

18 March 2008

## Brady

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	PE (x)	Yield (%)
12/06	4.64	0.64	1.7	1.0	25.6	2.3
12/07	5.71	0.64	1.6	1.1	27.2	2.5
12/08e**	5.85	0.75	1.8	1.1	24.2	2.5
12/09e**	6.67	1.00	2.4	1.1	18.1	2.5

Note: \*PBT and EPS are normalised, excluding goodwill amortisation. \*\*Consensus forecasts.

### Investment summary: Undervalued commodity

Established in 1985, and with a number of blue chip customers, Brady has a long track record of delivering software solutions to the commodities markets. The new management team is seeking to invest in sales and marketing, accelerate growth and boost the company's profile. Management aims to significantly accelerate annual licence wins, and the current enterprise value of c £6m could significantly undervalue the opportunity given the market size and scope for acquisitions.

### Preliminary results: Strong revenues and cash piling up

Revenues jumped 23% to £5.7m while recurring revenues lifted 19% to £1.6m and now approach £2m annual rate. Margins slipped, reflecting the investment in sales headcount. Free cash inflow (£0.65m), along with a share placement to the new chairman (also £0.65m) net of dividends (£0.26m) boosted the cash balance by more than £1m to £6m. Since balance date the cash balance has expanded to £6.7m.

### Strategy: Mission to reinvigorate a low-profile brand

The group has recently completed a reorganisation. It has established an office in the City of London to put sales and marketing staff closer to City-based clients and it has appointed a number of key sales executives. The key applications, Trinity and Opval, are now being integrated. Management aims to significantly accelerate last year's rate of new licence wins (three).

### Industry comment: A buoyant sector

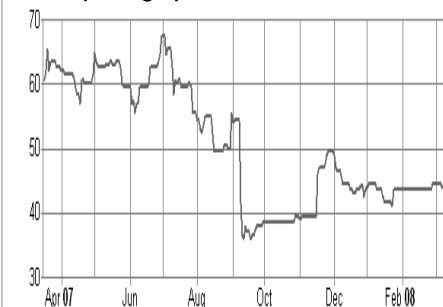
Commodity markets are buoyant, with participants in the sector enjoying high levels of activity. The US economy adds some uncertainty to the backdrop but target commodity customers (producers, fabricators, traders, etc) are cash-rich, dealing with record volumes and are significantly under-invested in IT trading platforms.

### Valuation: Well positioned and well capitalised

Brady has a market capitalisation of only £12m with some £6.7m cash, implying the company is trading on c 1x enterprise value to revenues. However, we believe Brady is well positioned in the buoyant commodities sector with scope to deliver a major uplift in organic performance and seek complementary acquisitions. In our view, in the medium term the group could potentially generate c £9m of organic revenues and close to £2.0m of EBIT.

Price 43.5p  
Market Cap £12m

#### Share price graph



#### Share details

Code BRY  
Listing AIM  
Sector Software & Computer Services  
Shares in issue 27.38m

#### Business

Brady provides a range of transaction and risk management software applications which help producers, consumers, financial institutions and trading companies manage their commodity transactions in a single integrated solution.

#### Bull

- Buoyant commodity markets.
- Strong balance sheet.
- Modest EV/sales valuation.

#### Bear

- Lower margins in 2007.
- Commodity markets are cyclical.
- Narrow product offering.

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## Business model and valuation

Brady operates a licence-based business model; it is also considering the merits of a rental model.

- **Revenue model.** The company licenses its software, much of which is implemented by outside consultants. A smaller value licence might take three months to implement and cost £150k while a high value licence might take 12–18 months and cost over £500k. Annual maintenance is 20% and the company also offers consultancy and development services (typically doubling the value of the licence sale).
- **Customer base.** Brady has some 50 customers and has identified a potential client base of nearly 3,000 industry players. Assuming a successful marketing campaign, we believe Brady is capable of generating some 10 new clients per year at an average £300k+ per licence (although the group has a very conservative revenue recognition policy, only booking a sale on customer acceptance).
- **Product offerings.** Brady is looking to widen its product portfolio and would like to utilise its cash resources to lead a consolidation process in the commodity software space.
- **Valuation.** Below we show an illustrative medium-term profit and loss. We assume the business is divided into roughly three equal parts – licensing, maintenance and professional services. We see £9m as a reasonable target level for revenues. Assuming a similar gross margin to current levels and operating costs of £3.5m (vs £3m in FY07) implies the shares are trading on an EV of less than 3x 'target' EBIT. We take no account of any benefits from an acquisition strategy.

### Exhibit 1: Illustrative profit and loss

	£m
Licences (10 x £300k)	3
Maintenance (20% on customer base)	3
Professional services	3
<b>Group revenues</b>	<b>9</b>
Consulting & R&D costs	(3.6)
<b>Gross profit</b>	<b>5.4</b>
Gross margin	60.0%
Selling & Administration	(3.5)
<b>EBIT</b>	<b>1.9</b>
<b>EBIT margin</b>	<b>21.1%</b>

Source: Edison Investment Research

### Ownership structure

Robert Brady, the CTO, holds 33% of the share capital while Sidlog Ltd, a company controlled by Joel Koschitzky, holds just under 22%. The CEO and CFO made market purchases in late 2007 at around current share price levels while the new chairman purchased 1m new shares at 60p in July.

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