Quilter

# Quilter plc

## Recommended cash offer for Lighthouse Group plc – Audio conference

Wednesday 3 April 2019


Quilter speakers:
Paul Feeney, CEO, Quilter plc
Andy Thompson, CEO, Quilter Financial Planning
Mark Satchel, CFO, Quilter plc


Paul Feeney: Good morning and thank you for joining us at short notice today.

You'll have seen our announcement earlier "a recommended cash offer for Lighthouse".

Hopefully you've received a short slide deck from our Investor Relations team. If not, the slides can be found on our website at www.quilter.com/investor-relations.

In terms of agenda, which you can see on slide 3, I'm going to talk about why we're delighted to be announcing our offer for Lighthouse this morning.

Andy Thompson, who heads up our advice business will then talk through the evolution of our advice model and how Lighthouse fits in alongside our recent acquisition of Charles Derby.

Mark Satchel will then run through the financials and the timeframe to completion.

Then I'll be back to lead the Q&A session at the end.

Okay, talking now to slide 5.

Let me take you back to a version of a slide that I used at our full year results – this shows you our Quilter advice model.

Everything we do at Quilter begins with advice and Quilter is dedicated to supporting advice in all of its forms: third party IFA; network partners; and our national advisers.

On the latter two, our focus is on high quality controlled advice; better choice, but not unlimited choice.

Now I said back at our full year results that the current environment is generating opportunities for acquisitions that simply were not there twelve months ago.

And when I said that, there was one particular opportunity which we were actively considering at the time, and that was Lighthouse.

So why Lighthouse? Simply because Quilter together with Lighthouse will move us more quickly to where we want to be.

And where we want to be is delivering our goal of making Quilter the best place to go for trusted financial advice in the UK.

We also think that we are in the end-game of advice consolidation in the UK. There is a scarcity of high-quality advice firms available. So we are delighted to be announcing a significant step forward with the proposed acquisition of Lighthouse this morning.

We have been admirers and observers of the business for some time. In fact, we have been minority shareholders, owning a 4.4% stake in the business since it originally listed and so we are delighted to be bringing their 400 financial advisers into the Quilter family.

Lighthouse provides a unique opportunity to add meaningful scale to our controlled advice proposition across each of the wealth segments that we serve.

So Andy now will talk about how the advice landscape is changing and how Lighthouse will integrate into our existing business.

Andy Thompson Thanks Paul and good morning everyone.

And can I just echo Paul's sentiments and say how excited I am to be here this morning announcing this transaction. It not only increases the distance between us, as one of the two leading UK scale players and the rest, but it also really gives us a significant strategic step forward in developing our national advice business.

What I want to do is say a few words on how the industry has evolved since RDR, how we at Quilter responded to those changes, I'll give an overview of Lighthouse, and then I'll talk about how Lighthouse will fit in with the controlled advice proposition that we passionately believe in.

So if I can turn you to slide 7.

For adviser firms, the last decade has seen an incredible amount of change. Perhaps counter-intuitively, there has been a significant reduction in the supply of qualified advisers at a time of rising client demand for quality advice.

As you know, pension reform, in particular has shifted responsibility for saving for retirement to the individual. And that has driven the need for retirement solutions and individual financial planning advice.

With the end of the obligation to take an annuity, that means that we have the opportunity to serve customers for decades longer.

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Alongside this we've experienced a significant change in the provider landscape. We've seen a shift away from traditional insurance-based investment products into open transparent solutions, which these days are largely held on platforms.

The critical point came with the Retail Distribution Review – or RDR – which focussed on enhancing the professionalism of the advice industry, to improve transparency and customer outcomes. And that's clearly a good thing, as customers now need trusted advice through both their accumulation and decumulation phases.

It is Quilter's ambition to be the go-to place for that trusted advice in the UK.

So let me move on to slide 8.

We have seen a decline in adviser numbers, together with increased demand for advice, and that has led to a "Race for Distribution".

Industry commentators estimate the number of financial advisers fell by approximately a third as RDR came in to effect. This reduction was driven by both the shift to a commission-free world – and an important consequence of this was that the banks exited the industry – and the new environment which has been particularly tough on sole-traders, smaller firms and sub-scale networks.

There have of course, been other affects from RDR as well. More clients see the value of advice: charging structures have evolved from transactional basis to an annual income stream based on an enduring service relationship. Scale and quality of offering is more important than ever. And we believe that the industry is moving into the last phase of consolidation. As we predicted, banks are now beginning to re-enter the space.

