

Investment update

UK Equity Research

6 September 2006

Independent International Investment Research * (IIR)

Speciality Retailers

"As the Spitzer dust settles..."

Previous close price (p):

10.8

Market cap (£m):

1.9

FTSE index:

AIM

52 week high (p):

13.3

52 week low (p):

6.1

Net debt 2006 (£m)

0.2

Year to 28 Feb (£'000s)	2005	2006	2007E	2008E
Turnover	683	914	1,089	1,564
EBITDA	(123)	(104)	14	271
Pretax profit IdB	(293)	(207)	(18)	238
IdB EPS (p)	(1.9)	(1.0)	(0.1)	0.7
Growth rate (%)	n/a	n/a	n/a	n/a
DPS (p)	-	-	-	-
P/E (x)	n/a	n/a	n/a	14.4
Yield (%)	-	-	-	-

Source: Insinger de Beaufort, IdB profit before goodwill and exceptionals

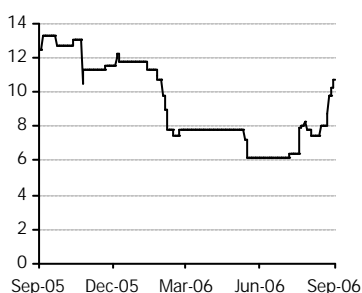
Reason for report

Initiation of coverage

A new business model

Independent International Investment Research (IIR) has re-invented itself as an independent equity research boutique with the advantage of its own in-house research team. The equity research business, Independent Financial Markets Research Ltd, has developed a strong reputation in the IRP market and benefits from the existing currency analysis overlay of the legacy Pronet product suite.

Share price performance (p):



IRP market has been driven by the 'Spitzer' settlement

IIR provides independent equity and currency research to seven of the world's top ten broker-dealers. The Independent Research Provider (IRP) marketplace was boosted in late 2002, with the announcement of an agreed settlement of conflict of interest charges against ten major investment banks in the US, in which the firms agreed to spend \$432.5m over the next five years to buy independent equity research for their retail clients.

Operational gearing should drive strong earnings growth

With the core administrative functions now in place, IIR should benefit from a high level of operational gearing. Ongoing US demand for non-US company research, product development and expansion into the buy-side market suggests there is good potential for medium-term growth. We expect EBITDA to turn positive in the current year to February 2007 and look for growth to accelerate sharply in the following year. The research business remains at a relatively early stage of development, but we note that in 2008 the Group would trade at a 22% discount to UK peers such as Datamonitor and Toluna.

Source: Insinger de Beaufort, Bloomberg

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* Insinger de Beaufort is broker and advisor to the company

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Overview

Independent International Investment Research (IIR) provides research on global companies and currencies, for broker-dealers, investment banks, money managers and private clients.

The equity research business comprises wholly owned subsidiary Independent Financial Markets Research Ltd. (IFMR). The 32-strong India-based (Chennai and Mumbai) equity research team now covers 200 companies, rising to 300 by the end of 2006, of primarily non-US with American Depositary Receipt programs. IFMR, established in 2002, has benefited from the 2003 Global Research Analyst Settlement (GRAS) in the US, which required broker-dealers to provide independent research to retail clients.

Supplementing the equity research business, Pronet Analytics.com Limited (Regulated and Authorised by the FSA in the UK and registered as an Investment Advisor with the SEC in the US) offers investment advice and trading strategies to clients such as Standard Chartered and Citigroup. The ability to combine currency forecasts with the Group's fundamental equity research also offers an attractive product differentiator and has helped improve the performance of recommendations for US\$-based investors in overseas stocks.

Company history

Table 1: IIR Company Timeline

Aug-00	The Market Age raised £4.3m from PPM Ventures via AIM listing
Jun-01	Prelims, pretax loss of £2.3m
Jan-02	Weak interims, pretax losses £0.9m, profit warning
Jun-03	Prelims, pretax loss of £2.2m
Sep-03	Shares suspended pending restructuring / refinancing Sale of Pronet considered
Dec-03	£0.7m Loan note converted to equity
Jan-04	Pronet contract win with Forex Capital Markets LLX Prelims, pretax loss of £0.8m
Apr-04	Trading update, company reaches EBITDA break-even Gmail™ / Google dispute begins
Jun-04	Prelims, pretax loss £0.4m
Aug-04	IFMR - "Significant" contract wins with two investment banks
Sep-03	Interims, pretax loss £99k
Aug-05	Prelims, pretax loss £0.3m
Oct-05	Google re-brands Gmail to Google Mail
Nov-05	Interims, pretax loss £148k
Jul-06	Prelims, pretax loss £201k

Source: The Company

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Business model

IIR listed on AIM in August 2000 as applications service provider The Market Age (TMA). The company raised £4.3m and was initially valued at £18.4m. TMA invested more than £5m in infrastructure and marketing to establish an instant analytics service covering all major currencies. At its peak, the service had around 40 institutional customers with up to 40 terminals each.

