

# Hardman & Co

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## Lighthouse Group Good Interim Profits

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Interim profits were two thirds higher than in H1 last year, and the company is on track for a good full twelve months. Key points are:

- Revenue growth was faster than we expected, but on lower margins – a function of business mix. The business returns to normal in H2.
- A maiden dividend will be declared for this year.
- There is no exposure to the crisis in the financial markets, there is no debt, and there is currently £8m cash in the bank at a time when cash is king.
- These H1 figures contain only a small contribution from the LV= (Liverpool Victoria) deal, which we expect to be an important contributor from 2008 onwards.
- Renewable income is up from 14.1% to 15.4% of the total – not a dramatic increase but indicative of the steady drive to upgrade the quality of the revenue stream.

Management believes its customer base is unlikely to be exposed to the collapse of City bonuses, mortgage lenders or the credit squeeze. Even so, given current conditions, it would be folly to increase our estimates at present.

**Share Price:** 26p  
**12m High:** 37p  
**12m Low:** 15p  
**Market Cap:** £23m  
**Shares in Issue:** 83.6m fully diluted  
**NAV/Share:** 15p inc intangibles, 5.5p ex intangibles  
**Gearing:** Nil (£8m net cash)  
**Interest Cover:** n.a.  
**EPIC Code:** LGT  
**Sector:** Financials  
**Market:** London AIM  
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Y/E	Sales	Declared	Adjusted	Adjusted	P/e	Divi	Yield
December	£m	Profit £m	Profit £m	Diluted Eps p.	ratio	p.	%
2005A	32.6	-0.5	0.4	1.0	3.8	0	0
2006A	47.1	0.7	2.2	2.9	9.3	0	0
2007E	53.0	2.7	2.7	2.9	9.3	0.3	1.1
2008E	56.0	3.3	3.3	3.0	9.0	0.5	1.9

## Background

Lighthouse Group is one of the few surviving quoted IFAs – Independent Financial Advisor-companies. It controls a network of 580 individuals, some of them salaried and fully employed, some self-employed, who place out £1bn worth of life insurance and other savings contracts annually. The IFA community in total is responsible for two thirds of all the product sold by the major life companies, and as such is a crucial part of the nation's financial machinery.

The industry as a whole is just starting to emerge from a long term period of underperformance that was caused by the mis-selling scandals, associated fines and compensation. As a result, most of Lighthouse's competitors have either ceased to trade or been taken over by the life companies that are their product providers. Lighthouse itself only reported its first profit in 2005. However, to date it has had a good record from the regulatory point of view, and as one of the few survivors of any size (it is probably the largest independent IFA group of its type in Britain) is wielding increasing influence.

## Interim Results

The interim results were, overall, better than we expected. The increase in revenue was particularly impressive. Diluted eps were up 58% and once again the cash pile has grown.

6m to June	2007	2006
Revenue	£26.6m	£20.5m
Gross Profit	£8.29m	£7.54m
Gross Margin	31.1%	36.7%
Admin Costs	£7.46m	£7.01m
Admin as a % of Revenue	28.1%	34.8%
EBITDA	£0.83m	£0.53m
Depreciation	£0.17m	£0.13m
Interest Income	£0.12m	£0.07m
Pre-tax Profit	£0.79m	£0.47m
Tax Charge %	Nil	Nil
EPS Diluted	0.98p	0.62p

**Revenue.** The 29% increase in revenue was driven by the self-employed elements of the IFA base, Lighthouse Temple and LighthouseXpress. Sales were higher than we expected because LighthouseXpress had a strong spell at the end of the tax year selling

film partnerships; this was the final year before the tax rules affecting them changed.

LighthouseXpress accounted for 56.4% of revenues during the half year, compared to 54.9% in the comparative half year. Sales at LighthouseCarrwood, the salaried, full service part of the business, were static, but group management is nevertheless happy with the result because it was achieved with fewer, more productive employees.

**Gross Margin.** Gross Margin is down. This is a consequence of the increased proportion of the business generated by LighthouseXpress, which carries lower margins than the other parts of the business, and the lack of growth at the potentially high margin LighthouseCarrwood. There will be some recovery in margins in the second half of the financial year, because the higher margin divisions will contribute more to the business mix.

**Admin Costs.** These are higher, but management drops a clear hint in the Interim Statement that cost reductions are in hand for the second half. Part of the costs increase we understand, because Lighthouse Group has been implementing some important changes, such as bringing the City Pensions business down from Milton Keynes to the City of London, and the initial integration work of the LV= portfolio of business. However, in the process management may have taken its eye off the ball from the cost point of view. The situation is now very much back under control.

**Interest Income.** Net interest income is well up, as indeed would be expected with both cash balances and average interest rates significantly higher than last year.

**Pre-tax Profit.** This is up by 66%.

**Tax.** Once again there is no tax charge. Our estimates for the full year assume a 10% tax charge, but there is a possibility that Lighthouse will once again have a tax free year. If so, it will be the last one. Rising corporation tax will take most of the steam out of earnings growth in 2008.

**Earnings Per Share.** These are up by 58%.

## Balance Sheet

Net assets, including intangibles, have grown from £10.2m at end-December to £12.9m at end-June. Cash and cash equivalents have grown from £6.8m to £7.7m over the same period, and we understand that at present (mid-September 2007) cash is in excess of £8m.

