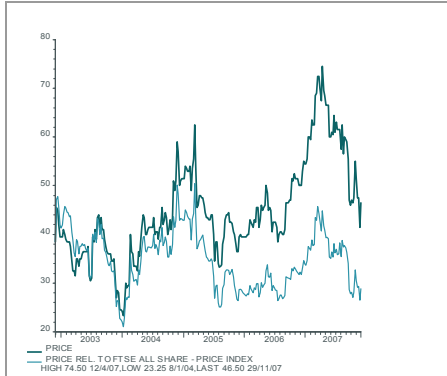


Financial Objects (FIO.L) (remains as) Buy

Price/Target: 47p/90p

Update 30 November 2007



Source: Thomson Datastream

Reuters	FIO.L
Bloomberg	FIO.LN
EVO Sector	TMT
EVO Sub Sector	Tech Software
Listing	AIM
No. of Shares	44m
Free Float	81%
Next News	TBD

Market Cap	£21m
Net Cash (FY07E)	£4m
Pension Surplus/(Deficit) (E)	£0m
Post Tax ROCE (E)	34%
ROE (E)	22%
Net Debt/(Equity) (E)	N/A
EBIT Interest Cover (E)	0x

Share price performance:	Abs	Rel to FTA
1 mth	-12%	-7%
3 mths	-21%	-22%
12 mths	-8%	-11%

Philip Sparks
+44 (0) 20 7071 4467
philip.sparks@evosecurities.com

EVO Securities makes markets in Financial

EVO Securities is broker and/or advisor and has in the last twelve months acted as broker and / or adviser or provided investment banking services, for which it has received compensation or is expecting compensation within the next three

The company has reviewed a draft of this research note and factual changes have been made.

A show of confidence

- ▶ Fall-out from the credit crunch will bring long-term opportunities to FIO
- ▶ The sales force has been bolstered by the appointment of a big-hitter from CSC
- ▶ Management share purchases signifying confidence in prospects

A tough quarter for the shares

Financial Objects shares have endured a triple-whammy over the last few months. The retirement of the Group's Chairman in April left a potential stock overhang, Financial Objects' banking customer base came under pressure from the credit crunch and the ongoing stock market volatility has deterred investors from small-cap stocks in general.

Stock overhang now cleared

The weak share price performance belies the ongoing success of the Group. The interim results in September were in-line, and would have beaten expectations were it not for some internal issues with the Banking division's sales process. Financial Objects has addressed these by appointing a new divisional head from the global IT firm CSC. Last month Financial Objects' Management team have demonstrated their faith in the business by spending £0.95m acquiring the bulk of the previous Chairman's shares.

Management share purchases suggest the stock market has mis-priced the shares

In its recent Q3 results, the European banking software provider Temenos said the sub-prime crisis had not impacted on its business. Temenos trades on a FY08 PE of 25.8x compared to Financial Objects on 6.8x (adjusted for cash). The magnitude of that rating gap is inexplicable. Even if Financial Objects Banking license sales dried up completely next year, the Group's FY08 Adjusted P/E would still rise to only 8.8x.

In the near-term we think the negative impact of the credit crunch will be less severe than the market fears. Ironically, the credit crunch and the Northern Rock crisis will probably prove to be good news for Financial Objects in the long-run: new banking regulations will force customers to purchase new software modules for their IT systems. The recent Management share purchases clear the stock overhang and is a clear indication that the stock market's negative sentiment is misplaced. The path is now clear for a recovery in the share price.

Year end Dec 31	2005A	2006A	2007E	2008E	2009E
Sales (£m)	13.9	19.9	22.0	24.2	26.0
EBITDA (£m)	1.2	2.6	3.1	3.5	4.1
EVO PBT (£m)	1.0	2.3	2.8	3.4	4.0
EPS (p)	3.3	5.4	6.2	7.5	8.1
DPS (p)	0.0	1.0	1.2	1.4	1.6
Growth PBT (%)	-	128.1	20.7	21.4	17.6
Growth EPS (%)	-	62.2	14.8	20.6	8.6
P/E (x)	13.9	8.6	7.5	6.2	5.7
EV/Sales (x)	0.8	0.9	0.7	0.6	0.5
EV/EBITDA (x)	9.4	6.8	5.3	4.2	3.1
EV/EBITA (x)	12.1	7.7	5.8	4.6	3.4
FCF Yield (%)	0.2	8.5	10.7	10.2	13.1
Yield (%)	-	2.2	2.6	3.0	3.4

