



Buy

from No Rec

Artilium*

Platform for progress

Current price 14p**Target price** 16p

Market cap: £12.7m
Shares in issue: 90.4m
NAV (FY1): £4.3m
Gearing (FY1): 29.5%
Interest cover (FY1): -3.3x

Performance

	Stock	All-Share
1 month:	30.2%	0.9%
3 month:	33.3%	4.7%
12 month:	60.0%	18.9%

High/low:

12 months: 14.3p / 7.8p

Last results: Finals, 21 Oct 10**Next results:** Interims, Mar 11**Next event:** Interims, Mar 11**Reuters/BBG:** ARTA.L / ARTA LN**Analyst:****Kevin Fogarty**

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Sales: 020 7012 2038**Sales trading:** 020 7012 2030**Priced at close:** 15 Feb 2011

Artilium's key financial milestone is breaking even at the EBITDA level by the end of FY2011. The recent trading statement confirmed that this target is achievable and with Artilium's telco-based customer base seeking to capture a greater share of the value chain, prospects for the group's end markets to expand are strong. With an asset light, scalable business model and a growing recurring revenue base, increasing market adoption would prompt a step-change in the financial outlook for the group. We initiate coverage with a Buy rating and a DCF-derived target price of 16p.

Year to	Sales	PBT	EPS	EPS	DPS	Dividend	P/E	EV/EBITDA	EBITDA
Jun	Em	Em	c	growth %	c	yield %	x	x	Em
2010A	3.2	-2.4	-2.6	na	0.0	0.0	na	na	-1.9
2011E	4.6	-1.1	-1.1	na	0.0	0.0	na	na	-0.6
2012E	6.3	-0.1	-0.1	na	0.0	0.0	na	36.3	0.4
2013E	7.8	1.0	0.9	na	0.0	0.0	17.8	9.3	1.4

Source: Arbuthnot estimates, company data

- Broad IP-based portfolio.** Artilium is focused on the development and commercialisation of software and solutions for telecommunications operators, managed service providers and systems integrators. Its platform enables its customer base to create, deliver and manage services and applications, respond to changing market demands and capture a greater share of the value chain. KPN and T-Mobile are strong reference clients and help validate its technology offering.
- Strong industry investment case.** Analysys Mason forecasts the global market for service delivery platforms to rise from c.£2.7bn in 2009 to £5.4bn by 2014, delivering a CAGR of c.15%. Key drivers include: the repositioning of telecom business models to capture a larger share of the data revenues on offer, the emergence of the mobile applications market and increasing smart phone penetration and emerging market mobile subscriber growth.
- Management has repositioned the business...** Since 2009, the current management team has repositioned Artilium, leaving the group well placed to reap the benefits of its revised business model. We expect the change in revenue mix to lift gross margins to c.78% within three years from the 68% reported in FY2010. The combination of a lower fixed cost base, increasing market adoption and an emphasis on growing the group's recurring revenue base is improving revenue and earnings visibility.
- ...putting it on track to meet its key financial milestone this year.** January's trading update confirmed that the company is on track to break even at the EBITDA level towards the end of this financial year and we forecast EBITDA of £376k for FY2012. Evidence of greater than anticipated momentum in contract wins should prompt a step change in the financial outlook for this operationally-gearred business model.
- Valuation attraction starting to emerge.** We initiate coverage of Artilium with a Buy rating and a DCF-derived target price of 16p, representing potential upside of 14%. At this stage of the group's development, a relative valuation approach fails to capture the medium-term value of the group, given the financial immaturity of the business.

Overview

Company activities

Artilium focuses on the development and commercialisation of software and solutions for telecoms operators. Its core application is its ARTA Service Delivery Platform, which provides open, scalable and flexible infrastructure enabling telecom operators to create, deliver, and manage services and applications efficiently.

Key issues on which investors must take a view

Artilium is exposed to the capital expenditure cycles of telecommunications operators; therefore the pace at which the group can commercialise its proprietary technology is dependent on industry spending cycles. In addition, the pursuit of the revised business model poses some risk of cannibalising existing revenue streams. Further, like many early-stage technology companies, Artilium is financially immature, as demonstrated by results for the year to June 2010. Management will mitigate this risk somewhat by achieving its financial objective of breaking even at the EBITDA level in this financial year.

Likely direction of consensus revisions

As the only provider of financial forecasts for the group, Arbuthnot Securities forms the consensus of market expectations for Artilium. Our financial forecasts are driven by the continued transition of the business model towards being opex-based, rather than capex-based. The pace of this transition and progress in converting the group's existing pipeline has both upward and downward potential to influence our earnings estimates.

Valuation and reason behind target price

At this stage of the business model's development, we believe that a discounted cash flow (DCF) model more appropriately reflects the group's potential value. Through successful execution of its strategy, leading to growth in its recurring revenue base, the improved visibility over future revenues and cash flows will provide greater confidence in this approach to valuation, in our view. Our DCF model assumes a terminal growth rate of 3% and a WACC of 10%.

Risks to our view

The most pertinent risks to the investment case for Artilium include a slower rate of contract wins and delays in converting the group's contract pipeline. Positive cash generation remains a target for Artilium, and therefore, failure to achieve this objective would adversely impact our financial forecasts, target price, and investment case for the stock. In addition, Artilium is exposed to the risks associated with smaller companies seeking to secure contracts with larger organisations.

