Outlook

Edison investment research

12 September 2006

FDM Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	PE (x)	Yield (%)
12/04	33.0	1.8	6.5	1.3	12.7	1.6
12/05	35.1	2.2	6.8	1.5	12.1	1.8
12/06e	43.0	2.9	8.8	1.7	9.4	2.1
12/07e	50.0	3.4	10.3	2.1	8.0	2.5

Note: *PBT and EPS are normalised, excluding goodwill amortisation and exceptional items and UITF 17/FRS20 option charges.

Investment summary: Set for strong growth

Strong interims included revenues up 28% at £21m and pre-tax profit 42% to £1.33m. Operationally, FDM achieved its objectives, with Mountie recruitment on track and a strong pipeline of new business providing good visibility for the full year and into 2007. Numbers on billing have climbed steadily in H2, as has the gross margin as a higher proportion of Mounties has come on line. FDM's distinct, proven business model and focus on IT skills in high demand should continue to enable it to generate revenues and earnings growth rates that justify a higher rating.

Operational metrics improving

Numbers on billing were 572 (469) at 30 June and have since moved above 600. In order to satisfy short-term demand from a client list 50% higher than at IPO, the use of freelancers increased in H1. However FDM added 41 Mounties in H1 and is comfortably on track for a 180 strong team by the year end.

Market: Robust demand proves benefits of business model

Management describes the market for its niche as solid and improving. In contrast with IT staffing generalists, FDM's model provides competitive advantages, resulting in industry leading margins and improved contract terms.

Strategy: Further investment in FDM Academy

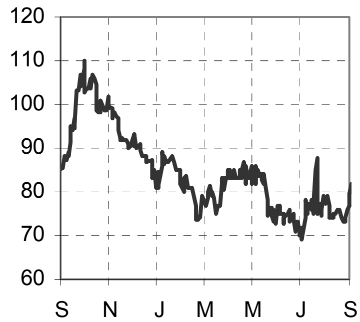
The scale and long term nature of recent client wins support plans to accelerate growth of the Mountie team and FDM is investigating a number of strategic options to achieve this. Acquisitions are also under consideration, to enhance margins.

Valuation: Underlying trends argue for higher rating

We will maintain our forecasts until we have more visibility on H2 trading, but the trends are very positive. The current price is behind events, as it does not reflect the improved performance or opportunities for FDM to leverage the competitive advantages generated by its unique business model.

Price	82.5p
Market Cap	£20m

Share price graph



Share details

Code	FDMG
Listing	AIM
Sector	Support Services
Shares in issue	23.2

Price

	High	Low
52 week	112p	68p

Balance Sheet

Debt/Equity (%)	N/A
NAV per share (p)	29
Net cash (£m)	1.5

Business

FDM provides IT solutions in three areas. Placing IT professionals in contract employment in UK, Europe and US. IT projects on behalf of corporate clients. Production/delivery of tailored training solutions.

Valuation

	2005	2006e	2007e
P/E relative	73%	65%	74%
P/CF	23.7	9.0	9.0
EV/Sales	0.5	0.4	0.4
ROE	24%	27%	27%

Geography based on revenues*

UK	Europe	US	Other
81%	13%	6%	0%

**12 months to end June 05*

Analyst

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FDM Group is a research client of Edison Investment Research Limited

Investment summary: Set for strong growth

Company description: Positioned to leverage important IT trends

The FDM Group provides two categories of IT solutions for clients.

The core business is IT Staffing, places IT professionals into contract positions of employment in the UK, mainland Europe and the US. However FDM is the only IT staffing provider that trains and maintains a core team of employees. These are the so-called 'Mounties' that it trains in skills in most demand by its clients (currently Java, .Net and C#). This gives FDM unique access to a database of highly trained and certified IT staff, not available to the general staffing industry. The Mounties are retained on fixed terms, and this represents a considerably higher margin activity than the provision of freelance IT contractors, which is a complementary activity for the group and provides additional resources for clients when its Mountie team is fully utilised. The other activity is IT Services & Training. This represents the development, support and implementation of projects on behalf of clients, as well as training for the client's in-house staff.

Valuation

FDM's shares have tracked the performance of the broader IT services companies, none of which replicates the underlying business model or prospects. As a result, the shares have fallen since their peak in early October 2005, despite significant progress made operationally (greater spread and diversity of revenues, enlarged Mountie team and pipeline) and market dynamics that provide strong arguments for a confident outlook and higher rating.

