HARDMAN&CO.

24 January 2019

AJ BELL

Platform for growth

AJ Bell is one of the largest and fastest-growing investment platforms in the UK. It serves both the adviser market and the DIY investor. Having transitioned to updated technology in 2014, it is well placed to ride the growth in the market and pick up disaffected clients from competitor platforms that are only now upgrading. We anticipate strong profit growth on the back of higher revenues and positive operational gearing. The new asset management business should add further momentum, and higher UK savings rates could be the icing on the cake.

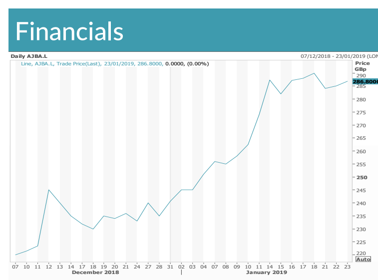
- **Strategy:** AJ Bell intends to be the easiest platform for investors and advisers to use, and to offer exceptional value – but not at the expense of service levels. It charges noticeably less than many of its competitors, putting it in a strong position as charges take a higher profile.
- **Plenty of scope for platform expansion:** Investment platforms are an obviously good way to concentrate the administration and custody of investments in one place, while offering a huge variety of investment choice, and freeing investors and advisers to focus on what they do best. There are still plenty of assets not yet corralled, as well as significant underlying growth.
- **Valuation:** We value the business on a DCF basis. At the current price, it is effectively assuming a discount rate of 8%, putting it at the top end of our wide range. Our central valuation of £912m would put it on a FY19E PER of 32x, which compares with Transact on 28x and Hargreaves Lansdown on 33x.
- **Risks:** There are inevitably market risks – revenue is linked to the value of assets and, to a lesser extent, the amount of trading on the platform. The business is also sensitive to tax and savings policies, which can have major impacts on investors' behaviour. The robustness of the technology is critical too.
- **Investment summary:** AJ Bell is a very attractive business, in our view. It is well positioned to benefit from the expected continuing growth in savings and the ever- higher proportion of those savings held on platforms. The business is highly cash-generative and holds significant net cash. These positive characteristics would seem to be well reflected in the current price.

Financial summary and valuation

Year-end Sep (£m)	2016	2017	2018	2019E	2020E	2021E
AuA (£bn)	32	40	46	49	55	61
Revenue	64.5	75.6	89.7	104.0	116.0	130.0
Net finance income	0.0	-0.1	0.1	0.0	0.0	0.0
PBT	16.8	21.7	30.1	37.0	41.0	47.0
Tax	-3.5	-4.2	-5.7	-6.7	-7.4	-8.5
Net profit	13.3	17.5	22.6	28.5	33.6	38.6
No. of shares (fully-diluted, m)	394	396	402	408	408	408
EPS (fully-diluted, p)	3.4	4.4	6.1	7.4	8.2	9.5
DPS (p)	2.7	2.9	3.7	4.5	5.4	6.1
PER (x)	83.0	63.4	46.1	37.7	34.0	29.6
Dividend yield	1.0%	1.1%	1.3%	1.6%	1.9%	2.2%
Dividend cover (x)	1.3	1.5	1.5	1.5	1.5	1.5

Source: Hardman & Co Research; 2018 and 2019E numbers exclude IPO costs and 2018 special dividend.

Financials



Source: Eikon Thomson Reuters

Market data

EPIC/TKR	**AJB**
Price (p)	**287**
12m High (p)	299
12m Low (p)	162
Shares (m)	407
Mkt Cap (£m)	1,170
EV (£m)	1,120
Free Float*	36.5%
Market	LSE Full listing

**As defined by LR 6.14 of the Listing Rules*

Description

AJ Bell is one of the largest investment platforms in the UK. It serves both DIY and advised customers, and offers SIPPs, ISAs and general accounts. It aims to be easy to use and very competitively priced.

Company information

CEO	Andy Bell
CFO	Michael Summersgill
Chairman	Les Platts

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Key shareholders

Invesco Perpetual	25%
Andy Bell	25%
Management and other	23%
Michael Spencer	3%

Diary

26 Apr	2Q trading update
23 May	Interims
25 Jul	3Q trading update

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Disclaimer: Attention of readers is drawn to important disclaimers printed at the end of this document

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Executive summary

Strong base for further growth

AJ Bell runs an investment platform targeting both individual savers and financial advisers. The platform market is growing fast, and AJ Bell is growing faster than most platform providers. It has settled technology, while others are struggling with upgrades, and it has a strong reputation for good service. It also has a deserved reputation for being good value – in some cases, it charges half the amount charged by its competitors. We expect revenue growth over the next few years to translate into even stronger profit growth, as the benefits of operational gearing flow through to the bottom line.

The platform market

An investment platform sits between an investor and his/her investments. It provides all the administrative support necessary to maintain portfolios of investments both inside and outside tax wrappers, allowing the investor or adviser to focus on investment strategy, selection and broader financial planning.

Asset growth

Platforms are relatively new in the financial firmament. In 2006, there was around £50bn under administration on platforms; by the end of 2017, this had grown to nearly £600bn. That still leaves trillions not invested through platforms. The continuing triggers for growth are:

- new clients who are not currently using platforms;
- existing assets being moved onto platforms by current clients;
- clients with savings on platforms continuing to add to them; and
- investment returns accumulating.

In 2017, platform assets grew an estimated 21%. With sluggish markets in the first half of 2018, Fundscape estimates that platform assets grew ca.6% to £604bn, and, in the third quarter, various platforms said that growth was slowing down, due to a reduction in the volume of pension transfers. Those impacts are reflected in our forecasts.

Tax wrappers

There are three main categories of investments: ISAs, SIPPs and general investment accounts. ISAs are tax wrappers that protect the assets from tax on both capital gains and income. Savers have an annual allowance and are generally loathe to remove the assets from the wrapper, as the benefits are lost forever. These remain an important source for growth – but not as significant as SIPPs.

SIPPs are self-invested pensions and benefit from tax advantages on the contributions to the pensions, although the income, when it is eventually drawn down, is taxable, albeit likely at a lower rate. There are several reasons why SIPPs are the engine of growth: the scale of the portfolios and contributions; the demise of the defined benefit pension scheme ("DB"); and the introduction of choice when the pension comes to be claimed.

Pension portfolios are generally much bigger than any other savings pot – they have to be in order to provide any worthwhile pension. Platforms are benefiting from investors moving their pensions from company schemes and insured personal pension plans to SIPPs, and the assets remain on the platform for many years – even after the pension starts being drawn.

Both ISA savings and SIPPs tend to be very sticky assets – the money is neither withdrawn to be spent for many years, nor do the clients tend to change platform providers unless they are particularly upset by the level of service they receive. This makes for a high-quality stream of revenue for the platform provider.

General investment accounts tend to provide the services that are provided by a stockbroker – the ability to deal in a wide variety of shares, funds, ETFs, etc. They are a good complement to the tax wrapper services: enabling a saver to keep all his/her assets in the same place. These assets tend to trade more and are more likely to be withdrawn, so the revenue is less high-quality.

AJ Bell business

AJ Bell started as a provider of SIPP and SSAS administration services, and the founders even wrote their own software to run the pension assets. These origins provide two core strengths for the AJ Bell business today, in our view: technology is at the heart of the business and well understood by the management; the SIPP business tends to have much larger pools of money and is more complex to administer, providing a very strong base from which to grow assets in other categories.

Also, at the heart of AJ Bell is a very strong corporate culture. The business has been run like a public company, with external institutional investors since 2005. The company is very proud of its ranking of 86 in the 2018 Best Companies survey – not for the ranking itself but because it firmly believes in the objectives behind the survey. This is also reinforced by the longevity of the staff: the executive management team has an average service length of 11 years, which, for a young, fast-growing company, is remarkable.

Measured by assets under administration (AuA), it is the sixth-largest direct to consumer (D2C) platform (AJ Bell Youinvest) and the seventh-largest adviser platform (AJ Bell Investcentre). It is also one of the fastest-growing platforms, backed by an imaginative publicity programme that seeks to get maximum publicity for limited outlay through its spokespeople appearing regularly in the mainstream media, and through high-profile but good-value sports sponsorship.

It has grown mostly organically, and all internally funded, with a few small deals to set it up in new areas. The latest area of expansion is asset management, with the first funds launched in 2016. It has the same policy as the platform business: to offer simplicity, value and transparency. This could become a substantial contributor to the profits of the business in time.

AJ Bell completed its move to new technology running its platform in 2014. This is a substantial competitive advantage, as many of its competitors are struggling with old and unwieldy systems that can cause major hiccups when upgrades are attempted. It also moved to a new Head Office in Salford Quays in 2017. With these two investments behind it, we expect to see the benefits of operational gearing coming through over the next few years.

Financials

The business is highly cash-generative, with relatively low capital requirements, and with all the profits being quickly converted to cash. For our forecasts, we have assumed that asset growth will slow from the levels achieved in 2017 and 2018, but this growth is still a very robust 20% in D2C and 15% in adviser. We have also assumed that the revenue margin will remain constant in AJ Bell Investcentre – this can vary depending on the average size of the portfolios moving onto the platform, the current level of savings rates and the amount of dealing activity. We estimate the margin in AJ Bell Youinvest to rise 2bps in 2019, to reflect the base rate increase, and the margin in non-platform to rise also, due to the loss of the lower-margin business.

AJ Bell – operating profit model

Year-end Sep	2016	2017	2018	2019E	2020E	2021E
AuA (£bn)						
AJ Bell Youinvest	4.7	6.6	8.7	10.1	12.1	14.2
AJ Bell Investcentre	18.6	24.3	29.9	33.1	38.1	42.7
Non-platform assets	8.5	8.9	7.5	6.0	4.8	3.8
Total	31.8	39.8	46.1	49.2	55.0	60.7
Revenue (£m)						
AJ Bell Youinvest	14.4	17.7	24.5	31.6	37.1	43.9
AJ Bell Investcentre	34.2	42.5	50.4	59.0	66.6	74.9
Non-platform assets	15.9	15.4	14.8	13.5	12.4	11.2
Total	64.5	75.6	89.7	104.0	116.0	130.0
Costs (£m)						
Fixed costs	-20.0	-21.0	-22.9	-24.5	-26.7	-28.6
Variable costs	-27.7	-32.5	-36.8	-42.5	-48.3	-54.4
Total costs	-47.7	-53.5	-59.6	-67.0	-75.1	-83.0
Operating profit (£m)	16.8	22.1	30.1	37.0	41.0	47.0

Source: Hardman & Co Research
Note: the operating profit excludes the impact of IPO costs in FY18 and FY19E

These forecasts drive our discounted cashflow (DCF) valuation model, which is then tied in to comparing the company with its two most comparable listed businesses: Hargreaves Lansdown ("HL") and Transact (listed as IntegraFin).

Our DCF model returns a range of values from £735m to £1,250m, depending on the discount rate used and the growth assumptions, with a central estimate of £912m. Our comparable companies' analysis comes to similar numbers, around the centre of the DCF range, with the HL comparables coming out higher and the Transact ones lower.

AJ Bell – DCF sensitivity table and comparable PER valuation

£m	Steady growth rate between 2022 and 2025			Variable growth rate between 2022 and 2025	
Discount rate	9%	11%	13%	13% down to 7%	
8%	1,104	1,176	1,250	1,142	
9%	882	938	997	912	
10%	735	780	828	759	
	Sep'19E PER	Sep'20E PER		Implied value for AJ Bell	
Hargreaves Lansdown	32.9x	29.5x		938	989
Transact	27.6x	24.1x		787	808

Source: Hardman & Co Research, Reuters consensus estimates, values as at 16 January 2019

Risks

In addition to the usual generic company risks, AJ Bell faces some specific issues. Primarily, forecasts are sensitive to market levels, dealing activity and savings interest rates. The tax wrapper assets tend to remain sticky, even in poor markets, but clearly, if the level of the assets falls, the revenue, which is largely *ad valorem*, will fall too.

The company makes money from paying a lower interest rate to its customers than it can achieve itself by aggregating the cash pile of all its savers, just as a bank does. When savings rates are at rock-bottom, the revenue from this source gets squeezed. We don't see too much downside from current levels but, in the future, after rates have risen to more normal levels, then it could once again become a risk.

The technology running the platform is critical to the whole business. Any serious faults or attacks on its integrity could have very serious repercussions. Unsurprisingly, the company is very alert to this risk.

Finally, but as importantly, is regulatory risk. This takes two forms:

- The first is the tax and savings regime, which is constantly changing. In general, the government is keen to encourage savings, but the method and scale of incentives are regularly altered. Any changes that make saving less attractive will have an impact on AJ Bell's business.

- The second is the regulatory regime presided over by the Financial Conduct Authority (FCA). It is currently surveying the industry; it reported its interim findings this summer and will issue its final report in 1Q'19. Its two chief concerns – the problems of shopping around and the difficulties of switching – we do not see as threats to AJ Bell's business. Indeed, it could be a beneficiary, as it has been a consistent net receiver of transfers, and its fees are generally lower than its competitors – so greater transparency will help its proposition in the market place.

IPO

AJ Bell floated on the London Stock Exchange with a premium listing in December 2018. There was no new capital raised; all the shares sold came from existing shareholders and provided a free float of 25% of the market capitalisation of the company.

Post the flotation, Invesco Perpetual owns approximately 25.4% of the company, Andy Bell a further 25.5%, and the rest of the management and staff and other "selling shareholders" 21%.

