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24 SEPTEMBER 2009

**BUY (PREV BUY 27/03/09)**

## Corero plc

Interims lower but in-line. Prospects for H2 brighter

**Interim results came in lower than the comparative period reflecting the absence of one-off revenues enjoyed last year. Nevertheless, the group remains on track to achieve our forecasts for the year with an encouraging business pipeline and increasing contracted support service revenues estimated to represent around 60% of forecast sales. We retain a Buy recommendation which reflects the expectation of earnings in 2010 of 14.2p putting the shares on a very modest prospective fully taxed PER of 2.7x.**

### Key points:

- The interim results were in line with management expectations and our forecasts. Revenue was 23% lower than the comparable period and an adjusted loss was incurred against a profit in 2008. This was however anticipated, with the bulk of the decline reflecting the fact that the comparative included £576,000 of REMS software sales which were one-off in nature and not expected to be repeated in the current year. Stripping out these sales the revenue decline was just 3%.
- The government's Academy schools programme represents an important customer base for the group's Business Services division which has a 30% share of this market and we believe the recent removal of the necessity for sponsors to invest £2m up-front in each new academy will be beneficial to Corero, as it should accelerate the opening of new schools. However, any benefit from this relaxation has not been factored into forecasts.
- Outside of the Academy programme the group has announced the confirmation that South Staffordshire College, a merger of Rodbaston, Cannock and Tamworth & Lichfield colleges, has committed to both the Resource Financials and REMS software products. We believe this is testament to the efficacy of the group's software offering and should provide additional revenues in 2010, although Cannock was already a customer of the group.
- Revenues within the Financial Markets division have, for the last two years, been affected by the financial crisis and its impact on the group's customer base, particularly banks and other financial institutions. Nevertheless, annual contract renewals for licensing, support and maintenance were encouraging and indicate an improvement in customer confidence. In addition beta testing of Blue Curve v.5 has been encouraging and as a result the sales pipeline has improved.
- Following the partial interest deferment on the CULS we expect the additional inflow of capital to enhance the group's cash profile over the 2009 - 2012 period. At 30 June 2009 cash balances (before the £4m CULS) were £351,000 against £422,000 at the comparative in 2008 and £1.1m at the 2008 year end. We anticipate that cash balances will improve to around £650,000 by the year end.
- The second half is traditionally the stronger of the two and management expects that this will be the case in 2009 although final results will be dependent upon a satisfactory conclusion to a significant Radica CAPS licence extension which is currently in negotiation with a major customer.
- Our PBT and EPS forecasts for 2009 and 2010 are fundamentally unchanged and call for adjusted PBT of £0.1m/2.7p and £0.3m/14.2p respectively. We continue to recommend the shares as a Buy with a prospective PER of 2.7x 2010 earnings representing a very modest valuation.

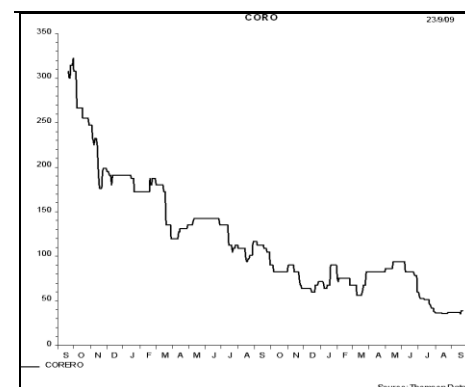
Price:	39p
Ticker:	CORO.L
Asset class:	AIM
Website :	<a href="http://www.corero.com">www.corero.com</a>
1 yr High/Low:	108.75p – 35.5p
Sector:	Software & Computer Services
Market Cap:	£0.6m
Net (debt)/cash:	(£3.4m) E
EV:	£4.0m E