Banking license exposure

Financial Objects Banking products

Our FY07 EBIT forecast of £3.9m (before £1.1m of central costs) includes £2.0m of EBIT from Financial Objects' Banking division (which delivered £0.9m in 1H07). This division has two main products:

- ▶ *Activebank*, a next generation, internet ready, retail and treasury banking solution based upon a Service Oriented Architecture allowing banks to reduce costs and improve time to market
- ▶ *ibis s2*, a web-based transaction processing system for financial institutions, providing in-depth functionality across a broad spectrum of business areas and deployed using state of the art technology in a single integrated front, middle and back office system

Overhauling a bank's IT system is a complex, expensive and risky process, so once a bank has adopted either Activebank, ibis or a competing product, they tend to stick with it. This barrier-to-switching generates a lot of repeat business for banking software vendors; customers need to license more seats as they expand, and if they want to add a new service (e.g. internet banking) their incumbent software vendor has a natural advantage over the competition.

License exposure

Of Financial Object's banking revenues, 50% comes from contracted maintenance fees, 40% comes from services and the remaining 10% (£1m est. in FY07) comes from software license sales.

Maintenance spending is typically contracted on a rolling twelve-month basis and is not an area that IT departments feel they can cut back on without putting their systems at risk. Services spending is related to ongoing changes in IT requirements (e.g. when a bank takes on new staff or reorganises a department, when it makes changes to a database function, installs a software upgrade etc). So, spending on services and maintenance is to a large extent non-discretionary and not at risk from the short-term budget cuts. License purchases, however, occur at the outset of a brand new IT project. It is license revenues that are most at risk if banks choose to postpone new projects. Software companies' earnings are extremely sensitive to fluctuations in license sales as they carry an effective gross margin of 100%.

The credit crunch will no doubt cause some of Financial Objects' customers to scale back staff numbers (reducing demand for extra seats) and postpone certain new projects. However, we do not believe that Financial Objects' license sales are about to dry up. Much of Financial Objects' license sales pipeline comes from markets outside the UK (e.g. South Africa, Oslo and Croatia) where the impact of the credit crunch has been less severe.

Longer term, the credit crunch could actually end up generating *increased* demand for software from Financial Objects' UK client base. One side-effect of the Northern Rock crisis is that there will almost certainly be changes to the regulatory environment for retail banks. Changes in legislation demands changes to banks' IT systems. MIFID has been a boon to investment banking software vendors, for instance and new rules for the credit markets could eventually lead to the creation of new Activebank and ibis modules and prompt customers to upgrade existing ones.

Valuation and recommendation

On our forecasts for FY08, Financial Objects is trading on a P/E of just 6.8x. This compares to an average P/E for the UK software sector of c16x.

Why is the rating so low? Our current forecasts show Financial Objects earnings rising at 14-15% per annum for the next few years, so it is not a matter of growth potential. The market is evidently sceptical of Financial Objects meeting our earnings numbers, which have not changed since the FY06 results were published in March.

Current forecasts

Financial Objects EBIT and Earnings	2006a	2007e	2008e	2009e
Banking	2.5	2.0	2.1	2.2
Wealth Management	0.1	0.3	0.5	0.8
Energy	0.0	1.0	1.0	1.1
Other software products	0.8	0.6	0.7	0.8
Unallocated costs	(1.0)	(1.1)	(1.1)	(1.1)
Group operating profit	<u>2.3</u>	<u>2.8</u>	<u>3.2</u>	<u>3.8</u>
Net interest	0.0	0.0	0.2	0.2
Adjusted PBT	2.3	2.8	3.4	4.0
Tax	0.9	0.0	0.0	0.0
Adjusted attributable profit	<u>2.3</u>	<u>2.8</u>	<u>3.4</u>	<u>4.0</u>
Adjusted EPS - diluted	5.4p	6.2p	7.0p	8.1p
<i>EPS growth</i>	+62.2%	+13.9%	+14.5%	+15.4%
Adjusted P/E (at 47p)	10.7x	6.8x	5.7x	4.7x

Source: EVO Securities

If Financial Objects banking license sales to new customers (which make up around 5% of Group revenues) dried up in 2008 and took £1m off PBT, the Company could still deliver FY08 EPS of 5.3p. Even in that unlikely scenario, at 47p the shares would be trading on an Adjusted P/E of only 8.8x.