The investment platform business

Introduction

AJ Bell runs an investment platform for UK investors and their advisers. Originally conceived in Australia, platforms are administrative systems sitting between investors and their investments. They perform many tasks that are necessary for the correct management of investments, including collecting dividends, providing tax wrappers and maintaining records (plus many more tasks). They also provide access, through one portal, to an enormous variety of funds, shares, bonds, ETFs and other investments.

In addition to providing the asset management plumbing, AJ Bell has recently developed a range of its own investment products, extending all the way to one end of the value chain. What AJ Bell doesn't do is provide personal recommendations; this is left to either an investor's financial adviser or the investors themselves. It has no intention of extending its reach into providing personal recommendations.

This report splits into two main parts: the first looks at the UK platform industry as a whole; the second looks at AJ Bell specifically.

The UK platform market

Brief history

Historically, investors would have held investments through their bank or stockbroker. In addition, they might have owned insurance products, and some may even have held shares in their own name. Two things changed: one was the advent of retail tax wrappers such as ISAs (originally PEPs) and SIPPs; the other was the opening up of the market, so that intermediaries sold not only their own products but those of third parties too – so- called "open architecture". Fund "supermarkets" were created, where it was possible for both intermediaries and investors to buy the investment products of more than one manufacturer (investment management company) in the same place.

This freedom led to much increased complexity. The tax wrappers had to be administered by third parties to be effective, and holdings in instruments from many different providers multiplied the administrative burden for the financial adviser or the DIY investor. Platforms solved this problem by allowing all the investor's assets to be held in one place and providing the administration required. This allowed advisers to focus on financial planning and investment strategy, and investors to concentrate on selecting their investments. A further benefit is that a platform can effectively operate as a buying group for its clients – sharing the benefits of scale with its customers. In retrospect, they are obviously a good idea – a highly efficient division of labour. There are millions of investors looking to invest in thousands of different products but, for each investor (or adviser), it makes perfect sense to have all the administration concentrated in one place.

At the end of 2006, Mintel estimated that there was ca.£50bn of assets on platforms. In 2017, that number was £590bn. Apart from a brief plateauing during the financial crisis, the value of assets on platforms has grown swiftly and continuously.

Data from Fundscape show the near £600bn in assets split among ISAs, SIPPs and other asset categories. It also shows the net and gross flows in 2017.

Platform industry in 2017, split by investment category						
(£bn)	Assets	Gross sales	Net sales	Assets	Gross	Net
ISAs	155.9	20.6	8.4	26%	16%	15%
SIPPs	194.1	49.0	35.2	33%	39%	63%
DC pensions	59.2	13.1	3.1	10%	10%	5%
Other	182.3	43.4	9.3	31%	34%	17%
Total	**591.6**	**126.0**	**55.9**	**100%**	**100%**	**100%**

Source: Fundscape

In 2017, £126bn was added to platforms and £70bn was withdrawn. The net figures are probably more enlightening: of the £56bn that was added to platform assets net of withdrawals, £35bn was in SIPPs, which we discuss below. The figures in 2016 were even more startling, with £24bn of the £38bn net added going into SIPPs.

Fundscape estimates that, by the middle of 2018, the industry had grown to £604bn, with net sales of £12bn in the first half of the year.

Future growth

Despite the very strong growth, platforms are still relatively new, and there are huge sums that are not yet administered on platforms – for example, historical life policies, occupational pensions, individual shares and ISAs are still run directly by asset managers. Total UK pension wealth alone was estimated by the Office for National Statistics at over £5,000bn in 2016. Life policies and occupational pensions will not move onto platforms but, as they mature (life policies) or are transferred out (pensions), the proceeds will need to be invested, and they are likely to find their way onto platforms.

We believe that the growth in the platform market will continue for many years. There are four strands of growth:

- new clients who are not currently using platforms;
- existing assets being moved onto platforms by current clients;
- clients with savings on platforms continuing to add to them; and
- investment returns accumulating. There is also a steady outflow, as investors spend their savings, but this is outweighed by the inflows.

Structure of the market

The platform market splits into three: adviser platforms, D2C investor platforms and corporate. We are not concerned in this report about the "corporate/institutional" market.

Some platform providers specialise in D2C, and some in advised, but only AJ Bell does both at scale. According to the Fundscape data for 2017, £352bn of platform assets were in the advised sector and £126bn were in D2C. Platforum [1], another consultancy, estimates that there is just under £500bn held on investment platforms used by advisers and just over £200bn on D2C platforms. The FCA, in its interim report, referred to £311bn on advised and £189bn on D2C. There would seem to be a definitional problem, although the FCA noted that one large platform was excluded from its data request – so its figures may be an underestimate.

[1] Platforum, UK Adviser Platform Guide, Issue 33, March 2018

We have used the Fundscape data to show the growth in the market, using a consistent basis.

Platform Industry 2017, split by client

(£bn)	Assets	Gross sales	Net sales	Assets	Gross	Net
Retail advised	352.1	70.2	35.5	60%	56%	63%
Corp./Inst.	113.9	33.8	9.3	19%	27%	17%
D2C	125.5	22.0	11.2	21%	17%	20%
Total	**591.6**	**126.0**	**55.9**	**100%**	**100%**	**100%**

Source: Fundscape

Since 2014, the advised segment has grown its assets by 73%, or 20% p.a., and the D2C market by 83%, or 22% p.a. Both are attractive businesses, in our view.

Platform industry, 2017 vs. 2014

(£bn)	Assets 2014	Assets 2017	Inc. in assets '17 vs. '14	Net flows 2014	Net flows 2017	Inc. in flows '17 vs. '14
Retail advised	203.7	352.1	73%	20.6	35.5	72%
Corp./Inst.	71.4	113.9	60%	13.4	9.3	-31%
D2C	68.6	125.5	83%	7.7	11.2	45%
Total	**343.7**	**591.6**	**72%**	**41.7**	**55.9**	**34%**

Source: Fundscape

The net flows have grown by a substantial amount too, but slightly slower in the case of D2C.

In the past few weeks, various competitors of AJ Bell have announced their latest AuA numbers. HL referred to "an industry-wide slowdown in net retail flows", Transact mentioned "an increasingly challenging market environment", and Nucleus talked about "the well-referenced market uncertainty that is continuing to impact investor sentiment". Nevertheless, they still all reported increased assets and positive net inflows.

Recent six-monthly net flows as a percentage of AuA

Six-months to	Sep'17	Mar'18	Sep'18
AJ Bell	11%	11%	7%
Transact	8%	8%	7%
Hargreaves Lansdown	5%	5%	4%
Nucleus	7%	6%	4%

Note: HL figures have been estimated, as the company reports to April, rather than March
Source: Company reports

Direct to consumer (D2C) platforms

The goliath in the D2C business is HL. It listed on the stock market in 2007, when it had £7.4bn under administration. Today, it has in excess of £90bn out of the D2C market, or not far off 50%. The number two player by size of AuA – the result of a recent merger with TD Investing – is Interactive Investor, with ca.£20bn. So, the two largest are independent operators. The next two are not: Barclays Stockbrokers is part of the retail bank; Fidelity Personal Investing is owned by one of the largest fund managers in the world, with a long-standing significant presence in the UK. The fifth largest is Alliance Trust Savings, a subsidiary of the long-established Scottish investment trust, Alliance Trust. It has just been acquired by Interactive Investors, subject to regulatory approval. Next comes the D2C arm of AJ Bell, AJ Bell Youinvest, with £8.7bn under administration. Below AJ Bell, there is a mixture of banks, brokers and independents.

Direct platforms by AuA, 2017/18

	AuA (£bn)
Hargreaves Lansdown (Jun'18)	91.6
Interactive Investor (Sep'17)	19.7
Fidelity Personal Investing (Sep'17)	16.0
Barclays Smart Investor (Sep'17)	15.4
Alliance Trust Savings (Jun'18)	16.2
AJ Bell Youinvest (Sep'18)	**8.7**
Total (Sep'17)	**205**

Source: Platforum [2] for Sep'17 data, company websites for the rest

The largest two have about half the market (rising to just over 60% once the Alliance Trust deal is complete), and the top seven around 70%. Mergers and takeovers do happen in this space, but they are fraught with difficulty, especially when it comes to moving the investors from one platform to the other. Not consolidating onto one platform removes the main rationale for a deal; moving them risks upset, even if the process runs smoothly, which is not a given. We would expect the bigger players, in general, to continue to consolidate market share and the "others", at the bottom of the table, to pull out gradually from providing a platform service, as they simply don't have the scale to make it worthwhile.

Steady-state customers

In general, customers of platforms (and indeed advisers and fund managers too) are very sticky – that is they tend to stick with whichever provider they have chosen. AJ Bell's client retention rate is ca.95% each year and, of the ones who leave, some will be forced moves, either through death or simply needing the savings. It is rare for a customer to move over investment performance or even just because another provider is offering a cheaper service. Clients tend to move only after they have had bad service or because the price has been increased.

AJ Bell does not need its competitors to perform badly, but every one that trips up provides potential opportunities to grow market share.

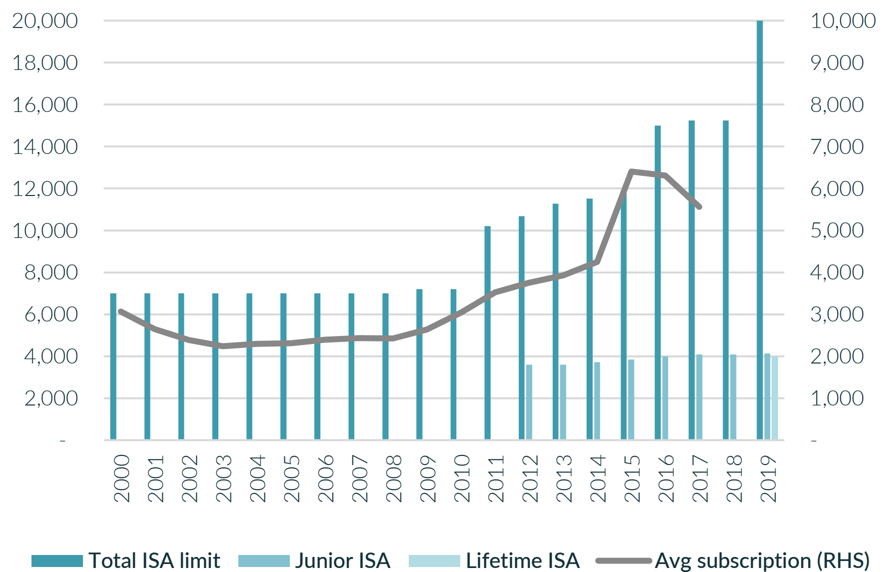
[2] Platforum Feb 2018 UK D2C Market size report

Products provided

The principal products D2C platforms provide are pensions, ISAs and plain vanilla share dealing accounts. The last is self-explanatory. ISAs, or Individual Savings Accounts, are tax-exempt savings schemes. Originally introduced as PEPs (personal equity plans) in 1987, they morphed into ISAs in 1999. The key change was that cash was allowed to be saved in the ISA wrapper, providing tax-free income. Cash and share ISAs were separate (and had different annual savings allowances) until 2014, when they were merged, and an ISA could hold any mixture of cash or qualifying shares. This made the scheme more attractive and easier to administer.

The annual allowance has been increased over time, with the current limit set at £20,000 p.a. Capital gains within ISAs are tax-free, as is the income derived from the investments, which can be kept either within the wrapper or paid out.

ISA annual limits and average subscription (£) per financial year



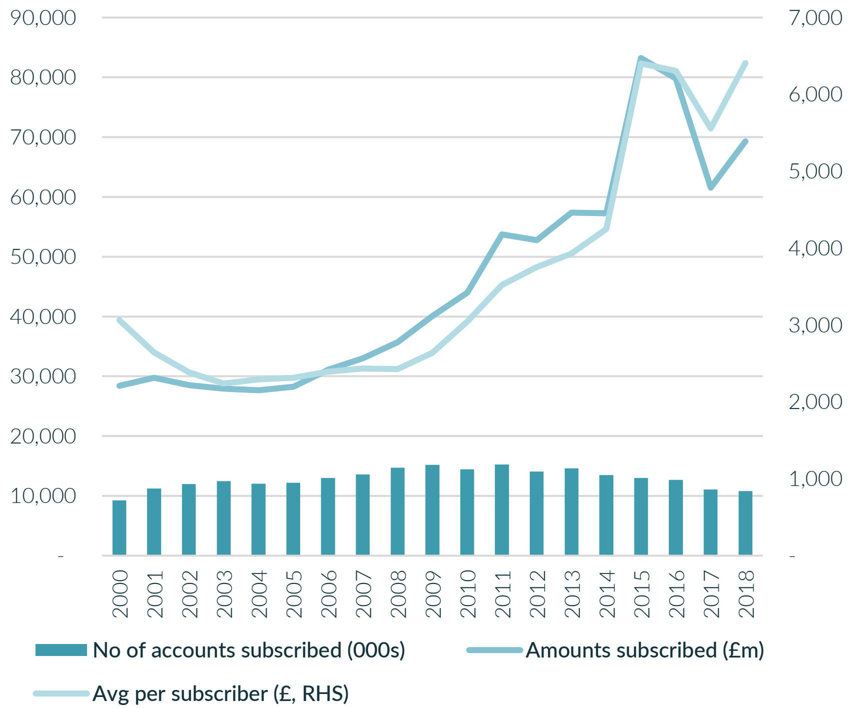
Source: HMRC

Interestingly, the average subscription moved sharply higher in 2015, to £6,400, but fell back again after the limit was raised.