## The LV= Deal

LV= is the new name for Liverpool Victoria Friendly Society, the largest of the remaining Friendly Societies and an organisation with over £8bn under management. In March, Lighthouse reached an arrangement with LV= to be sole provider of financial advice to its customer base. LV='s core strength is its relationship with Trade Unions and special interest groups, ranging from Unison and Prospect through to the Caravan Club and Readers Digest. Under the arrangement, all requests for financial advice from individual members of these organisations will be passed through to Lighthouse Group. LV= took a 5% share stake in Lighthouse Group, which we believe ties the two companies together very effectively.

120,000 individual clients were transferred to Lighthouse as a result of this deal.

When giving financial advice through its own internal resources, LV= employed 40 advisers. Approximately 20 of these were transferred to Lighthouse Temple, while the remaining 20 either became totally independent and self-employed or joined other financial organisations. Some of those who initially decided not to join Lighthouse have, we understand, since come over to the company.

Over a full twelve months, the business leads from LV= should be capable of generating over £1m a year of additional business to the Lighthouse Group revenue line. The impact in H1 was minimal, however, because the arrangements were still in the process of being implemented. The full impact is unlikely to be felt until early 2008.

Whilst Lighthouse Temple advisers provide most of the service to LV= clients, Lighthouse Group is aiming to capitalise on the LV=

relationship by passing some of the leads through to Lighthouse Carrwood, which is the salaried, full service, high margin part of the group. This should ensure that group shareholders reap as much benefit as possible.

## Dividend

A maiden dividend is expected to be paid for the 2007 financial year, depending on the outcome for the full year. We think a 0.3p/share payment will be made after approval by the Annual Meeting, with dividend cheques being received sometime in late Spring 2008.

## Forecasts

We have upgraded our revenue forecasts for the current year, but have reduced our gross margin expectation from 34.75% to 33%. Our pre-tax profit estimate has been marginally increased, our eps estimate marginally reduced (to allow for a greater number of shares in issue on a diluted basis).

It is important to remember that the at least part of the organic growth being generated by the group over the next two years will be absorbed by the rising tax charge.

Given normal circumstances we would be increasing our 2008 estimates at this point. However, circumstances are anything but normal, with the Northern Rock and sub-prime mortgage crises driving the personal finance marketplace at present. Even though Lighthouse's customer base is unlikely to be directly exposed to these, there are bound to be knock-on effects and our estimates at all levels of the p & l account for 2008 show little or no change.

## Lighthouse Group plc

<b>P &amp; L Account</b>	<b>2001A</b>	<b>2002A</b>	<b>2003A</b>	<b>2004A</b>	<b>2005A</b>	<b>2006A</b>	<b>2007E</b>	<b>2008E</b>
<b>£000</b>								
<b>Ongoing Total Turnover</b>	<b>5166</b>	<b>14895</b>	<b>22863</b>	<b>26476</b>	<b>32559</b>	<b>47159</b>	<b>53000</b>	<b>56000</b>
<b>Change in Turnover</b>		<b>188.3%</b>	<b>53.5%</b>	<b>15.8%</b>	<b>23.0%</b>	<b>44.8%</b>	<b>12.4%</b>	<b>5.7%</b>
Gross Margin	18.00%	17.51%	20.92%	26.18%	26.54%	33.29%	33.00%	33.00%
Gross Profit	930	2608	4783	6932	8640	15701	17490	18480
Other Operating Expenses	-2577	-4641	-6101	-7868	-8168	-13395	-14700	-15200
<b>EBITDA</b>	<b>-1647</b>	<b>-2033</b>	<b>-1318</b>	<b>-936</b>	<b>471.53065</b>	<b>2306</b>	<b>2790</b>	<b>3280</b>
Depreciation	99	164	184	139	142	272	350	375
Interest In/-Out	0	-24	65	50	68	158	240	400
<b>Ongoing Pre-tax Profit/Loss</b>	<b>-1647</b>	<b>-2057</b>	<b>-1253</b>	<b>-886</b>	<b>398</b>	<b>2192</b>	<b>2680</b>	<b>3305</b>
Tax £000	0	0	0	0	0	0	268	826.25
Tax %	0%	0%	0%	0%	0%	0%	10%	25%
Net Profit/Loss	-1647	-2057	-1253	-886	398	2192	2412	2478.75
No.Shares, Average, Diltd, 000	4440	11014	23600	38165	39404	75775	81910	83630
<b>Diluted EPS per share p.</b>	<b>-37.1</b>	<b>-18.7</b>	<b>-5.3</b>	<b>-2.3</b>	<b>1.0</b>	<b>2.9</b>	<b>2.9</b>	<b>3.0</b>
<b>Declared P &amp; L</b>								
Exceptional Costs	-1111	0	-1466	-526	-431	-1519	0	0
Goodwill Amortisation	-63	-250	-330	-405	-449	0	0	0
Profit/-Loss on Disposals	0	60	0	0	0	0	0	0
Share of operating profit/-loss in jv	0	0	0	7	0	0	0	0
<b>Declared Profit/(Loss)</b>	<b>-2821</b>	<b>-2247</b>	<b>-3049</b>	<b>-1810</b>	<b>-482</b>	<b>673</b>	<b>2680</b>	<b>3305</b>
Tax £000	0	0	0	0	0	0	268	826.25
Tax %	0	0	0	0	0	0	10.0%	25.0%
Declared After Tax Loss	-2821	-2247	-3049	-1810	-482	673	2412	2478.75
<b>Diluted EPS per share p.</b>	<b>-63.50</b>	<b>-20.40</b>	<b>-12.92</b>	<b>-4.74</b>	<b>-1.22</b>	<b>0.89</b>	<b>2.94</b>	<b>2.96</b>

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