Shares priced at intra-day 24 September 2009

Forecasts Source: John East & Partners Limited

YE Dec (£m)	2008	2009E	2010E
Revenue	5.25	5.00	5.50
EBITA	0.72	0.40	0.60
PBT adj	0.37	0.10	0.30
EPS FD adj (p)	17.68	4.74	14.22
DPS (p)	-	-	-
EV	3.5	4.0	4.3
EV/EBITA	4.4	8.4	6.5
PE Ratio (x)	2.2	8.2	2.7
Yield (%)	-	-	-

John East & Partners Limited act as Broker and NOMAD to Corero plc



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## Background

Corero designs and develops software products for financial institutions through its Financial Services division and business and education markets through its Business Systems division. The principal products relating to the former division are *Blue Curve* and *Radica CAPS* while the latter division's products are *Resource Financials* and *Resource Education Management System (REMS)*. Revenue is earned from new licence fees and software support and maintenance fees.

## Interim Results Summary

Interim results summary £m	6 mths to 30/06/2009	6 mths to 30/06/2008	Year to 31/12/2008
Revenue	2.180	2.830	5.249
Operating profit	-0.287	0.175	-0.317
Financing	-0.158	-0.170	-0.341
Profit before tax	-0.445	0.005	-0.658
Add back separately disclosed items	0.051	0.001	0.669
Add back amortisation of intangibles	0.204	0.166	0.365
Add back share based payments	0.000	-0.003	-0.003
Adjusted pre tax profit	-0.190	0.169	0.373
Adjusted EPS (p)	-12.3	11.1	29.8

Source: Company

The interim results were in line with management expectations and our forecasts. Revenue was 23% lower than the comparable period and an adjusted loss was incurred against a profit in 2008. This was however anticipated, with the bulk of the decline reflecting the fact that the comparative included £576,000 of new REMS software sales which were one-off in nature and not expected to be repeated in the current year. Stripping out these sales the revenue decline was just 3%.

The second half is traditionally the stronger of the two and management expects that this will be the case in 2009 although final results will, as usual, be dependent upon a small number of significant potential sales in the Financial Systems division.

Our PBT and EPS forecasts for 2009 and 2010 are fundamentally unchanged and call for adjusted PBT of £0.1m/2.7p and £0.3m/14.2p respectively.

## Business Systems division

Business Systems Division £m	6 mths to 30/06/2009	% chge	6 mths to 30/06/2008	Year to 31/12/2008
Revenue	1.306	-29.2%	1.844	3.208
Operating profit	0.300	-55.0%	0.666	0.873
Operating profit margin	23.0%	-36.4%	36.1%	27.2%

Source: Company

This division derives the majority of its revenues from software sales into the education market. The opening of new academy schools under the government's Academy programme has been a particularly strong area of growth with Corero maintaining a market share of around 30%. Currently approximately 75% of the Business Systems division's revenues are derived from the Resource Financials product and 25% from REMS.

The Academy programme promotes the establishment of state-funded schools which are managed by sponsors that include high performing schools and colleges, individual

philanthropists, businesses and the voluntary sector. Some 200 academies have now been opened since the scheme began in 2002 and a further 200 are planned.

We believe the recent removal of the necessity for sponsors to invest £2m up-front in each new academy will be beneficial to Corero, as it should accelerate the opening of new schools in the future. In addition it will remove the financial constraints which previously limited the ability of charities, parents' groups and education sector organisations such as colleges and universities to participate fully in the scheme. However, any benefit from this relaxation has not been factored into forecasts.

As stated earlier, 2008 comparatives include the receipt of £576,000 of one-off sales relating to the conversion of existing customers to REMS, the group's new learner management product. Stripping out this effect would have resulted in sales being just 3% lower than the first half of 2008.

The division is seasonal in that, typically, many educational establishments order new products during the early summer so they can install them and implement any required operational changes during the summer vacation period.