Wide coverage

In total, there are 22.1 million adult ISA holders (or about 40% of the adult population). The value of ISA holdings was £608bn in April 2018. In the peak years, over 15 million investors subscribed to an ISA (2011), and £83bn was invested (2015). In 2016 and 2017, there was a tailing-off in both subscriber numbers and amounts subscribed, which may have been a function of below-inflation wage growth putting pressure on marginal savers. In FY2018, the amount subscribed rose to £69bn, from £62bn the year before, although from a slightly smaller number of subscribers – 10,800, down from 11,100.

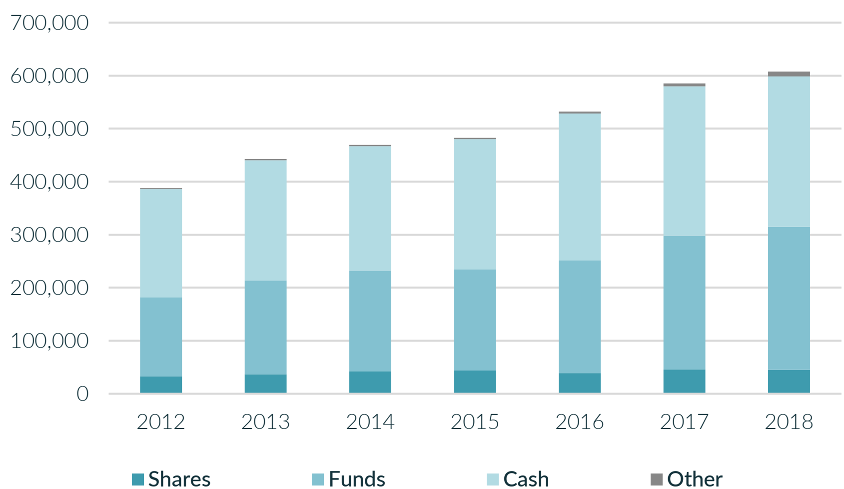
ISA annual subscribers and subscriptions, year to April



Source: HMRC

Only 7.5% of the April 2018 figure of £608bn is invested directly in shares, but a further 44% is invested via collective schemes (unit trusts, OEICS, investment trusts), and just under 50% is held in cash. Many (or possibly most) of the pure cash ISAs will be held in banks or building societies and are not directly AJ Bell's target market, although they could, in time, be transferred to a stocks and shares ISA to seek a higher return.

ISA investment split (£m) as at April 2018



Source: HMRC

Over the past five years, ISAs have grown at a compound rate of 7%, with stocks and shares ISAs growing at 9% and cash ISAs at 4%. While there has been some volatility in the rate of new subscriptions, the value of funds remains very substantial and is still growing.

Proportion of ISAs on platforms

At the end of December 2017, HL held £32.6bn in ISAs, or about 40% of its total AuA. By contrast, ISAs are only about 19% of AJ Bell's D2C business, reflecting its origin as a SIPP provider. Taking HL as a proxy for the D2C platform market as a whole, it would imply that just under £90bn of share ISAs are on platforms, or about 27% of the total. So, there is still plenty of scope for transfers onto platforms as investors rationalise their savings.

Other ISAs

Further developments were the introduction of the Junior ISA (JISA) in 2011, with a current annual saving limit of £4,260 for under-18s only, and the Lifetime ISA (LISA), introduced in 2017. The lifetime ISA was introduced to help people save for their first home, and has a £4,000 annual contribution limit. The Government adds 25% to the annual contribution up to a maximum of £1,000. The savings do not have to be put towards buying a home, but there is a 25% charge to withdraw cash if it isn't, unless the saver has reached the age of 60. In other words, the government claws back its contribution, plus any accrued interest. Lifetime ISAs can be opened only by over-18s and under-40s, although contributions can continue to be made until the investor is 50.

Both junior ISAs and lifetime ISAs are relatively new, and there is about £4bn in total invested, but both have the chance to become very substantial. In AJ Bell's D2C business, AJ Bell Youinvest, 13% of accounts are junior or lifetime ISAs but only 1% of the assets.

Sticky business

It is worth emphasising that the ISA business is very sticky. Once the cash is put in an ISA, if it is subsequently removed, the tax benefits are lost forever. The real benefit of ISAs is accumulated over time – very few people derive enough income or capital gains in a single year to benefit from the tax breaks.

Regulatory risk

The annual ISA allowance has been increased very substantially in the past few years by the Coalition and then the Conservative Government. It seems highly unlikely to us that a future Labour government would remove the tax breaks on existing ISA assets (although this is not impossible), but it might well reduce or remove altogether the future annual allowances. Anyone who can afford to save £20,000 per year, or £40,000 per couple, is likely to be in the top 1% of earners and scarcely in need of such fiscal beneficence.

Pensions

Anyone who has ever had anything to do with pensions will know that the subject is highly complex, and the rules are in constant flux. It is beyond the scope of this report to look at the rules in detail, but several key changes have been highly beneficial to the platform industry.

Demise of the defined benefit scheme

Pensions split into two: those defined by what pension income you are entitled to (defined benefit or "DB") and those where your pension is based on what was contributed to a personal fund, and the returns this fund has achieved (defined contribution or "DC"). The DB scheme used to dominate; now, outside the public sector, there are few still open to new members, or indeed where existing members can continue to accrue additional entitlements.

According to the Pensions Policy Institute, there are approximately 44,000 pension schemes in the UK, of which 22,000 are open to new members, 11,000 are shut, 8,000 are frozen and 2,000 are being wound up. Of the 44,000, 33,000 are DC and, of the 11,000 DB schemes, only 2,200 are still open.

The demise of the DB scheme is down to several factors: increased longevity (unaccompanied by an equivalent rise in the pensionable age); removal of tax breaks on dividends; and the impact of extremely low interest rates on the calculation of the current value of future liabilities. What has become clear is that providing DB schemes is extremely expensive for employers and is largely underappreciated by at least the younger employees, and so is very unlikely to ever return.

Despite the dominance of DC schemes in operation today, more than 80% of the assets are in DB schemes, reflecting the longevity of those schemes (especially in the public sector) and the much higher funding levels. Nevertheless, all the growth is in the DC sector, and DC schemes are much more relevant for platform providers.

DC schemes

Whereas the funds behind a DB scheme will typically be managed in one large separate pool of assets or form part of a pooled pension fund provided by a life insurer, DC schemes are represented by millions of individual pools of assets. Every employer now must provide employees with a pension scheme, and so every employee in the country (with a very few exceptions) now has some investments in his/her name. For most, these sums are very small and of little interest to platform providers such as AJ Bell, but there are still a very large number of employees with significant sums attached to their name.

When employees move jobs, they may leave their pools behind with their old employers, or they can transfer them. They might choose to mingle them with their new stream of contributions at their new employers, or they might keep them separate. If they keep them separate, one of their options would be to transfer them into a SIPP, and, even if they didn't transfer an existing pension, they could still set up a SIPP into which they could put additional contributions, which (with some restrictions) they could do gross of any income tax payable. In addition, SIPPs are ideal for the self-employed. There are inheritance tax benefits too.

SIPPs

The D2C platform is ideal for people who wish to manage their own SIPPs, and 80% of SIPPs are sold without advice according to the FCA – that is the beneficiary sets up the plan and manages the assets himself/herself without input from an adviser. This is the group that AJ Bell services on its D2C platform.

According to a Mintel survey in 2017, the SIPP market is worth around £260bn, including assets not held on platforms. At AJ Bell Youinvest, 63% of assets are in SIPPs – this is much higher than the platform average, reflecting AJ Bell's origins as a dedicated SIPP provider. By contrast, HL's SIPP business represents just 33% of its customer assets.

In contrast to the ISA business, the tax benefits of SIPPs occur when money is put into the scheme. With various limits, taxpayers can put very substantial sums into their SIPPs and offset the contributions against their income tax liability. There have been frequent changes in the rules, and the limits on the size of the total pot accrued have been steadily reduced. If the fund exceeds the limit, then the excess is taxable at a penal rate. In practice, the tax benefit is simply a deferral of income tax, as the pension that is eventually paid out of the fund will be subject to income tax. It is likely, though, that a higher-rate taxpayer will be paying a lower rate when he/she withdraws his/her income.

Pension freedoms

Another important legislative change was the introduction of flexibility in the way pensions could be managed at retirement in the March 2014 budget. In the past, when a retiree wished to access his/her pension, he/she had to convert the sum into an annuity. Now he/she has a range of choices, from taking a tax-free lump sum of 25% of the fund, to leaving it all in "drawdown" (where the funds remain invested) or buying an annuity – or a mixture of all three.

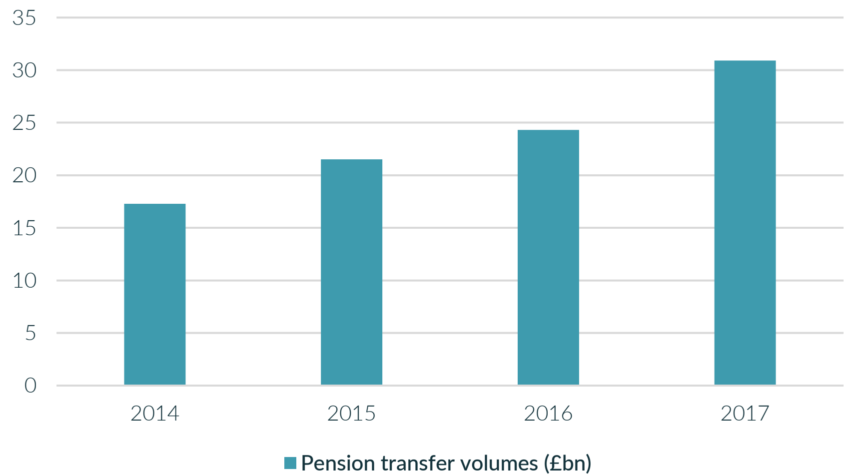
Once again, the details are beyond the scope of this report, but the salient information is that the flexibility allowed on retirement choices makes the SIPP a much more attractive product than it once was, when you were forced to buy an annuity. And from a platform perspective, the value of the pension portfolio doesn't disappear in one go into an annuity, but can remain being actively invested for many years into retirement. According to HMRC, £14bn of pension savings have been accessed since 2015, and £50bn has been transferred out of DB schemes.

SIPP growth

The SIPP market is, like the ISA market, a very attractive proposition for platforms. The SIPP business, because it is still quite young, is immature. The number of people accessing the funds in their SIPPs remains small, and the majority are still making contributions. On top of this growth, there are also expected investment returns, to keep the pot growing even larger.

In recent years, some of the large DB schemes have been looking to reduce the number of their beneficiaries and have been encouraging deferred members to take lump sums to invest in DC schemes, including SIPPs. This too has provided a steady stream of new clients. Data from Origo, a not-for-profit organisation that manages the electronic transfer of pension assets, show the huge increase in pension transfers in the past few years.

Pension transfer volumes through Origo

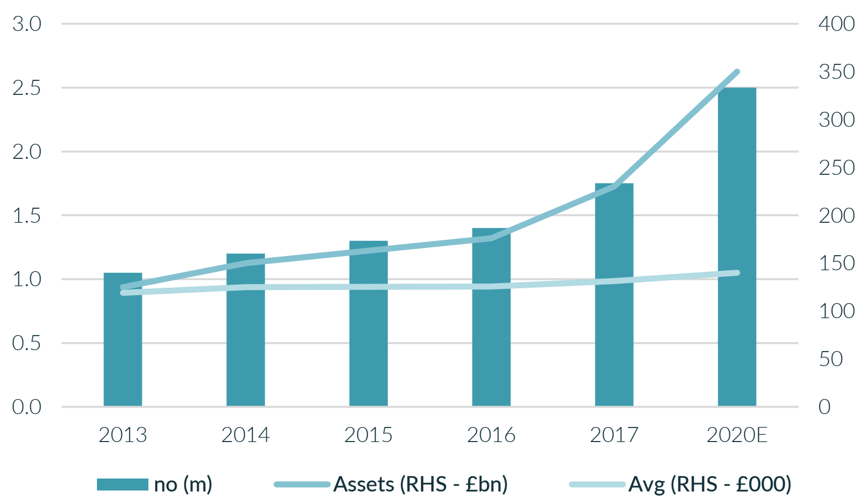


Source: Origo

It estimates that about half the transfer volume is money going into SIPPs and that, in 2017, there was a 30% increase in the volume of SIPP transfers and a 39% increase in their value. Since 2014, those data points are +98% and +121%, respectively. This is a fast-growing business, and is widely expected to remain so, although the volumes transferred in 2017/18 may prove to be a peak.

