.87	0.68	0.24
2016	47.9	1.89	1.19	0.27
2017	54.1	2.52	1.49	0.42
2018**	56.9	2.70	1.60	0.46
2019**	57.8	3.00	1.80	0.50
% change	+2	+11	+13	+9
*Includes intangible assets of £5.13m, or 4p a share			Normal market size: 7,500	
**FinnCap forecasts. EPS estimates fully diluted and based on standard corporation tax rate			SETSp	
Source: Lighthouse annual report, London Stock Exchange				

It's a trend that's been gaining traction as revenue per advisor has risen by more than half since the introduction of the RDR at the start of 2013 when the directors decided to re-launch their Lighthouse Financial Advice (LFA) unit as an affinity-focused business. The fact that recurring revenue accounts for almost half the group total is an indication of the willingness of clients to continue to engage with, and seek advice from, Lighthouse's advisers and highlights the strength of the operating model. It's also highly supportive of the £4.7m plus investment made by the board in the LFA division to create the scale whereby it's now generating substantial financial returns.

Recurring revenues on the increase



“Revenue from affinity groups has more than doubled since 2013”

Revenue per advisor

Year to 31 Dec	Revenue per advisor (£)	Growth rate (%)
2013	82,000	na
2014	86,000	5
2015	93,000	12
2016	99,000	6
2017	122,000	23

Recurring revenues on the increase

Year to 31 Dec	Total revenue (£m)	Recurring revenue (£m)
2013	47.8	19.2
2014	46.8	20.0
2015	48.9	22.1
2016	47.9	21.9
2017	54.1	25.0

Source: Lighthouse annual report and accounts

To put this growth into some perspective, revenue earned by Lighthouse from affinity groups surged by 41 per cent from £6.8m to £9.6m in the 12-month trading period, and has more than doubled from £4.2m in 2013, representing an eye-catching annual compound growth rate of 23 per cent. There is real momentum building as illustrated by a near 80 per cent hike in new business wins from affinity relationships to a record high of £5.2m in 2017. Lighthouse carried out 1,100 seminars and surgeries last year to more than 15,000 members of these affinity groups, and signed up no fewer than 5,000 of them in the process. The current run rate is 100 seminars and surgeries per month, and chief executive Malcolm Streatfield says annual revenues from this unit now exceed £10m.

Affinity business on a roll

Year to 31 Dec	Revenue from Affinity (£m)	New business (£m)	Affinity relationships
2015	6.6	2.5	17
2016	6.8	2.9	19
2017	9.6	5.2	21

Source: Lighthouse annual report and accounts

It's a lucrative niche to be operating in as cash profits from Lighthouse's affinity-focused business activity increased from £1.1m to £1.9m in 2017, accounting for two-thirds of group cash profits of £2.8m. Please note that cash profits are also referred to as Ebitda (earnings before interest, taxation, depreciation and amortisation charges). Depreciation and amortisation accounting charges are non-cash items (£274,000 in FY2017), so by adding them back to Lighthouse's operating profit of £2.53m you arrive at the Ebitda figure of £2.8m and have a more accurate

“Lighthouse’s distribution pipeline to Middle Britain is a unique and efficient method of distributing financial services in a cost effective manner”

idea of the overall cash profitability of the business.

Moreover, a spate of contract wins, renewals and extensions to these affinity agreements not only underlines LFA’s position as the financial adviser of choice for affinity groups and their members, but provides a rock solid base to maintain this heady growth rate. For instance, Lighthouse has just been appointed the preferred provider of expert financial advice to The Public and Commercial Services Union (PCS). The three-year agreement encompasses the provision of retirement planning, mortgages and investments. The PCS is one of the largest trade unions in the UK, with around 200,000 members, and is organised throughout the civil service and government agencies, making PCS the UK’s largest civil services trade union. PCS also organises widely in the private sector, usually in areas that have been privatised.

It’s not the only major award this year as Lighthouse has also been appointed the preferred mortgage adviser to UNISON, Europe’s largest public service union with more than 1.3m members, and renewed its agreement with the General Federation of Trade Unions (GFTU) which has 27 affiliates and 260,000 members. Lighthouse’s distribution pipeline to Middle Britain is a unique and efficient method of distributing financial services in a cost effective manner, something many robot advisers and workplace distributors have failed to achieve. LFA is clearly reaping the rewards as the unit’s revenues increased by a quarter overall to £19.8m in 2017 to generate cash profits of £2.8m of which affinity based business accounted for half the division’s revenue, and two-thirds of the cash profits.

