Lombard Risk Management Plc

Sales Desk Note

29 October 2015

HYBRIDAN

Sea & C-Level Change at Lombard Risk

At the interims (H1 to Sept 2015), Lombard Risk Management (Lombard) reported a pre-tax loss of £1.8m (vs. profit £10k H1 2014). The loss was attributed to functional changes in the business. The Company is currently undergoing a major re-structuring of personnel and business focus, and the process is perhaps only halfway through to completion. Consequently the numbers will continue to look grim for the full year to March 2016, but – we would argue - this is what is creating an opportunity for investors. There is a great underlying business at Lombard, and a huge and needy customer market for their products.

- **Restructuring in Transition**
- **Strong Product in Strong Market**
- **Refocused Sales & Marketing Strategy**
- **Recurring Revenues**
- **Sticky Customers**

On 19 May 2015, Mr John Wisbey announced his intended resignation as CEO, but continued as a NED. (Mr Wisbey has since resigned as a NED in August but still retains 33% of the shares). In consequence Philip Crawford migrated from Non-exec Chair to Exec Chair.

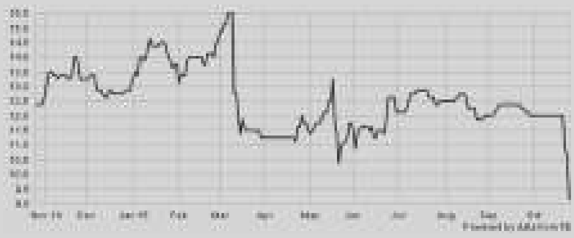
While the Group continues to seek a new CEO, Mr. Crawford is enjoying the challenge of running the Company, which he notes is relatively straightforward as they already have the products that are needed by the customers and they are very good products. So it is all about getting them marketed, sold and delivered. The interim executive team has elected to focus on the products where the revenues are available now, and they have written off some of the non-core projects that the Company was previously working on.

For disclosures, refer to the Disclosure Section

Key Statistics

Code	: LRM
Listing	: AIM
Sector	: Software & Computer Services
Market Cap	: £28.10m
Share in issue	: 304.26m
Current Price	: 9.49p
12 month High/Low:	: 15.80p/8.51p

Stock Performance



Source: InvestEgate

Financials

£'m	2015 A	2014A	2013A	2012A
Revenue	21.49	20.40	16.77	12.76
PBT	2.26	4.42	3.90	2.49
Profit	2.25	5.15	3.71	2.47

Source: Lombard Risk Management Annual results

Company description

Lombard Risk Management plc is a holding company. The Company is a technology company with a focus on collateral management, regulation and compliance. It operates in two segments: Regulatory Compliance software, and Risk Management and Trading software. Regulatory Compliance software is for regulatory, anti-money laundering and compliance systems to financial markets. Risk Management and Trading software provides trading, valuation and risk management systems to the financial markets.

HYBRIDAN LLP
20 Ironmonger Lane, London, EC2V 8EP
Website: www.hybridan.com

William Lynne
Tel: 020 3764 2342
Email: william.lynne@hybridan.com

The sales & marketing team has been overhauled and also has a new leader, Kieran Lees, who has a strong track record of leading significant revenue growth in a range of corporations such as **Oracle, Sun Microsystems, NCR** and **Computacenter** as well as smaller organisations.

The wider customer facing team has been bolstered and re-trained, and already the order book is beginning to grow, though as they are selling a five year term licence and the revenues are spread over that period, it will take time for these to flow through to the P&L.

Additionally they have strengthened the board with two new NEDs who are names that the customers will know and respect: John McCormick formerly Chairman and CEO of the Royal Bank of Scotland Group, Asia Pacific and Sandy Broderick formerly Chief Executive officer of DTCC Deriv/SERV, CEO of New York Portfolio Clearing and Managing Director and Director of Société Générale London.

The Business

For over twenty-five years, Lombard Risk has delivered risk management and regulatory compliance solutions to the financial services industry and large corporations around the world. More recently, the Company has expanded its portfolio of technology solutions to include collateral optimisation, compliance monitoring and advanced eXtensible Business Reporting language (XBRL) functionality.