It is hard to find any definitive data on the size or growth in the SIPP market. MoretoSIPPs provides some estimates. The data show that the market has grown rapidly in the past four years, from £125bn to £230bn, with the number of accounts showing a similar rise, from 1.1 million to 1.8 million. In the chart below, we have made estimates for 2015, as numbers for that year were missing

Total SIPP market by assets (£bn) and number (m), 2013-17 and 2020E



Source: MoretoSIPPs, Hardman & Co Research

MoretoSIPPs forecast that the market will continue to grow at 15% p.a. for the next three years, taking the SIPP market to £350bn by 2020. It anticipates £50bn of DB

transfers, £30bn of DC transfers, £30bn from life companies and £10bn of new client contributions. The opportunity for AJ Bell and its competitors is potentially rather bigger than this, since the market in 2016 was split 52:48 in favour of platform SIPPs vs. non-platform SIPPs. And it is the platform SIPPs that are providing most of the growth. Non-platform SIPPs is where the SIPP market started and when the emphasis was on non-standard investments. Since pension freedoms, the growth has been much more mainstream, largely coming from savers seizing the opportunity to take control of their money (and the way in which they access their pensions), and not from those looking to use their pension assets more constructively.

Stickiness

As with ISAs, pension money is very sticky, and has become more so. Savers cannot access their pot of money until they reach 55 and, even then, the tax consequences impact how much and how quickly they can draw it down. We see pension savings as the most durable of the accounts held on a platform.

Regulation

There are substantial tax benefits when investing in pensions, but they have been trimmed at the top end, as the total savings limit has been steadily reduced. It now stands at £1m. In the table below, we show how the percentage of tax breaks accruing to the ultra-high earners (£150k or more) has steadily reduced.

Percentage of total tax relief on individual and employee pension contributions by income band

Income band	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
£0 to £19,999	8%	6%	5%	6%	5%	5%
£20,000 to £44,999	31%	32%	35%	37%	37%	36%
£45,000 to £74,999	25%	26%	28%	32%	33%	34%
£75,000 to £99,999	7%	8%	8%	10%	10%	10%
£100,000 to £149,999	8%	9%	9%	7%	8%	8%
Over £150,000	20%	18%	14%	8%	7%	7%

Source: Pensions Policy Institute

It is likely that the rules will continue to be tinkered with, but we would not see this break being at substantial political risk. At most, we might see a limit to basic rate tax relief, instead of at the tax payers' marginal rate. This would take some of the gloss off, in our view, but would not stop the market from continuing to grow.

General dealing accounts

After ISAs and SIPPs, the third category of assets on a D2C platform is the funds held, not inside a tax wrapper. The saver accrues no tax benefits but has complete freedom. In many cases, they will be savings ready to use up future ISA allowances as the investor has already utilised his/her annual limit.

Adviser platforms

Adviser platforms are very similar to D2C platforms – the end customer tends to invest in the same things – the difference is that there is an intermediary between the investor and the platform. The intermediaries, the financial advisers, can range from one-man bands to national organisations with branches all over the country.

Market size

Data from the FCA show that there are around 34,600 regulated financial advisers, of whom about 8,400 are not AJ Bell's target market, because they work in banks, building societies or other institutions that have their own platform solutions, or

would not need them. AJ Bell currently deals with around 6,600 individual advisers at over 2,800 firms (as at January 2018) – or about a quarter of the target market.

The other key difference is that this part of the sector is dominated by large life companies or fund managers. The largest player by AuA is the merged business of Aegon and Cofunds, followed by Fundsnetwork (owned by Fidelity), then Standard Life and Old Mutual, now renamed Quilter, and then Transact. AJ Bell's adviser platform, AJ Bell Investcentre, is currently the sixth- or seventh-largest, we estimate.

Structure of UK adviser platform market – June 2018

AuA (£bn)	
Aegon Cofunds	121.1
Fundsnetwork	81.6
Standard Life (Wrap and Elevate)	56.3
Quilter	52.3
Transact	31.8
AJ Bell Investcentre (Sep'18)	**29.9**
Total (Platforum/ FCA)	500+/311

Source: Fundscape for Aegon Cofunds and Fundsnetwork, company websites for the remainder

According to data from Platforum[3], the top five platforms account for 65% of the adviser market, and the top 10 combine to cover 88%. It estimated that the total adviser market is now over £500bn, and grew at 22% in 2017. AJ Bell outgrew the market, with 31% growth in the year to September 2017. The FCA estimates the size of the adviser market at £311bn and says that "none of the top platforms achieves a 20% market share", equivalent to £62bn of assets. We presume it excludes either part or all of Cofunds and Fundsnetwork.

Growth drivers

The same factors driving growth in D2C are driving growth in the adviser segment: growth in pension transfers; more assets being transferred to platforms that previously were held separately; and the underlying growth in savings, driven largely by demographics.

Advisers typically use more than one platform. Different platforms specialise in different areas, and sometimes are regarded as being particularly good at, say, one asset class, but maybe don't provide the full range of alternatives that an adviser is looking for.

Another reason might be charges: different platforms have different charging scales, so an adviser may use one outfit for its smaller clients and another one for larger clients who can get a better deal on a different platform. An adviser will typically have a primary platform – its default or preferred administrator – and then one or more others. In the table below, we show what percentage of each platform its users consider to be their primary choice or secondary choice.

[3] Platforum, UK Adviser Platform Guide, Issue 33, March 2018

Tiered platform use in 2017	Primary	Secondary	Other
Transact	50%	29%	21%
Standard Life	49%	27%	24%
Nucleus	46%	28%	26%
AJ Bell Investcentre	46%	24%	30%
Ascentric	40%	25%	35%
Zurich	38%	21%	41%

Source: Platforum[3], Hardman & Co Research

AJ Bell is fourth only to Standard Life, Transact and Nucleus in being considered by its users as their primary platform. From the same survey, Platforum calculated that the primary platform attracted a 58% share of the advisers' platform spend.

The next table shows the current attractiveness of each of the major platforms, as viewed by the advisers. In the first column, we show the percentage of a platform's users that are transferring assets away to a rival platform; in the second column, we show the percentage of advisers who would consider each platform for future use (it not being currently one of their suppliers); in the third column, we subtract the "transferrers out" from the "would considers" to arrive at a net score.

Asset transfer momentum – 2017	Transfer from	Transfer to	Net
Aviva	4%	18%	14%
AJ Bell Investcentre	5%	18%	13%
Standard Life	7%	20%	13%
Transact	6%	16%	10%
Parmenion	3%	8%	5%
Aegon	6%	10%	4%
Fundsnetwork	15%	19%	4%
7IM	8%	9%	1%
Zurich	12%	11%	-1%
Quilter	18%	16%	-2%

Source: Platforum [4], Hardman & Co Research

The methodology is not exactly scientific, but it is a simple way of ranking the platforms by their current perceived attractiveness. AJ Bell scored well in both columns, and hence arrives near the top of the table.

Platform priorities

What are the characteristics that advisers are looking for when selecting a platform? None of the answers to that question is surprising, but it is interesting to see how they are ranked when asked in a Platforum survey. The top five priorities are, in order, with the most important first: low charges, investment choice, service, usability and functionality.

"Low charges" has moved up the table recently, possibly as a function of the regulator 'sniffing around'. One answer sticks out as an anomaly – "financial stability" – and shows the inevitable limitations of surveys of this sort. Financial stability *must* be the first criterion: no adviser would consider a platform that was not financially stable. In the Platforum survey, it came seventh.

"Service" is a bit of a catch-all, but is clearly crucial, and noticeably the most important reason why an adviser moves its business away.

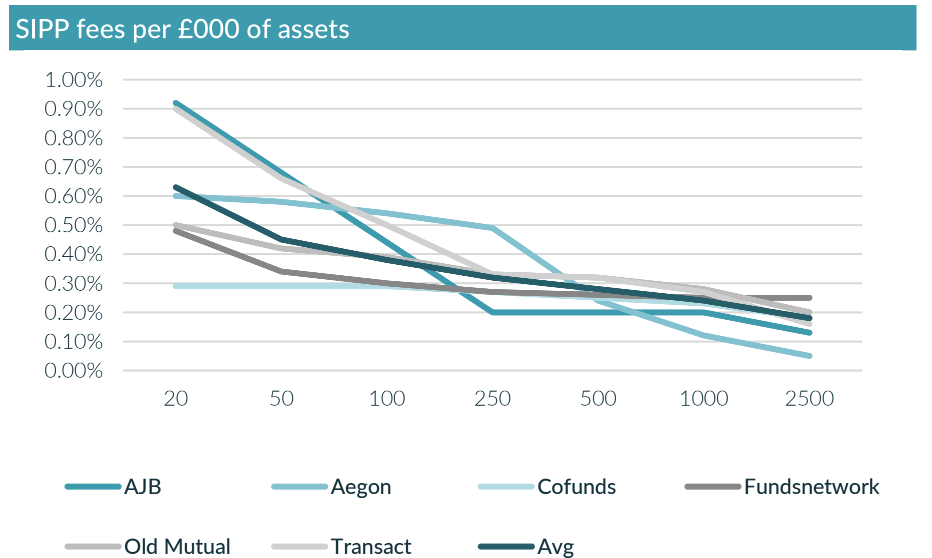
[4] Platforum, UK Adviser Platform Guide, Issue 33, March 2018

Otherwise, the reasons for leaving pretty much mirror the importance of choices for choosing a platform in the first place. In order of importance, the top five are: service, looking for low charges, usability, functionality and investment choice. Once again, the financial stability issue appears to be an afterthought, coming in at twelfth.

Pricing

Price is not everything, but it is important. The headline fees of the various platforms do vary significantly, especially towards the smaller portfolio end of the range. For SIPPs, in our sample below for a £20,000 portfolio, the fees range from 92bps at AJ Bell and 90bps at Transact down to 29bps at Cofunds. At £100,000, the range has narrowed down to 54bps at Aegon to 29bps at Cofunds. By the time you get to £250,000, AJ Bell is the cheapest, at 20bps, and remains the cheapest, with the exception of Aegon, whose fees come down rapidly at the £1m mark.

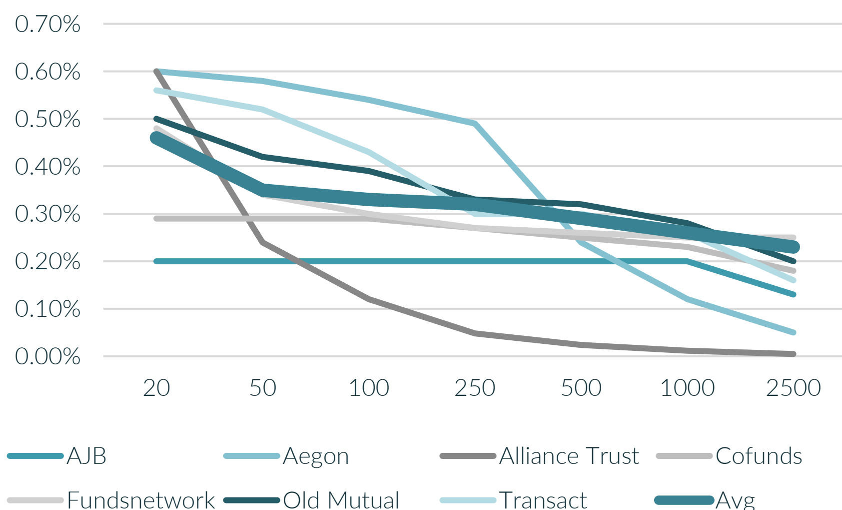
SIPP fees per £000 of assets



Source: The Lang Cat

We have excluded Alliance Trust from the chart above, which levies a flat fee of £250, which is cheaper than the others from the £100,000 level and very substantially cheaper thereafter. We have included Alliance Trust in the chart below, which shows the headline fees for ISAs and General Investment Accounts. A similar pattern emerges, with AJ Bell being the cheapest (excluding Alliance Trust), until Aegon undercuts at £1m and above.

ISA/GIA fees per £000 of assets



Source: The Lang Cat

These fees tell only part of the story, though. There are many other charges that clients of these platforms might incur, from dealing costs, to foreign exchange dealing charges, to fees for transferring in assets, to closing down accounts. The actual cost of having assets on a platform will, to a large extent, depend on the activity of the client.

Perhaps the best way to compare the true costs is to look at the revenue that platforms make as a proportion of the AuA. In the table below, we look at some large providers where that information is publicly available.

Fees charged as percentage of AuA

	Avg. AuA (£bn)	Revenue (£m)	bps
HL total ex-other income	71.7	338.8	47.3
AJ Bell Youinvest	**5.7**	**17.7**	**31.5**
Transact total	25.3	80.2	31.7
AJ Bell Investcentre	**21.7**	**42.5**	**19.8**
Quilter UK platform	45.5	150.2	33.0
AJ Bell Total	**36.2**	**75.6**	**21.1**

Notes: Excludes advisory, Funds Library and ancillary revenues
Source: Individual company information from presentations or accounts, all for FY17 [5]

HL is a D2C platform and, as such, we would expect it to have higher fees than an adviser platform where the advisers are commanding much larger sums of money and can negotiate lower fees.

Transact, which is a pure adviser platform, earns 32bps including the revenue it generates from wrapper fees and dealing commission. Quilter (Old Mutual as it was called previously) earns 33bps all-in.

AJ Bell made 21bps overall in FY18, 18.8bps from its adviser business and 31.6bps its retail platform. Its lower rates reflect two things: first, AJ Bell's strategy to be a

[5] Hargreaves Lansdown: *http://www.hl.co.uk/investor-relations/investor-news/2018*
Transact: Prospectus *https://www.integrafin.co.uk/document-library/*
Old Mutual: *https://www.oldmutualwealth.co.uk/globalassets/documents/quilter/20180425-showcase-ii.pdf*

low-cost provider; second, that its average client is bigger than other platforms, and so tends to pay lower rates, on average.