The sharp decline in license sales currently priced into the shares is far from inevitable. Although license sales were soft in 1H07 (prior to the credit crunch), Management believes that this was not because of weak market conditions, but because the Banking division's sales team was under-resourced. This issue has since been addressed with the appointment of John McKee, formerly head UK sales director for the financial services arm of CSC Computer Sciences. CSC is a global IT company with \$15bn of revenue, and Mr McKee is used to closing large deals with major institutions. The sales team is currently in the midst of a recruitment drive.

Improvements to Financial Objects' sales process next year could help offset any general market weakness. We should not rule out the possibility that Financial Objects' license revenue could even exceed expectations – operational gearing works both ways, and the current FY07 Adjusted P/E of 6.8x could look even lower if the revamped sales team pushes revenues ahead of expectations.

Recommendation

Temenos, the pan-European banking software provider, recently reported strong 3Q results and said "So far, we have not seen any impact on our business from the sub-prime crisis in the US and our pipeline remains strong". Temenos' shares are currently trading on a P/E of 25.8x.

Financial Objects has not yet detected a softening in demand either, and with the shares trading on a P/E of 6.8x versus the UK software sector average of 15.7x, there is ample room for the shares to perform even in adverse market conditions. If the market were to slow down in FY08 as the share price evidently expects, we think a lull in spending will be relatively short-lived. Any new legislative and regulatory changes introduced in the UK following the Northern Rock crisis is likely to drive an upgrade cycle for banking software among Financial Objects' UK customer base.

Since Financial Objects published its FY07 results in March, there has been no Company-specific news to prompt a change to our PBT forecasts or target price. The recent share purchases by the Management suggest that the stock market's concerns of an imminent profit-warning are misplaced. Our target price of 90p would leave the shares on an Adjusted FY7 P/E of 12.0x, a comfortable rating relative to the UK software sector and a substantial discount to Temenos.

Income Statement

	2006a	2007e	2008e	2009e
TURNOVER				
Banking	11.4	10.0	10.5	11.0
Growth (%)	+9.6%	-12.3%	+5.0%	+4.8%
Wealth Management	2.4	3.5	4.5	5.0
Growth (%)	+100.0%	+45.8%	+28.6%	+11.1%
Energy	1.9	4.5	5.0	5.5
Growth (%)		+136.8%	+11.1%	+10.0%
Other software products	4.2	4.0	4.2	4.5
Growth (%)	+81.1%	-4.8%	+5.0%	+7.1%
Group turnover	19.9	22.0	24.2	26.0
Group turnover growth	+43.0%	+10.6%	+10.0%	+7.4%
PROFIT				
Banking	2.5	2.0	2.1	2.2
Operating margin	21.6%	20.0%	20.0%	20.0%
Wealth Management	0.1	0.3	0.5	0.8
Operating margin	4.2%	8.6%	11.1%	16.0%
Energy	0.0	1.0	1.0	1.1
Operating margin		22.2%	20.0%	20.0%
Other software products	0.8	0.6	0.7	0.8
Operating margin	18.1%	15.0%	16.7%	17.8%
Unallocated costs	(1.0)	(1.1)	(1.1)	(1.1)
Group operating profit	2.3	2.8	3.2	3.8
Operating margin (exc goodwill charge)	11.7%	12.7%	13.2%	14.6%
Net interest	0.0	0.0	0.2	0.2
Exceptional items	0.1			
Goodwill amortisation	(1.0)	(0.3)	(0.3)	(0.3)
Reported PBT	1.4	2.5	3.1	3.7
Exceptional items adjustment	(0.1)			
Goodwill writedown adjustment	1.0	0.3	0.3	0.3
Adjusted PBT	2.3	2.8	3.4	4.0
EARNINGS				
Tax	0.9	0.0	0.0	(0.3)
Effective tax rate	-38.8%	0.0%	0.0%	7.5%
Reported profit after tax	2.3	2.5	3.1	3.4
Period-end no. of shares	44.5	44.5	44.5	44.5
Reported EPS - basic	5.5p	5.7p	7.0p	7.6p
Adjusted EPS - diluted	5.4p	6.2p	7.5p	8.1p
EPS growth	+62.2%	+13.9%	+21.6%	+8.6%
DPS	1.0p	1.2p	1.4p	1.6p
Dividend cover	0.2x	0.2x	0.2x	0.2x
Dividend growth		+20.0%	+16.7%	+14.3%