As you know we've adapted our advice model too, so that we're well-placed to meet these market changes.

We scaled up rapidly through acquisition of networks such as Intrinsic, Sesame Wealth, and Caerus. And once acquired, we have focussed on the converting independent financial advisers into restricted financial planners.

With these core foundations in place, we've driven our adviser acquisition further, with solid organic growth at the mid-single digit percentages each year.

More recently, the National Advice business has been our strategic growth priority. And we completed 14 small acquisitions into PCA at the cost of some £12 million last year.

And as Paul said back at the full year with the acquisition of Charles Derby, we took a meaningful step towards delivering a national, controlled advice business under the Quilter brand.

Now, our proposed acquisition of Lighthouse takes another significant step forward in that journey by giving this business real scale and UK-wide presence, helping us to deliver on our ambition to be the trusted place for advice.

So let’s move on to slide 9.

Although Lighthouse is an AIM-listed business, I’m conscious that for many of you this will be a business that you are not familiar with and so I thought I’d give you a brief overview.

Firstly it has approximately 400 financial advisers across its three core channels. Taking each of these in turn.

Lighthouse Financial Advice is a market leader in the affinity space with 23 principal relationships which give it access to more than 6 million adults in the UK.

This channel is targeting mass affluent and affluent customers and has been the focus for strategic growth in recent years.

The second channel is Lighthouse Carrwood. It works with regional accounting firms and other professional connections to provide advice to their customers. These customers will often be high net worth individuals.

Both of these channels provide controlled advice on a national basis.

The third channel is Communities and this operates through a network of appointed representative firms providing advice to customers in their local areas.

As it’s possible to see from their public disclosure, Lighthouse is a scale advice business delivering profitability to its current shareholders.

Let’s look at how Lighthouse fits into Quilter.

You will recall the slide showing the Quilter advice model that Paul described earlier.

And on the next slide, slide 10, I’ve highlighted the components of the Quilter branded advice business and how the three advice channels within Lighthouse map to the existing channels within Quilter.

With its high net worth client focus, Lighthouse Carrwood has a strong alignment with Quilter Private Client Advisers. We see good potential revenue opportunities from this business working more closely with Quilter Cheviot.

Lighthouse has been building out their national advice business, under the Lighthouse Financial Advice brand and this is highly complementary to what we are seeking to achieve with our controlled advice proposition through Quilter Financial Advisers.

We see strong revenue opportunities from bringing this business together with our Platform and Investment Solution capabilities, to deliver a market-leading solution for mass affluent customers.

Finally, Lighthouse Communities is very similar to our existing network business. Here, we see good scope to integrate them. We will offer them our solutions and platform where they will benefit from the attractive platform pricing that our network advisers currently enjoy, as well as a wider range of quality investment solutions for their clients.

We are particularly excited about Lighthouse's business development capabilities. They have long-standing relationships with 23 large affinity groups and 40 regional accountancy firms. We believe that adding the strength of the Quilter brand and our greater distribution capacity, particularly following the acquisition of Charles Derby Group, will be a potent mix.

As Lighthouse is a public company, we have agreed that we will work on acquisition integration planning between now and expected completion towards the end of Q2. So we should be in a position to execute our plans as soon as the transaction closes.

Let me now hand over to Mark to discuss the financials and timeline of this transaction.

Mark Satchel — Thank you Andy. I am now looking at slide 12 which runs through the details of the transaction.

We are proposing to pay £46.2 million in cash for 100% of Lighthouse which equated to 33 pence per share. Lighthouse shareholders will also be entitled to their final dividends of 0.5 pence per share which was declared at the time of their results.

This represents a premium of 26% to the volume-weighted average price of Lighthouse over the last six months and a premium of 25% to its closing price as at the market close last night.

Based on historic 2018 results, the multiple we are paying represents approximately 18 times after tax profit for Lighthouse.

This multiple drops to approximately 17 times after deducting the £4 million of surplus cash on Lighthouse's balance sheet over and above the capital required for regulatory requirements.

And on a proforma basis, after delivery of around £2 million of anticipated cost synergies, the multiple is approximately 10 times before any revenue benefits.

The transaction will be funded from our own cash resources, no equity is being issued to fund the acquisition.