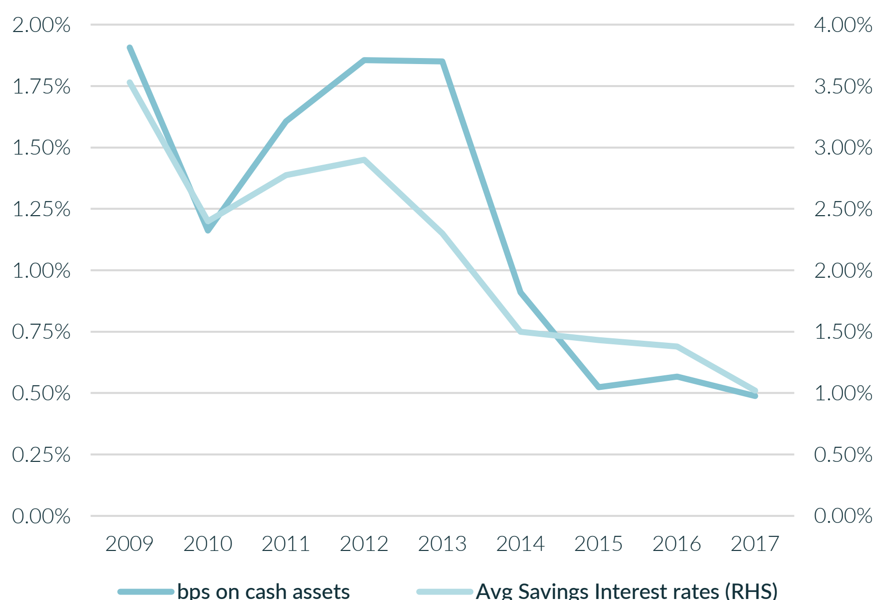
Cash interest

In the days when interest rates were above rock-bottom, platforms could make significant sums from the interest received on cash balances. As with any bank, the platform would pay a slightly lower rate to its customers than it would receive itself. As interest rates fell all the way to 0.25% – with savings rates barely above 1% – so the net interest margin that platforms made shrank.

Different platforms adopt different approaches to how they manage the cash margin. There are a number of factors at play too; for example, FCA rules prohibiting CASS funds from being placed on deposits of more than 95 days, whereas SIPP funds operate under different rules, decisions made on maturity profiles by the platforms, and the banks' appetite for deposits, which will impact the rate they are prepared to pay. The bottom line is that the net cash margin is managed by platforms as part of their overall pricing policy.

In the chart below, we show the rate of interest income (on client accounts) expressed as a percentage of the cash being held that HL reported between June 2008 and June 2017, and the average savings rates for the period. We have had to make some estimates on the level of average cash balances.

HL's cash interest margin and UK savings rates



Source: Hargreaves Lansdown, Swanlow Park, Hardman & Co Research

(Note: the right-hand scale for the savings rate is twice that of the HL net rate.) It shows clearly that the rate netting to HL was approximately half the current savings rate – or even higher between 2012 and 2013, when LIBOR spiked upwards – and this fell from a peak of 186bps to around 50bps in 2017.

Cash interest is still an important source of revenue for platforms, and we would expect it to become a bigger contributor as and when savings rates revert to more normalised levels; however, the competition in the industry makes it unlikely, in our view, that the net interest spread will rise to former levels.

Advisers moving away from investment selection

Traditionally, one of the key roles a financial adviser would play was as asset allocator and selector of investments. Increasingly, the advisers are moving away from investment selection and focusing more broadly on financial planning. Simple index funds or ETFs, or ready-made portfolio products, satisfy the investment need once the individual financial strategy is established. This is creating more room for the platforms to provide investment solutions themselves.

There is also a big trend towards retail investors not taking any professional advice and doing their own investment strategy. Around 80% of SIPPs are managed by individuals with no professional input, but they still need administrative services.

Technology

Large organisations tend to be less adept at managing technological change and, to be fair, they tend to have additional layers of complexity. Many of the players are themselves products of deals and mergers, and trying to combine different platforms is fraught with difficulty. No-one would ever choose to start from where they start when deciding to upgrade their technology.

Aviva's customers have experienced significant issues since a platform migration. According to the trade press [6], the platform was unavailable for six days from 17 January and, one day after it came back on stream, some advisers and clients were locked out again. In the words of FT Adviser: "since then there have been a litany of problems with processing adviser charges, switching funds, processing income drawdown, facilitating Isa contributions and erroneous alerts sent out indicating huge value drops in client portfolios".

The acquisition of Cofunds by Aegon in 2017 will lead to customers being migrated to a new platform during 2018 – although some of Cofunds' paper-based processes will be retained [7]. Users of Alliance Trust, Ascentric and FundsNetwork will all see substantial changes to the underlying technology [8]. All this change makes disruption much more likely, which could lead to an increase in the amount of churn between platform providers.

AJ Bell completed its major migration to new technology in 2014. Ongoing investment will keep the platform up to date and add incremental improvements, but no major, disruptive, change is anticipated.

[6] FT Adviser *https://www.ftadviser.com/investments/2018/05/10/aviva-platform-issue-threatens-adviser-client-relationship/*

[7] *https://www.ftadviser.com/investments/2018/05/08/aegon-admits-some-platform-processes-still-rely-on-paper/*

[8] See Platforum report UK Adviser Platform Guide Issue 33, March 2018

Platform review

The FCA published its interim report on investment platforms in July 2018; it wanted responses before the end of September. It said that the platform market appeared to be working well in many respects, and it identified five groups of customers for whom competition was not sufficient.

Concerns regarding the first two and, in our view, most substantive, group of customers were the ability to switch platforms and making it easier for consumers to shop around. Without getting into a discussion of the merits of the FCA's interim conclusions, we would simply point out that, as AJ Bell is a consistent net receiver of transfers, it would only likely benefit from any rules to make transfers easier. Similarly, anything that makes it easier to identify costs for consumers would only serve to highlight AJ Bell's competitive pricing, in our view.

The third group of customers the FCA was concerned about was those using platform model portfolios without fully understanding the risk levels. We see no financial risk to AJ Bell in any likely solution to this perceived problem.

The fourth category concerned investors who might be missing out by holding too much cash. This seems to us to be tricky territory for the FCA: how much is too much cash? Just because investors without advisors are holding more than advised clients does not mean that it is the wrong thing for them to do. While interest rates are so low, paying platform fees might make returns negative but, if the cash is held within a tax wrapper, the customer has limited choice, and the ease of having all his/her assets in one place could easily offset the few basis points that might be saved by moving them.

The last category are so-called "orphan clients" – investors who used to be advised but no longer are. The FCA estimates that there are just over 400,000 of these clients, with just over £10bn of assets. AJ Bell had just under 1,400 orphan clients at the end of September 2018 on its AJ Bell Investcentre platform. It encourages them to appoint a new adviser or, if they don't want an adviser, to move to a DIY platform such as AJ Bell Youinvest. This is not always possible if they own assets that are not supported by the DIY platform. We see no material risk to AJ Bell, whichever action the FCA might finally recommend to deal with this type of client.

Conclusion

Platforms are now an integral part of the money management scene, in our view, and provide a very useful service: allowing advisers and individuals to focus on investments and planning, while having the administration carried out in one place.

Future growth of assets held on platforms will come from four sources:

- existing assets that are not currently on platforms being moved there, either by existing clients consolidating all their assets on a platform or
- new clients moving to a platform for the first time;
- new investments being added to existing portfolios;
- investment returns.

There is still a vast swathe of assets not yet on platforms: some of them can be transferred in the form they are currently in (e.g. ISAs); some of them will be assets that mature (e.g. life policies) and need reinvesting; and, possibly the largest source of them all, are the savings pots from defined benefit pension schemes and insured

personal pension plans being transferred out of segregated pools, to be reinvested as SIPPs.

There is an advantage of scale in these markets, which will probably drive continued consolidation in the sector, but any deal runs the risk of severe disruption, as platforms are merged or assets transferred from one platform to another. Clients do not like quantum change – if they wanted a different platform, they could move themselves – so any mass transfer is likely to lose assets along the way. The same is true of technology updates: platforms need to be running on modern, scalable infrastructure, and so updates are inevitable, but if it is a wholesale, massive change, such as the one Barclays imposed on its customer base in 2017, it is quite likely to lead to a substantial fall-out, to the benefit of the more stable competitors.

The platform business is partially driven by regulation and tax rules, so there is always risk that changes will upset things or create further opportunities. A change to a "hard left" government could well have serious implications for future growth in savings products like ISAs, which largely accrue to the wealthy but, in our view, this would have much less of an impact on the pension market, where the benefits are more evenly spread, and pension provision is not something a government would want to disrupt.

AJ Bell's business

AJ Bell's origins are in a company established by Andy Bell and his co-founder, Nicholas Littlefair, in 1995. The company focused on administration services for SIPPs and SSASs (Small Self-Administered Schemes). The original software was developed in-house and also sold to third parties. Two key strengths persist from these foundations: an internal IT development capacity and understanding of the underlying technology at the heart of the business; and an emphasis on high-value SIPP accounts. In 2007, Littlefair became a non-executive and, in 2011, he retired.

Public company culture

In 2005, AJ Bell attracted its first institutional investor, Midas Capital Partners, now called Seneca Investment Managers, when it acquired part of Littlefair's stake. It was joined by Invesco in 2007 and by Woodford in 2015. Consequently, AJ Bell has been run like a public company since at least 2007. It has published annual reports, had non-executive directors, a full suite of audit, nominations and remuneration committees, and paid progressive dividends every year since 2003. It has also built a distinctive culture.

In 2018, AJ Bell was ranked 86th in the Best Companies survey. As the company says, it has adopted the eight measures of the Best Company framework, not because it wanted to do well in the survey, but because it believed that the measures were worthwhile in themselves. In 2017, the company moved to new offices in Salford Quays, and part of its motivation was to improve the wellbeing of the staff through having an attractive, modern environment with great facilities, including a free gym on site. (Information about Best Companies can be found here: www.b.co.uk)

Another stand-out characteristic of the business is that the Executive Management Board has an average service length of 11 years, which, for a young, fast-growing company, is remarkable. In 2010, there were just over 300 staff in the business; today, there are over 700 employees. We have not included any management biographies in this report for reasons of space, but details of all the senior people can be found here: http://www.ajbell.co.uk/about-us/people .

Organic development

The company has grown largely organically. It has made some bolt-on acquisitions, but these have always been small and readily absorbed into the company and its culture. There are no plans to change this strategy for the future.

The first key development was transforming the SIPP business from a bespoke operation that catered for complex SIPPs, to helping business people to use their pensions to help run their businesses efficiently, and to streamlining the offer so that it could be run online. Two businesses emerged from this: Sippdeal, which became AJ Bell Youinvest; and Sippcentre, which became AJ Bell Investcentre. The former is the D2C business, and the latter is the adviser service, which added more investment options and provided the service, which advisers needed.

At this stage, AJ Bell was effectively just an administrator, and involved only with SIPPs. Three transactions and their subsequent development transformed the business. The first, in 2007, was the acquisition of a stockbroker, Lawshare. This brought share dealing in-house and removed the risk of relying on an external third party for such a crucial part of the business. The business was acquired for just over £2m, but the same again needed to be spent on it to turn it from an institutional business into a retail broker as well. It was based in Tunbridge Wells, but the decision

was taken in 2017 to shut the Tunbridge Wells office and move the business to Manchester. That transition is currently under way.

In December 2012, AJ Bell acquired MSM Media, which brought with it *Shares* magazine, which forms the core of the content that AJ Bell provides for its customers. It resists actually offering advice, but it does provide its customers with plenty of free information for them to make their own decisions. The media business is also core to AJ Bell's marketing strategy, which we discuss below.

In 2016, it acquired Indexx Markets, an investment management business that designed investment products, and Mansard Capital, a discretionary fund manager, which facilitated the launch of AJ Bell's Managed Portfolio Service. It has been radically transformed into the fund management proposition that AJ Bell now offers. That too is discussed in more detail below.

The original business – the pensions administration service – is now called AJ Bell Platinum. It continues to offer services to owner-manager businesses to help them run their pensions efficiently. It represents around 10% of the revenue currently, but it is expected to be outgrown by the rest of the business, which is growing much faster.

Third-party services

The company used to offer third-party services or white-label products to what are now competitors. Most of that business has now been terminated, but it still provides a white- label SIPP business to Barclays and Halifax. It withdrew from the service it provided to TD Securities when TD Direct was acquired by Interactive Investor last year.

The history of the group is important to give an understanding of the culture of the business and also an explanation for its competitive strengths – in particular in its IT core understanding and its SIPP background, giving it a reputation for dealing with complex issues with large sums of money. It is far easier to expand into the simplified world of providing ISAs, general investment accounts and smaller sums than it is to do the reverse. It is also noticeable that the business has always been run with an eye to the longer term, with investments being made in technology and group functions to enable the steady expansion of the business from being a pure SIPP player to a fully functional investment platform.