Currently Lombard has two business lines; ***Risk (Collateral) Management and Regulatory Compliance:***

Risk Management and Trading Division – 54% of Group revenues in FY 2015 (2014: 53%):

- COLLINE® – OTC Collateral management, Repo, Securities Lending, Cash and Inventory Management, Optimisation. Market-leading position including several Tier 1 banks; and
- OBERON® valuation and risk of derivatives and other financial products REGULATORY COMPLIANCE

Regulatory Compliance Division – 46% of Group revenues in FY 2015 (2014: 47%)

- REPORTER – Regulatory Reporting in multiple countries; market-leading position in UK (e.g. FCA and PRA reporting);

- REG-Reporter® – Regulatory Reporting in the US (eg FDIC, FRBNY reporting) and various countries in Americas; market leader for reporting by foreign banks in the US;
- LISA® – stress testing of liquidity reporting; and
- ComplianceASSESSOR™ – product that allows firms to manage their ongoing compliance with regulations and produce multiple reports around the related compliance risks.

Lombard Risk does business with around thirty of the top fifty banks in the world, often across multiple geographies. In the UK they work with over 140 separate banking groups, with the number of legal entities using its software, considerably higher than that. Management regards the client base and the associated relationships as a very important asset of the Group and reports very few client losses over the past few years, excepting where a bank closes a branch.

In FY 2015, 47% of the revenues were from the UK (2014: 59%) and a further 16% from EMEA non-UK (2014: 13%). Revenues from the Americas represented 24% of Group revenue (2014: 20%) as a result of strong COLLINE® revenue.

The intellectual property of the Group is a key asset to maintain a market-leading position, and the Group continues to invest in its intellectual property. The Group capitalises these development costs, in line with and subject to the conditions of IAS 38. In FY 2014 the Group capitalised £5.1m.

Executive Team

Philip Crawford – Executive Chairman (as of May 2015) joined the Board of Lombard Risk in 2010. He has been working in the IT industry since 1983. Philip has held a number of senior positions in software, hardware and services companies including senior vice president of Oracle Corporation with membership of the executive board and Larry Ellison's Strategy Council, President of EDS International with responsibility for all markets outside the US, Chief Executive of Bull UK and Executive Vice President and head of EMEA for i2 Technologies.

Since retiring from full time employment in 2002, Philip has concentrated on his non-executive director portfolio, and acts as a *'business angel.'* He is currently the Chairman of Avanti Capital plc and Non-executive Director of Crimsonwing plc, as well as being chairman and investor in a small number of private companies mainly in the technology space.

Nick Davies – CTO joined the Board of Lombard Risk in 2010 having joined the firm in 2008 as the group's CTO. As CTO, Nick has global responsibility for Lombard Risk's technical vision as well as for the delivery and quality of all software products. At Lombard Risk, Nick's achievements include leading the technical group through the achievement of ISO9001 and CMMI-D Level 3 and providing the architectural vision for the re-architecture of the COLLINE collateral management platform to provide additional business resilience and processing capacity capabilities. These architecture and design principles contributed to COLLINE winning its first Tier-1 enterprise client in early 2009, and REPORTER MIS winning its first Tier-1 enterprise client in 2010, and REFORM winning its first Tier-1 clients in 2012.

At JP Morgan he was the head of technology for three global businesses; Globeclear, Collateral Management and Global Trust. He oversaw the technical integration of the Hedge Fund acquisitions into the Alternative Investment group, and was responsible for several high profile merger projects. He was responsible for the technical teams that architected and implemented the JP Morgan CommanD product servicing OTC Derivatives.

Nigel Gurney – Chief Financial Officer is a qualified chartered accountant with 20 years' experience in the financial services, wholesale distribution and telecommunications industries. He was previously Chief Financial Officer at Lepe Partners LLP, a specialist independent banking company, prior to which he was Chief Financial Officer of Merchant Securities Group plc and Chief Financial Officer of W.H. Ireland Group plc.

OUTLOOK

The Development Cost to Revenues ratio is set to decline. Not from cost cutting but from increasing revenues. Though there have been cuts to various non-core activities, the continuous development of the core products is essential and no cost cutting is planned.