Investment case

Investment in service delivery platforms to increase

Service Delivery Platforms (SDP) enable telcos to rapidly develop and deploy products that extend their product offering

With a variety of definitions and interpretations, a service delivery platform (SDP) usually refers to a set of both software and hardware components that facilitate the creation, delivery and management of services through a network in a telecommunications environment. Service delivery platforms are typically optimised for the provision of a particular service and normally include a control environment, a creation environment, and an execution environment. The economic rationale for implementing an SDP is to enable telecommunications operators to rapidly develop and deploy converged products that extend their product offering from basic voice services to the provision of a broader service offering.

Downward pressure on ARPU is leading to revision of traditional telco business models

The business models of traditional telecommunications operators are under pressure from a number of fronts, prompting the need for operators to direct more resources to the development of new revenue streams, enhance existing services and, in many cases, adopt new business models. First, due to their gradual commoditisation, voice revenues remain under pressure in the fixed and mobile environments. One response to the resulting downward pressure on ARPU (average revenue per user) has been to reposition business models to capture a higher share of revenues available from data services.

Telcos seeking to capture a greater share of the value chain

Second, the development of the mobile applications market, driven by the continued growth in smart phone penetration, has created a market for telecommunications operators to compete in as it provides a route for operators to increase their share of the available data revenues, through opening their networks to both internal and external developers of mobile applications. The former reflects their desire to have greater control over the content delivered via their network and capture a greater share of the value chain.

Capitalising on emerging market mobile subscriber growth

Finally, in emerging markets, all of the above factors are having an impact on the requirement for SDP-directed investment. However, this requirement is further exacerbated by the growth in mobile subscriber numbers, as mobile penetration rates continue to rise. This is placing greater demands on the infrastructure of telecommunications operators in areas such as call handling, prepaid billing and the provision of value-added services.

Economic recovery and normalised capex cycles to prompt growth in SDP spending

The combined effect of these influences is to stimulate greater spending on SDPs. Set against the backdrop of a gradual global economic recovery and the normalisation of capital expenditure cycles, the size of the market for SDPs is expected to rise from c.£2.7bn in 2009 to an estimated £5.4bn by 2014, representing a CAGR of almost 15% (Source: Analysys Mason).

Capturing opportunities through broad product suite

Product suite allows quickly react to changing market demands in a cost effective manner

Artidium has developed a suite of communications software solutions for a market that includes mobile and fixed telecommunications operators, managed service providers and systems integrators. The group's ARTA Service Delivery Platform (ARTA) provides robust, scalable, flexible and open infrastructure that enables providers to create, deliver and manage services and applications in an efficient manner. A key point of focus for the platform is to allow its customer base to react to changing market demands for products, services and applications in a cost-effective manner. Typical demands from Artidium's customer base include: the introduction of a branded mobile communications service, the addition of location-based services to an existing offering, or the development of mobile applications. In addition, the

platform facilitates the ongoing convergence in services, through integrating fixed line and mobile voice services within a billing and control environment.

Key functionality includes:

Launch of mobile communications service for communities or affinity groups

Launching a branded mobile network: The platform provides a low cost solution to Mobile Virtual Network Operators (MVNOs) and Mobile Virtual Network Enablers (MVNEs) seeking to introduce mobile communication services, often targeted at a particular community or niche target market. ARTA allows the creation of a mobile network bespoke for the targeted audience's lifestyle, facilitates social networking and includes location-based services and branded applications, in a cost effective, flexible and fully-customisable environment that aids customer retention.

Smart phone and non smart phone location-based services

Provision of location-based services: Since the acquisition of Trisent in 2008, Artilium has been providing its patented Tri-cell Intelligent Location System (TILS), which supports GPS, as part of its offering. An added advantage of this is that it provides location-based services to non-smart phone handsets, in a low cost manner with a high degree of service availability.

Improving network efficiency and billing across a variety of networks

Real time routing: With ongoing convergence in communication services central to Artilium's product and service offering, the ARTA platform analyses network traffic loads to automatically select the most cost effective, efficient and convenient route for end users, for voice and data traffic, based on a defined set of parameters. ARTA seeks to improve network efficiency at minimal cost across fixed line, mobile and VoIP networks. The ability to provide effective billing across the variety of networks is also a key feature.

Facilitates network access to internally and externally generated applications

Application development: The increasing penetration of smart phones and mobile devices provides a greater opportunity for telecommunications operators to share in the revenues generated by data services, against the background of declining voice revenues. Increased competition for mobile applications places greater emphasis on the importance for service providers to have access to both internally and externally-generated applications, in addition to having a rapid and flexible route to deploying these to market. Artilium's ARTA Mobile Applications platform enables operators to open their networks to third-party application developers to facilitate the deployment of applications, where time to market is minimised, in addition to allowing application developers to add network-based functionality to their offering.

On track for financial milestone, business model in transition

Artilium is on track to meet its key financial milestone in the current financial year

Since the current management team was put in place in 2009, its financial objective has been to deliver positive operating cash flow during the financial year to June 2011. The trading update in January this year confirmed that Artilium is now on track to break even at the EBITDA level towards the end of this financial year. We believe that this, combined with the operationally-gearred business model, and improved momentum in contract wins should represent a step change in the financial outlook for the group.