Tapping into these 6m affinity group members provides a natural organic growth platform for Lighthouse. LFA now has more than 50,000 active clients, so assuming the affinity business continues to convert a third of the 15,000 potential clients attending its seminars into active clients, then it should be able to post double digit growth in the customer base, thus providing obvious upside to profits too. Also, having invested £4.7m in the LFA business to get to this point, and acquired a £1.1m property close to Brighton to facilitate the operation, the operational leverage in the business is now really kicking in.

It’s also worth pointing out that the strong growth being generated by targeting affinity groups is masked in Lighthouse’s headline numbers by investments made in new products, the upside from which is likely to start flowing through later this year.

Lighthouse segmental reporting

Year to 31 Dec	Lighthouse Financial Advice (National including Affinity)		Lighthouse Advisory Services (communities/network)	
	Revenue (£m)	Ebitda (£m)	Revenue (£m)	Ebitda (£m)
2013	13.9	1.10	27.1	0.68
2014	14.3	2.32	24.8	-0.31
2015	16.0	3.04	24.0	-0.72
2016	15.7	2.68	23.8	0.06
2017	19.8	2.85	24.5	0.94

Year to 31 Dec	Wealth Management		Other segments	
	Revenue (£m)	Ebitda (£m)	Revenue (£m)	Ebitda (£m)
2013	6.9	0.48	nil	-2.00
2014	7.7	0.38	nil	-1.18
2015	8.8	0.25	nil	-0.97
2016	8.4	-0.32	nil	-0.22
2017	9.7	-0.34	0.2	-0.64

Source: Lighthouse annual report and accounts

A nascent asset management business

From a standing start in the autumn of 2016, Lighthouse's asset management business, Luceo Asset Management, now offers five funds for five risk classes with Octopus Investments acting as Investment Adviser. The Luceo funds are available on several leading platforms, including the Lighthouse Zurich platform, a service exclusively available to the Lighthouse Group, its advisers and clients. They are proving popular as Luceo funds had risen from £4m to £37m during 2017, and the funds flows have been between £750,000 to £1m per week this year, according to Mr Streatfield.

Three-quarters of advisers within the LFA business have arranged investment within these funds for their clients. Luceo is looking to develop and launch new investment options in due course, thus tapping into a wider number of customers and providing additional revenue as it scales up. Given the investment required for the operation to hit critical mass, Luceo Asset Management posted a loss of £500,000 on a cash profit basis in 2017, but profits are not far away.

Analyst Jeremy Grime at broking house FinnCap believes that "the principal three funds may reach break-even towards the end of 2018 when the operational leverage in the model starts to generate increasing amounts of cash." To achieve this target, each fund will need to be around £20m in size, a forecast that the board of directors are comfortable with and one that the funds flows this year suggest is more than possible. Moreover, Mr Grime believes Lighthouse's asset management unit "may well reach break-even around the end of 2018". That's well worth noting because it augurs well for further outperformance in 2019 when FinnCap is predicting Lighthouse's cash profits will increase by 10 per cent to £3.3m, a very conservative looking estimate in my view.

How Lighthouse markets its services

“Lighthouse advisers are highly proficient in advising on NHS, teachers’ and other public sector pension schemes. We work with each of our 21 affinity partner organisations to deliver appropriate and relevant financial solutions, giving members a sound financial plan to help them reach their financial goals.”

“Clients increasingly expect professional advice which takes into account all aspects of their financial affairs. However, very few accountancy and legal firms are able to provide a financial advice service. That is why we have been working with a significant number of accountancy practices and legal firms since 1994. We understand from first-hand experience how professional advisers work with their clients, enabling us to provide that fully integrated wealth management service that so many clients and practices desire”

Source: Lighthouse Group website

Wealth management and auto-enrolment businesses approaching inflexion points

Based out of the Stockport office, so within easy reach of Manchester, Lighthouse’s wealth management business has contractual relationships with 45 accountancy firms to deliver financial advice to their high net worth clients through a team of employed and specialist advisers. The division contributed revenues of £9.7m in 2017, a 15 per cent increase year on year, with average revenue per adviser within the accountancy sector maintained at £215,000. The division traded at close to break-even, excluding £331,000 of third-party costs it incurred for investment in Lighthouse’s fully advised auto-enrolment offering for small- and medium-sized enterprises (SMEs), the Lighthouse Pensions Trust.