Sensitivities

FDM operates a distinct business model that results in sector leading margins and revenue visibility and enables it to manage many of the risks associated with a cyclical IT market. Corporate IT spending on its Mounties' Java and .Net skills is still growing and the prospects remain highly encouraging, in line with clients' desire to progressively web-enable their businesses.

In order to capitalise upon this demand, the group needs to maintain a steady rate of growth in the size of its employed Mountie team. This will require an increased investment in its 'FDM Academy' programme to enable it to progressively step up the scale of recruitment and training. Recent initiatives have kept the growth rate on target, but management is considering further expansion, possibly opening further facilities and possible acquisitions that it believes will enhance margins. The recent addition of Ivan Martin (ex-Misys) as chairman adds experience in the acquisition and integration of new businesses.

Financials

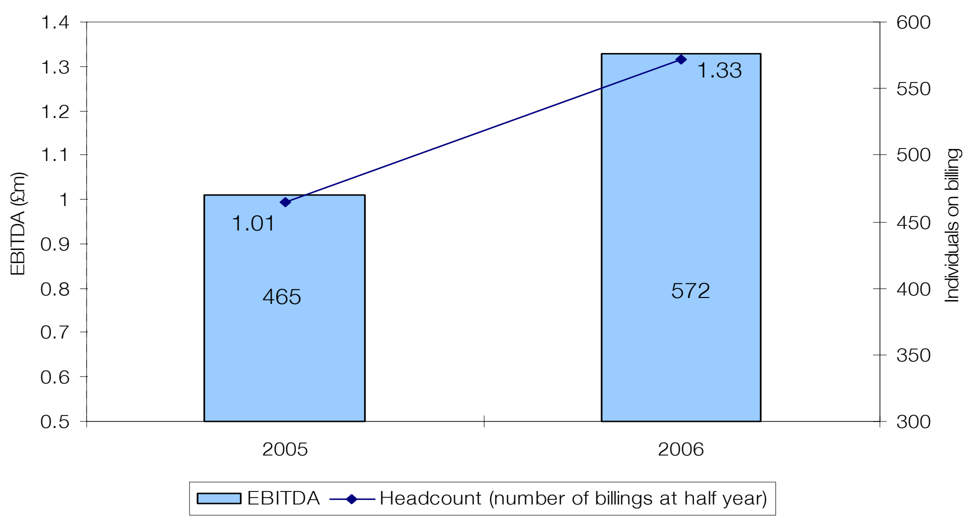
All divisions traded well in H1 with substantial new business lined up for H2 and beyond. Sales were up 32% in the UK and The Benelux produced a record performance. We expect further growth in H2 as the Mounties team builds towards 180. The decline in gross margins to 18.7%, from 19.6%, reflects the increased ratio of freelancers to Mounties. This is already reversing as new Mounties come on stream at steadily improving margins.

Investment summary: Strong H1 & outlook

Interim results

Revenues grew 28% on the back of new client wins, with numbers on placement up by 23% to 572 (including 118 Mounties) during the first half. A 32% increase in EBITDA reflects higher average charge out rates, although gross margins fell to 18.7% (19.6%) as FDM met increased demand in the short term via higher use of freelance contractors. This margin is still well above the industry average and has already recovered towards 19% with higher Mountie use during H2.

Exhibit 1: Interim EBITDA and Numbers on Billing



Source: FDM Interim results to 30 June 2006

Revenue profile: Improved client and sector spread

During the first half FDM continued to grow the client list and won further business from existing clients, on longer term contracts of a higher value. Financial Services continues to be a key source of new revenues, with further demand from clients such as ABN Amro, HSBC and Deutsche Bank. The prospects for Transportation are also interesting, with further projects for The AA and the first contribution from BA at Terminal 5 and further growth to come. The table below illustrates the sector spread. The addition of 50 clients to a total of 150 since IPO has reduced dependence on any client, with the top ten accounting for 35% of first half revenues.

Exhibit 2: Revenue sources by industry

6 months ended 30 June	2005	2006
System Integrators	32.8%	37.7%
Financial Services	36.6%	28.8%
Transportation	8.4%	13.0%
Media	14.4%	9.5%
Telecoms	9.8%	6.0%
Public Sector	0.6%	1.0%

Source: FDM Interim results to 30 June 2006

Operational Review

The group has made a logical decision to combine its Professional Services and Commercial Training divisions into a new FDM IT Services operation. These previously provided complementary elements of projects for clients, supplying staff to install a new IT system, taking responsibility for implementation and ongoing support, and training the in-house team. The new structure will also simplify the marketing of these services.