Business model in transition

During FY2009 the group adapted its strategy to more closely align its activities with underlying market developments. This resulted in a move away from a capex-based software licensing and delivery model to an opex-based model, which may ultimately include the delivery of its solutions on a SaaS (software as a service) basis. Revenue from licence sales, which have traditionally been paid and recognised at the point of deployment, are now spread over a licensing period of several years. While the results of this strategy will only be evident over the medium term, its aim is to provide greater predictability and visibility of revenues, in addition to improving market adoption of Artilium's product suite.

Lower fixed cost base increases operational gearing

The reduction in the group's cost base, which has been undertaken by the management team, has increased the operational gearing of the business. Importantly, the trading update from the company highlights that it has seen greater interest in its product portfolio in recent months, which we believe bodes well for near-term contract wins.

Momentum in contract wins has potential to change the financial outlook

Having successfully skewed its contract pipeline in favour of opex-based contracts, the anticipation of greater momentum in contract wins, from both its location based services and its broader technology offering, has the potential to meaningfully improve the group's financial outlook in the near term as Artilium starts to reap the benefits of its revised business model.

Valuation attraction starting to emerge

We initiate coverage with a target price of 16p

We initiate coverage of Artilium with a Buy rating and a target price of 16p, which is based on our DCF valuation. Assuming that we are in a period where earnings and cash generation will normalise during the life of our forecasts, we believe that confidence in a cash flow-based valuation approach will increase.

In our view, the current market capitalisation ascribes little value to Artilium's core business. We believe that the risk is to the upside that this anomaly is corrected should the group see better market adoption of its product offering, through demonstrating greater momentum in contract wins in the months ahead.

The investment case for Artilium is obscured by the historic loss making and cash absorbing nature of group activities and the uncertainty as to precise timing of when the group will begin to generate positive earnings. However, achieving EBTIDA break even this year should be beneficial for equity investors and will provide greater confidence in financial forecasts for the group. An absolute valuation approach best quantifies the potential for a re-rating of the stock, in our view.

Investor focus will be on the execution of management's strategy through the remainder of FY2011 and into FY2012

We believe that investor focus will be on the execution of management's strategy for the remainder of H2 FY2011 and into FY2012, seeking evidence that the group is successfully growing its recurring revenue base and thereby improving revenue and earnings visibility.

Table 1: Key valuation ratios

Year to June (£ k)	2011E	2012E	2013E
P/E (basic)	-13.7	-196.7	14.5
P/E (diluted)	-15.7	-239.4	17.6
EV/EBITDA	-28.8	42.6	10.6
EV/Sales	3.5	2.5	1.9
P/NAV	3.7	3.6	4.5

Source: Arbutnot estimates

Key investment risks

Investment is not without its risks

To provide balance to our investment case for Artilium, it is important to highlight what we perceive to be the key risks associated with the company, from an investor's perspective. Though not exhaustive, we summarise these as: financial risk, technology risk, and competition risk.

In common with many growth companies, financial risk for Artilium is high, as demonstrated by the financial immaturity of the business. We assume that the group will remain loss-making and cash absorbing in the current financial year and failure to achieve its financial milestone this year will negatively impact our cash flow forecasts, which underpin the investment case.

The group is also exposed to technology risk should management fail to keep pace with technological developments. Finally, Artilium faces significant competition risk as its marketplace is dominated by larger organisations, such as Ericsson and Huawei.

Valuation

DCF model reflects group's potential value

At this stage of the business model's development, with the group forecast to be EBITDA break even during the current financial year, we believe that a discounted cash flow (DCF) model more appropriately reflects the group's potential value. Through successful execution of its strategy, leading to growth in its recurring revenue base, the improved visibility over future revenues and cash flows should provide greater confidence in this approach to valuation, in our view.

No exact comparable among the UK peer group

Our relative valuation approach involves benchmarking Artilium against software stocks with a predominant focus on the telecommunications sector, to demonstrate the valuation multiples that it may achieve upon generating positive earnings and cash flow. Here, Artilium should be differentiated as it grows its recurring revenue base. Our valuation acknowledges that the company does not have an exact comparable among the UK peer group and it has yet to fully commercialise its SaaS offering.

Investment attractions include growing revenue visibility

For us, the principal investment attraction of Artilium's business model is its potential to grow its recurring revenue base. With negative earnings forecast for this financial year, a return to revenue growth, combined with operational gearing will be positive for earnings progression during the life of our forecasts. However, we are mindful that the financial immaturity of the business fails to accurately capture the medium-term value of the group. For this reason, our investment case centres on an absolute rather than a relative approach to valuation.

Relative valuation

Compare its valuation with software providers to the telecoms sector

Artilium does not have a single peer that is truly comparable in terms of its service offering and stage of development, which complicates a relative valuation of the company. Further, valuation ratings among AIM-listed software companies vary greatly, highlighting the risk in valuing the group by using a sector earnings or cash flow-based multiple.

Reflecting its service offering, we compare Artilium's valuation multiples to those software providers with a particular focus on the telecoms sector.

The conclusions of our analysis include the following:

1. Our selected peer group trades on an average P/E for FY2011 of 11.7x (excluding outliers), falling to 7.3x for FY2012. However, the range of multiples for both years from low single-digit to mid-teen levels remains unhelpfully wide. Further, the financial immaturity of Artilium's business renders a P/E-based valuation meaningless for valuation purposes.
2. The peer group commands an average EV/EBITDA of 5.8x for FY2011, again excluding outliers, falling to 4.2x for FY2012.