However, demand for the service was hit during the market downturn in 2000 and 2001. The shares were suspended in September 2003 at 2p as the Group explored different financing options. A debt for equity swap in December 2003 enabled the Group to switch £0.7m of an outstanding 6% Loan Note to £70k with the same coupon. Equity was swapped on the basis of 1 ordinary share (1p nominal) for every £4 original nominal value of Loan Note. The Group's delayed results were subsequently published in January 2004.

IFMR began hiring a team of analysts in early 2004 as the Group looked to capitalise on the 'Spitzer' effect. In late 2003, the New York Attorney General Elliot Spitzer, together with the SEC and NASD, announced an agreed settlement of conflict of interest charges against ten major broker-dealer firms (investment banks). The firms involved agreed to spend \$432.5m over the next five years to buy independent equity research for their retail clients.

The first two customers went 'live' with research supply relationships in August 2004, followed by a third in October. By July 2005 IFMR was supplying research to seven of the ten large broker-dealers involved in the GRAS settlement. IFMR now has a coverage universe of over 200 non-US stocks, which it sells to seven of the top-ten broker-dealers predominantly via Jaywalk, the independent equity research consultancy of the Bank of New York. IFMR also sells direct via Reuters to one significant client under a service contract.

The Group's medium-term target is to raise research coverage to 400-500 global companies, with a longer-term target of 1,000-1,500 companies. However, management concede that "labour arbitrage" benefits of India-based sourcing will diminish as demand from North America and European firms begin to put pressure on the supply of graduates. Malaysia, Thailand, other SE Asian countries and Africa, are under consideration as alternative research bases.

The Group has re-invented itself as an independent equity research boutique, with the benefit of its own cost-effective in-house research team. Moreover, a recent buy-side client win suggests that expansion outside the current limited sell-side audience could provide good growth opportunities.

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Google – Gmail issue

IIR is currently in discussions with Google regarding a “fresh” approach to a settlement of the Group’s claims for compensation for breach of trademark. IIR has a pending trademark application over the Gmail™ name, around which Google Inc. launched a web-based email service on 1 April 2004. In October 2005 Google withdrew the name in the UK, though only partially; and separately offered a financial settlement to IIR.

However, the terms were not deemed acceptable. IIR commissioned an independent report which concluded that the worldwide value of the trademark to Google was in the range of £25-£34m. The Company has a number of potential litigation partners, who could financially support an intellectual property rights action. IIR has recently resumed negotiations with prospective third-party litigation partners and independent legal counsel is being obtained.

The dispute with Google Inc. over the rights to the ‘Gmail’ trademark has negatively impacted the Group’s marketing plan for Pronet, which distributes its research using the Pronet GMail™ web-based email service. With the exception of the Greater China market (where the service will be offered free in collaboration with broking firm Forex Capital Markets LLC in return for a share of transaction revenues) Pronet revenues attributable to the FX research business have suffered accordingly.

Growth drivers

Management point to a number of medium-term revenue growth drivers:

- Ongoing impact of GRAS and ‘ripple-through’ to buy-side
- US demand for non-US company research
- Additional services targeted at user base
- Need for deeper analyst coverage of smaller companies
- Further product development (Trading ideas, Quantitative research)

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Forecasts

With the core administrative functions now in place, IIR should increasingly benefit from a high level of operational gearing. We expect the most significant near-term additions to the cost base will be in the Group's sales capacity, as IFMR attempts to leverage its growing research library and stock coverage universe.

The Group also intends to be "alert" to potential acquisition opportunities. We have not included acquisitions in our forecasts, but would expect any such move to target similar business and investment research businesses. Management have also stated that any acquisition would be earnings accretive.

Currency risk adds a degree of uncertainty to our forecasts. The majority of the Group's revenues are in US dollars, whereas costs are largely in sterling or Indian Rupees. IIR's currency exposure is not hedged. Our forecasts are based on flat rate exchange rates of US\$1.85 / £1.00 and RUP70 / £1.00. The Group carries £4.6m of unutilised tax losses. As such, we do not envisage the payment of any tax within our two year forecast period.