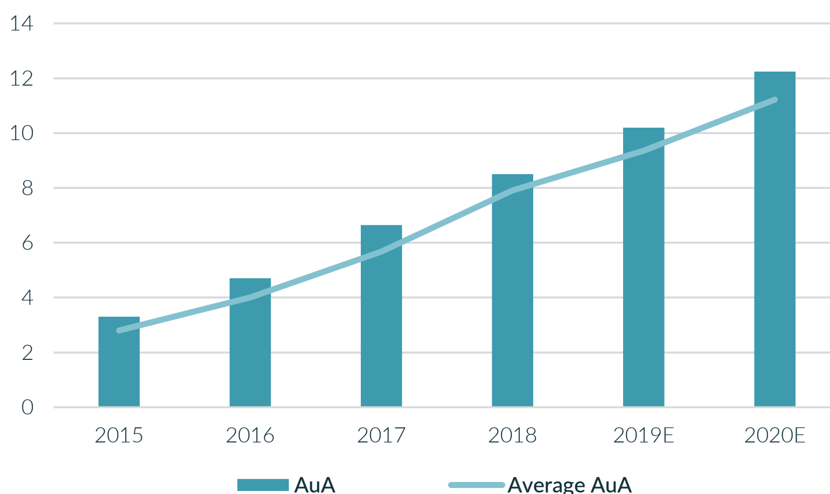
In the section below, we look first at AJ Bell Youinvest, then at AJ Bell Investcentre, and then at the remaining businesses.

AJ Bell Youinvest

AJ Bell Youinvest is the D2C business of AJ Bell. It currently (September 2018) has £8.7bn of AuA, making it currently the sixth-largest player in this space, but it will rise one place when the Alliance Trust/Interactive Investor deal completes. It is one of the fastest- growing. AJ Bell Youinvest emerged from the business that was called Sippdeal, which was launched in 2000. Initially just dealing in simplified SIPPs, which could be administered online, it added ISAs and straight dealing accounts in 2011. Over the past seven years, it has added additional functionality: Junior ISA (2012), mobile app (2013), *Shares* magazine (2016), Lifetime ISA (2017), and the launch of AJ Bell's proprietary passive funds and Favourite funds list.

It has also grown its assets and customer numbers very substantially. In the past five years, customer numbers have grown from fewer than 20,000 to 94,000 as at September 2018, and assets have grown from less than £2bn to £8.7bn. We are forecasting assets grow to £10.1bn by September 2019 and then to £12.1bn by 2020.

AJ Bell Youinvest AuA (£bn)



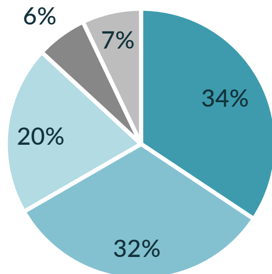
Source: AJ Bell (2015-18) and Hardman and Co Research estimates (2019-20E)

This growth will be fuelled by precisely what has driven growth in the past: transfers in of existing assets (especially SIPPs), existing customers bringing additional assets onto the platform, and investment returns. Further growth will come from investors setting up savings plans for the first time, like Lifetime ISAs (LISAs), and continuing to add to their accounts.

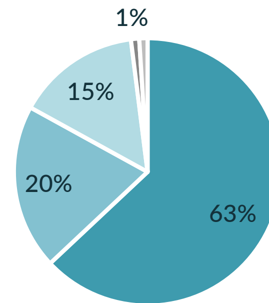
Currently, there are 1.25 accounts per customer. This is a clear area for potential improvement by cross-selling. AJ Bell has been seen traditionally as a SIPP provider, and so many of its SIPP customers are likely to have other assets held elsewhere. Concerted efforts to cross-sell the other accounts available should enable a steady increase in that number. This should be particularly true when compared with other platforms that have glitches when they transfer or upgrade their platforms.

AJ Bell's origins are also clear when looking at the split by account type: SIPPs are just the largest category by number (34%), ahead of ISAs (32%), but very substantially the largest by assets (63%).

Split of AJ Bell Youinvest accounts by number



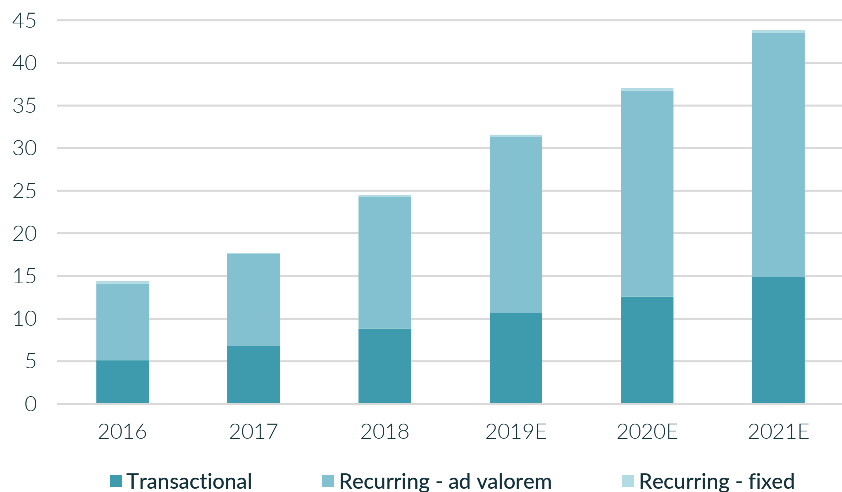
Split of AJ Bell Youinvest accounts by assets



Source: AJ Bell, September 2018

The AJ Bell Youinvest clients are much more active than the adviser clients. In FY18, 36% of AJ Bell Youinvest revenues came from transactions (for AJ Bell Investcentre, the equivalent number is just 10%), with the balance coming from custody and administrative fees. This makes the revenue potentially more volatile, depending on market conditions, but it is largely at the margin, and we assume, in our forecasts, that the split remains fairly constant.

AJ Bell Youinvest revenues (£m), recurring and transactional split



Source: AJ Bell (2016-18) and Hardman and Co Research estimates (2019-21E)

New business

In addition to attracting new business through the usual routes – word of mouth, advertising and promotion and cross-selling – AJ Bell Youinvest also picks up books of business typically from players looking to exit the administrative side of the business. A good example is Scottish Investment Trust (SIT). In August 2017, around 6,000 investors in SIT were transferred to the AJ Bell Youinvest platform, as Halifax Share Dealing, which had previously administered the holdings, pulled out of the business of administering investment trust savings schemes. SIT selected AJ Bell to take over. The clear opportunity is not only in charging for the administration of the investment trust assets but to cross- sell to these new customers the other accounts on the AJ Bell Youinvest platform.

Competitiveness

Retail platforms operate in a highly competitive market, but comparing one with another is complex and will depend on what an individual wants from the platform: Cheap dealing? Guidance? Ease-of-use? Wide range of investments? Charges are difficult to compare too, as this will depend on the size of a portfolio, its type of holdings (e.g. shares vs. funds) and the frequency of dealing.

We feel it is safe to say that AJ Bell is very competitive on both price and service. A review of various D2C platforms in the *Daily Telegraph* in September 2017 concluded:

"If you don't mind paying for it, it's hard to go wrong with Hargreaves Lansdown. However, AJ Bell ranks similarly in a number of categories and has lower platform and share dealing fees, although it charges £1.50 for fund dealing while Hargreaves is free."

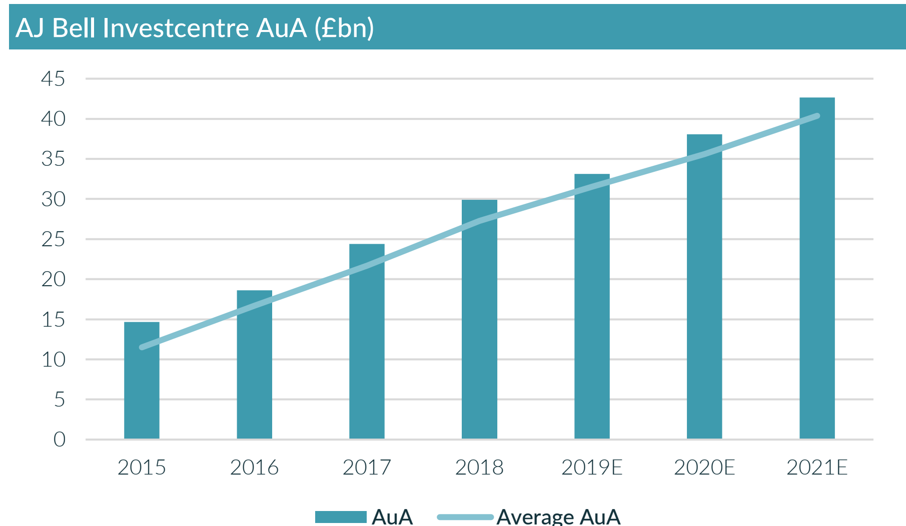
HL is an impressive operator in this market, but its headline fee – 45bps – is nearly twice AJ Bell's 25bps, so to be compared with HL favourably in the same sentence is, we would argue, a significant endorsement of AJ Bell's proposition.

AJ Bell Investcentre

AJ Bell Investcentre is AJ Bell's platform for financial advisers, previously branded Sippcentre. It is currently substantially larger than AJ Bell Youinvest, with £50.4m of revenues in FY18 and £29.9bn AuA as at the end of September 2018. We estimate it will reach £33.1bn AuA by September 2019, before growing to £38.1bn by FY2020.

In addition to its flagship AJ Bell Investcentre proposition, the company offers dealing, settlement and custody services, typically to Private Wealth Managers who want to outsource their administration to allow them to focus on investment and financial advice.

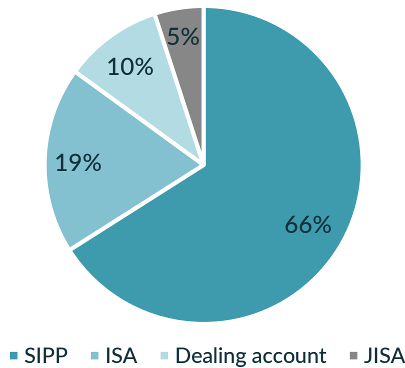
AJ Bell Investcentre AuA (£bn)

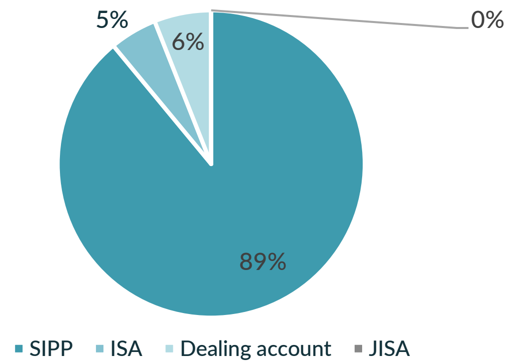


Source: AJ Bell (2015-18) and Hardman and Co Research estimates (2019-21E)

AuA has grown 27% p.a. over the past four years. AJ Bell Investcentre now has just under 89,000 customers, and, on average, 1.16 accounts. The vast majority of the assets are in SIPPs, reflecting AJ Bell's heritage.

AJ Bell Investcentre accounts by number	AJ Bell Investcentre accounts by assets

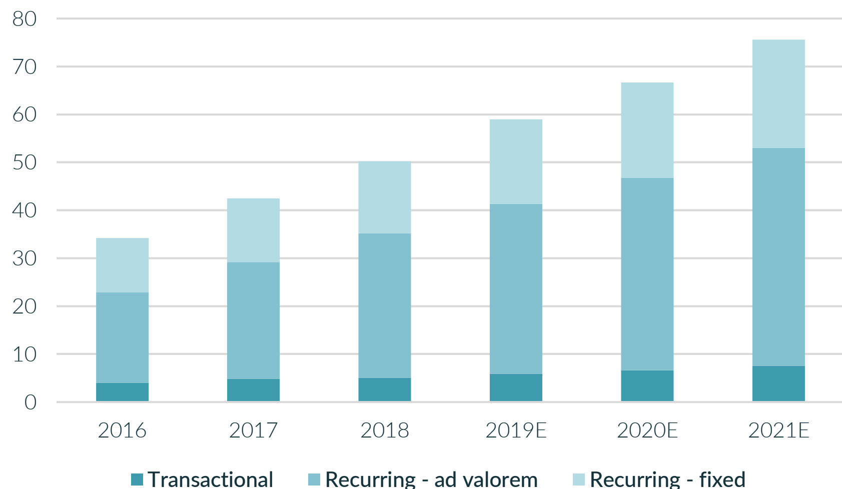




Source: AJ Bell, September 2018

As mentioned in the AJ Bell Youinvest section, the AJ Bell Investcentre accounts are much less active, with transactional revenues making up 10% of revenues. We see no reason for this to change.

AJ Bell Investcentre revenues (£m), recurring and transactional split



Source: AJ Bell (2016-18) and Hardman and Co Research estimates (2019-21E)

It is the fifth-largest in Platforum's March 2018 survey (seventh on our adjusted figures), but a distance behind the number four player Old Mutual Wealth. Behind it are Transact, Zurich and James Hay, which are all of a similar size. As with AJ Bell Youinvest, it is one of the fastest-growing businesses. The actual size is unimportant – all of these players have sufficient scale to be profitable.

In the same Platforum survey, AJ Bell Investcentre came second in the "Platforum User Leaderboard", a composite ranking based on user reviews. This is a very strong base on which to continue to grow its assets, in our view.

The target market for AJ Bell Investcentre is mid-sized IFAs – not one-man bands or national networks. It estimates that there are around 25,000 regulated individuals in over 5,000 different firms comprising its target market. It currently deals with about 6,600 of them in over 2,800 unique firms – so there is a substantial number still to go after. Also, with its current client list, it is usually one of two or more

platforms being used. It still has significant potential to attract non-SIPP assets, in particular, which are currently held elsewhere, in our view.