Bearing this in mind, the Lighthouse Pensions Trust now has over 4,700 individual members signed up across 355 company auto-enrolment schemes, or 43 per cent more than at the end of 2016. It has a decent pipeline, too. The business is expected to approach break-even during 2018 and is well placed to take advantage of consolidation opportunities as well. That’s because the first wave of employers establishing auto-enrolment compliant workplace pensions draws to a close around the middle of this year, and there could be rich pickings to be had amongst sub-scale scheme operators who have failed to win enough business. Also, it’s only realistic to expect Lighthouse’s auto-enrolment business to start generating cash as revenue scales up further following the investment made.

A move into profit for both Lighthouse’s wealth management and auto-enrolment businesses offers potential for upside to analysts’ conservative looking profit estimates for Lighthouse’s 2019 financial year.

Improved contribution from a community-focused network of advisers

Lighthouse’s final division, Lighthouse Advisory Services, comprises an authorised network of self-employed advisers operating under their own brand within local communities. The strategy here is to focus on improving margin and minimising risk for the business, its clients and network advisers.

The plan is working, as divisional cash profits soared 14-fold to £941,000 last year on net revenues up only slightly to £24.5m. The much improved financial performance reflected a reduction in costs from the lower complaint numbers post-RDR, debt and professional indemnity insurance recoveries, and a modest reduction in adviser numbers as less productive ones fell by the wayside. As a result, revenue per adviser increased by 15 per cent from £107,000 to £123,000.

“FinnCap’s forecasts look too conservative given the positive momentum in Lighthouse’s higher-margin affinity business”

Profits on the upgrade

To give you some idea of the strength of momentum in the business, Lighthouse posted a 4 per cent pre-tax profit beat for 2017 and that was after analysts at house broker FinnCap had upgraded their pre-tax estimates twice since the autumn, raising them by six per cent at the time of the pre-close trading update in January 2018, and by 10 per cent at the time of the interim results in September 2017. Furthermore, FinnCap upgraded its 2018 and 2019 pre-tax profits by 7.5 per and 16 per cent, respectively, following the 2017 financial results, having already raised these estimates by 7 per cent and 4 per cent last autumn. The earnings upgrade cycle looks far from over.

That’s because FinnCap’s forecasts look too conservative given the positive momentum in the Lighthouse’s higher margin affinity business (which added £800,000 of cash profits on £2.8m of incremental revenues). Their estimates point to Lighthouse increasing both current year cash profits and pre-tax profits by £200,000 to £3m and £2.7m, respectively, on revenues up by 5 per cent to £56.9m. Frankly, if the asset management business moves towards break-even this year, the ongoing robust growth in Lighthouse’s affinity business could be significantly underestimated. But ignoring the strong likelihood of further earnings beats, the shares are too lowly rated based on current estimates in the market.

Strip out net cash of £8.7m on the balance sheet, a sum worth 6.8p a share, and Lighthouse’s shares are being rated on a forward PE ratio of 12.5 for 2019 based on analysts’ conservative looking fully diluted adjusted EPS estimates of 1.8p. That’s a very low rating for a company that has posted three earnings beats since last autumn, lifted pre-tax profits by a third in 2017, and where the risk to forecasts is skewed to the upside.

Moreover, Lighthouse still has valuable tax losses to utilise which will wipe out its corporation tax charge this year. This means that analysts’ fully diluted adjusted EPS estimates of 1.6p for 2018, up from 1.49p in 2017, both of which incorporate a theoretical corporation tax charge, significantly understate the actual EPS reported.

“The company produced an eye-catching 21.6 per cent return on capital employed in 2017”

Rock solid balance sheet

Lighthouse’s lack of debt is not the only positive movement on its balance sheet. The company is also benefiting from significantly reduced provisioning.

