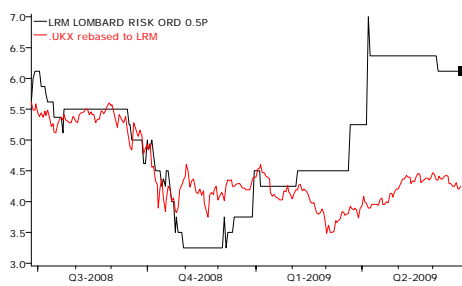


**Lombard Risk Management** 6.125p  
Visit and Update

26 June 2009

**Share Price: 6.125p**



**12m High:** 7p

**12m Low:** 3.25p

**Market Cap:** £8.3m

**Shares In Issue:** 136m

**NAV/Share:** 0.4p including intangibles, nil ex intangibles.

**Gearing:** No bank debt, but £1.3m of loans from directors

**Interest Cover:** -

**EPIC Code:** LRM

**Sector:** Software & Computer Services

**Market:** London AIM

**Broker:** Noble Group +44 (0)20 7763 2200

**PR:** Broker Profile +44 (0)20 7448 3244

**Website:** www.lombardrisk.com

**Description:** LRM provides financial software systems targeted at the banking and fund management sector, focused on collateral management and regulatory reporting.

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**Email:** research@hardmanandco.com

Following encouraging news from two other UK quoted companies in the same business space, we have visited Lombard Risk Management. The company is in close period so we did not discuss the forthcoming results for y/e March 2009, and we have not changed the estimates we issued in December 2008. Key points are:

- Results are likely to be announced at end-July or early August, which is earlier than the previous year. No date has been finalised yet, however, and there can be no guarantee that the release date will not slip again as it did last year.
- The contract announced in April with 'a Top Tier Continental European bank' is likely to produce revenue of £1.2m, possibly more, in the first year and is accompanied by a maintenance contract worth c.£0.2m/year.
- Some of the revenue from this contract, we believe about £0.4m, will be recognised in the accounts to y/e March 2009.
- Three other major contracts, two with other leading European banks, the third with a major US bank, are at an advanced stage of negotiation. The pipeline for the collateral management software product COLLINE has risen sharply in the last few months.
- Short term cash is still tight. While there is no debt, there are directors' loans of £1.3m. An equity capital raising, and/or the conversion of some directors' loans into shares, would be beneficial. Either way, that would mean dilution for existing shareholders.
- The move from 'light touch' to 'heavy touch' regulation worldwide, and specifically the new FSA rules on bank liquidity reporting and liquidity stress testing, have created an encouraging trading environment for Lombard Risk which is the leading player in the UK bank regulatory reporting market.
- c. 45% of revenue in the new current financial year will be recurring revenue.

On a Sales/Enterprise Value basis, Lombard Risk Management is less highly rated than its two closest UK quoted comparators, **Ffastfill** and **Statpro** (neither of these competes with Lombard Risk).

| Y/E   | Group Sales | Declared Profit | Adjusted Profit | Adjusted EPS | P/E ratio | Divi | Yield |
|-------|-------------|-----------------|-----------------|--------------|-----------|------|-------|
| March | £m          | £m              | £m              | p.           |           | p.   | %     |
| 2007A | 6.9         | -1.3            | -1.3            | -1.0         | -         | -    | -     |
| 2008A | 8.5         | -1.1            | -1.1            | -0.7         | -         | -    | -     |
| 2009E | 8.7         | -1.0            | -1.0            | -0.7         | -         | -    | -     |
| 2010E | 10.0        | 0.75            | 0.75            | 0.5          | 12.2      | -    | -     |

## Lombard Risk Management

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Despite the severe banking downturn, the international banking community's spend on software has been relatively buoyant, particularly in those areas that help improve the bank in the current environment or help the bank comply with increasingly onerous regulatory requirements. Examples of the latter are the requirements of the Basel II legislation which was implemented in the UK in 2008 and more recently because regulatory organisations worldwide have moved into 'heavy touch' rather than 'light touch' regulation following the 2008 banking crisis. While the 2008 financial collapse reduced the number of banks worldwide that are potential customers for this software, it highlighted the urgent need for improved systems and tighter internal controls.

While we have not seen any reliable industry figures for the annual spend on software by the banking community internationally, there are indications that the trading background is beneficial. The sole exception is for those software houses affected by the forced banking mergers (e.g. the Lloyds takeover of HBOS) or those banks that have collapsed (e.g. Lehman Bros, the Icelandic banks). The industry is also being aided by a trend for regulatory reporting and risk management to be closely integrated by banks and regulators rather than be treated as separate areas.