In many cases, it is substantially cheaper than its competition and, with the FCA putting more emphasis on price competitiveness and requiring IFAs to do annual due diligence, including on the value of services they are providing, there is plenty of scope to win more business in the coming years.

AJ Bell Investments

The investment management business is AJ Bell's latest major development and a natural extension of the platform business. Its approach is the same as the rest of the business: to approach investment solutions in a simple, transparent and low-cost way.

The first product was a Managed Portfolio Service (MPS) on the AJ Bell Investcentre platform, launched in 2016. It offers a broad range of active, passive and income-based options. The options are based on risk profiles and are packaged to make an adviser's life as easy as possible. The MPS charges 15bps (+VAT). There are 16 possible portfolios, half active and half passive, with four separate income options, and the balance running the risk spectrum, from cautious to adventurous to global growth.

The MPS was followed in 2017 by the launch of five passive funds available for both the advised market and the DIY investor. These too have a risk-based approach, ranging from cautious – a mixture of cash (14%), bonds (58%), equity (22%) and property (6%) – all invested in a mixture of ETFs and index funds – through to adventurous – cash (3%), bonds (18%), equities (63%) and property (16%). The annual management charge for the funds is 0.15%, and the ongoing annual charge is capped at 0.5%, with AJ Bell undertaking to absorb any costs above that level.

The next funds will be actively managed portfolios, but with passive level charges. While the market for passive investment products is very price-competitive, the same is not true of the active market. In addition, where active funds are really no more than closet- tracking funds, the fees can be extremely poor-value, in our view. Following the FCA's review of the investment management market, we expect there will be a further and continuing focus on fees and transparency in the future. This is a good time to be expanding into this area of the investment business.

In the year to end-September 2017, the investment management business had revenue of just £1.1m. Its objective is to reach industry levels of penetration with its investment products. HL, in December 2017, had £9bn in its own funds, or just over 10% of the assets on its platform. If AJ Bell had 10% of its AJ Bell Youinvest and AJ Bell Investcentre assets currently (around £32bn) and charged just 15bps, this would amount to around £5m of annualised revenue – and that sum would grow with the assets.

Other businesses

AJ Bell Platinum

The biggest of the other businesses is the AJ Bell Platinum service – the original core of the business. It currently accounts for about 10% of revenue, but should be steadily outgrown by the rest of the business. It offers pension administration services to both SIPPs and SASSs. SASSs were the forerunner to SIPPs, and are primarily set up by private and family-run businesses for the benefit of the owner-directors and senior employees, and even family members not involved in the enterprise.

The business uses all the same skillsets as the rest of AJ Bell, but it doesn't fit on the platform. The schemes tend to be individual and complex, and not suited to automation. They are sold through intermediaries and direct to customers. As with the rest of AJ Bell's business, AJ Bell Platinum does not offer regulated investment advice.

There is also a white-label SIPP administration service, but this is small and has been shrinking, notably when AJ Bell withdrew from the TD Investing contract, when it merged with its direct competitor, Interactive Investor.

AJ Bell Media

AJ Bell Media was formed when it acquired MSM Media and, in particular, *Shares* Magazine. The magazine moved to on-line only in mid-2016 and offers digital subscriptions for £12 per month. It provides daily online comment about stocks, funds, investment trusts, ETFs, ISAs, SIPPs, savings and personal finance. Although the brand name is *Shares*, its coverage extends to all parts of investing and saving. Subscribers to its digital magazine also get free access to a wide range of tools and services, including live share prices, charts and financial information on companies. The content is provided free to the majority of AJ Bell's customers. The media business has revenue of around £2.5m and is profitable.

Publicity

An important part of AJ Bell's development is its publicity machine. It is a highly visible (and audible) brand. There are three key elements to its publicity strategy: public relations (PR), sponsorship and advertising.

The PR approach is critical. It focuses on getting investment experts into the public eye through TV, radio and print appearances. It has daily market comment written by the *Shares* journalists, has regular appearances by Russ Mould, Kevin Doran and other spokespeople on high-profile money and news programmes, and it is always available to give responses to political or regulatory announcements on pensions or investment in general. This provides a steady 'drip, drip' impact, where the name is ever-present and attached to financial expertise.

In addition, it is engaged in high-profile sports sponsorship, having sponsored (and, in some cases, continues to sponsor) Lancashire County Cricket, the London Triathlon, the AJ Bell Stadium, home to the rugby union club, Sale Sharks and others. These are not big- money deals and are structured to get the biggest impact per pound spent.

It has also done a limited amount of TV and radio advertising.

The company monitors the impact its publicity has in terms of number of viewers, number of mentions, the amount of web traffic generated (notably to the group

website, and when that leads to a referral to the AJ Bell Youinvest site). It also tracks brand awareness through YouGov. Ultimately, it is impossible to measure precisely what contributes to any new piece of business, but it appears to us to be an impressive and efficient promotional operation.

Technology

AJ Bell runs on the technology underlying its platform. The whole business model relies on it being able to process millions of transactions as smoothly and efficiently as possible, while presenting a clear and easy-to-use interface for the customers – both individuals and professional advisers.

It is, in our view, no surprise that AJ Bell has managed to negotiate the continual need to upgrade the platform without any externally noticeable hiccups. The origin of the business was in the software the founders wrote to manage the administration business they had started. If technology fails or incurs massive cost overruns, it is often because the users are separated from the technicians and neither fully understands the other. At AJ Bell, the technology is front and centre. This is a very substantial competitive advantage.

Essentially, AJ Bell runs, at its core, with three external systems: GBST Composer, JHC Figaro and, joining the two together, TIBCO. Composer and Figaro are similar but have different strengths, and TIBCO allows the two systems to share data. Around the core, it runs its own proprietary interfaces for both internal and external use.

It makes sound sense to have external providers for the engine of the platform – they are specialists whose job it is to specialise and to continue to improve the systems, and keep them compliant with the latest regulations. AJ Bell can then concentrate on the client- facing look and functionality.

The major updating of back-office systems was completed in 2014, and there is no quantum change now necessary for the foreseeable future. The whole cost was funded from internal cashflow, while the business continued to generate substantial amounts of cash. This puts AJ Bell in a very strong position: it does not need to worry about its own platform, while it can watch competitors struggling with their updates and platform migrations, and stand to benefit from any fall-out when customers are left unhappy with unfamiliar systems or failed transitions.

One of the key tests for any administrative system is its ability to cope with peaks of activity. Some peaks are predictable – such as the tax year-end burst of activity – and some less so – any sudden market move like the shock Brexit result. AJ Bell's systems have proved they can cope with the extremes of activity without any significant increase in staff or any noticeable deterioration in performance.

Financial information

In the following pages, we include five tables. The first shows the drivers we use for making our forecasts, the second a simple profit statement, and the other three are the historical and prospective income statement, balance sheet and cashflow statement. All our forecasts are based on our work and assumptions; they are inevitably subject to uncertainty, and the actual results are inevitably likely to differ.

General observations

AJ Bell has been a consistently profitable business during the period covered by the accounts on its website (since FY10) and before then too. It has paid a steadily progressive and fully covered dividend in each year since 2003, reflecting that the reported profits are genuinely backed by cash.

Between 2010 and the financial year-ending September 2018, revenue grew by 253% (12% p.a.) and net profits by 195% (9% p.a.). That period covers the investment in the new platform, the move to a new head office, and the absorbing of the shrinking of cash interest received as savings rates plummeted. In that time, it has funded all the development itself and has had no recourse to external debt, with the exception of some very modest finance leases (£300k at their peak in 2014).

The combination of lower interest and higher development costs saw operating margins shrink from a very high 51% in 2012 to 26% in 2016, before rising again to 29% in 2017 and 31.5% in 2018.

Looking to the future, with savings rates unlikely to go lower in the near future, in our view, and the additional costs of moving and upgrading the platform firmly behind it, we would expect to see the benefits of operational gearing showing through.

Cash estimate

AJ Bell does not disclose its net interest receivable, but it has said that a 25bp increase in interest rates would increase revenue and PBT by ca.£2.2m (all other things being equal) and that a 25bp fall would cost £3.9m of revenue and profits. This asymmetry should disappear once rates rise above 100bps, in our view. Once rates get back to, say, 4% or 5%, the net interest margin should, we believe, become fairly constant. These sensitivities happen only near the zero bound mark or when the interbank markets are misbehaving.

Forecasts

To forecast future profits, we have made only a few simplistic assumptions. We have estimated the expected rise in assets for each of AJ Bell Youinvest, AJ Bell Investcentre and the non-platform assets. We have assumed that the revenue per pound of assets remains reasonably consistent with last year (growing slightly in the case of the non-platform assets, as lower-yielding assets shrink, and bouncing 2bps in the case of AJ Bell Youinvest to reflect the recent rise in interest rates). We have assumed that about 40% of the costs are fixed – i.e. independent of the growth in the business but rising at 5% p.a. – and that the balance will grow proportionately with revenues.

We have not made any assumptions about the level of markets – in other words, we assume zero growth in assets from investment returns – nor do we assume interest rate rises.

Asset growth and revenue margin assumptions						
	2016	2017	2018	2019E	2020E	2021E
AuA (£bn)						
AJ Bell Youinvest	4.7	6.6	8.7	10.1	12.1	14.2
AJ Bell Investcentre	18.6	24.4	29.9	33.1	38.1	42.7
Non-platform	8.5	8.9	7.5	6.0	4.8	3.8
Total	**31.8**	**39.8**	**46.0**	**49.2**	**55.0**	**60.7**
Asset growth						
AJ Bell Youinvest	41%	40%	33%	20%	20%	17%
AJ Bell Investcentre	27%	31%	23%	15%	15%	12%
Non-platform	5%	4%	-15%	-20%	-20%	-20%
Total	**22%**	**25%**	**16%**	**7%**	**12%**	**10%**
Revenue (bps)						
AJ Bell Youinvest	36.6	31.5	31.6	33.6	33.4	33.4
AJ Bell Investcentre	20.9	19.8	18.8	18.7	18.7	18.6
Non-platform	19.5	17.6	18.2	20.0	23.0	26.0
Total	**22.6**	**21.1**	**21.0**	**21.8**	**22.3**	**22.5**
Revenue (£m)						
AJ Bell Youinvest	14.4	17.7	24.5	31.6	37.1	43.9
AJ Bell Investcentre	34.2	42.5	50.4	59.0	66.6	74.9
Non-platform	15.8	15.5	14.8	13.5	12.4	11.2
Total	**64.5**	**75.6**	**89.7**	**104.0**	**116.0**	**130.0**

Source: AJ Bell (2016-18) and Hardman and Co Research estimates (2019-21E)

We have assumed AJ Bell Youinvest assets grow at an underlying 20% and AJ Bell Investcentre assets at 15% for each of 2019 and 2020. To reach our "underlying" number, we have assumed that £1.1bn of Investcentre and £0.3bn of Youinvest flows in 2018 were exceptional. There was a surge in transfers out of DB schemes in FY17 and FY18, which we think will ameliorate as the regulator makes it harder for advisers to recommend such transfers.

Investment custody solutions is contained within AJ Bell Investcentre, as it is a platform business used by institutions.

The "non-platform" revenue is primarily AJ Bell Platinum and AJ Bell Media. It also includes the third-party SIPP administration business and an institutional stockbroking business, which is no longer a core focus of the group.

We have assumed that revenue from "non-platform" shrinks at 20% p.a., but that the revenue margin increases as lower-yielding assets leave.

There is an implicit assumption that the new assets arrive evenly throughout the year. There is no particular reason for the rate of asset gathering to slow from the rates seen in previous years, apart from the exceptional inflows mentioned above; it is simply a question of being prudent but not excessively so.

There is little to say about costs. The Tunbridge Wells office was closed during 2018, and the business moved to the Manchester and London offices. The one-off charge was absorbed in operating costs in the FY18 accounts. There is a £1.8m exceptional charge in FY18 relating to the IPO, and that is expected to be repeated in FY19. The IPO costs are not included in the table below but are split out in the income statement.

Otherwise, we expect cost growth to be fairly stable, with inevitable growth attached to the growth in the business, especially within technology and sales & distribution, but with a reasonable proportion fixed (notably in the operational and support segment), and so giving rise to operational gearing adding around 1.5 ppts to the operating margin in the forecast period.

Costs, operational gearing and operating profit						
£m	**2016**	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue	64.5	75.6	89.7	104.0	116.0	130.0
Costs						
Sales & Distribution	-6.6	-7.0	-7.7	-8.9	-9.5	-10.4
Technology	-11.4	-12.7	-15.4	-17.7	-19.5	-22.0
Operational & Support	-29.8	-34.1	-36.6	-40.5	-46.1	-50.6
Total costs	-47.7	-53.8	-59.7	-67.0	-75.1	-83.0
Operating profit	**16.7**	**21.8**	**30.0**	**37.0**	**41.0**	**47.0**
Operating margin	26%	29%	33%	36%	36%	36%

Source: AJ Bell (2016-18) and Hardman and Co Research estimates (2019-21E)

With revenue growing at 10%-14% and costs growing at 8%-11%, we estimate the operating margin to expand steadily, from 33% in FY18 to 36.2% in FY21.

We assume that the company will continue to pay out approximately two-thirds of its earnings as dividends, with 40% of the annual dividend paid at the interim stage.