Lighthouse’s complaints provision, representing the expected cost of settling claims from clients, declined by more than 40 per cent to less than £2.5m last year. Legacy provisions, all of which date back prior to 2008, account for £1m of this sum. Provision for clawback of indemnity commission, representing the expected cost of clawbacks from product providers for subsequent policy cancellations, is also moving in the right direction, falling by a quarter to £1.28m in 2017.

The working capital position is improving, too. Current assets of £16.9m, which includes cash of £8.7m, exceeds current liabilities of £11.6m by a very healthy margin, so the liquidity position is very strong. Property assets worth £1.4m are unencumbered, and include the £1.1m leasehold property purchased near Brighton.

Despite the write-offs in the past, I don’t think anyone can take exception to the intangible assets of £5.1m on Lighthouse’s balance sheet given the profitability of its operations; the company produced an eye-catching 21.6 per cent return on capital employed in 2017.

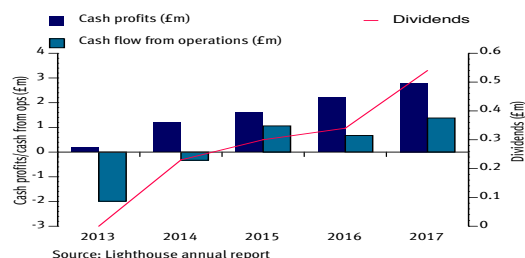
Recycling cash flow back to shareholders

Having paid off all its loan notes in recent years, the board has adopted a very progressive dividend policy to recycle an increasing amount of cash flow generated from operations back to shareholders, while retaining surplus funds for investment in their business. Cash profits have risen by 133 per cent from £1.2m to £2.8m in the past four financial years, during which time the directors have hiked the payout at exactly the same rate from 0.18p to 0.42p a share.

After accounting for working capital movements, and changes in indemnity commission clawback and complaint provisions, Lighthouse’s net cash inflow from operating activities doubled to £1.38m last year and covered the cost of the annual dividend more than 2.5 times over. This left enough surplus cash available to purchase over £300,000 of property and equipment, and enabled Lighthouse to completely pay off the £439,000 balance of the bank mortgage taken out to part-fund the £1.1m acquisition of a long-leasehold property close to Brighton in 2013.

A focus on tighter working capital management is highlighted by the sharp reduction in debtor days. This is the average number of days required for a company to receive payment from its customers for invoices issued. A larger number of debtor days means that a business must invest more cash in its unpaid accounts receivable asset,

Improving cash flow and rising dividends



thus reducing cash available for other uses. Debtor days is calculated by taking the trade receivable figure in the balance sheet, dividing it by annual sales in the income statement, and then multiplying by 365 days.

Lighthouse's debtor days improved from 69 days in 2016 to only 55 days last year, and looks well on course to trend down towards the 50 day level. The point is that a company that sweats its balance sheet by collecting invoices promptly frees up more cash to reinvest back in the business which in turn generates a financial return to boost cash flow and profits.

Lighthouse improving cash flow and rising dividends

Year to 31 Dec	Cash profits (£m)	Cash flow from operations (£m)	Dividends (£m)
2013	0.2	-1.99	nil
2014	1.2	-0.33	0.23
2015	1.6	1.06	0.30
2016	2.2	0.67	0.34
2017	2.8	1.38	0.54

Lighthouse rising earnings and dividends

Year to 31 Dec	Earnings per share (p)	Dividend per share (p)	Dividend cover
2013	-1.26	nil	nil
2014	0.44	0.18	2.44
2015	0.68	0.24	2.83
2016	1.19	0.27	4.41
2017	1.49	0.42	3.55

Source: Lighthouse annual report

Moreover, with the benefit of an unencumbered balance sheet, and the cost of last year's annual dividend covered 3.5 times by post-tax profits, and 2.5 times by net cash flow from operations, there are sound prospects of the board maintaining the progressive payout policy in the future. Mr Grime at FinnCap expects a near 10 per cent hike in the dividend per share to 0.46p in 2018, rising to 0.504p in 2019, implying Lighthouse's shares offer prospective dividend yields of 1.5 per cent, rising to 1.7 per cent. There is scope for an even faster hike in the annual payout given that those dividend forecasts are still covered 3.5 times by fully diluted EPS estimates of 1.6p and 1.8p for the 2018 and 2019 financial years.