Much banking industry software is supplied by major international organisations servicing many other industries (such as **Oracle**, **Infosys**) or private companies (such as **Fitch** (owned by quoted Fimalac) and **FRS Global**). Among specialist providers, however, the trading news has been good. Last month **Ffastfill** reported its first ever trading profit. Two months previously **Statpro** reported its second highest ever profit, record sales revenue and free cash flow, and a 40% increase in annualised contracted recurring revenue.

## Lombard Risk – The Position of its Products

Lombard has three key product offerings for the banking/fund management community. These are Colline, Oberon and STB-Reporter.

**Collateral Management.** The Colline® product is the flagship Lombard Risk product, and services the collateral management needs of banks. Colline is a relatively young product, and appears to be making a significant impact. The winning of the order from the 'Top Tier Continental European bank' in April (the bank is German) will we estimate have an upfront value of £1.2m - £1.4m, plus an annual maintenance income of £0.2m/year. This will consist of £0.7m of licence fees, £0.02m of consulting revenue for approximately ten months, and £0.3m for software development especially commissioned by the client. It is possible that the eventual spend on software development could amount to as much as £0.5m, making the total upfront value of the contract £1.4m.

Having a reference contract of this nature is aiding Lombard Risk in its sales to other large banks. Three other contracts are at an advanced stage of negotiation. Two further top tier North European banks are currently engaged in negotiations with Lombard Risk. Also, Lombard Risk is on a short list of two for a major US banking organisation.

Other, smaller Colline contracts are also being signed. One of these is a €0.2m contract for a South European bank. Other imminent prospects include two more US based financial organisations. Management tell us that the overall sales pipeline for Colline is appreciably higher than even 6 months ago.

**Financial Instrument Valuation and Risk.** Oberon® is Lombard Risk's legacy system and Lombard Risk also has a more modern product called Firmament®. We had expected revenues from Oberon to be tailing off by now. In fact Oberon appears to be holding up well. What it does (valuation of financial instruments and related risk measures like VaR) is still highly relevant and we expect that Lombard Risk will re-use some of its software components in its newer offerings where risk and regulatory markets converge.

**'Colline® is making a significant impact'**

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**Regulatory Reporting and Liquidity.** Lombard Risk Compliance is Lombard Risk's regulatory reporting business. Its main product is called STB-Reporter (STB is the historic name of Lombard Risk Compliance pre-acquisition). Lombard Risk's management views the regulatory reporting sector as a 'huge opportunity'. In the middle years of the decade it signed good contracts that were under-priced, and losses on these have held back group performance. The company had previously stated that 65% of the impact of these loss-making contracts had been taken at the interim stage (September 2008). We believe that there will still be some losses from the conclusion of these contracts in the year to March 2010, but hopefully they should be relatively minor. In other respects Lombard Risk Compliance appears to be making progress, with some successes in the Far East, including a £0.3m contract for the Asian operations of a major North European bank. However, Lombard Risk has yet to make the hoped for breakthrough in China with its regulatory reporting, although a number of opportunities are being followed.

Apart from Colline described above, the biggest opportunity for Lombard Risk this year is expected to come from the initiatives by the FSA and other regulators in the liquidity reporting area as part of the move from Light Touch to Heavy Touch regulation. As the market leader in FSA bank reporting with around 140 customers, Lombard Risk expects this to be an appreciable source of revenue over the next 18 months - much of which will be recognized in the current financial year.

## Software Development

The technology has been appreciable enhanced, with an improved interface available and much better scalability built into the latest versions of the software. Lombard Risk does not capitalise its software development expenditure – it is all expensed in full through the p & l account, and some is charged to clients. The £3.6m of intangible assets in the balance-sheet all relates to goodwill on the acquisition of the STB group of companies in 2005. An impairment charge on these is possible for the March 2009 financial year, but management regard this as highly unlikely.

**'Recurring revenue is 40 – 50% of the total and has potential to increase'**

## Recurring Revenue

Lombard Risk Management currently has recurring revenue, mainly from software maintenance contracts, of c. £4.4m. This amounts to 40-50% of revenue, which we last estimated to be c. £8.7m. in y/e March 2009, c. £10m for y/e March 2010. Management feels that there is potential to significantly increase this, particularly on the regulatory reporting side.