IT Staffing

The addition of 40 new clients in the first half, including AIG, BNP Paribas, Virgin Mobile, Logica, Xansa and M&G Investment Management provides a strong basis for future growth and reduces dependence upon any single client. The transportation sector has also grown in importance, on the back of demand from clients including British Airways (to 30 contractors at the half year from a standing start), BMW, Daimler Chrysler and the AA.

The division placed significantly higher numbers of both freelance contractors and Mounties. The gross profit margin for Mounties grew to 44.5% (42.3%:H1 05), illustrating the strong underlying demand for niche skills (Java and .Net) in short supply. The average charge out rate grew by 40% over the last 12 months. The equivalent margin for freelance contractors slipped to 11.9% (12.6%), which demonstrates the value of progressively building the supply of Mounties.

IT Professional Services & Training

The newly combined division reported revenues of £2.27m for the first half, 9% growth year-on-year and £0.7m gross profit, broadly in line. New projects will begin to contribute in H2. It has increased the number of contractors on billing by 59% over the last 12 months to 89 at end June. The banking industry is the core driver, with new work underway for ABN AMRO, Deutsche Bank and HSBC based upon long term contracts and the division remains on target to achieve revenues of £5.4m and £1.8m gross profit. The division has revenue visibility into 2007, with new projects in the pipeline for major customers due to commence early next year. The strategy is to focus on securing relationships that generate longer term, annuity revenues.

International operations: US & Europe picking up

The US operation, FDM Inc. performed ahead of target in the first half, with sales up 24%. It increased its presence in the government sector and added new financial services clients such as Searchspace and HSBC. The strategy is to leverage existing UK client relationships into the USA during the H2 and it has already seconded UK Mounties to ABN AMRO in New York.

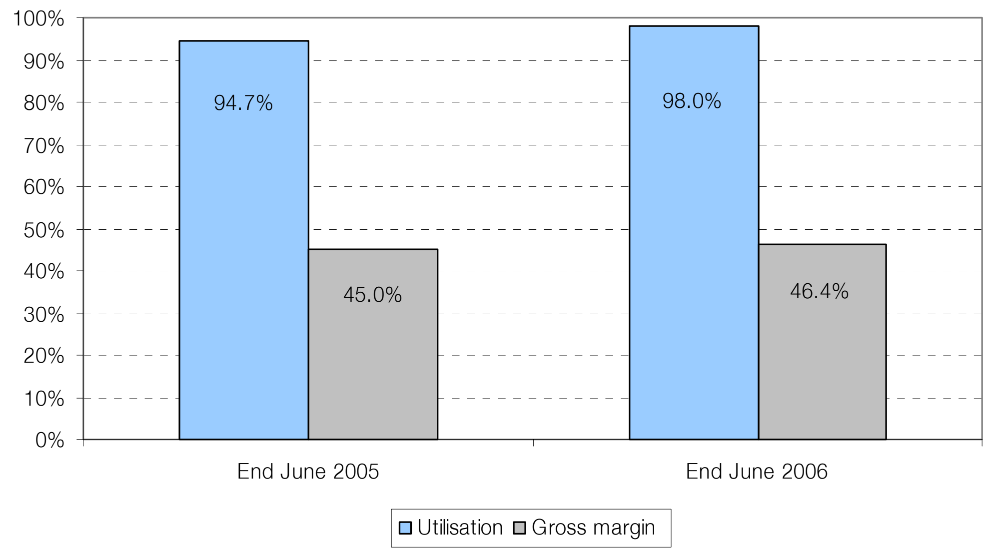
European offices increased turnover 11% year-on-year, with gross profit up 15%. The Benelux region reported a record profit on the back of demand for Mounties on longer term, higher margin projects. Additional business was generated from existing customers such as JP Morgan, Deutsche Bourse Systems, Sony and the European Commission. New customers include IKB Bank, BNP Paribas and Avery Dennison.

Outlook: Emphasis on scaling up Mountie model

FDM's Mountie model provides material competitive advantages over quoted IT staffing sector 'peers'. Where the competition generally provides a high-volume and commoditised (albeit sector focused) service, FDM trains and maintains a core contingent of employees in specialist IT skills (notably Java and .Net), which it maintains as an in-house resource. This gives it access to a database of highly trained and certified IT staff not shared by the general staffing industry, via which it generates margins well above those accessible by placing freelance contractors.