There are opportunities to improve and upsell their products to add value to their customers beyond fulfilling their regulatory requirements, i.e. they can allow the customer to use their own data that currently only goes to the regulators.

Lombard Risk's management has negotiated a non-exclusive deal with Oracle to sell the REPORTER Portal product which they believe will be a very important source of new business. They are presenting to 60k Oracle customers in a few weeks at an Oracle conference, but more focus will be given to the 500 banks serviced by Oracle in US and India which are target areas.

Oracle has integrated its Financial Services Data Foundation (FSDF) compute engines with Lombard Risk's regulatory reporting solution (REPORTER Portal). For the first time, they will provide end-to-end automation for financial institutions regulatory reporting requirements. The solution ensures complete data integrity, freeing firms to focus on analysing and gaining new business insight from their growing stores of data, over simply preparing data and reports in order to meet submission deadlines. In addition, multi-jurisdiction institutions can now establish a global regulatory report production platform integrated with a single source of truth and full data lineage, regardless of where they are situated, or how many jurisdictions they operate in.

On the Risk Management side the Plan is to continue to offer COLLINE (the existing solution), but to offer a 'Cloud' based option and a 'Hub' based option too, which will both broaden the prospective audience for these products as well as helping to retain and upsell to existing customers.

Because Lombard Risk's product is regulatory focussed they know exactly who needs it, and when they need it; which makes the sales process relatively straightforward. They want to sign up some 'big guys' as that validation will encourage the 'little guys'.

They are happy with their market forecast of £23m for the full year, and we estimate the extra £12m to hit the implied H2 target would come from roughly; £5m of recurring revs; £5m from the pipeline and £2m of new biz.

The management have re-iterated that they have no need to raise further funds.

VALUATION

Lombard Risk pays a Dividend yielding slightly less than 1% similar to comparative AIM listed companies; **GB Group(GBG), Eckoh(ECK), and IP Plus(IPP).**

Historic PE is around 11x which does look cheap against the comps, and in the market as a whole. Due to the re-structuring costs, the current year (to March 2016) is likely to be slightly better than break-even, making for a large PE but looking out to the year to March 2017 (and assuming a further 10% top-line growth on this year, and normalised costs) the PE will be back to somewhere around 12x which again is hardly stretched.

There perhaps some concern regarding the future of Mr Wisbey's 33% stake. Certainly there is execution risk in the re-structuring, and perhaps the market does not see such heady growth potential as some of the other comps, (which view I do not share) but this is surely offset by the reduced 'business' risk as the business and the products are already proven with revenues over £21m and dozens of sticky tier 1 customers; they are not trying to find a market or prove the concept but to scale it up.

CONCLUSION

The Exec Chairman is making some very positive changes to focus and accelerate the return to profitable growth. Obviously there is a mismatch between the immediate costs involved with making the changes, and the future revenue streams, but early green shoots in terms of pipeline build-up are looking good. At the Interim stage they have a record order book of £6.8m and bookings are up 48% on last year. If the Oracle collaboration catches fire the 10% growth forecast for next year could be significantly breached on the upside.

There is plenty of operational gearing in the P&L (this is software after all) and driving the top-line is a plausible approach to generating large profits given the Oracle deal and the scale that can bring. The Exec Chair and the new sales & marketing director are both ex-Oracle and were senior figures in that organisation, so we can be confident that they understand how to make that arrangement work for them. Basically it is all about the scale-up and there are plenty of reasons to be optimistic about that.

Consolidated Unaudited interim statement of comprehensive income for six months ended 30 September 2015