Table 2: Peer group comparison

Company	Price (p)	Mkt. cap (£m)	P/E (x)		EV/EBITDA (x)	
			FY2011E	FY2012E	FY2011E	FY2012E
Bango	150.0	56.8	115.4	13.5	139.2	12.7
Globo	18.0	31.5	6.4	4.3	2.2	1.7
Netcall	18.3	22.3	12.2	12.2	7.8	7.4
Synchronica	26.3	24.2	16.4	5.4	7.4	3.5
Linear average			11.7	7.3	5.8	4.2

Source: Consensus data

Absolute valuation

DCF reflects the business model's cash flow characteristics

We have conducted a discounted cash flow analysis of Artilium to reflect the value of the business model's cash flow characteristics. Evidence of management's success in growing the group's recurring revenue base will increase investor confidence in its ability to generate sustainable cash flows, in our view. Our analysis assumes the group achieves typical software company returns on a medium term view.

The principal assumptions of our DCF model are:

- A terminal growth rate of 3%, post cash flow forecasts to FY2024
- An assumed weighted average cost of capital of 10%
- Capital expenditure is assumed to remain at less than 1% of revenues

Our DCF model implies a fair value of 16p per share. Our assumed WACC of 10% reflects an assumed beta of 1.2, a risk-free rate of 3.7% and an equity risk premium of 5%. We provide a sensitivity analysis for a variety of terminal growth rates and WACC assumptions below.

Table 3: DCF summary

Year end June (£m)		Value	Proportion (%)
NPV cash flow 2011-2024		9.5	54.6
Cash flow @ 2025	2.5		
Terminal multiple (x)	14.3		
Terminal EV	36.4		
PV of terminal EV		7.9	45.4
Total PV (EV)		17.5	
Less (net debt)/cash		-1.1	
DCF equity value		16.4	
DCF per share (p)		16.1	

Assumptions:

L-T perpetuity growth rate (%)	3
WACC (%)	10

Source: Arbutnot estimates

Table 4: DCF sensitivity analysis

WACC (%)	Terminal growth (%)					
	8.0	1.0	2.0	3.0	4.0	5.0
8.0	20.3	22.0	24.5	28.1	34.2	
9.0	16.9	18.0	19.5	21.6	24.8	
10.0	14.3	15.1	16.1	17.4	19.2	
11.0	12.3	12.8	13.5	14.3	15.5	
12.0	10.7	11.1	11.5	12.1	12.8	

Source: Arbutnot estimates

Trading & financial outlook

On track to meet key financial milestone this financial year

The trading update in January signalled that Artilium is on track to achieve a key financial milestone in this financial year. In addition, Artilium has experienced greater interest in both its location-based services and its broader technology offerings, underpinning expectations for contract wins during the second half of this financial year.

For FY2010, during a phase of transition, the group's revenue base was lower, albeit of a higher quality. Revenue generation in FY2010 was differentiated from prior years by a higher proportion coming from recurring revenue streams. Revenues of ₹3.2m (FY2009: ₹6.6m) disguised the higher-quality revenue generation and was negatively impacted by the reduced contribution from lower-margin hardware reselling. The latter contributed ₹0.3m (FY2009: ₹2.6m) during the financial year.

Table 5: Financial track record

Year to June (₹ m)	2006A	2007A	2008A	2009A	2010A
Revenues	0.6	4.5	3.8	6.6	3.2
Gross profit	0.6	3.3	3.6	3.5	2.2
Gross margin (%)	91	72	94	54	68
Reported EBIT	(1.9)	(3.0)	(5.2)	(11.2)	(3.9)
EBIT (pre x)	(1.2)	(3.0)	(2.8)	(5.0)	(2.7)
EBIT margin (%)	(195)	(65)	(74)	(75)	(86)
Reported PBT	(2.8)	(2.9)	(6.0)	(13.6)	(3.6)
PBT (pre x)	(2.1)	(2.9)	(3.6)	(7.3)	(2.4)
Diluted EPS (c)	(9.8)	(6.1)	(5.6)	(8.7)	(2.6)

Source: Company data, Arbuthnot estimates

Improved profitability reflects higher quality of revenues

A notable feature was the improved profitability. On the back of lower revenues, the group delivered gross profits of c.₹2.2m (FY2009: ₹3.5m), representing an increase in the gross margin to 68% from 54% for FY 2009. The reported EBIT loss of ₹3.9m compares with a reported loss of ₹11.2m for FY 2009.

The LBT came in at ₹3.6m (FY2009: ₹11.1m), continuing the trend of improving profitability. EPS for FY2010 was a loss of 3.88c, representing a significant improvement on the loss of 16.19c reported for FY2009. Reflecting the issue of the ₹2.5m convertible loan notes in November 2009, Artilium ended FY 2010 with net debt of ₹0.9m, translating to balance sheet gearing of 16%. Driven by a combination of 1) a greater emphasis on sales and marketing, 2) the ongoing transition of its business model, and 3) improved pipelines in India and Europe, management highlighted improved visibility in the business, and had secured in excess of 50% of the expected group revenues for FY2011.

Prospects for cash generation better, management have greater confidence in achieving financial target

In summary, full-year results for FY2010 reflected the ongoing shift in the business model to reflect the group's growing recurring revenue base, with greater scope to improve revenue visibility, improve profitability and materially enhance cash generation. Against this background, the improved prospects for the group provide management with greater confidence in realising its financial target for the current financial year.