Book value per share rising sharply

The rising profitability of Lighthouse's operations is illustrated by the fact that retained profits are boosting the company's net asset value (NAV) per share. In the past four financial years, equity shareholders funds have more than doubled to £11.7m to lift book value per share from 4.4p to 9.2p, during which time the board have declared total dividends of 1.11p a share. In other words, Lighthouse is achieving the rare feat of adopting a progressive dividend

policy on a rising income stream and retaining surplus cash flow and net profits to boost shareholder funds.

The obvious take from this is that investors will be more willing to pay a higher multiple for Lighthouse's earnings stream, and a higher price-to-book value too, safe in the knowledge that the company is generating a bumper return on its equity and adding shareholder value in this way. True, part of the sharp rise in NAV per share in the past two financial years reflects the fact that Lighthouse generated cumulative IFRS basic EPS of 4.2p, well ahead of the adjusted EPS figure of 2.68p used by analysts, reflecting the availability of tax losses to offset its corporation tax liability. But even if Lighthouse had paid corporation tax on these profits, it would still have increased net asset value per share.

Shareholder value creation

Year to 31 Dec	Net asset value (£m)	Net asset value per share (p)	Earnings per share (p)	Dividend per share (p)
2013	5.6	4.39	-1.26	nil
2014	6.0	4.66	0.44	0.18
2015	6.6	5.14	0.68	0.24
2016	9.0	7.02	1.19	0.27
2017	11.7	9.16	1.49	0.42

Source: Lighthouse annual report and accounts

Peer group comparison

There are only a few small-cap listed operators specialising in wealth management and financial advice, but Lighthouse is by far the lowest rated.

On a price-to-book value, the company is rated on a discount of around 17 per cent to rivals **Harwood Wealth Management (HW.)** and **AFH Financial (AFH)**, both of which have market values north of £100m and have been growing by bolt-on acquisition. Interestingly, AFH tried unsuccessfully to acquire Lighthouse a couple of years ago.

The discount is even wider if you compare the ratings on an enterprise value (market capitalisation less net cash on the balance sheet) to operating profit basis (earnings before interest and taxation). Lighthouse is rated on a modest 11 times operating profit once you strip out its likely net cash pile at the end of this year, a hefty 20 per cent discount to the average multiple of 13.8 times for its three peers, which also includes larger rival **Brooks MacDonald (BRK)**. The ratings gap on this basis is just as wide using 2019 estimates when Lighthouse is rated on a multiple of around nine times.

There is certainly a case to be made that Lighthouse should be at least rated on the same multiple as both Harwood Wealth Management and AFH Financial, if not higher, given the potential for its earnings and cash flow

to start to ramp up as it reaps the upside from the investments made in its fast growing affinity-based national adviser operation, the Luceo funds business, and exploits the opportunities in auto-enrolment workplace pensions. Indeed, Lighthouse's operating profit is forecast to rise from £2.7m in 2018 to £3.1m in 2019, and this could be conservative.

If you were to value Lighthouse's equity at 40p a share, or 38 per cent higher than the current share price, this implies a market value of £51m and an enterprise value of £42m after deducting 2019 estimated year-end cash of £8.8m. On this basis, Lighthouse's enterprise value would equate to 13 times 2019 operating profit estimates of £3.1m. That doesn't seem an unreasonable valuation in light of the valuations of listed rivals and also those in the private sector.

For instance, privately-owned LEBC, an independent financial advisory firm, is 60 per cent owned by Aim-traded **BP Marsh & Partners (BPM)**, an insurance-focused small-cap investment company which has been producing record results in recent years. LEBC's equity was valued in BP Marsh's last set of accounts at £42.85m, representing a multiple of 14 times the trading profit of £3.1m it made in the 2017 financial year.

Lighthouse's directors clearly believe there is scope for the ratings discount to narrow to both Lighthouse's listed and privately owned rivals.