	Unaudited six months ended 30 Sep 2015 £'000	Unaudited six months ended 30 Sep 2014 £'000	Audited year ended 31 Mar 2015 £'000
Continuing operations			
Revenue	**10,762**	9,269	21,491
Cost of sales	-97	-114	-298
Gross profit	**10,665**	9,155	21,193
Administrative expenses	-10,137	-8,374	-16,799
EBITDA	**528**	781	4,394
Depreciation, amortisation and impairment	-2,271	-759	-2,116
Net finance expense	-19	-9	-23
(Loss) / profit before taxation	**-1,762**	13	2,255
Taxation charge	-159	-24	-2
(Loss) / profit for the period from continuing operations	**-1,921**	-11	2,253
(Loss) / profit for the period from continuing operations attributable to:			
Owners of the Parent	**-1,921**	4	2,290
Non-controlling interest	-	-15	-37
	-1,921	-11	2,253
Other comprehensive income			
Exchange differences on translating foreign operations	-95	2	194
Total comprehensive income for the period	**-2,016**	-9	2,447
Total comprehensive income attributable to:			
Owners of the Parent	-2,016	6	2,484
Non-controlling interest	-	-15	-37
	-2,016	-9	2,447
(Loss) / earnings per share			
Basic (pence)	-0.66	0	0.87
Diluted (pence)	-0.66	0	0.86

Sources: Lombard Risk Management Half Yearly Results

Consolidated unaudited interim statement of financial position as at 30 September 2015

	Unaudited six months ended 30 Sep 2015 £'000	Unaudited six months ended 30 Sep 2014 £'000	Audited year ended 31 Mar 2015 £'000
Non-current assets			
Property, plant and equipment	374	196	322
Goodwill	5,841	5,769	5,881
Other intangible assets	15,066	12,433	14,361
Trade and other payables	1,013	-	974
Deferred tax asset	869	982	1,048
	23,163	19,380	22,586
Current assets			
Trade and other receivables	5,636	5,272	6,791
Cash and cash equivalents	2,733	2,167	2,241
	8,369	7,439	9,032
Total assets	**31,532**	26,819	31,618
Current liabilities			
Borrowings	-	-333	-
Trade and other payables	-2,482	-2,573	-3,746
Deferred income	-6,452	-5,788	-7,222
Total liabilities	**-8,934**	-8,694	-10,968
Net assets	**22,598**	18,125	20,650
Equity			
Share capital	1,951	1,747	1,750
Share premium account	13,156	9,375	9,404
Foreign exchange reserves	-182	-279	-87
Other reserves	1,831	1,622	1,739
Retained profit	5,842	5,757	7,963
Equity attributable to owners of the Parent	22,598	18,222	20,769
Non-controlling interest	**-**	-97	-119
Total equity	**22,598**	18,125	20,650

Sources: Lombard Risk Management Half Yearly Results

Consolidated unaudited interim statement of cash flow for the six months ended 30 September 2015

	Unaudited six months ended 30 Sep 2015 £'000	Unaudited six months ended 30 Sep 2014 £'000	Audited year ended 31 Mar 2015 £'000
Cash flows from operating activities			
(Loss) / profit for the period	-1,921	-11	2,253
Tax charge	159	24	2
Net finance expense	19	9	23
Operating (loss) / profit	**-1,743**	22	2,278
Adjustments for:			
Depreciation	127	98	210
Amortisation and impairment	2,146	661	1,906
Share-based payment charge	148	92	212
Decrease / (increase) in trade and other receivables	1,116	495	-2,107
(Decrease) / increase in trade and other payables	-1,264	-122	1,160
(Decrease) / increase in deferred income	-770	617	2,051
Foreign exchange difference	-27	-34	-8
Cash generated by operations	**-267**	1,829	5,702
Tax credit received / (paid)	10	-7	-43
Net cash (used in) / generated by operating activities	**-257**	1,822	5,659
Cash flows from investing activities			
Interest received	-	-	1
Purchase of property, plant and equipment and computer software	-209	-116	-369
Capitalisation of development expenditure	-2,840	-2,005	-5,109
Net cash used in investing activities	**-3,049**	-2,121	-5,477
Cash flows from financing activities			
Shares issued, net of issue costs	3,954	-	31
Repayment of loans	-	-334	-666
Interest paid	-19	-10	-24
Dividends paid	-137	-119	-211
Net cash flow generated by / (used in) financing activities	**3,798**	-463	-870
Net increase / (decrease) in cash and cash equivalents	**492**	-762	-688
Cash and cash equivalents at beginning of period	2,241	2,929	2,929
Cash and cash equivalents at end of period	**2,733**	2,167	2,241

Sources: Lombard Risk Management Half Yearly Results

Disclaimer

This document, which does not constitute research, has been issued by Hybridan LLP for information purposes only and should not be construed in any circumstances as an offer to sell or solicitation of any offer to buy any security or other financial instrument, nor shall it, or the fact of its distribution, form the basis of, or be relied upon in connection with, any contract relating to such action. This document has no regard for the specific investment objectives, financial situation or needs of any specific entity and is not a personal recommendation to anyone. Recipients should make their own investment decisions based upon their own financial objectives and financial resources and, if any doubt, should seek advice from an investment advisor.