Source: EVO Securities

Cash Flow

	2006a	2007e	2008e	2009e
OPERATING CASH FLOW				
Operating profit	1.4	2.5	2.9	3.5
Goodwill amortisation	0.3	0.3	0.3	0.3
Depreciation	0.3	0.3	0.3	0.3
Debtors (increase) / decrease	(0.0)	(0.5)	(1.0)	(1.0)
Creditors increase / (decrease)	(0.0)	0.2	0.2	0.2
Change in working capital	(0.1)	(0.3)	(0.8)	(0.8)
Provision (utilisation) / creation	(0.5)	(0.3)	(0.3)	(0.3)
Other operating items				
Operating cashflow	1.4	2.5	2.4	3.0
NON-OPERATING ITEMS				
Net interest (paid)	(0.0)	0.0	0.0	0.2
Preference dividends (paid)				
Tax (paid)	(0.0)	0.0	0.0	(0.2)
EVO cash flow	1.4	2.5	2.4	3.0
INVESTMENT AND EQUITY FINANCING				
Capex	(0.3)	(0.3)	(0.3)	(0.3)
Fixed asset sales				
Acquisitions	(1.8)			
Disposals	0.8			
Change in net cash before forex adj.	0.1	1.6	1.5	2.0
Forex adjustments and other items	(0.0)			
Change in net cash	0.1	1.6	1.5	2.0
Opening net cash	2.6	2.8	4.3	5.9
Change in net cash	0.1	1.6	1.5	2.0
Closing net cash	2.8	4.3	5.9	7.9

Source: EVO Securities

Balance Sheet

	2006a	2007e	2008e	2009e
BALANCE SHEET SUMMARY				
Intangible fixed assets	10.0	9.7	9.4	9.1
Tangible fixed assets	0.4	0.4	0.4	0.4
Debtors	5.6	6.1	7.1	8.1
Creditors	(8.0)	(8.2)	(8.4)	(8.6)
Other provisions and liabilities	(0.1)	0.2	0.7	1.0
Unadjusted capital employed	8.2	8.5	9.5	10.2
Net cash (debt)	2.8	4.3	5.9	7.9
Net assets	11.0	12.8	15.4	18.1

Source: EVO Securities

Valuation

	2006a	2007e	2008e	2009e
MARKET VALUE				
Share price	46.5	46.5	46.5	46.5
Market cap	20.7	20.7	20.7	20.7
Average net debt (cash)	(2.7)	(3.6)	(5.1)	(6.9)
Net pension deficit (surplus)				
Enterprise Value	18.0	17.1	15.6	13.8
Target price	90.0	90.0	90.0	90.0
Enterprise Value at target price	37.3	36.5	34.9	33.1
SPOT RATIOS AT 47p				
P/E	8.6x	7.6x	6.2x	5.7x
Adjusted P/E	10.7x	6.8x	5.7x	4.7x
EV/EBITDA	6.9x	5.5x	4.5x	3.4x
EV/Sales	0.9x	0.8x	0.6x	0.5x
Yield	2.2%	2.6%	3.0%	3.4%
NAV per share	25p	29p	35p	41p
PEG ratio	0.5x	0.5x		
RETURNS				
Asset turn	3.2x	2.8x	2.9x	3.0x
NOPLAT margin	19.7%	12.7%	13.2%	13.5%
ROCE (post-tax)	62.8%	35.0%	38.8%	40.2%
ROE	26.4%	23.5%	24.1%	22.1%
GROWTH RATES				
Turnover growth	+43.0%	+10.6%	+10.0%	+7.4%
EPS growth	+62.2%	+13.9%	+21.6%	+8.6%
FINANCIAL GEARING				
Dividend cover	5.4x	5.3x	5.5x	5.2x
SPOT RATIOS AT OUR 90p TARGET				
Target P/E	16.6x	14.6x	12.0x	11.1x
Target EV/EBITDA	14.3x	11.8x	10.0x	8.1x
Target Yield	1.1%	1.3%	1.6%	1.8%
Target PEG ratio	0.9x	1.0x		

Source: EVO Securities

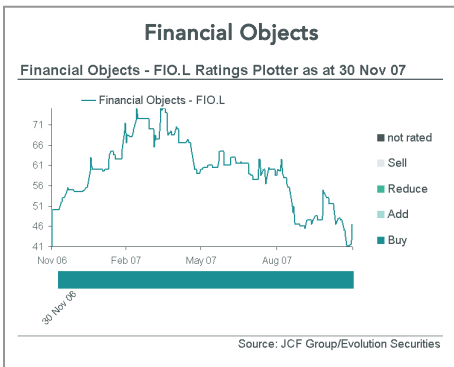
The Adjusted P/E applies a tax rate of 30% to the earnings, but reduces the market cap by the NPV of the Group's tax losses. It also strips out the Group's net cash and interest income.