Forecasts

Guidance suggests that profitability outlook is better

Wider market adoption is the prime revenue driver

For the current financial year, contracts valued at c.£1m have been announced, for delivery by the end of FY2011. January's trading update suggested that there has been renewed interest in Artilium's technologies, and as a result, the group expects to convert this interest into new projects during H2 FY2011. Therefore, our revenue estimate for this financial year assumes ongoing contract wins during H2, while beyond FY2011 wider market adoption is the prime revenue driver of our forecasts for the group.

Contracts valued at £1m announced during H1, more to be secured in H2

The expected improvement in the gross margin, implied by our forecasts, reflects the changing revenue mix assumed in our model as we have assumed that all licensing revenues from all new contract wins are recognised over an average period of three years. The realisation of higher gross margins is dependent on successfully developing a recurring revenue base of licence and maintenance revenues.

Figure 1: Revenue & margin development

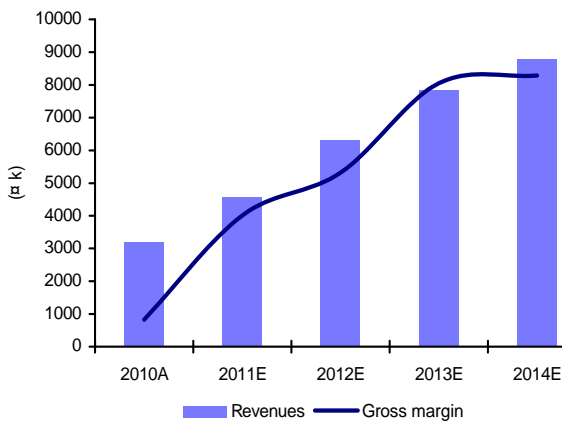
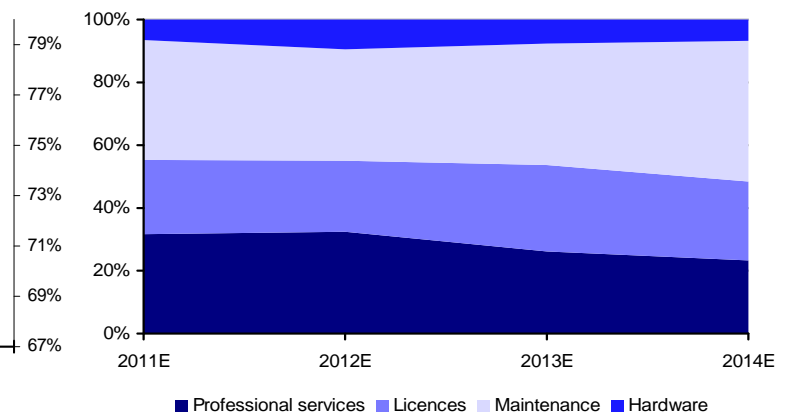


Figure 2: Segmental revenue development



Source: Company data, Arbutnot estimates

Management guidance provided so far this year implies that our revenue and EBITDA forecasts for the current year are achievable by the group. However, on our assumptions surrounding the cost base required to support the group's near-term development, we estimate that the group will remain loss making at the PBT level through to FY2012. Note, our revenue forecasts could be positively impacted by the release of the £2m of deferred income currently on the group's balance sheet, though there is uncertainty as to the timing of this event.

Cash flow prospects have improved

Low capital intensity and set to generate operating cash flow in this financial year

Operating cash generation has historically been volatile reflecting the group loss-making status, prior to the rationalisation of the cost base during FY2010. Prospects for operating cash generation have clearly improved and we believe that they are currently adequately reflected in our forecasts. The scalable nature of the business model, and its low capital intensity, leaves the group well positioned to generate positive free cash flow, once it can demonstrate meaningful market adoption and convert contract wins into revenues.

In the near term, proving the cash generating ability of Artilium's business model is fundamental to our valuation and investment case for the group.

Table 6: Profit & loss account

Year end June (€ m)	2009A	2010A	2011E	2012E	2013E
Revenues	6.6	3.2	4.6	6.3	7.8
% increase	+74.0	-51.9	+43.8	+38.1	+24.2
Cost of sales	-3.1	-1.0	-1.3	-1.6	-1.8
% group revenues	46.5	31.9	27.8	26.1	22.5
% increase	1,170.2	-66.9	25.2	29.7	7.3
Gross profit	3.5	2.2	3.3	4.7	6.1
% group revenues	53.5	68.1	72.2	73.9	77.5
Operating expenses (pre-x)	-8.5	-4.9	-4.1	-4.5	-4.8
% group revenues	128.4	153.7	90.1	71.0	61.5
Operating profit (pre-x)	-5.0	-2.7	-0.8	0.2	1.3
% group revenues	-74.9	-85.6	-17.9	2.9	16.0
EBITDA	-4.1	-2.0	-0.6	0.4	1.4
Exceptional / non-recurring items	-6.2	-1.2	-	-	-
% gross profit	176.2	54.8	-	-	-
Operating profit	-11.2	-3.9	-0.8	0.2	1.3
% group revenues	-169.2	-122.9	-17.9	2.9	16.0
Net financial items	-2.4	0.3	-0.3	-0.3	-0.2
Net interest % net debt	-3.1	34.8	19.6	23.9	-155.8
PBT	-13.6	-3.6	-1.1	-0.1	1.0
% group revenues	-205.2	-113.7	-23.4	-1.2	13.2
PBT (pre-x)	-7.3	-2.4	-1.1	-0.1	1.0
Tax (reported)	0.2	0.1	-	-	-
% reported PBT	1.1	3.0	-	-	-
Effective tax charge	151	110	-	-	-
% pre-exceptional PBT	2.1	0.0	0.0	0.0	0.0
Net profit	-13.4	-3.5	-1.1	-0.1	1.0
% group revenues	-202.9	-110.2	-23.4	-1.2	13.2
Net profit (pre-x)	-7.2	-2.3	-1.1	-0.1	1.0
% group revenues	-108.6	-73.0	-23.4	-1.2	13.2
Basic EPS (€ c)	-16.18	-3.88	-1.18	-0.08	1.14
% increase	+63.5	-76.0	-69.5	-92.9	-1459.1
Diluted adjusted EPS (pre-x) (€ c)	-8.66	-2.57	-1.05	-0.07	0.94
% increase	+54.1	-70.4	-59.1	-93.4	-1459.1