The information contained in this document is based on materials and sources that are believed to be reliable; however, they have not been independently verified and are not guaranteed as being accurate. This document is not intended to be a complete statement or summary of any securities, markets, reports or developments referred to herein. No representation or warranty, either express or implied, is made or accepted by Hybridan LLP, its members, directors, officers, employees, agents or associated undertakings in relation to the accuracy, completeness or reliability of the information in this document nor should it be relied upon as such.

Any and all opinions expressed are current opinions as of the date appearing on this document only. Any and all opinions expressed are subject to change without notice and Hybridan LLP is under no obligation to update the information contained herein. To the fullest extent permitted by law, none of Hybridan LLP, its members, directors, officers, employees, agents or associated undertakings shall have any liability whatsoever for any direct or indirect or consequential loss or damage (including lost profits) arising in any way from use of all or any part of the information in this document.

This document should not be relied upon as being an independent or impartial view of the subject matter and, for the avoidance of doubt, does not constitute "independent investment research" for the purposes of the Financial Conduct Authority rules. The individuals who prepared this document may be involved in providing other financial services to the company or companies referenced in this document or to other companies who might be said to be competitors of the company or companies referenced in this document. As a result both Hybridan LLP and the individual members, directors, officers and/or employees who prepared this document may have responsibilities that conflict with the interests of the persons who receive this document. Hybridan LLP and/or connected persons may, from time to time, have positions in, make a market in and/or effect transactions in any investment or related investment mentioned herein and may provide financial services to the issuers of such investments.

In the UK, this document is directed at and is for distribution only to persons who (i) fall within Article 19(5) (persons who have professional experience in matters relating to investments) or Article 49(2) (a) to (d) (high net worth companies, unincorporated associations, etc) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended) or (ii) are Professional Clients or Eligible Counterparties (as those terms are defined in the rules of the Financial Conduct Authority) of Hybridan LLP (all such persons referred to in (i) and (ii) together being referred to as "relevant persons"). This document must not be acted on or relied up on by persons who are not relevant persons. For the purposes of clarity, this document is not intended for and should not be relied upon by persons who would be classified as Retail Clients (as defined by the rules of the Financial Conduct Authority).

Neither this document nor any copy of part thereof may be distributed in any other jurisdictions where its distribution may be restricted by law and persons into whose possession this document comes should inform themselves about, and observe, any such restrictions. Distribution of this report in any such other jurisdictions may constitute a violation of UK or US securities law, or the law of any such other jurisdictions.

Hybridan LLP and/or its associated undertakings may from time-to-time provide investment advice or other services to, or solicit such business from, any of the companies referred to in this document. Accordingly, information may be available to Hybridan LLP that is not reflected in this material and Hybridan LLP may have acted upon or used the information prior to or immediately following its publication. In addition, Hybridan LLP, the members, directors, officers and/or employees thereof and/or any connected persons may have an interest in the securities, warrants, futures, options, derivatives or other financial instrument of any of the companies referred to in this document and may from time-to-time add or dispose of such interests.

Neither the whole nor any part of this document may be duplicated in any form or by any means. Neither should this document, or any part thereof, be redistributed or disclosed to anyone without the prior consent of Hybridan LLP.

Hybridan LLP is a limited liability partnership registered in England and Wales, registered number OC325178, and is authorised and regulated by the Financial Conduct Authority and is a member of the London Stock Exchange. Any reference to a partner in relation to Hybridan LLP is to a member of Hybridan LLP or an employee with equivalent standing and qualifications. A list of the members of Hybridan LLP is available for inspection at the registered office, 2 Jardine House, The Harrovian Business Village, Bessborough Road, Harrow, Middlesex HA1 3EX.