Disclosures & Disclaimers

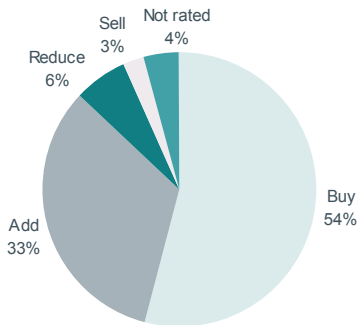
<p>Philip Sparks Research Analyst</p>	Amstrad	Bede	Big Yellow Group	Billing Services Group
	Eatonfield	Environmental Recycling Technologies	Financial Objects	Greenhouse Fund
	Henry Boot	Interior Services Group	Kingspan Group	Newport Networks
	OMG	Prosperity Minerals	PSPI	ROK
	ServicePower	SQS	Sutton Harbour	Volex Group
	Waterman	Wichford		

Key: ◆ = Analyst has financial interest ● = Analyst has material interest ■ = Analyst is a director □ = Analyst has a business interest

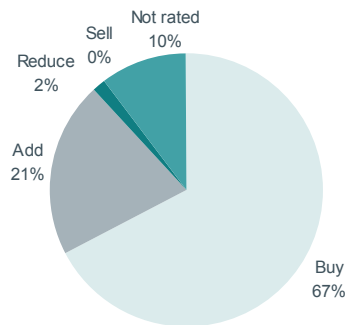
Recommendation History Charts (For the last 12 months to previous days closing)



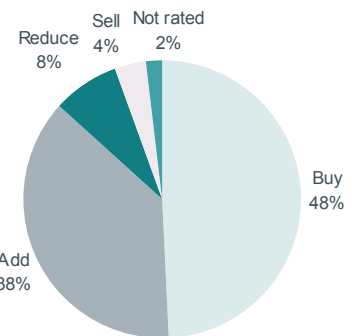
% of recommendations (all stocks)



% of recommendations (corporate stocks)



% of recommendations (non corporate stocks)



Updated on a quarterly basis; last updated 1 August 2007

Evolution Securities – Recommendation Guide

- Buy:** Expected to outperform the FTSE All-Share Index by 10% or more in the next 12 months
- Add:** Expected to outperform the FTSE All-Share Index by up to 10% in the next 12 months
- Reduce:** Expected to underperform the FTSE All-Share Index by up to 10% in the next 12 months
- Sell:** Expected to underperform the FTSE All-Share Index by 10% or more in the next 12 months

Evolution Securities previous recommendation structure (to 21 July 2006) was similarly segmented into buy, add, reduce and sell recommendations. For FTSE 100 stocks buy and sell recommendations were based on +10% and -10%, respectively, expectations of share price performance; FTSE Mid 250 stocks buy and sell recommendations were based on +15% and -15%, respectively, expectations of share price performance; and for FTSE Small Cap, Fledgling and AIM buy and sell recommendations were based on +25% and -25%, respectively, expectations of share price performance.

This document is issued by Evolution Securities Ltd (ESL) (Incorporated in England No. 2316630), which is authorised and regulated in the United Kingdom by the Financial Services Authority (FSA) for designated investment business and is a member of the London Stock Exchange.

This document is for information purposes only and should not be regarded as an offer or solicitation to buy the securities or other instruments mentioned in it. Expressions of opinions are those of the research department of ESL only and are subject to change without notice. No representation or warranty, either expressed or implied, is made nor responsibility of any kind is accepted by any Evolution Group company, its directors or employees either as to the accuracy or completeness of any information stated in this document. There is no regular update series for research recommendations issued by ESL.

ESL and/or its officers, directors and employees may have or take positions in securities mentioned in this document (or in any related investment) and may from time to time dispose of any such securities (or instrument). ESL may act as a market maker in the securities of companies discussed in this document (or related investments), and may sell them or buy them from customers on a principal basis and may also perform underwriting services for or relating to those companies.

ESL or persons connected with it may provide or may have provided corporate services to the issuers of securities mentioned in this material and recipients of this document should not therefore rely on this report as being an impartial document. Accordingly, information may be known to ESL or persons connected with it which is not reflected in this material.