Source: Company data, Arbutnot estimates

Table 7: Cash flow statement

Year end June (€ m)	2009A	2010A	2011E	2012E	2013E
Stated operating profit	-11.2	-3.9	-0.8	0.2	1.3
Depreciation reversal	0.2	0.1	0.1	0.1	0.1
Amortisation	0.7	0.6	0.1	0.1	0.1
Impairments	2.5	-	-	-	-
Change in core working capital	0.9	0.6	0.1	0.1	0.1
Changes in provisions	2.1	-1.1	-	-	-
Cost of equity employee share schemes / bonuses	1.4	-	-	-	-
Share based payments	0.2	0.7	-	-	-
Net interest (paid)/received	-0.2	-4.9	-0.3	-0.3	-0.2
Gross cash flow	-3.4	-3.0	-0.7	0.2	1.3
Cash conversion (Free cash flow/PAT) (%)	47.8	129.3	64.2	-296.5	122.9
Gross TFA capex	-0.1	-0.0	-0.0	-0.0	-0.0
Net capex on TFA	-0.1	-0.0	-0.0	-0.0	-0.0
Intangible fixed assets expenditure	-1.1	-	-	-	-
Free cash flow	-4.6	-3.0	-0.7	0.2	1.2
Repayment of finance leases	-0.1	-0.0	-	-	-
Issue of ordinary shares	3.2	-	-	-	-
Other	-0.2	2.2	0.3	-	-
Change in net debt	-1.7	-0.9	-0.4	0.2	1.2
Net (debt) / cash	2.0	-0.9	-1.3	-1.1	0.1

Source: Company data, Arbutnot estimates

Table 8: Balance sheet

As at end June (€ m)	2009A	2010A	2011E	2012E	2013E
Assets					
Tangible fixed assets	0.5	0.3	0.2	0.2	0.2
Goodwill / intangibles	11.8	11.2	11.0	10.9	10.8
Deferred tax assets	0.0	0.1	0.1	0.1	0.1
Non-current assets	12.2	11.5	11.3	11.1	11.0
Trade and other receivables (debtors)	1.9	1.2	1.8	1.9	2.0
Gross cash (and equivalents)	2.4	1.6	1.6	1.6	1.6
Current assets	4.2	2.8	3.4	3.5	3.6
Total assets	16.5	14.3	14.7	14.6	14.6
Liabilities					
Provisions	-1.1	-0.3	-0.3	-0.3	-0.3
Deferred tax liabilities	-0.3	-0.2	-0.2	-0.2	-0.2
Gross debt (and equivalents)	-0.0	-2.3	-2.9	-2.7	-1.5
Deferred income	-2.1	-2.1	-2.6	-2.6	-2.6
Non-current liabilities	-3.5	-4.9	-6.1	-5.9	-4.6
Debt	-0.3	-0.4	-	-	-
Provisions	-1.0	-1.1	-1.1	-1.1	-1.1
Trade and other payables (creditors)	-3.0	-2.4	-3.2	-3.4	-3.5
Current liabilities	-4.2	-4.0	-4.3	-4.5	-4.6
Total liabilities	-7.8	-8.9	-10.4	-10.4	-9.3
Equity					
Share capital	6.6	6.6	6.6	6.6	6.6
Equity reserve	6.5	6.5	6.5	6.5	6.5
Share premium	40.8	40.8	40.8	40.8	40.8
Other reserves	-1.7	-1.5	-1.5	-1.5	-1.5
Retained earnings	-43.5	-47.0	-48.1	-48.2	-47.1
Shareholders' funds	8.7	5.4	4.3	4.3	5.3
Minority interests	-	-	-	-	-
Equity capital	8.7	5.4	4.3	4.3	5.3

