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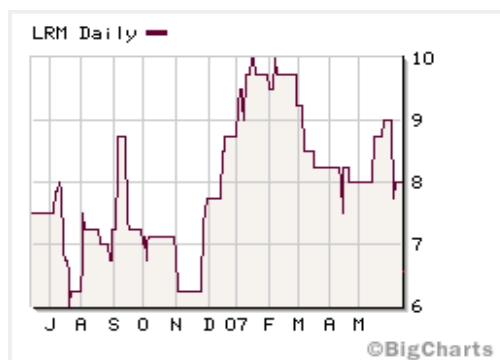
Lombard Risk Management

8.38p 12 June 2007

Timing Issues Impact Growth

We are reducing our 2007 revenue estimate slightly as although the pipeline remains very strong and LRM continues to win orders, implementation delays on two contracts won during the year make it almost certain that the company will be unable to book all revenues from these contracts this financial year, as had earlier been expected. Other business has not exceeded forecasts to make up this slippage. The current forecast of £6.9m revenue still represents a very significant increase on 2006 and an excellent performance from all the major businesses (Colline, Oberon and STB).

- We understand that the contracts are continuing, but that go-live will be delayed owing to issues with the customers' systems, and to delays in finalizing South African regulatory requirements which has held up a large project. The delays appear largely not to have been within LRM's control.
- We expect most of the remaining revenues from these contracts to fall into the next financial year and have, accordingly, raised our revenue forecast for that year to include these revenues and reflect further progress in contracts.
- LRM is still talking to potential investors in the Independent Valuation service, but it was not sold last financial year. The company will therefore take a loss of £1.1m from this source. We exclude this from adjusted profit and EPS since this business remains likely to be spun off – it is only the timing which differs.
- LRM will also have to take a writeoff on its stake in IDOX. At current market prices this is about £0.16m negative. We exclude it from our adjusted profit and EPS figures.
- The investment in building up capacity in Shanghai appears to have worked well and costs are now falling in London.
- We still expect the company to make a profit next year. The shares continue to be cheaply rated compared to the sector, on a PER of just under 8 for FY 2008.



Share Price: 8.38p

12m High: 10.25p

12m Low: 5.75p

Market Cap: £11.3m

Shares in Issue: 134.7m

NAV/Share: 2.2p

Gearing: cash

Interest Cover: -

EPIC Code: LRM

Sector: Software and computer services

Market: London AIM

Nominated Advisor and Broker: Noble Group

Website: www.lombardrisk.com

Previous Research Note: 14 December 2006, 'Gaining Traction', 8.5p

Analyst: Andrea Kirkby

Y/E	Sales	Declared	Adjusted	Adjusted	P/e ratio	Divi p.	Yield
March	£m	Profit £m	Profit £m	Eps p.			%
2005	4.6	-1.1	-1.2	-1.1	-	0	0
2006	4.7	3.2	-2.7	-2.2	-	0	0
2007e	6.9	-2.3	-0.7	-0.6	-	0	0
2008e*	10.5	1.0	1.5	1.1	7.9	0	0

*assuming no disposal of IVRS

Our forecast for this year is affected partly by the late completion of software contracts. Some of the revenue will still be taken to the books since it represents contracting revenue, booked on a time and materials basis. However the element of contract value that relates to the software licence cannot be taken until the contracts have gone live and been accepted by the customer. Thus we estimate some £500k of revenue which would otherwise have been booked this year will be taken in the 2008 financial year, probably in the first half.

This means that instead of breaking even, the software business will make a £700k loss this year. This includes £330k of one-off Shanghai start-up costs incurred in the first half of the year.

The other changes to forecast only affect the declared pretax number; we have excluded them from the adjusted profit and EPS figures.

First, there will be a writedown on the cost of LRM's remaining stake in IDOX. This was sold in May 2007 at 7.5p, and we are assuming that LRM will take the write-down in the 2007 numbers. This writedown will be about £160k, although LRM's profit on IDOX overall will have been about £3m on a £1m investment between 1994 and 2000.

Secondly, because no deal to spin off IVRS (Independent Valuation and Risk Services) has been concluded, its losses for the year will be consolidated. The business is estimated to lose £1.1m this year. However in revenue terms it has performed well, building its revenues quarter on quarter. It has been particularly successful at moving into the valuation of structured credit derivatives – a slight move away from the original business model but which has delivered real benefits.

We therefore arrive at a declared pretax loss this year of £2.3m, but an adjusted loss of only £0.7m (compared with our earlier forecast of breakeven).

For next year, we are assuming that IVRS will not be spun off, but that costs will be very much reduced. We have pencilled in a loss of £0.5m. This is a long way more conservative than management's stated intention to finalise a spin-off deal by July 2007. Discussions are ongoing with several different potential partners for the business,

all of whom are highly rated businesses in financial services or information services and would bring gravitas as well as money to the table.

If the business is indeed spun off by the end of July, the attributable loss from IVRS would be much lower, probably about £200k. It would be matched by a possible extraordinary profit on the spin-off. We would then be able to upgrade our forecast.

The downgrade of our assumptions on software in FY 2007 is purely due to timing issues. This doesn't mean that LRM is doing poorly in sales terms – quite the opposite as we expect the Lombard Risk Systems part of the business (Oberon and Colline) to show sales growth of over 50% in the 2007 financial year. There was a risk that LRM could become resource constrained, particularly in its STB-Reporter business, but we understand that the company has now hired new staff to deal with the demand that is coming through as banks finalise their preparations for the introduction of Basel 2.

Valuation

At the current share price LRM is valued at 7.9 times our forecast of 2008 earnings. This compares with valuations in the high teens in the finance software sector as a whole.

Several companies in the sector have done very well recently. For instance *Patsystems* has broken into profit and has seen the shares run up from 15p to well over 20p over the past year. First Derivatives has seen its shares increase from only just over £1 to 343p in the same period as the result of good newsflow.

First Derivatives is now trading on 20x 2008 estimates (its year end is February so this is directly comparable to the LRM 2008 FY figure). *Patsystems* is trading on 11.7 times earnings to December 2008.

LRM still has a little way to go but if management is successful in taking the company into profit next financial year, a similar rerating should be on the cards. While the shortfall this year is a setback, we believe the company's increasing pipeline, and its cost reduction through investment in Shanghai, put it in a good position to achieve its targets.

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