Although FDM can respond to client needs by both placing Mounties and accessing a general pool of IT contractors, the former is a far higher margin activity. It also enables the group to secure stronger client relationships, based upon longer term contracts that improve earnings visibility. The underlying demand for the skill-set is illustrated below, in high utilisation rates and increasing margins.

Exhibit 3: Mountie statistics



Source: FDM Interim results to 30 June 2006

We expect the group gross margin to recover during the second half, reflecting improved balance of freelancers and Mounties. FDM has stepped up investment in its academy to increase the supply of suitably qualified Mounties and improve conversion rates. It added 41 new Mounties during the first half of the year and remains on target to add another 35 by the year end, which will bring the complement to 180. New initiatives such as online recruitment are working well, particularly FDM's adverts on graduate web-sites and the Academy receives, on average, over 55 new applicants per week.

It has also developed innovations such as 'Banking Mounties', with skills most specifically tailored to needs of this customer base. This enables FDM to place the individuals with customers at an earlier stage and provide training on-site. It thus generates revenues (at similar margins to full Mounties) sooner and is able to meet client demand more readily.

Other initiatives to step up the rate of growth of the Mountie team are under consideration.

Sensitivities: Building the Mountie team

Few competition issues thus far

The group has seen little in the way of competitive pressure, either from the IT staffing sector or the impact of offshore outsourcing of IT implementation. The work undertaken by the Mounties tends to comprise complex, multilayered applications that need to be carried out on site. In addition, the nature of the group's contract with the Mounties makes the pricing highly competitive relative to offshore providers.

The business model is designed to manage the risks associated with a cyclical market. The proposition is to focus on ways to improve access to niche IT skills in shortest supply, which are expected to experience strongest demand. FDM's concentration on Java and .Net has positioned in a part of the IT market that continues to grow. Additionally, the creation of a pool of Mounties enables the group to generate industry leading margins, and improves visibility of earnings as they result in stronger customer relationships based upon longer term contracts.

Mounties: No let up in demand

Demand for Mounties currently exceeds supply. FDM's latest figures show that 131 Mounties are currently placed, vs. around 93 at the same stage last year. Increasing the rate of growth of the Mounties team is a key component of future potential. Recent investment has addressed capacity constraints relating to training greater numbers. The key factors are now to identify, recruit and train members of the Mountie team. A number of initiatives have generated increased applications for its Academy programme during the first half. Of over 1,600 applicants, 97 joined the course, with approximately 80% expected to qualify during the current year. During the first half, 41 passed the course, with further 35 needed in the second half to hit the 180 year end target. Post that the original target was 240 for end 2007. Drop offs and starts are better synchronised than at IPO and in the last year, average training times have fallen from nine to as short as 4/5 months.

'Banking Mounties' and career development

The strategy since IPO has been to scale up the training process and simultaneously compress the period to bring new Mounties to market. The 'FDM Academy' has been transformed over the last 12 months and actively recruits graduates, which it trains in specialist programming skills that support major client IT investment programmes. These individuals are employed on a fixed contract for two years post qualification. Many retain that status beyond the initial period and take advantage of career progression provided by the group.

The introduction of 'Banking Mounties' accelerated the growth rate without comprising quality. FDM provides ongoing training while on site, with a view to a Mountie joining a bank after two years for a pre-agreed payment. FDM gets paid earlier in the cycle, with some clients treating the Academy as part of their graduate recruitment programme and agreeing contracts under which they agree terms to hire individuals directly at the end of the two years in return for a placement fee. In order to encourage retention rates post the initial two year period, the group has hired staff to promote career progression for Mounties within the group, e.g. relocate to the US office.

Financials

The first half underpins our forecasts for the year. Underlying operating profit (adjusting for the cost of the IPO in 2005) was up 30% to £1.2m, on turnover up 28% to 21.1m. Gross margins of 18.7% fell due to the freelance/Mountie mix already discussed, but the group reports no other underlying trends that undermine their expectation that a target above 19% is achievable. Pre-tax profit of £1.33m was up 42%, adjusted for IPO costs and FRS20 share charges.

Overheads are under good control. Increased 'headcount' represents growth in Mounties and freelance consultants, with a modest increase in support staff from 61 to 68. Spending was below the £0.5m budgeted for investment in the training school, marketing and additions to the sales force. The group still has plans to upgrade its infrastructure and systems to support an enlarged operation, and introduce efficiencies (e.g. billing systems) that should further enhance margins.