Balance sheet

AJ Bell has a very strong balance sheet. The company is intrinsically cash-generative, with few capital requirements and no working capital issues. The assets in the business are overwhelmingly cash (£50m as at September 2018) with intangibles making up £6.8m of the £64m of net assets.

The company has regulatory capital requirements, of which the key is the operational risk and which requires the company to be able to run the business for a fixed period with existing resources. The Pillar I capital requirement was £13m in FY18, and was covered by relevant capital resources of £56m, or more than four times cover.

The company, throughout the past eight years and before, has been self-financing, while paying out over half its profits each year in dividends. This, we note, is the clearest demonstration of the financial strength of the business.

Income statement						
Year-end Sep (£m)	**2016**	**2017**	**2018**	**2019E**	**2020E**	**2021E**
Revenue	64.5	75.6	89.7	104.0	116.0	130.0
Admin. expenses	-47.7	-53.8	-59.7	-67.0	-75.1	-83.0
Operating profit	16.7	21.8	30.0	37.0	41.0	47.0
Investment income	0.1	0.0	0.1			
Finance costs	0.0	-0.1	0.0			
PBT	**16.8**	**21.7**	**30.1**	**37.0**	**41.0**	**47.0**
Exceptional IPO costs			-1.8	-1.8		
Tax	-3.5	-4.2	-5.7	-6.7	-7.4	-8.5
Net profit	13.3	17.5	22.6	28.5	33.6	38.6
Minorities	-0.1	-0.1				
Equity holders' interest	13.4	17.6	22.6	28.5	33.6	38.6
No. of shares fully-diluted (m)	394.2	396.0	402.2	408.0	408.0	408.0
EPS (basic, p)	3.4	4.5	5.8	7.0	8.2	9.5
EPS (fully-diluted, p)	3.4	4.4	5.6	7.0	8.2	9.5
EPS (f-d, adj, p)	**3.4**	**4.4**	**6.1**	**7.4**	**8.2**	**9.5**
DPS (p)	2.7	2.9	3.7	4.5	5.4	6.1
Dividend cover (x)	1.3	1.5	1.5	1.5	1.5	1.5
Revenue	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*
Admin. expenses	*-74%*	*-71%*	*-67%*	*-64%*	*-65%*	*-64%*
Operating profit	*26%*	*29%*	*33%*	*36%*	*35%*	*36%*
PBT	*26%*	*29%*	*34%*	*36%*	*35%*	*36%*
Tax rate	*-21%*	*-19%*	*-19%*	*-18%*	*-18%*	*-18%*
Net profit	*21%*	*23%*	*25%*	*27%*	*29%*	*30%*

Source: AJ Bell accounts (2016-18) and Hardman and Co Research estimates (2019-21E)
Excludes the 2.03p special dividend paid in FY18

Balance sheet						
@ 30 Sep (£m)	2016	2017	2018	2019E	2020E	2021E
Goodwill	3.7	3.7	3.7	3.7	3.7	3.7
Other intangibles	5.0	3.8	3.1	1.9	0.7	-0.5
PP&E	1.3	4.0	4.4	4.7	4.9	5.1
Deferred tax	0.0	0.2	0.4	0.4	0.4	0.4
Non-current assets	10.0	11.7	11.6	10.6	9.6	8.6
Trade receivables	17.7	22.2	20.1	23.3	26.0	29.1
Cash	39.5	42.1	49.7	58.5	69.3	81.6
Current assets	57.2	64.3	69.8	81.8	95.3	110.7
Total assets	**67.2**	**76.0**	**81.4**	**92.4**	**104.9**	**119.3**
Trade and other payables	-9.6	-10.1	-11.4	-13.3	-14.8	-16.6
Current tax	-1.7	-1.9	-2.5	-2.5	-2.5	-2.5
Finance leases	-0.1	-0.1	-0.3	-0.3	-0.3	-0.3
Provisions	-0.4	-1.6	-1.3	-1.3	-1.2	-1.2
Total current liabilities	-11.7	-13.6	-15.5	-17.2	-18.8	-20.6
Finance leases	0.0	-0.1	-0.4	-0.4	-0.4	-0.4
Provisions	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Deferred tax						
Other payables	-1.0	-0.2	-0.6	-0.5	-0.4	-0.3
Non-current liabilities	-1.8	-1.0	-1.8	-1.7	-1.6	-1.5
Total liabilities	**-13.5**	**-14.7**	**-17.3**	**-19.0**	**-20.4**	**-22.1**
Net assets	53.8	61.4	64.0	73.4	84.5	97.2
Share capital	0.0	0.0	0.0	0.0	0.0	0.0
Share premium	2.2	2.8	4.4	4.4	4.4	4.4
Other reserves			-1.4	-1.4	-1.4	-1.4
Retained earnings	51.9	58.5	60.9	70.4	81.4	94.2
Equity interests	54.2	61.4	64.0	73.4	84.5	97.2
Minorities	-0.4					
Total equity	**53.8**	**61.4**	**64.0**	**73.4**	**84.5**	**97.2**

Source: AJ Bell accounts (2016-18) and Hardman and Co Research estimates (2019-21E)

Cashflow

Year-end Sep (£m)	2016	2017	2018	2019E	2020E	2021E
Profit	13.4	17.6	22.6	28.5	33.6	38.6
Amortisation & depreciation	2.4	2.1	2.0	2.0	2.0	2.0
Working capital changes	-0.8	-3.9	3.5	-1.4	-1.2	-1.3
Tax expense	3.5	4.2	5.7	6.7	7.4	8.5
Other	0.6	0.6	0.1			
Operational cash	19.1	20.6	33.9	35.8	41.8	47.7
Income taxes	-3.5	-4.1	-5.0	-6.7	-7.4	-8.5
Interest paid	0.0	-0.1	0.0			
Net cash from ops.	**15.6**	**16.4**	**28.8**	**29.1**	**34.4**	**39.2**
Purchase of intangibles	-0.1	0.0	0.0			
Purchase of PP&E	-0.6	-3.5	-1.0	-1.0	-1.0	-1.0
Interest received	0.1	0.0	0.1			
Acquisitions	-0.2					
Net cash from investing	**-0.8**	**-3.5**	**-0.8**	**-1.0**	**-1.0**	**-1.0**
Finance lease payments	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1
Share issues	0.3	0.4	-0.2			
Dividends paid	-11.8	-10.6	-20.1	-19.1	-22.5	-25.8
Net cash from financing	**-11.6**	**-10.3**	**-20.5**	**-19.2**	**-22.6**	**-25.9**
Net increase in cash	3.2	2.6	7.5	8.9	10.8	12.3
Cash at beginning of year	36.3	39.5	42.1	49.7	58.5	69.3
Cash at end of year	**39.5**	**42.1**	**49.7**	**58.5**	**69.3**	**81.6**

Source: AJ Bell accounts (2015-18) and Hardman and Co Research estimates (2019-21E)

Valuation

We have two approaches to valuing the business of AJ Bell.

DCF valuation

The first is a discounted cashflow model (DCF). This takes the forecast cash generated out to 2021, then assumes a period of growth at 13%, falling steadily to 7% between 2022 and 2025, and then finally assumes nominal growth of 4% in perpetuity.

The discount rates we use are 8%-10%. This is a business wholly funded by equity, and the cost of equity is equivalent to the expected returns investors in that equity would expect to receive. We rarely use a cost of equity of less than 10%, and would use higher rates if the business were particularly volatile or unforecastable.

In AJ Bell's case, while there is an element of volatility associated with market returns, and some unpredictability linked to government tax and savings policy, the main business produces very predictable cashflows from the charges it levies on its very sticky assets.

There is very little capex requirement, and it is generally below the depreciation and amortisation charge. There was, however, a one-off higher cost in 2017 associated with moving into the new building. We are happy to use net profits as a reasonable proxy for cashflows.

DCF calculation

£m	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E	2026E
Net profit	22.6	28.5	33.6	38.6	43.6	48.4	52.7	56.4	58.7
Growth	30%	26%	18%	15%	13%	11%	9%	7%	4%
Discount factor		1.0	1.1	1.2	1.3	1.4	1.6	1.7	1.9
Discounted cash		28.0	30.3	31.9	33.1	33.7	33.7	33.1	31.6

Sum	£m	per share (p)
2019-21	90	22
2022-25	134	33
2025+	688	169
Total	912	224

Source: Hardman & Co Research

Our central valuation thus emerges at £912m, or 224p per share. Using a discount rate of 8% raises the business value to £1,142m or 281p and using 10% reduces it to £759m (187p). In the table below, we have also shown the impact on the valuation of varying the growth rate between 2022 and 2025.

DCF sensitivity table

	Steady growth rate between 2022 and 2025					Variable growth
Discount rate	7%	9%	11%	13%	15%	13% falling to 7%
8%	1,035	1,104	1,176	1,253	1,333	1,142
9%	829	882	938	997	1,060	912
10%	692	735	780	828	878	759

Source: Hardman & Co Research

We have used a range of steady-state growth rates for the 2022-25 period. The 11% rate is very close to the 13% – declining to 7% – rate that we have used as our central assumption.

We have *not* added back AJ Bell's cash pile, as we see holding significant net cash as a part of the business to help maintain confidence with its customers.

Comparable companies valuation

The second approach is to consider how comparable companies are valued. The two most suitable comparisons are HL and Transact. The former has been listed for more than 10 years and the latter for about a year. The former is a D2C-only business and the latter is a platform serving advisers. Both are highly-rated stocks.

We look at PER ratios, which we have adjusted in HL's case to match AJ Bell's September year-end. The data are consensus forecast data and come from Reuters. There is no added value in looking at EV/EBITDA ratios, as all three companies have similar balance sheet structures (i.e. significant net cash) and the depreciation and amortisation charges are very modest – so net income gives a fair comparison.

Comparable company valuation

	Price (p)	Sep'18	Sep'19E	Sep'20E
Hargreaves Lansdown EPS (p)		50.9	55.1	61.5
Transact EPS (p)		10.7	11.5	13.2
Hargreaves Lansdown (growth)		11%	8%	12%
Transact (growth)		19%	7%	15%
Hargreaves Lansdown (PER multiple)	1,812	35.6x	32.9x	29.5x
Transact (PER multiple)	317	29.5x	27.6x	24.1x
AJ Bell net income (£m)		22.6	28.5	33.6
AJ Bell growth		29%	26%	18%
AJ Bell valuation on HL multiple (£m)		806	938	989
AJ Bell valuation on Transact multiple (£m)		668	787	808

Source: Hardman & Co Research and Reuters consensus estimates; prices from 16 January 2019

Here, if we apply the different multiples to AJ Bell's forecasts for Sep'19, we arrive at a market value of £787m to £938m and, for Sep'20, that rises to £808m to £989m.

The market values HL highly – not least, in our view, because of its record of delivering very consistent results throughout all market conditions. It also seems to value the D2C business slightly higher than the adviser business in which Transact is engaged. AJ Bell does both, and so might expect to be valued somewhere in between the two, but it is also forecast to grow earnings substantially faster than both of them, and so could be expected to attract a premium.

One of the attractions of using comparable company valuations is that the market prices should discount everything the market knows and expects about future threats and opportunities for the business segment. The disadvantage is that, however similar the businesses are, there will always be differences, and the market may attach significance to some of these.

Risk section

In addition to all the normal risks associated with running a business, including competitive activity, there are several specific risks worth pointing out.

Market risk

AJ Bell's revenues are largely a function of the level of assets on its platform. The value of the assets will fluctuate with market movements, which are inherently unpredictable. Some revenues are also derived from trading activity, which is impacted by, among other things, investor sentiment, which is also unpredictable. As discussed above, AJ Bell makes money from the spread on interest rates it receives, and pays to clients. This spread is partly a function of the level of interest rates. If savings rates were to fall further, (although this is highly unlikely, in our view, as they are already close to the zero bound), then this source of revenue would be squeezed.

Technology risk

At the core of AJ Bell's business is its platform and the technology on which it runs. Any disruption to this technology could result in significant damage to the business: clients could lose confidence in the platform, and they could be sufficiently disappointed, so that they might move their business elsewhere.

Technology is continually evolving, and the company needs to ensure that it is constantly improving its systems so as to be able to compete effectively.

Regulatory risk

Much consumer and adviser behaviour is determined by the rules governing savings and, in particular, by the tax regime. Both regulation and tax are subject to constant change, and either or both may make it harder for AJ Bell to continue to thrive. In general, the government tends to encourage savings, but the precise details matter and can have a direct impact on savers' actions. In particular, we believe the current ISA regime is very generous to the richest layers of UK society, and may prove vulnerable to a more left-leaning administration.

There is also an ongoing review of the platform market being carried out by the FCA. It is currently surveying the industry; it reported its interim findings this summer; and will issue its final report in 1Q'19. Its two chief concerns – the problems of shopping around and the difficulties of switching – we do not see as threats to AJ Bell's business. Indeed, it could be a beneficiary of these, as it has been a consistent net receiver of transfers and its fees are generally lower than those of its competitors – so greater transparency will help its proposition in the market place.

It is subject to formal capital requirements, which may change, but its headroom is so great that we do not see this as a significant issue.

Overall

It would be foolish to dismiss any of these risks but, overall, we do not view AJ Bell's business as especially risky. Whatever changes there are to market levels or tax rules, people still need to save for future requirements, and that is not going to change. Adverse changes may knock profits in the short term but will not, in our view, undermine the fundamental investment case. The technology issues are critical but appear to be well understood within the business and well under control.

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