Update

Edison investment research

1 September 2005

Financial Objects

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	PE (x)	Yield (%)
12/03	10.4	(1.6)	(5.98)	1.0	N/A	3.0
12/04	9.5	0.3	1.14	0.0	34	N/A
12/05e	14.0	0.8	2.22	0.0	16	N/A
12/06e	18.0	1.6	3.96	0.0	10	N/A

Note: *PBT and EPS are normalised, excluding goodwill amortisation and exceptional items

Investment summary: Shifting up a gear

Financial Objects' strategy continues to evolve as it seeks to capitalise on a considerable investment in its product range over the last few years. With the restructuring now largely complete, the emphasis over the next 12 months will progressively shift to sales and marketing, targeting both existing and new customers, both directly and via partners. Growth is likely to be stead; with existing customer the most cost effective source of new business.

Improving investment case

Significant investment has resulted in a credible suite of core banking software products, which we will review shortly in a detailed report. They are now deployed at customer sites and are thus useful references for new business. Management has got a strong grip on costs and the relocation of production to Bangalore has provided significant competitive advantages.

Acquisition of WMS adds scale

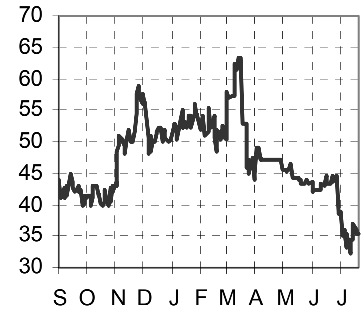
The institutional nature of potential customers means that there are benefits to be gained by increasing the size of the group. The acquisition of WMS has enlarged the customer base and product range and Financial Objects now has a broader product range to sell. Opportunities for joint marketing initiatives have already emerged and the group intends to consider further acquisitions that could add to credibility and scale, and thus improve its prospects with major banking clients.

Valuation: Good prospects

We have adjusted our forecasts to include WMS and cost savings, but not any benefits of cross-selling new investment management and IFA products alongside existing retail and wholesale banking software. Although the shares have recovered from recent weakness, the forecasts could prove conservative. There is scope for upward revision over the next six months and the prospective rating for 2006 does not fully discount the prospects.

Price	39.5p
Market Cap	£16m

Share price graph



Share details

Code	FIO
Listing	AIM
Sector	Software & Computer Services
Shares in issue	40.39m

Price

	High	Low
52 week	65.0p	30.0p

Balance Sheet

Debt/Equity (%)	Nil
NAV per share (p)	16.5
Net borrowings (£m)	Nil

Business

The group provides software and related services to financial services organisations, particularly core banking systems for international banks.

Valuation

	2004	2005e	2006e
P/E relative	207%	92%	60%
P/CF	(4.3)	N/A	N/A
EV/Sales	0.7	N/A	N/A
ROE	21%	N/A	N/A

Geography based on revenues

UK	Europe	US	Other
61%	29%	5%	6%

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Financial Objects is a research client of Edison Investment Research Limited

Interim results: first phase nearing completion

The completion of software development, cost cutting and restructuring means that the first phase of the evolution of the business model is largely complete. Financial Objects' Offshore Development Centre (ODC) in Bangalore has progressively improved its ability to price business at a level at which customers can justify investment in the development of their core systems.

Solid performance by key divisions

First half revenues of £5.6m included the first contribution from WMS, but like for like turnover was 9% up, reflecting existing clients' investment in banking systems. The group's core business produced its first organic revenue growth since 2000. IBIS had a profitable first half and grew its sales pipeline and there is further potential to migrate existing clients to IBIS S2 over the next 18 months. activebank recorded relatively faster growth, with revenues up 38% year on year due to both new clients (such as Aegon) and existing users buying further enhancement and upgrades. The majority of the implementation of this was carried out within the ODC. The enlarged group has firm orders of £11m for the next 12 months, and has reported increasing activity, especially amongst existing clients.

Acquisition of WMS: Important strategic move

WMS made a solid start although the full cost savings will flow into 2006 and there may yet be some exceptional H2 costs relating to the closure of its London office. Funded by a £5.3m all-share acquisition in April, the WMS enabled Financial Objects to fill in a few gaps in its product portfolio, particularly in private banking. It also added to the overall client base and improved its access to new clients seeking a broader based product range. WMS has two main divisions, LISA (wealth management) and FAIRS (IFA), i.e. complementary products and client base for IBIS/activebank. Two other divisions, both profitable, offer products and services that are a less obvious fit for Financial Objects, which will review its strategy during the second half of the year.

Outlook and valuation

Management's growing confidence is based upon a broader portfolio of completed products, installed across customer sites, supported by a strong order book and enlarged sales pipeline. The ODC continues to drive competitive advantage in a market exhibiting some signs of improvement. Recent share price weakness can be put down to, inter alia, the impact of switching the listing to AIM, which triggered disposals by ISA investors, and some overhang of shares (the consideration paid to two directors of WMS) disposed of by mid August. Paul Fullagar, a non-executive director, bought 500,000 shares in August at an average price of 33.9p.

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