All divisions, by operation and geography appear well-positioned for the second half and beyond, based upon a full contribution from enlarged Mountie teams, recent contract wins and continued growth in the underlying market. The interim dividend was increased by 0.1p to 0.6p.

The balance sheet remains strong with net cash of £1.46m at the half year. FDM is considering acquisitions, but has yet to identify opportunities that would add value and complement the existing offering. These are likely to be IT related service businesses, with a strong profit record and good fit with the Mountie model. It looks for opportunities to push up margins and may also use an acquisition to broaden its geographical coverage in the UK, and bring its training capacity closer to its clients which, in the financial services industry, tend to be based in London.

Outlook

There is a strong outlook for H2 and 2007. We estimate that half FDM's revenues are derived from the financial services industry overall (direct and via systems integrators), with an increasing proportion based upon longer term contracts and teams embedded within clients' core support systems. An example of this is the work carried out on behalf of HSBC, where FDM provides a growing desktop support team for the bank's global derivatives division.

FDM has experienced significant increase in demand for its services over the last 12 months. Although demand for IT professionals picked up in early 2004, these figures reveal real acceleration over the 12 months to the half year end. Corporate IT spending has recovered significantly and trends based upon implementation of new, web-enabled strategies work in FDM's favour.

Valuation

We have maintained our forecasts post these results and regard the figures as readily achievable.

FDM's revenue growth is well supported by strong growth in the client base, the extension of the scale and scope of work lined up on behalf of major customers and its ability to progressively deliver the Mountie numbers to capitalise on these opportunities.

The performance during the first two months of H2 has been strong, and although we take a conservative view regarding FDM's ability to maintain the kind of growth achieved over the last 4-5 months, believe that the prospects justify a higher rating than 9/8x earnings for this year and next.

In part, the group suffers by comparison with a quoted IT staffing sector 'peer group' which is not a relevant template. The UK IT staffing market is highly fragmented, either within large, generalist staffing agencies or IT specialists that provide a far more general, commoditised service than FDM. Indeed, we cannot identify another UK quoted IT staffing company with a comparable business model. Where others operate a high turnover, low margin structure that has begun to come under pressure, FDM's distinct business profile and value-added services protect its higher margins.

The group reports major contracts under discussion with substantial new clients that would potentially provide visibility out as far as 2008. Important markets, such as the sale of core banking software are performing well, providing a lead indicator that supports an argument for market growth out to 2008.

Exhibit 4: Financials

Year-ending 31 December	£'000s	2003	2004	2005	2006e	2007e
Accounting basis		UK GAAP	UK GAAP	UK GAAP	UK GAAP	IFRS
PROFIT & LOSS					FRS20	
Revenue		25,980	32,971	35,068	43,000	50,000
Cost of Sales		(20,938)	(26,692)	(28,274)	(34,850)	(40,500)
Gross Profit		5,042	6,279	6,794	8,150	9,500
EBITDA		1,111	1,917	2,223	2,940	3,480
Operating Profit (before GW and except.)		996	1,808	2,127	2,860	3,400
Goodwill Amortisation		0	0	0	0	0
Exceptionals		0	0	(587)	0	0
Other (FRS20 adjustment)		0	0	0	(160)	(200)
Operating Profit		996	1,808	1,540	2,700	3,200
Net Interest		4	(3)	25	80	20
Profit Before Tax (norm)		1,000	1,805	2,152	2,940	3,420
Profit Before Tax (FRS 20 adjusted)		1,000	1,805	1,565	2,780	3,220
Tax		(347)	(590)	(666)	(900)	(1,030)
Profit After Tax (norm)		653	1,215	1,486	2,040	2,390
Profit After Tax (FRS 20 adjusted)		653	1,215	899	1,880	2,190
Average Number of Shares Outstanding (m)		18.7	18.7	21.8	23.2	23.2
EPS - normalised (p)		3.5	6.5	6.8	8.8	10.3
EPS - FRS 20 adjusted (p)		3.5	6.5	4.1	8.1	9.4
Gross Margin (%)		19.4%	19.0%	19.4%	19.0%	19.0%
EBITDA Margin (%)		4.3%	5.8%	6.3%	6.8%	7.0%
Operating Margin (before GW and except.) (%)		3.8%	5.5%	6.1%	6.7%	6.8%
BALANCE SHEET						
Fixed Assets		216	248	204	241	1,190
Intangible Assets		22	11	14	21	500
Tangible Assets		194	237	190	220	690
Investment in associates		0	0	0	0	0
Current Assets		5,775	8,034	10,272	10,974	12,879
Stocks			0	0	0	0
Debtors		4,731	6,498	7,704	7,800	9,100
Cash		1,044	1,536	2,568	3,174	3,779
Current Liabilities		(2,927)	(4,645)	(4,323)	(3,660)	(4,200)
Creditors		(2,799)	(4,149)	(4,097)	(3,600)	(4,200)
Short term borrowings		(128)	(496)	(226)	(60)	0
Long Term Liabilities		0	(1,600)	0	0	0
Long term borrowings		0	(1,600)	0	0	0
Other long term liabilities		0	0	0	0	0
Net Assets		3,064	2,037	6,153	7,555	9,869
CASH FLOW						
Operating Cash Flow		1,207	857	781	2,187	2,580
Net Interest		4	(3)	25	80	20
Tax		(556)	(155)	(513)	(1,000)	(900)
Capex		(147)	(148)	(51)	(110)	(550)
Acquisitions/disposals		0	0	0	0	0
Financing		34	(2,136)	3,493	0	0
Dividends		(237)	103	(814)	(385)	(485)
Net Cash Flow		305	(1,482)	2,921	772	665
Opening net debt/(cash)		(588)	(916)	560	(2,342)	(3,114)
HP finance leases initiated		3	3	0	0	0
Other		20	3	(19)	0	0
Closing net debt/(cash)		(916)	560	(2,342)	(3,114)	(3,779)

