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Lighthouse Group (LGT) — Financial Services

The level of net cash held by Lighthouse Group means that the share price continues to defy logic. Even before the sale of the pensions administration business City Pensions/City Trustees net cash exceeded the market capitalisation. That disposal brought in a further £1.6m net, taking cash balances to broadly £14m versus a market capitalisation of barely over £10m. With the business remaining in the black in 2010 prospects of the cash pile being burnt appear minimal. Hence, the market is currently putting a negative value on a business which has proven itself able to generate seven figure profit at the pre-tax level. Should the company decide to buy back stock in the market it would be able to do so at a discount to net cash per share.

Although it is fair to say that a healthy cash position is necessary to meet regulatory requirements, this also highlights an advantage over rivals, particularly smaller players. The Retail Distribution Review, due to be implemented by the start of 2013, brings challenges to those operating in the sector. Those companies in a position of relative strength, such as Lighthouse Group, should benefit from their scale and financial resources and this may also bring about some attractive opportunities for acquisitions.

Overall, the current depressed share price would appear to reflect ongoing apathy amongst investors rather than any fears over any deterioration in trading. When significant profits return the intrinsic value of the business should feed through to the share price.

Activities

Lighthouse is a top IFA distribution company and the leading quoted IFA and Wealth Management Group. The company's core activities include the provision of services to Independent Financial Advisers (IFAs) and it has clients throughout the UK. The services are delivered through LighthouseCarrwood, Lighthouse Financial Advice, LighthouseWealth, Lighthouse Adviser Services, Group Employee Benefits and LighthouseFSAS. LighthouseCarrwood is the Group salaried advisor division, formed following the acquisition of the Carrwood Group. LighthouseCarrwood advisers trade principally in partnership with accountancy practices with which the group has introductory arrangements. Lighthouse Financial Advice has been formed by merging LighthouseTemple and LighthouseGP. This is an important trading division operating through self-emplyed IFAs. LighthouseWealth is geared towards High Net Worth clients and the advisers research and deliver advice on a range of sophisticated investments aimed at meeting the needs of wealthy individuals and professionals. This City of London based division was created in November 2005 out of Lighthouse Independent Financial Advisers Limited. The network division is called Lighthouse Adviser Services. This was formerly LighthouseXpress and Falcon, which was the main revenue generator for Sumus and a Premium Wealth Management National and Network IFA. Regulatory cover and professional indemnity insurance are provided to IFAs trading under their own brand. Lighthouse Adviser Services also collects income due on behalf of these IFAs. It supports each of Lighthouse Group's IFA and Wealth Management focussed divisions in terms of regulation and supervision. Group Employee Benefits focusses on the group personal pension and associated protection products markets. LighthouseFSAS was formerly part of Sumus and is a Scottish based Network providing advice to around 60,000 clients.

Results and Consensus Forecasts

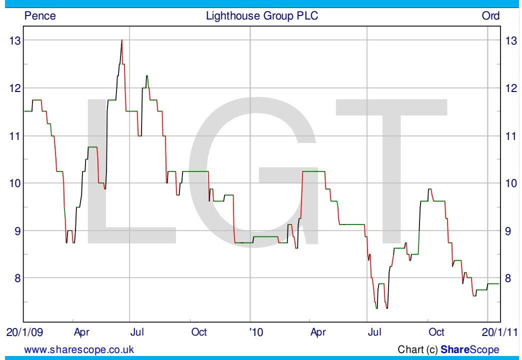
Year to 31 December	Revenue (£m)	Pre-tax Profit (£m)	Earnings per share* (p)	P/E Ratio	Dividend (p)	Yield (%)
2007A	52.9	1.90	2.58	3.1	0.50	6.3
2008A	54.4	(8.49)	(6.98)	-	0.70**	8.9
2009A	60.7	0.09	0.12	65.6	0.40***	5.1
2010E	63.0	0.20	0.23	34.2	0.35	4.4

* - Basic undiluted; ** - inc. special interim dividend of 0.50p; *** - inc. 0.10p in respect of 2008