In the first half of the financial year 13 new academy contracts were won with a further 10 being awarded in July. While seasonal ordering usually favours the April to August period the group is still anticipating further wins in the second six months which will enhance the sale of the Resource Financial product and bring the number of Academy-based contract awards up to around 63.

Outside of the Academy programme the group has announced that South Staffordshire College (a merger of Rodbaston, Cannock and Tamworth & Lichfield colleges), has committed to both the Resource Financials and REMS software products. We believe this is testament to the efficacy of the group's software offering and should provide additional revenues in 2010, although Cannock was already a customer.

### Financial Markets division

Financial Markets Division £m	6 mths to 30/06/2009	% chge	6 mths to 30/06/2008	Year to 31/12/2008
Revenue	0.874	-11.5%	0.988	2.041
Operating profit	-0.215	18.1%	-0.182	0.010
Operating profit margin	-24.6%	33.5%	-18.4%	0.5%

Source: Company

Revenues within the Financial Markets division have, for the last two years, been affected by the financial crisis and its impact on the group's customer base, particularly banks and other financial institutions. Nevertheless, annual contract renewals for licensing, support and maintenance were encouraging and indicate an improvement in customer confidence.

Revenues declined by 11.5% and the operating loss increased over the comparative. Overhead savings have been implemented resulting in a charge of £60,000 relating to redundancies, the benefits of which will be seen in the second half.

The group is awaiting confirmation from a major customer of a significant extension to a licence agreement for Radica CAPS software. Negotiations have proved to be protracted, as there are some significant changes to the original terms and conditions of the contract while sign-offs are inevitably impacted by pressures on clients' capex budgets caused by the financial crisis.

Blue Curve v.5 was launched in Q3 2009 and feedback from beta testing has been positive. As a consequence the group has seen an improvement in the sales pipeline (compared to that at the beginning of 2009 and H2 2008) and the expectation is for an improved performance in the second six months, subject to the satisfactory conclusion of the Radica CAPS licence extension referred to above.

## Financials

In June 2009, in order to provide additional working capital facilities and to fund required investment in the Resource Financials software product, Corero announced an amendment to the terms of the £4m 8% Convertible Unsecured Loan Stock (CULS) and a capital reorganisation.

In essence the redemption date for the CULS has been extended from 2011 to 2015 and half of the annual interest liability will be deferred for three years thus providing the group with an additional £480,000 of capital over the period. As part of the capital reorganisation every 30 existing ordinary shares were consolidated into one new ordinary.

We expect this reduction in outflow of capital to enhance the group's cash profile over the 2009 to 2012 period and at June 2009 cash balances (before the £4m CULS) were £351,000 against £422,000 at the comparative date in 2008 and £1.1m at the 2008 year end. We anticipate that cash balances will improve to around £650,000 by the year end.

## Conclusion

Clearly Corero needs to build its top line through new licence sales and service and maintenance fees while at the same time continuing to invest in its suite of software products. The operational gearing potential is obvious but at the moment a significant proportion of its potential customer base is being affected by the financial crisis and recessionary conditions within the global economy. However, we do acknowledge that the Business Systems division is partially protected by the Academy scheme roll-out and the expected maintenance of the group's share of this market.

We continue to see 2009 as a year of consolidation for the group. Having achieved its goal of modest profitability in 2008 it is the management's aim to sustain this position in the current year. Further out the marketing of new versions of software products and an increasing recurring revenue stream should provide the foundation for strong organic growth in 2010 and 2011.

Therefore, in conclusion, while the group will continue to face a challenging trading environment for the rest of 2009, management is making progress across a number of fronts and we are maintaining our PBT and EPS forecasts for 2009 (£0.1m/4.7p) and 2010 (£0.3m/14.2p respectively) albeit on marginally lower revenue forecasts. As referred to above, the 2009 forecast is subject primarily to a satisfactory conclusion to the Radica CAPS licence extension.