Peer group valuation

Company	TIDM	Share price (p)	Market cap (£m)	Price-to-book value
Lighthouse	LGT	29	37	3.2
Harwood Wealth Management	HW.	165	103	3.9
AFH Financial	AFH	335	127	3.8
Brooks MacDonald	BRK	1952	276	3.3

Source: finnCap, FT.com Market Data

Company	TIDM	Ebit 2018E (£m)	Net cash 2018E (£m)	EV/Ebit 2018E
Lighthouse	LGT	2.7	7.9	11.1
Harwood Wealth Management	HW.	5.3	18.9	15.9
AFH Financial	AFH	7.5	24.9	13.6
Brooks MacDonald	BRK	19.3	46.6	11.9

Source: finnCap, FT.com Market Data

Company	TIDM	Ebit 2019E (£m)	Net cash 2019E (£m)	EV/Ebit 2019E
Lighthouse	LGT	3.1	8.8	9.4
Harwood Wealth Management	HW.	6.4	20.9	12.8
AFH Financial	AFH	8.6	26.7	11.7
Brooks MacDonald	BRK	24.5	62.8	8.7

Source: FinnCap, FT.com Market Data

Skin in the game

Interestingly, the insiders have been topping up their holdings since Lighthouse issued its full-year results in late February. Chairman Richard Last acquired 100,000 shares around 22.4p each in April to lift his holding to 912,500 shares; chief executive Malcolm Streatfield acquired 67,000 shares the following month at 23.87p each to raise his holding to 2.79m shares; and compliance and risk director Ken Patterson followed suit a few days later, more than doubling his shareholding to 100,000 shares.

Mr Last holds a number of executive positions on the boards of other companies, including events business **ITE (ITE)**; Mr Streatfield has been with Lighthouse since 2003; and Mr Patterson joined in 2012 and has more than 20 years' experience in senior compliance, risk and regulatory roles within the UK financial services sector, encompassing regulatory bodies, life companies and advisory businesses. Finance director Peter Smith has held the position for a decade and was previously a corporate finance and assurance partner with KPMG. The board's experience and skin in the game (combined holdings of 4.1 per cent of the issued share capital) is reassuring.

Their decision to top up their shareholdings is understandable given the momentum the business is exhibiting: in the second half of 2017 Lighthouse delivered pre-tax profit of £1.4m, up from £1.1m in the first half of last year, and well ahead of the £1.06m posted in the comparable period in the second half of 2016. Clearly, the three main board directors are confident of the company reporting another positive trading update in July, otherwise the timing of their recent share purchases is a bit strange. It could also be the catalyst for the rating gap with rivals to narrow.

Directors' interests

Directors	% of share capital
Malcolm Streatfield (chief executive)	2.19
Richard Last (chairman)	0.71
Ken Patterson (compliance and risk director)	0.68
Peter Smith (finance director)	0.26
Alex Scott-Barrett (non-executive director)	0.24
Total	4.08

Source: Lighthouse annual report, London Stock Exchange

Bearing in mind the possibility of more good news being reported by the company, and potential for further earnings beats, I would flag up that the seven largest shareholdings on the company's register account for almost 70 per cent of the 127.7m shares in issue. This means that the largest shareholders and the board control almost 75

per cent of the issued share capital which will accentuate price moves. That's clearly a good thing when the momentum is with the business as is the case right now, but it can also work against investors if the tide turns. Not that the lower than average free float is an issue right now given the benign trading backdrop.

Also, the shares are liquid enough with bargains of around 25,000 shares passing through the market after the company announced yet another contract for its affinity-focused business at the end of May.

Major shareholders

Name of shareholder	% of share capital
Helium Rising Stars Fund	20.15
Mr Allan Rosengren	15.83
MI Discretionary Unit Fund	13.76
Liverpool Victoria Financial Advice Services Limited	6.54
Cavendish Asset Management Limited	5.57
Old Mutual Wealth Holdings Limited	4.37
Aegon UK	3.51
Total	69.73

Source: Lighthouse annual report, London Stock Exchange

Target price

Interestingly, Lighthouse's share price has been consolidating last year's gains and has been moving sideways all year, attempting to breach the 27p key resistance level on no fewer than three occasions. However, the company's share price broke through this glass ceiling last week, a very bullish sign. The fact that a stock overhang has cleared after former chairman David Hickey reduced his stake below the 3 per cent disclosure level is another positive for a continuation of the rally.