## Balance Sheet

The end-September 2008 Interim Accounts showed £1.3m of loans to Lombard Risk by directors, bearing an interest rate of 1% per month. There was no bank debt, and £0.1m of cash in hand, for net debt of £0.8m. Total equity, including goodwill, amounted to £1.3m so balance sheet gearing was 92%. This was a noticeable deterioration over the previous six months. Stripping out goodwill, Lombard Risk's balance sheet showed negative net worth. (although it should be noted that IP assets are in the balance sheet at zero)

Working capital has been a constant issue for this company. Trade and other payables, excluding directors' loans, were running at 14 weeks' sales revenue at the interim stage. To put this in context, receivables from the international banking customers were running at an even higher figure. Another key item in the balance sheet is deferred income, which was £2.3m at end-September 2008, but had reduced over the previous six months as customers paid less up-front on new contracts. This reduction in deferred income was at least partly responsible for the cash squeeze.

## Lombard Risk Management

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CEO John Wisbey also points out that the group has a successful record for selling businesses (e.g. IDOX plc floated and ValuSpread sold to Fitch), and that he regularly has conversations with firms interested in buying one of the group's businesses. He stresses however that no such disposal is being planned at present.

### Possible Capital Raising?

Lombard Risk's balance sheet may be stronger than it looks at first sight, because the £1.3m of directors' loans cannot be withdrawn on demand. From the company's point of view it would be desirable to strengthen the balance sheet, however, for three reasons. First a stronger balance sheet would help Lombard Risk's sales pitch to potential new customers. Second, it would aid Lombard Risk's profits and cash flow considerably to be rid of the very heavy interest charges involved. Third this, together with the expected profitability in the year to March 2010, would improve the wording of the audit report for y/e March 2010. The balance sheet could be strengthened by a conversion of part of the directors' loans into equity, or a conventional placing with institutional and private client stockbroker sources, ideally both. It would strengthen Lombard Risk's case for additional capital if the directors were seen to be converting some of their loan into risk capital rather than merely using institutional money to reduce their lending to the business.

Lombard Risk's management will say no more than that the matter is always under consideration. Lombard Risk's NOMAD and broker, Noble Group, has successfully raised funds on a number of secondary issues in 2009.

Lombard Risk's largest shareholder is chief executive John Wisbey, with 60% of the equity.

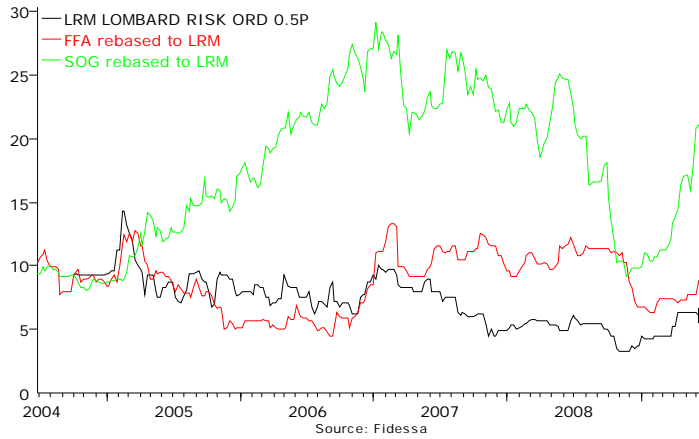
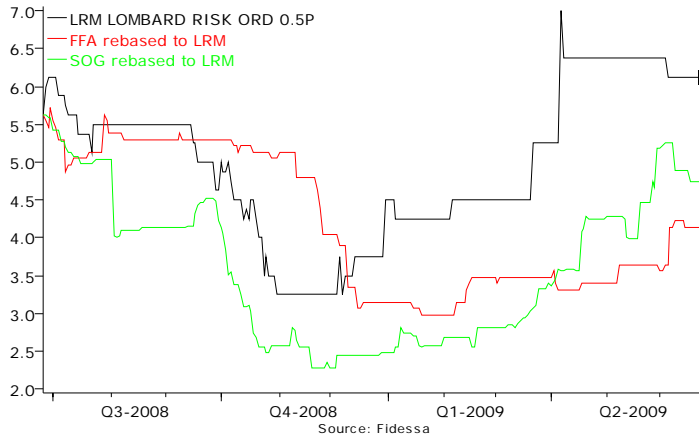
### Valuation

Lombard Risk Management's Enterprise Value is currently 1.0X sales revenue, compared to 2.2X for **Statpro (SOG)** and 1.6X for **Ffastfill (FFA)**. Lombard Risk Management is smaller than the other two companies by some way – SOG has a market cap of £43m and Ffastfill of £25m, compared to Lombard Risk's £8m.

**'Valued at  
1.0X sales  
revenue'**

Lombard Risk Management

26 June 2009



*On a one year view, Lombard Risk Management shares have outperformed those of Fastfill and Statpro. On a five year view, however, Statpro has been far the best performer, and Fastfill shares have also performed slightly better than those of Lombard Risk Management.*

**Lombard Risk  
Management**

26 June 2009

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