Source: Company accounts; Edison Investment Research

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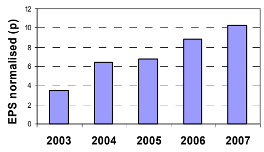
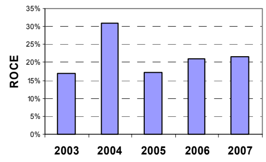
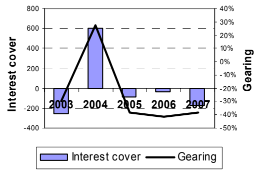
Growth	Profitability	Balance sheet strength
		

Sensitivities evaluation	
Litigation/regulatory	○
Pensions	●
Currency	◐
Stock overhang	○
Interest rates	●
Oil/commodity prices	○

Growth metrics	%	Profitability metrics	%	Balance sheet metrics	
EPS CAGR 03-07e	20.3	ROCE 06e	21.1	Gearing 06e	N/A
EPS CAGR 05-07e	8.8	Avg ROCE 03-07e	20.4	Interest cover 06e	N/A
EBITDA CAGR 03-07e	21.5	ROE 06e	27.0	CA/CL 06e	3.0
EBITDA CAGR 05-07e	9.8	Gross margin 06e	19.0	Stock turn 06e	0.0
Sales CAGR 03-07e	10.6	Operating margin 06e	6.7	Debtor days 06e	66.2
Sales CAGR 05-07e	7.0	Gr mgn / Op mgn 06e	2.8	Creditor days 06e	27.2

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Principal shareholders	%
Roderick Neil Flavell	12.2
Brian Ross Divett	12.1
Julian Nigel Divett	5.2

Forthcoming announcements/catalysts	Date *
Interim announcement	Sep 2007
Preliminary announcement	Apr 2007
AGM	May 2007
*Note: * = estimated*	

Management team

CEO: Rod Flavell

Rod has been with within the IT industry since 1982. He has overseen a significant year in FDM's history, with the successful launch of FDM on AIM in April 2005. As a founder of FDM, he has a solid background in sales and business management and is responsible for the overall strategic development and organic growth of the group.

CFO: April Denney

April has worked for FDM over 12 years, predominantly within the finance function. In July 2002, she was appointed the Group's Finance Director, with responsibility for all finance functions within the group. She brings a high standard of control and professionalism to the finance department.

Chairman: Brian Divett

Brian has been Chairman of FDM since its inception in 1991. His career spans 50 years, of which the majority of his time was as a Senior Manager & Regional Director of Cable & Wireless and Director of Bahrain Telecoms Co. Ltd. He is a member of both the Remuneration and Audit Committees. He will be stepping down as Chairman on 1st October but will remain on the board as a Non-Executive Director.

Edison Investment Research

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