Source: Company data, Arbutnot estimates

Appendix

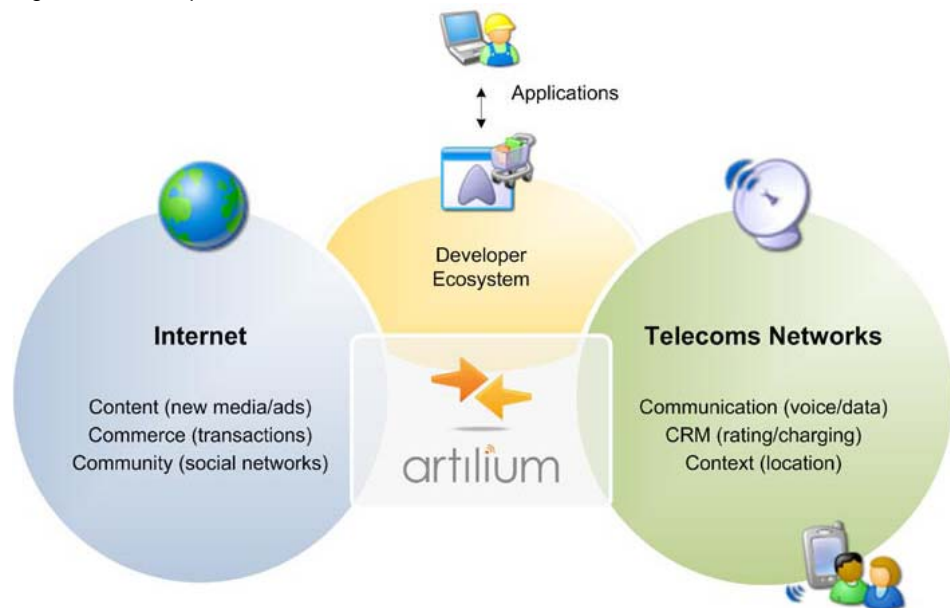
Company activities

Provides scalable, flexible and open infrastructure to the telecoms sector

Artidium focuses on the development and commercialisation of software and solutions for telecoms operators, managed service providers and systems integrators. Its core application is its ARTA Service Delivery Platform, which provides scalable and flexible infrastructure enabling telecoms operators to deploy voice, data and IP services in a rapid manner in response to changing market needs. ARTA's open infrastructure provides operators with the architecture to create, deliver and manage services and applications efficiently.

Detailed divisional revenue splits have not, historically, been provided by the group. However, the group's revenue base consists of the following elements: professional service revenue, derived from product deployment and bespoke software development, licensing revenue, maintenance revenue from the installed base, and an element of third-party hardware revenues.

Figure 3: Artidium platform



Source: Company data

Credible customer base comprising fixed line, MNOs, MVNOs and MVNEs

Artidium's customer base includes a mix of fixed line telecommunications operators, MNOs, MVNOs and MVNEs. Examples of key customers include: KPN, Belgacom, BT, Proximus, and Versatel. The group has reasonably high customer concentration, with KPN accounting for c. 10% of group revenues during FY 2010. Currently, the group generates almost all of its revenues within Europe. However, execution of its strategy is likely to result in a growing international element to the revenue base going forward.

Group structure

Headquartered in Belgium, office in the UK, presence in 11 countries

Artiliium is headquartered in Bruges, Belgium, and has an office and R&D facilities in the United Kingdom. It has software installed in 11 countries, having completed more than 40 installations for its customer base to date. While the majority of the group's presence is concentrated in Europe, it is increasing its international exposure, as demonstrated by its emerging activities in India.

In our view the business has four key areas of focus to commercialise its IP platform:

1. Capitalise on the growing markets for service delivery platforms, and applications within this environment, which are being driven by its customer's need for flexibility to quickly launch applications. ARTA 8 is the group's route to competing in this marketplace.
2. Provide MNOs and MVNOs with the flexibility to launch sub-brands to target niche market segments. ARTA MVNE (Mobile Virtual Network Enabler) facilitates this and eliminates the group's dependence on service implementation.
3. Location-based services have been a key service offering for Artiliium, since its acquisition of Trisent Communications Limited (Trisent) and its subsequent R&D investment in this space.
4. Emerging markets provide the group with opportunities for its traditional core technology, in particular in the market for non-smart phone applications.

Business model

FY 2010: a year of transition for the business model

The financial year to June 2010 represented a year of transition for Artiliium as management sought to stabilise the business, and improve earnings quality and financial visibility. In addition to lowering the fixed cost base, management initiated the process of changing its business model from being capex-based (comprising of software licensing, project delivery, and capex) to one that is opex-based (comprising of revenue sharing and operating expenditure) to enhance visibility of revenues and provide greater predictability of earnings.

Group history

Evolved from providing engineered-led solutions

The group has evolved from developing engineering-led service delivery platform solutions to telecommunications operators through to providing next generation software solutions, with the potential to do this via a SaaS delivery model. Though largely organically driven, the group's product suite has been enhanced by acquisition, while its geographic presence has expanded beyond its original Benelux footprint.

The origins of Artiliium date back to 1999 when a service delivery platform that enabled telecom companies to provide integrated telecom solutions (voice, data and IP) was developed by a group from a telecommunications engineering background. Initially, the group provided services that facilitated intelligent call routing, number portability, pre and post-paid billing and advanced messaging. The business continued to provide engineering-led solutions, but was geographically constrained to the Benelux region. Driven by the motivation to exploit Artiliium's technology, internationalise the business and capitalise on the potential to deliver its software as a service, the group was acquired in 2006 by Future Internet Technologies plc, which was AIM-listed.

KPN Mobile contract and Tata Consulting Group agreement provide validation of group's product offering

Accompanying FY2007 results, and providing some validation of the group's IP, was a licensing agreement with KPN Mobile International, allowing it to deploy ARTA as a platform

for next generation converged solutions across its subscriber base. The licence agreement is due for renewal in March 2012.

In February 2008, Artiliium acquired Trisent for a consideration of £1.7m, of which £0.46m was in cash. Trisent, based in Dunfermline, Scotland, brought location-based service capability to the group. This extended the group's product offering, allowing telecoms operators to rate, charge and deliver services based on location, without the necessary infrastructure required to provide GPS services.