Since our last note in March 2009 the share price has fallen by 53% from 82.5p to the current 39p. However, in spite of this disappointing reduction we continue to recommend the shares as a Buy based on the potential for a strong turnaround in profitability in 2010 which would put the shares on a very modest PER of 2.7x fully taxed earnings.

## CORERO PLC - Recommendation BUY (prev. Buy 27/03/09)

Summary P&L				
Years ended December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Revenue</b>	<b>5.24</b>	<b>5.25</b>	<b>5.00</b>	<b>5.50</b>
<b>Gross profit</b>	<b>4.94</b>	<b>4.89</b>	<b>4.55</b>	<b>5.00</b>
Administration expenses	-5.69	-4.53	-4.55	-4.65
Associates	0.00	0.00	0.00	0.00
<b>Operating Profit</b>	<b>-0.75</b>	<b>0.35</b>	<b>0.00</b>	<b>0.35</b>
Separately disclosed items (SDI)	-0.40	-0.67	0.00	0.00
Finance income	0.02	0.01	0.00	0.00
Finance charge	-0.35	-0.35	-0.30	-0.30
<b>Profit before tax as stated</b>	<b>-1.49</b>	<b>-0.66</b>	<b>-0.30</b>	<b>0.05</b>
IFRS 3 adjustment for amortisation of intangibles	0.27	0.37	0.40	0.25
Adjustment for SDI	0.40	0.67	0.00	0.00
IFRS 2 adjustment for share based payments	0.00	-0.00	0.00	0.00
<b>Adjusted Profit before tax</b>	<b>-0.75</b>	<b>0.37</b>	<b>0.10</b>	<b>0.30</b>
Tax	0.05	-0.10	-0.03	-0.08
Post tax profit	-1.44	-0.76	-0.33	-0.03
Minorities	0.00	0.00	0.00	0.00
<b>Net Profit</b>	<b>-1.44</b>	<b>-0.76</b>	<b>-0.33</b>	<b>-0.03</b>
<b>Adjusted Net Profit</b>	<b>-0.77</b>	<b>0.27</b>	<b>0.07</b>	<b>0.22</b>
<b>EBITDA and exceptionals</b>	<b>-0.42</b>	<b>0.79</b>	<b>0.48</b>	<b>0.67</b>
Depreciation	-0.06	-0.08	-0.08	-0.07
<b>EBITA</b>	<b>-0.48</b>	<b>0.72</b>	<b>0.40</b>	<b>0.60</b>
IFRS 3 amortisation of intangibles	-0.27	-0.37	-0.40	-0.25
<b>EBIT</b>	<b>-0.75</b>	<b>0.35</b>	<b>0.00</b>	<b>0.35</b>
<b>Equity</b>				
Weighted average shares (m)	1,445	1,519	1,519	1,519
Weighted average shares FD (m)	1,445	1,519	1,519	1,519
Year end shares in issue (m)	1,519	1,519	1,519	1,519
<b>EPS</b>				
EPS FD (p)	-99.87	-50.19	-21.59	-2.24
<b>EPS FD and adjusted (p)</b>	<b>-53.15</b>	<b>17.68</b>	<b>4.74</b>	<b>14.22</b>
<b>Dividend</b>				
Interim dividend (p)	0.00	0.00	0.00	0.00
Final dividend (p)	0.00	0.00	0.00	0.00
<b>Total dividend (p)</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>

Key ratios				
Market cap (£m)	0.6	0.6	0.6	0.6
Enterprise value (EV) (£m)	3.8	3.5	4.0	4.3
EV/EBITA (x)	-7.9	4.4	8.4	6.5
<b>Share price (p)</b>	<b>39.0</b>			
PER (x)	-0.7	2.2	8.2	2.7
Yield (%)	-	-	-	-

