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Lombard Risk Management 9.25p Moving The Product Forward

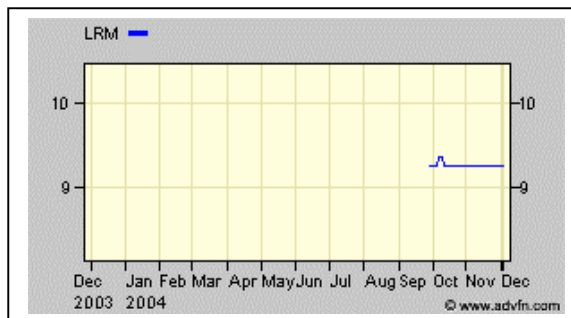
3.12.2004

LRM's first set of interims as a quoted company demonstrate that it has kept its costs well under control - rather better than we had forecast in fact - and has successfully developed its Firmament product and gained early sales of new functional modules. This is impressive given that it was achieved despite a slightly lighter than expected revenue number. We believe the company is moving along the right lines in building up its product base, with customers now supporting substantial elements of its R&D.

Putnam Lovell has recently invested £1.1m in LRM. Putnam Lovell, a subsidiary of National Bank of Canada, and a well regarded investment bank, has invested in the financial software field before - it publishes FinTech Universe, a monthly report on the sector, and it has in the last few months invested in Derivative Portfolio Management, a hedge fund administrator. As an expert in the hedge fund and technology sectors, the Putnam Lovell investment is a great vote of confidence in the company and its products and services.

The IPO took three months longer than expected to achieve and therefore delayed the application of these new funds to the business for several months. Now that funding has been raised, although it was lower than expected, we expect to see a more active sales programme and the positive impact of the appointment of a new Director of Sales.

We are slightly lowering our forecasts for the full year and 2006 following this announcement, to reflect the delayed ►



Share Price: 9.25p

12m High: 9.5p

12m Low: 8p

Market Cap: £10.7m

Shares in Issue: 115.9m

NAV/Share: 2.6p forecast

Gearing: Nil. (Net cash)

Interest Cover: -

EPIC Code: LRM

ISIN No: GB00B030JP46

Sector: Software and computer services

Market: AIM

PR: -

Website: www.lombardrisk.com

Previous research note: 14.6.2004, 'New Issue in the Software Banking Market'

Analyst: Andrea Kirkby

Y/E	Sales	Declared	Adjusted	Adjusted	P/e ratio	Dividend p	Yield
March	£m	Profit £m	Profit £m	EPS p.			%
2003A	4.5	-3.0	-3.1	-3.8	-	0	0
2004A	4.5	-1.2	-1.2	-1.0	-	0	0
2005E	5.0	-0.5	-0.5	-0.3	-	0	0
2006E	6.6	0.4	0.4	0.6	15.5	0	0
2007E	9.1	2.0	2.0	2.0	4.7	0	0

Adjusted Profit and EPS exclude Exceptionals and Goodwill Amortisation, and are before Tax and R & D Tax Credits.

◀ application of the IPO and Putnam Lovell funding but leaving the 2007 figures unchanged. This puts the company on just over 2x forecast sales taking into account the new Putnam Lovell shares, and gives it a PER of 15.5x for the year further out (FYE March 2006).

Results

We believe that the company's financial numbers are not as important as the development of the pipeline and products at this stage, as Lombard transitions from its older Oberon software to the new Firmament product suite.

The figures are largely in line with forecasts. Revenue came in a little lighter than we had expected, but we believe the protracted flotation process, and the subsequent delayed application of funds, which were also slightly lower than expected, impacted the performance of the business. Importantly the revenue profile showed a broader base in terms of license revenue than the same period last year. A new Director of Sales has now joined the company, and the pipeline is stated to have built up well. As a result H2 should show growth in revenues over both the first half of the year and H2 last year. Gross margins were maintained at above 95%.

On the cost side of the equation we are feeling quite happy - costs have been well contained, and have come in some way below our forecast. LRM states that it aims to achieve 'regular monthly profitability' within twelve months and we believe this should be attainable on the current cost base. As LRM fully expends its R&D expenditure as it is incurred, the impact of increased revenue is significant as it flows straight to the bottom line.

Indeed two areas of the company - the ValuSpread pricing service and Oberon software - are already profitable. This implies that the losses are attributable to the R&D spend on the newer Firmament product. As we stressed in our previous note, if LRM had taken the decision to stop R&D during the software recession, it could easily have been profitable, though possibly at the cost of its long-term future.

More important for us than the raw numbers is the development of the product base, and there is good news to report here. The Firmament equity module, which was still in development over the summer, has now been released and its first implementation has

been carried out. There is a useful pipeline for the credit trading module, the collateral management module is finished, and fixed income should follow later this year. All of this is on target and some of the development is now being carried out in strategic partnerships with customers.

ValuSpread, the pricing service, has seen an increase in the data volume it handles. It is now working on a daily basis whereas previously pricing has been carried out weekly. This is a key source of recurring income for the group. The company is now developing the service, by combining the ValuSpread credit derivative data with their Firmament software to offer a compliance product for independent valuation of bond and derivatives portfolios. With the increased focus (and spend) on compliance issues, we believe this has the potential to create an interesting upside to our forecasts.

The company has not yet claimed R&D tax credits for the year ended Mar 2004, nor are any accrued for the current year, although it has received refunds for the previous three years. We are estimating that £240k will be recovered with respect to Y/E 2004 and credited to the P&L in this financial year.

New investor

Investment bank Putnam Lovell has taken a stake of just over 10% in LRM, investing £1.1m in the company. Together with the proceeds of the AIM placing in September, this gives the company a solid balance sheet, with over £1.2m in cash and current investments. It is worth noting that Putnam Lovell has come in at a higher price than the original float (9p, against an 8p introduction price) - not always the case with such placings.

The investment in Lombard Risk Management is the second strategic initiative made by Putnam Lovell NBF in the last twelve months in the alternatives investment arena. In December 2003, Putnam invested in Derivative Portfolio Management, LLC (DPM), one of the world's largest independent fund administrators specializing in alternative investments including hedge funds.

Putnam Lovell has a good reputation and substantial knowledge and expertise in the financial technology and hedge fund sectors, so we regard this as a very positive endorsement of LRM and validation of its credentials.

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