The move above the 27p level opens the door to a rally towards the 2007 bull market high of 35p and ultimately to my 40p target price, which is my year-end target. That price objective is based on Lighthouse lifting its operating profit from £2.5m in 2017 to £3.1m in 2019. I have valued Lighthouse's operations on a multiple of 13 times forecast operating profits, and then added in the company's cash pile of £8.7m to given a target market value of £51m, or 38 per cent above the current market cap of £37m.

Trading on a bid-offer spread of 28.2p to 29p, with a chart break-out confirmed, and offering significant share price upside to my year-end target of 40p, Lighthouse's shares offer a compelling buying opportunity worth exploiting.

Risk assessment

Of course, no investment is without risk and there are several to consider here:

■ **Professional indemnity insurance:** This is the most obvious risk for a financial adviser as professional indemnity insurance (PII) is a mandatory cost for all businesses that advise clients within the UK retail financial services market.

The market for PII cover in the UK has been tight in recent years, but Lighthouse managed to secure an early renewal of its coverage last autumn for a further 18-month period, with the adoption of the company's carefully risk-rated researched solutions for clients being a key factor in achieving renewal on more favourable terms including reductions in certain individual case excesses. The annual premium paid was £250,000 lower than at the last renewal, another cost benefit from the type of business the company is focused on now.

Pensions account for a high percentage of the business its advisers undertake, but Lighthouse also arranged more than £1bn in mortgages last year, as well as advising on savings and investments. The use of technology to risk profile clients and the application of psychometric tests are just some of the methods Lighthouse's team of 400 financial advisers use to achieve the right solution for clients. It also helps to keep down the cost of PII too.

■ **New regulations:** There is an ongoing expansion of regulations applied to the UK financial services distribution sector including the new Mifid II legislation and the General Data Protection Regulation (GDPR) this year. This has imposed additional obligations on providers and distributors in areas such as client information and data protection. Lighthouse allocated a dedicated resource to establish and deliver plans to comply fully with all relevant aspects of the new legislation. It has also engaged with regulatory authorities to ensure on-going regulation of retail financial services is appropriate whilst at the same time minimising risk and providing the appropriate advice to its customers. Despite incurring costs ahead of the introduction of Mifid II and GDPR, Lighthouse managed to achieve a robust financial result in 2017 and there is little reason to suggest the regulatory back drop will hinder progress in the future.

■ **Economic uncertainty:** The threat posed by UK economic uncertainty and the country's exit from the European Union is worth considering. The impact of Brexit on the UK financial services markets has still to be determined even though the UK Government served formal notice to leave the EU in March 2017. However, Lighthouse's customer base is domiciled principally within the UK, so the business is not exposed to the cross border legislation that is more

relevant to larger international financial services groups.

A greater risk to the business is a hard Brexit outcome to the current government negotiations as this could lead to a downturn in UK economic activity, make consumers more risk averse and dampen demand for investment products. Lower market returns reduce investors' appetite for retail investment products and so would impact the recurring revenue stream the company derives from fund-based products.

■ **Technology:** The increasing use of technology could enable UK consumers to procure retail financial products directly rather than seeking the advice of a financial adviser. However, the fact that Lighthouse continues to perform well suggests that there is still a significant pool of potential customers willing to seek advice.

■ **Customer claims:** There is an increasing tendency for UK consumers of retail financial products to make claims for redress in the event of lower than anticipated performance of these products. That said, Lighthouse mitigates the risk of complaints occurring by maintaining a rigorous compliance framework. Its complaints provisioning has dropped markedly in recent years which is a good sign, and one that undoubtedly has enabled the company to negotiate favourable terms on its PII.

■ **Clawback of commission:** The clawback of commission from product providers where a client cancels a policy is an inherent risk for financial advisory firms, and one that Lighthouse mitigates by retaining a proportion of funds from advisers to cover this eventuality. Both clawbacks and complaints are closely monitored and recoveries from Lighthouse's advisers are initiated on the basis of an agreed repayment schedule. Of course, a product provider could get into financial difficulty, but the risk of this is deemed minimal.

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Registered office: Number One, Southwark Bridge,
London SE1 9HL. ISSN 0261-3115.