P&L Analysis				
Years ended December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Analysis of revenue</b>				
Financial Markets	2.53	2.04	2.20	2.50
Business Systems	2.72	3.21	2.80	3.20
<b>Total Revenue</b>	<b>5.24</b>	<b>5.25</b>	<b>5.00</b>	<b>5.70</b>
License revenue	0.99	1.23	1.20	1.60
Professional services revenue	1.55	1.17	1.20	1.20
Support revenue	2.70	2.85	2.90	2.90
<b>Total Revenue</b>	<b>5.24</b>	<b>5.25</b>	<b>5.30</b>	<b>5.70</b>
<b>Analysis of operating profit</b>				
Financial Markets	-0.47	0.01	0.28	0.20
Business Systems	0.77	0.87	0.55	0.85
Separately disclosed items	-0.08	-0.60	0.00	0.00
Unallocated costs	-1.38	-0.60	-0.62	-0.65
<b>Total Operating Profit</b>	<b>-1.15</b>	<b>-0.32</b>	<b>0.21</b>	<b>0.40</b>
<b>Operating margin (pre exceptional and central costs)</b>				
Financial Markets	-18.5%	0.5%	12.7%	8.0%
Business Systems	28.2%	27.2%	19.6%	26.6%
<b>Group Operating margin</b>	<b>5.7%</b>	<b>16.8%</b>	<b>15.1%</b>	<b>18.3%</b>

Key Ratios				
EBITA margin	-9.1%	13.7%	8.0%	10.9%
Administration costs as a % of revenue	108.6%	86.4%	91.0%	84.5%
Effective tax rate	Cr	28.0%	28.0%	28.0%
Net interest cover by EBITDA (x)	-1.3	2.3	1.6	2.2
Dividend cover by adjusted EPS (x)	n/a	n/a	n/a	n/a

Summary Cash Flow				
Years ended December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
Cash from operating activities	-0.69	0.76	0.45	0.59
Increase in trade and other receivables	0.82	0.66	-0.10	0.20
Increase in trade and other payables	0.57	-0.33	-0.16	-0.40
Change in provisions for liabilities and charges	0.00	0.00	0.00	0.00
<b>Cash generated by operations</b>	<b>0.70</b>	<b>1.10</b>	<b>0.19</b>	<b>0.39</b>
Taxation paid	0.00	0.00	0.00	0.00
<b>Net cash generated by operating activities</b>	<b>0.70</b>	<b>1.10</b>	<b>0.19</b>	<b>0.39</b>
<b>Cash flow from investing activities:</b>				
Interest received	0.02	0.01	0.00	0.00
Acquisition of subsidiaries (net of cash acquired)	0.00	0.00	0.00	0.00
Proceeds from the sale of subsidiary (net of cash disposed)	0.00	0.00	0.00	0.00
Purchase of PP&E	-0.13	-0.05	-0.05	-0.05
Purchase of intangible assets	-0.35	-0.42	-0.30	-0.35
Proceeds from sale of PP&E	0.00	0.00	0.00	0.00
Decrease/(increase) in short term deposits	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Net cash used in investing activities</b>	<b>-0.46</b>	<b>-0.46</b>	<b>-0.35</b>	<b>-0.40</b>
<b>Financing activities:</b>				
Purchase of own shares	0.00	0.00	0.00	0.00
Net movement in borrowings	0.00	0.00	0.00	0.00
Dividends paid	0.00	0.00	0.00	0.00
Interest paid	-0.32	-0.32	-0.30	-0.30
Issue of shares (net)	0.00	0.00	0.00	0.00
Capital element of finance lease rentals	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Net cash inflow from financing activities</b>	<b>-0.32</b>	<b>-0.32</b>	<b>-0.30</b>	<b>-0.30</b>
<b>Net increase in cash and cash equivalents</b>	<b>-0.08</b>	<b>0.32</b>	<b>-0.46</b>	<b>-0.31</b>
Cash and cash equivalents at start of year	0.91	0.83	1.15	0.68
FX changes	0.00	0.00	0.00	0.00
<b>Cash and cash equivalents at end of year</b>	<b>0.83</b>	<b>1.15</b>	<b>0.68</b>	<b>0.37</b>