ESL has a policy in relation to the management of the firms conflicts of interest, this is available at: <https://research.evosecurities.com/conflicts.pdf>

The stated price of any securities mentioned herein is as at close of business 29 November 2007 unless otherwise stated and is not a representation that any transaction can be effected at this price. No personal recommendation is being made to you; the securities referred to may not be suitable for you and should not be relied upon in substitution for the exercise of independent judgement. Forecasts are not a reliable indication of future performance and an investment in equity could put your capital at risk

ESL shall not be liable for any direct or indirect damages, including lost profits arising in any way from the information contained in this material. This material is for the use of intended recipients only and only for distribution to professional and institutional investors, i.e. persons who are authorised persons or exempted persons within the meaning of the Financial Services and Markets Act 2000 of the United Kingdom, or persons who have been categorised by ESL as professional clients under the rules of the FSA.

This document is being supplied to you solely for your information and may not be reproduced, re-distributed or passed to any other person or published in whole or in part for any purpose.

The material in this document is not intended for distribution or use outside the European Economic Area. This material is not directed at you if ESL is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you.

Financial Objects

 Price / Target
47p / 90p
Buy

Business	Info	Capitalisation
Software for wholesale and retail banking sectors, financial risk assessment consultancy	Reuters/Bloomberg FIO.L / FIO.LN	Market Cap £21m
	Issued Shares 44m	Net Cash/(Debt) (E) £4m
EVO Sector TMT	12 mth high/low 75p / 41p	Pension Surplus/(Deficit) (E) 0m
EVO Sub Sector Tech Software	Free Float 81%	

Year end Dec	2005A	2006A	2007E	2008E	2009E	Year end Dec, %	2005A	2006A	2007E	2008E	2009E
P&L (£m)						Growth Drivers					
Sales (excluding joint ventures)	13.9	19.9	22.0	24.2	26.0	Sales growth	-	43.0	10.6	10.0	7.4
EBITA	1.0	2.3	2.8	3.2	3.8	EBITA growth	-	144.0	20.7	14.3	18.8
Net Interest	0.1	0.0	0.0	0.2	0.2	EPS growth	-	62.2	14.8	20.6	8.6
EVO PBT	1.0	2.3	2.8	3.4	4.0	DPS growth	-	-	20.0	16.7	14.3
Exceptionals and other adjustments	-0.8	0.1	0.0	0.0	0.0	Effective tax rate	0	CR	0	0	8
Per share data (p)						Returns (%)					
EVO EPS	3.3	5.4	6.2	7.5	8.1	Gross margin	100.0	100.0	100.0	100.0	100.0
Consensus EPS	3.3	5.4	6.3	7.3	-	EBITDA margin	8.9	13.2	14.1	14.5	15.8
DPS	0.0	1.0	1.2	1.4	1.6	EBITA margin	6.8	11.7	12.7	13.2	14.6
NAV	21.7	23.9	28.1	33.8	40.2	Asset turn	3.5	2.5	2.7	2.6	2.6
Cash flow (£m)						Valuation (x)					
EBITDA	1.2	2.6	3.1	3.5	4.1	Post-tax ROCE	23.9	41.0	34.4	35.0	35.3
Change in working capital	-0.8	-0.1	-0.3	-0.8	-0.8	P/E	13.9	8.6	7.5	6.2	5.7
Interest, tax & pref dividends	0.0	0.0	0.0	0.0	0.0	EV / Sales	0.8	0.9	0.7	0.6	0.5
Free cashflow	0.4	2.5	2.8	2.7	3.3	EV / EBITDA	9.4	6.8	5.3	4.2	3.1
Capex and acquisitions net	-1.1	-1.3	-0.3	-0.3	-0.3	EV/EBITA (x)	12.1	7.7	5.8	4.6	3.4
Share issues / (buybacks)	0.0	0.0	0.0	0.0	0.0	FCF Yield (%)	0.2	8.5	10.7	10.2	13.1
Dividends (paid)	0.0	0.0	-0.6	-0.6	-0.7	Yield (%)	-	2.2	2.6	3.0	3.4
Other items	-0.9	-1.1	-0.3	-0.3	-0.3	Financial gearing (x)					
Change in net cash	-1.6	0.1	1.6	1.5	2.0	Net Debt/Equity (%)	-	-	-	-	-
Closing net cash	2.6	2.8	4.3	5.9	7.9	Net Debt/EBITDA	-	-	-	-	-
Balance sheet (£m)						EBITA interest cover	-	-	-	-	-
Net assets	6.6	10.6	12.5	15.0	17.9	Dividend cover	0.0	5.4	5.2	5.3	5.1
Capital employed	4.0	7.8	8.1	9.1	10.0						