Turning now to slide 13. The transaction is all about revenue growth.

As I said back at the results day, the strong revenue growth that Quilter Investors delivered last year, up 45%, was due to the investments we made in distribution two years ago.

Similarly, the moves we are making today will underpin the Quilter revenue growth story in the next few years and beyond.

We expect cost savings from this transaction of around £2 million. The main savings are obviously from delisting and removing the costs of running the Lighthouse head office.

We expect these cost savings will be delivered over the next 12 to 24 months, and to be fully realised by March 2021, when Lighthouse's existing property lease commitments will end.

There will be one-off costs to achieve these synergies, as well as integrate the Lighthouse business, of between £5 million and £8 million. This will include restructuring and redundancy costs, as well as the costs in respect of updating and upgrading the Lighthouse IT infrastructure to Quilter standards.

Despite Lighthouse having an operating margin somewhat below the Quilter group level, we do not expect this transaction to have a meaningful impact on the operating margin targets that we set out for 2020 and 2021 at our full year results.

From a modelling perspective, we expect Lighthouse to add circa £12 million to our run costs per annum with the impact for 2019 being about half of this, given that the transaction is likely to close towards the end of the second quarter. As with Charles Derby, this needs to be added to the £555 million figure we indicated as being the flat cost target for 2019.

In the appendix to the presentation slides, you will find a summary of what Lighthouse has previously achieved in revenue and expenses, which can be used for modelling purposes, and obviously also take into account the one-off costs for the transaction and integration that I have already mentioned.

In terms of intangibles arising on the acquisition, we expect this to be spread roughly 50:50 between goodwill and other intangibles, the former being held on our balance sheet, with the latter amortised over approximately 8 years. We have also provided what we expect the proforma NAV at acquisition to be.

We expect the overall return on investment on the transaction to be in line with the mid-teens level that we typically generate on distribution deals after three years of acquisition.

Now, we are conscious that we have announced two meaningful acquisitions this year – Charles Derby and now Lighthouse.

As Andy said, this will give us national scale and critical mass for our national advice business.

So I wanted to make it clear that we do not envisage undertaking further large distribution transactions in the near term. Given that the transaction is more strategic in nature, we regard it as being outside of our £20 million target of annual spend for bolt-on distribution acquisitions.

Moving now to slide 14 and the timeline.

Obviously as this is a public market transaction, we will be abiding by the usual timetables set out by the Takeover Panel and the process for a scheme of arrangement in the UK. The critical dates are set out on this slide.

As this is a recommended offer for cash, we expect the process to move relatively quickly, with an anticipated completion date around the end of the second quarter of this year.

The scheme will require approval by a majority in number representing 75% of Lighthouse's shareholders voting by value. As announced this morning, we have received irrevocable undertakings from Lighthouse's top three shareholders, representing 43.5% of shares outstanding.

Righ,t let me now hand you back to Paul.

Paul Feeney Okay. Thank you Mark.

Before I open up to Q&A, I just wanted to echo a point that Mark made about how we're thinking about future distribution acquisitions.

We view both Charles Derby and Lighthouse as being very important strategic steps for us.

There is a lot of work to be done by Andy and his team to both integrate and to successfully build out our national advice business. We expect them to be very busy focussing on execution over the next year or so while we digest, integrate and deliver the benefits of these acquisitions.

So, while we will still add smaller bolt-on PCA acquisitions, as we have been doing over the last year or so, in terms of larger distribution acquisitions, we do not have anything else on the radar right now.

We are very excited by the opportunity ahead of us. Our ambition is to make Quilter the best place to go for trusted advice in the UK.

Right, with that let me turn over to the operator to open up for questions.