Reconciliation of cash flow to net debt				
Net (debt)/cash at start of the year	-3.04	-3.20	-2.91	-3.41
Net increase in cash and cash equivalents	-0.08	0.32	-0.46	-0.31
Net change in borrowings during the year	0.00	0.00	0.00	0.00
<b>Net (debt)/cash at end of the year</b>	<b>-3.18</b>	<b>-2.91</b>	<b>-3.41</b>	<b>-3.75</b>

Key Ratios				
Free Cash Flow (£m)	0.7	1.1	0.2	0.4
Free Cash Flow per share (p)	48.2	72.3	12.2	25.4

### Free Cash Flow:

Cash flow from operating activities, less interest paid, less tax paid, less equity dividends paid

Summary Balance Sheet				
Years ended December	2007	2008	2009 E	2010 E
	£m	£m	£m	£m
<b>Assets</b>				
<b>Non-current assets</b>				
PP&E	0.15	0.12	0.10	0.15
Goodwill	2.36	1.68	1.68	1.68
Other intangible assets	1.19	1.24	1.25	1.30
Deferred tax asset	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Total non-current assets</b>	<b>3.70</b>	<b>3.04</b>	<b>3.03</b>	<b>3.13</b>
<b>Current assets</b>				
Trade and other receivables	1.64	0.98	1.08	0.88
Deferred tax assets	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
Cash and short term deposits	0.83	1.15	0.65	0.50
<b>Total current assets</b>	<b>2.46</b>	<b>2.12</b>	<b>1.73</b>	<b>1.37</b>
<b>Total assets</b>	<b>6.16</b>	<b>5.16</b>	<b>4.75</b>	<b>4.50</b>
<b>Liabilities</b>				
<b>Current liabilities</b>				
Trade and other payables	-1.09	-0.83	-0.67	-0.27
Taxation liabilities	0.00	0.00	0.00	0.00
Bank overdrafts and other short term borrowings	0.00	0.00	0.00	0.00
Provisions	-0.09	-0.01	0.00	0.00
Other	-1.96	-1.89	-1.89	-1.80
<b>Total current liabilities</b>	<b>-3.15</b>	<b>-2.74</b>	<b>-2.57</b>	<b>-2.07</b>
<b>Non-current liabilities</b>				
Long term borrowings	-4.03	-4.06	-4.06	-4.06
Provisions	-0.05	-0.01	0.00	0.00
Deferred taxation liability	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
<b>Total non-current liabilities</b>	<b>-4.08</b>	<b>-4.07</b>	<b>-4.06</b>	<b>-4.06</b>
<b>Total liabilities</b>	<b>-7.23</b>	<b>-6.81</b>	<b>-6.62</b>	<b>-6.13</b>
<b>Net Assets</b>	<b>-1.07</b>	<b>-1.65</b>	<b>-1.87</b>	<b>-1.63</b>
<b>Key Ratios</b>				
Net cash/(debt) (£m)	-3.2	-2.9	-3.4	-3.8
Net debt/shareholders funds	-299.0%	-177.0%	-182.1%	-230.0%
Capital employed (£m)	3.1	2.4	2.2	2.4
ROCE	-24.3%	14.5%	0.0%	14.4%
Current ratio (x)	0.8	0.8	0.7	0.7

### Capital Employed:

Shareholders funds, add debt, add obligations under finance leases, add minorities, add provisions, less associates, less investments

### ROCE:

Operating profit / Capital Employed

**Risks**

This note makes a number of assumptions regarding the outlook for trading conditions within the companies that are included, relating to demand for services and the specific drivers for future growth, including assumptions regarding the economic climate in the UK and overseas. There is a risk that this outlook may deteriorate or that the market conditions may alter leading to a significant downturn in certain segments of these companies activities.

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