KEY DATA

Share Price:	7.875p
Prospective p/e ratio:	34.2x
Prospective net yield:	4.4%
Market Capitalisation:	£10.1m
Next Results Due (Fins):	MAR
Gearing:	N/A

SHARE PRICE PERFORMANCE



2010/11 High/Low: 10.75p/7.375p

SNAP BULLETS

- Strong net cash position remains a key positive
- Share price represents a significant discount to net cash per share
- Healthy and growing dividend
- Retail Distribution Review will act as a catalyst for change in the industry
- Some exciting acquisition opportunities may emerge

Date of Report : 21 January 2011

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COMPANY DATA

Stockbrokers:
Shore Capital

Significant Shareholdings:

Allan Rosengren	14.73%
Liverpool Victoria FAS Ltd	6.54%
Friends Provident Life & Pen	5.87%
Southern Rock Ins Co, Mr A Banks and Mr P Chase-Gardener	5.43%
Julian Telling	5.14%
A Lancaster & Boston Trust	5.07%
Mr David Hickey	4.04%
Aegon UK Plc	3.51%

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Information:
Allan Rosengren - Joint Chief Executive
Malcolm Streatfield - Joint Chief Executive
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Interim Results

Interim results covering the six months ended 30 June 2010 were released on 20 September. Revenue was up 11% at £32.6m (2009: £29.3m). The company is keen to improve the visibility of its revenues, which means that an emphasis is placed on recurring revenue. This comprises regular income derived from client investments and other products placed on their behalf. During the first half of 2010, recurring revenues rose to £8.6m (2009: £7.2m), which means that it now represents approximately 26% of group revenues.

Gross profit rose from £8.6m to £8.9m but operating costs rose at a lower rate from £8.1m to £8.2m. Resultantly EBITDA rose by 23% on a like-for-like basis to £648k (2009: £526k) and profit before taxation more than doubled to £117k (2009: £56k). Basic earnings per share were 0.09p (2009: 0.05p). The interim dividend for 2010 was raised to 0.12p (2009: 0.1p normalised) reflecting continuing confidence in the group's prospects. Subject to satisfactory trading, the company plans to adopt a progressive dividend policy and we have 0.35p per share pencilled in for 2010 (2009: 0.30p).

The balance sheet is notably strong. Cash balances amounted to £12.3m as at 30 June, broadly the same as 12 months earlier. No bank debt was held but the group continues to hold a trading facility which is repayable in instalments between 2010 and 2012. At 30 June 2010 the outstanding balance had been reduced from £4.5m to £3.6m and the facility is expected to be retired fully from surplus operating cash flows, in line with expectations, by the end of 2012. Since the period end, the proceeds of the sale of City Trustees also enhanced cash balances. The company has stated that it continues to believe that financial strength is an essential prerequisite to advisory operations, in the interest of shareholders, advisers and customers. It will continue to preserve a robust and liquid balance sheet.

Prospects

Having managed to generate profits during the recent downturn, Lighthouse Group can view the future with considerable optimism. The group's scale and financial strength mean it has a considerable advantage over many other businesses operating in the same space. Regulatory drivers, most notably the Retail Distribution Review which is due to be implemented by the start of 2013, continue to heavily influence the financial services sector. Although challenges are presented by this, many other businesses are less able to cope with the changing landscape than Lighthouse, most notably in terms of advisers gaining necessary qualifications and capital adequacy.

The risk of investing at the current share price looks to be fairly minimal given the discount this represents to the level of net cash held. The headline pre-tax profit figures also mask the fact that 2010 EBITDA (before exceptionals and non-recurring items) should be approximately £1.2m before taking into account the £1m gain which will result from the sale of SIPP and SSAS administration business City Trustees. This is a 9% increase on 2009 EBITDA of £1.1m despite turnover being up less than 4%.

The merger of Sumus and Lighthouse Group in 2008 promised much but macro factors have ensured that trading conditions have been tough since that time. Nevertheless, the business has remained resilient and is well placed to adapt to the changing environment created by legislation such as the Retail Distribution Review. Over the medium to long term the strengths which have created value for the group historically should ensure that shareholders are rewarded for their patience.

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