

# Hardman & Co

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## Lombard Risk Management 8.5p 14 December 2006 Gaining Traction



These results demonstrate LRM is gaining traction with its products. 13 new contracts in the first half year allowed the company to increase its revenues significantly with particularly high growth in its risk management business. If similar levels of new business are enjoyed in the second half, the company should be on track to meet our forecast.

- Colline, the collateral management system, has done exceptionally well with a 57% increase in revenues and 8 deals in the first seven months of the year. It enjoys a high win rate and is attracting industry attention.
- STB's recurring revenues are now higher than ValuSpread's were, and the total group recurring revenues of over £4m annualised underpin our profit forecast.
- Costs increased during the period owing to two main factors – firstly, start up costs of the Shanghai operation, and secondly, the £590k cost of the independent valuation business. We expect the latter to be spun out and the company is already negotiating with a number of potential partners.
- With a PER for 2008 of 7.7x, the stock remains very modestly valued compared to the sector. While there is still some execution risk, the way that both STB and Colline have gained since the end of last financial year suggest the company is on the brink of real profitability. With the sector trading on high teens multiples there is room for significant rerating.

**Share Price:** 8.5p

**12m High:** 9.75p

**12m Low:** 5.75p

**Market Cap:** £11.8m

**Shares in Issue:** 135m

**NAV/Share:** 2.2p

**Gearing:** cash

**Interest Cover:** -

**EPIC Code:** LRM

**Sector:** Software and computer services

**Market:** AIM

**Nominated Advisor and Broker:**  
Noble Group

**Website:** [www.lombardrisk.com](http://www.lombardrisk.com)

**Previous Research Note:**  
'A Year of Change' 5 July 2006,  
7.75p.

**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	Neg	0	0
2006	4.7	3.2	-2.7	-2.2	neg	0	0
2007	7.6	0.0	0.1	0.1	141.1	0	0
2008	9.6	1.4	1.6	1.1	7.7	0.1	1.2

## Strong Revenue Growth

LRM is increasing its revenues strongly. Its regulatory reporting business, STB, saw 23% growth in the half year, though management expects this to pick up in the second half. Meanwhile the risk management business grew even faster, at 57% year-on-year, with 8 new deals for the Colline collateral management software. Colline is enjoying a high win rate and has gained a number of excellent reference sites.

Oberon made two contract wins in the period. It is the company's cash cow, generating cash which can be invested into other areas of the business. It has been further developed in the period, using the Shanghai resource to do so at low cost, and is becoming an open system. We consider that extremely important to secure its future, as bespoke legacy systems fall out of favour.

A number of the 13 major new deals (ie, over £100k in value) have not yet produced significant revenues – we expect the benefit to come through in the second half of the year. Basel II requirements are certainly helping as banks need more sophisticated collateral management systems.

LRM management states that the software business is now operating around breakeven. Taking the half year EBITA loss of £1.015m, we can analyse it as follows:

	£k
EBITA loss as shown	1,015
Start up costs of Shanghai operation	330
Losses in the independent valuation business	590
Loss on recurring basis	95

The operation in Shanghai now employs 28 staff (compared to 107 staff in the entire group in March 2006). During the first half, costs were duplicated as Shanghai was built up, but costs have now been trimmed in London. This should benefit H2.

Management intends to spin off the independent valuation business, and discussions are under way with a number of potential partners. The company's

results would have been more than half a million pounds better if it had not continued to invest in this business. However, we believe that value can be created for shareholders through a partial sale or a joint venture. LRM management has a good track record of building and achieving a good price for spin-off businesses (IDOX, ValuSpread). However we cannot yet forecast how this will affect the numbers for the year.

Excluding these two cost areas, then it appears the company is close to breakeven. Annualised recurring income is now over £4m, representing over 50% of our turnover forecast for the year and providing good underpinning to our forecasts. STB, the regulatory reporting business, is now providing higher levels of recurring revenue than ValuSpread did before it was disposed of – excellent progress. Even without winning any new business, management expects the company to generate revenues of £6.7m, against our forecast of £7.6m.

We believe the main area of risk to our forecasts is cost, rather than revenue, and this depends very much on what is done with the independent valuation business. LRM appears to be making good progress in cutting duplicate costs, and the Shanghai venture should allow the company to expand its activities at a lower incremental cost. The independent valuation business is now the main loss maker with the other businesses trading close to or better than breakeven. This will be the main swing factor in H2.

LRM's cash flow was £1.17m negative this period. However £454k of this was due to an increase in debtors owing to the new deals signed. This contrasts with a decline in debtors for both periods last year. The independent valuation business is also responsible for £590k of the net loss, so we would strip that out on a recurring basis.

In fact, stripping out the disposal of ValuSpread from last H1's cash flow, we believe LRM used nearly £1.3m of cash, so this period's performance represents an improvement despite the increase in debtors. H2 should prove cash positive.

The company retains £0.9m of net cash (£1.1m gross) in the balance sheet.

We retain our forecasts for the year unchanged at the present time.

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