In early 2009, the group achieved further progress in extending its international presence by signing a partnership agreement with Tata Consultancy Services, part of the Tata Group. During this period, the recently-installed management team announced a radical change to the group's strategy, which forms the basis for the business model currently employed by the group.

Management

Adriaan Reinders, Executive Chairman Adriaan Reinders has over 30 years of management and consultancy experience in the technology sector. Over the course of his career, he has founded and grown a number of businesses in the information and technology sectors and served as an advisor and board member for several private and public companies. Examples include his role as Chairman of the Advisory Board for the Residex Ventures fund of Achmea Insurance, and a member of the Executive Board of British Telecom's subsidiary, Syntegra. He is CEO of OHM Business Development Inc. and of E.Factor, a web based network specialising in early stage ventures.

Maarten Bisseling, Chief Executive Officer Maarten Bisseling has a background in the deployment of mobile telecoms software systems. He led the ARTA deployment for KPN Mobile, and has consulted to other operators, including Belgacom, Energis, Tiscali, Romtelecom and Telemar. He has a masters degree in public administration and public policy from the University of Twente.

Wim Seynaeve, Chief Financial Officer Wim Seynaeve, a Belgian national, was appointed acting CFO of the company in May 2009. He has a broad experience in financial management of publicly and privately held smaller companies. He has held several interim CFO positions within the software & IT environments. He began his career at Arthur Andersen and having spent six years in auditing and outsourcing, joined Ingram Micro Europe in 2002 as financial controller. He holds a masters degree in Applied Economics from the University of Antwerp.

Thomas Trainer, Non-executive Director Thomas Trainer has previously worked for a number of large, international firms, across a range of sectors, including Eli Lilly, Citigroup and Pepsico, helping to transform their global IT platforms. He is currently on the Board of Directors of EQmentor, a private consultancy firm in North Carolina, US, and of Btm Corporation. He has been a member of Btm's Board since its inception, and performs various customer-centric roles.

Lex Roukens, Non-executive Director Lex Roukens has extensive experience in the mobile telecoms and corporate finance sectors. He is a Partner at Alcap B.V. in the Netherlands, investing in TMT (telecoms, media and technology) related companies, with a focus on restructuring and growth. Prior to joining Alcap, Mr Roukens was Chief Financial Officer at Spyker Cars N.V., Group Treasury Director at Zain Group, the mobile telecoms operator with a focus on sub-Saharan Africa and the Middle East and Group Corporate Finance Director of

Celtel International. Previously, he held the position of CFO of Fronter A.S., in the TMT division at Toronto Dominion Bank as Regional Director for Asia Pacific and then as a Director in London. Prior to this, he performed a variety of telecoms-related roles for ING Bank International.

Explanation of recommendations

Our analysts award a Strong Buy rating in those cases where they believe there will be total shareholder return - defined as the absolute rise in share prices plus dividend payment - in excess of 20% over a 12-month period. We assign a stock a Buy recommendation where our analysts believe there will be a total shareholder return of 10% or more over a 12-month period. We apply a Neutral recommendation where we anticipate a shareholder return of between plus 10% and minus 10%. We assign a Reduce recommendation where we anticipate a shareholder return of between minus 10% and minus 20%. Our Sell recommendation implies an expected shareholder loss over a 12-month period of 20% or more. Analysts have assigned a 'trading view' to stocks that they think might move materially within the following ten trading days; possibly in response to a move in currency, sentiment, or a specific event. The trading view is a short-term suggestion and does not contradict the 'recommendation'.

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Summary financial data, year to Jun (€m)	2010A	2011E	2012E	2013E
Sales	3.2	4.6	6.3	7.8
EBITDA	-2.0	-0.6	0.4	1.4
Operating margin (%)	-85.6	-17.9	2.9	16.0
EBIT	-2.7	-0.8	0.2	1.3
Interest charge	0.3	-0.3	-0.3	-0.2
PBT	-2.4	-1.1	-0.1	1.0
Tax rate (%)	3.0	0.0	0.0	0.0
Underlying tax rate	0.0	0.0	0.0	0.0
NOPLAT	-2.7	-0.8	0.2	1.3
Profit after tax	-3.5	-1.1	-0.1	1.0
Reported EPS (c)	-3.9	-1.2	-0.1	1.1
Underlying EPS (c)	-2.6	-1.1	-0.1	0.9
Underlying EPS YoY growth (%)	na	na	na	na
DPS (c)	0.0	0.0	0.0	0.0
Basic no. of shares (m)	90.4	90.4	90.4	90.4
Fully diluted no. of shares (m)	90.4	102.0	110.0	110.0

Source: Company data, Arbuthnot estimates

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Nicholas Smith 020 7012 2085

Transport

Gerald Khoo 020 7012 2089

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David George 020 7012 2039

Nicholas Feldman 020 7012 2045

Steve Yelland 020 7012 2018

Darren Winter 020 7012 2042

Chris Morris 020 7012 2037

Jonathan Clements 020 7012 2044

Alexandra Clement 020 7012 2036

Sam Banerjee (India) 020 7012 2041

Tim Willis (Emerging) 020 7012 2053

Sales trading

Paul Kersey (Head of Sales Trading) 020 7012 2030

Lisa Letham 020 7012 2029

Mark Barnes 020 7012 2019

Michael Harrison 020 7012 2031

Trading

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