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| Gurjit Kambo<br>JP Morgan | Hello, good morning everybody. Just a few questions. So, firstly, what sort of relationship does Lighthouse have with Quilter? Does it use the platform for any of its services currently? Does it use any of your products like Cirilium? That's the first question. Secondly, any sort of indication of what the AuA Lighthouse was managing? You know, previously. Just in terms of the £2 million of cost savings, I know you mentioned things like the property lease obviously will be completed in a couple of years. You know, where are the other savings? Is it mainly, sort of, IT platform? Those are the three questions. |
| Paul Feeney | Andy, do you want to take the first one, how much they use our platform? I don't think they use a lot of our investment solutions so far, which is good, because that means they'll, you know… |
| Andy Thompson | Yes, that's right, Paul. The percentage of investment solutions is pretty low, as Quilter Solutions do not currently form part of the Lighthouse research in investment solutions. Again, if we remember, solutions like Cirilium have been designed specifically for our advice business customers. They do have a reasonable level of penetration on the platform, in terms of our normal market share plus. |
| Mark Satchel | Just in terms of, if I just pick up on the other two questions there. Lighthouse estimates, and it is an estimate because the records aren't necessarily very detailed on these matters, that they advise clients with assets in excess of £5 billion. They have new investments and pension flows of circa £1 billion plus, per annum. So, that gives you sort of an idea of some of the scale and the opportunity over there. In terms of the £2 million of cost savings, they obviously currently operate as a listed business, so there are some duplicative costs over there. You will also see from the release that some of the senior management team members are anticipated to depart the business after a period of time. Then there is obviously the property within London that has already been referenced. So, that's the majority of the composition of the cost savings that we anticipate in making. |
| Gurjit Kambo | That's great. Thank you. |
| Greg Simpson<br>Exane | Morning all, it's Greg from Exane. Three questions. The first one would be, could you just remind us of the retention of advisers in previous deals you've done, how many of the advisers typically stay with Quilter? Second question would be the 23 contractual relationships you mentioned, did you expect to be able to retain all of those with no change of control clause in those contracts? Some colour there would be helpful. Lastly, longer term, I think the productivity of existing advisers at Quilter is 1.7 million, from memory, is that a potential target level of productivity for Lighthouse, taking a longer term view? Thanks very much. |
| Paul Feeney | Okay, Andy do you want to take those? I think that's in your court. |

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Andy Thompson Yes, no problem at all, Greg. So, in terms of retention of advisers, over time, for us is very strong. I think we've spoken about this before, where the turnover that we do get tends to be inside the appointed representatives whereas actually retention of the appointed representatives is exceptionally strong. And we've seen that both in terms of our existing organic population and have been able to achieve that through acquisitions as well. Where you do get some displacement is where we look to move the independent advisers to restricted, and clearly at that point you do get some displacement. But we factor that fit into our assumptions when we look at these deals.

In terms of the 23 affinity relationships then, clearly that was a concern for us as to, you know, in terms of the acquisition. There aren't any change of control terms and clauses in those, but clearly what we need to do is make sure that those affinity relationships are comfortable with us. We actually think they'll welcome us, one of the challenges that Lighthouse has had is actually meeting the demand for advice, and clearly our greater distribution, I think, will be viewed as positive. Then in terms of productivity, then yes, I think probably the short answer to that is that you could see them as broadly equivalent to us.

Greg Simpson Great, that's so helpful.

Johnny Vo
Goldman Sachs Good morning. Just a quick question. Just in regards to the number of restricted advisers versus IFAs within this network, can you give us a split of that? Also, what's the average case size at Lighthouse? Could you provide that, as well? Thanks.

Paul Feeney Okay, Andy I think that's over to you, too.

Andy Thompson Yes, no problem at all. So, just being clear then, all of the advisers in Lighthouse Financial Advice, the affinity-based relationships, those 160 advisers are restricted. The Carrwood advisers are currently independent, and in terms of Communities it's a mix but with a high majority in independents, which is pretty typical of what we find in terms of the network businesses that we've acquired in the past.

In terms of the average case size, they're firmly in the, kind of, upper mass affluent to affluent. It clearly varies, but when we did our work it was around about 85% of customer assets were coming from that top end. So again, really fits well in terms of that average customer size.

Johnny Vo Just a follow up question, how long do you think it's going to take for the conversion of the existing IFAs over to restricted? Thanks.

Andy Thompson Yes Johnny, one of the slight restrictions in this transaction, they're being publicly listed, is that we've not been able yet to do the kind of level of integration planning and engagement with those individual channels that we'd want to. So, we now move into that phase. What we've found is that actually, where we've taken those on a, kind of, journey over a year or two has allowed us to deliver very successfully in terms of conversion rates.

Johnny Vo Okay, brilliant. Thank you.

Paul Feeney Okay, thank you very much. Thank you, operator. Thanks everybody for joining us this morning. As I said, we are very excited about this, this strategic deal. It really does leap us forward in our ambition, and we have a simply ambition in this space which is to be the go-to place for trusted financial advice in the UK.

Thanks very much guys, speak soon. Take care.