Revenue visibility is low. The majority of revenues are generated through intermediary sales via Jaywalk, where banks select their own 'packages' of research from the pool of 150 IRP contributors. IRPs must therefore compete with each other for clients; they have no say over their commercial terms and little visibility over the quarterly payments received from Jaywalk. However, this IFMR also sells direct to one significant client under a 12-month service contract, which raises overall revenue visibility. Revenue growth will therefore be driven by incremental sales of both existing and new research coverage.

Forecast model				
Year to 28 Feb (£'000s)	2005	2006	2007E	2008E
Turnover	683	914	1,089	1,564
Growth (%)	59	34	19	44
Analysts (average)	-	12	35	37
Salesmen (average)	-	-	1	2
Gross profit	500	471	820	1,266
Gross margin (%)	73	52	75	81
EBITDA	(123)	(104)	14	271
EBIT	(283)	(194)	(31)	221
Pretax profit IdB	(293)	(207)	(18)	238
Net income IdB	(303)	(207)	(18)	238

Source: Insinger de Beaufort (All ratios are calculated before exceptionals and goodwill)

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Sales sensitivity

We have conservatively assumed the addition of just 1 full-time salesperson during 2007 (rising to 2 in 2008), but given that they would only be active for half the financial year we assume a limited impact in 2007. Going forward, we have assumed each sales person is capable of closing 2 sales of research coverage sets of 25 stocks each per year via Jaywalk, combined with similar sized direct buy-side sales of 1 per quarter. This would equate to annual sales of just under \$375k, or £200k per salesperson. This would contribute to 2008 Group sales of £1.51m.

IIR should benefit from a high level of operational gearing. Incremental research sales less sales commissions (of c.10-15 per cent) will fall directly to the profit line. By way of illustration, if buy-side sales were 5 per year, versus our expectation of 4 per year in 2008, our sales forecast would rise by just 2 per cent to £1.56m, but our underlying pretax estimate would increase by 16 per cent to £238k. Alternatively, a sales shortfall of 2 per cent (based on buy-side sales of 3 per salesperson year) would lead to a 16 per cent profit shortfall.

Valuation

Table 2: Valuation

Company	Ticker	Mcap	Year End1	PE1 (x)	PE2 (x)
Datamonitor	DTM	293	Jun-06	28.1	23.8
Taylor Nelson Sofres	TNN	903	Dec-06	16.0	13.9
Toluna	TOL	63	Dec-06	39.1	26.3
IIR	IIR	2	Feb-07	n/a	16.7
Average (ex IIR)				27.7	21.3

Source: Consensus, Insinger de Beaufort

We have selected a range of research-oriented businesses to provide some idea of the earnings multiples that an equity research business might command. However, we note that although the core IIR research business is now up and running, the Group remains at a relatively early stage of development and has no direct listed competitors on the UK market. In the US, the relatively mature and closer comparator Morningstar Inc. trades on P/E of 25.4x for the year to Dec 2007. Should IIR prove capable of achieving our forecasts to Feb 2008, the Group would trade at a 22% discount to its UK listed peers.

It is also worth noting that our EPS estimates are based on the average fully diluted number of shares in issue, which includes an expected 6.2m new options to be issued over the next two years under an ESOP scheme to retain key staff. We have assumed all options are retained and exercised at maturity, although in reality this is unlikely to be the case.

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Management

Shane Smith (Chairman and CEO)

Shane began a career in equity research in 1986 and subsequently joined the early team behind Bloomberg in London. In 1992 he established his own currency research firm, and then in 1996 founded Pronet Analytics.com, which became a regulated investment advisor. He led the Group through admission to AIM in 2000 and is the architect of the current equity research product line.

Karen Griffith (Director)

Karen is a director and chief currency strategist. Over 15 years working with the CEO, she has become one of the City's most seasoned and respected technical commentators.

Richard Hutchinson FCA (Finance Director)

Richard qualified with Arthur Andersen 1976. He has been Group FD since 1998. Richard serves on the boards of a number of private companies.

Malcolm Lewis-Donaldson (Non-executive Director)

Malcolm has spent his City career in board positions covering sales, marketing and CEO roles. Malcolm is presently Sales Director for a leading financial markets database firm.

Albert Maasland (Non-executive Director)

Albert has spent his City career in roles at major global banks. Now a senior executive at Standard Chartered, Albert was formerly a managing director a Deutsche Bank in London and Marketing Director for a leading ecommerce firm.

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Independent International Investment Research

IIR provides research on global companies and currencies for broker-dealers, investment banks, money managers and private clients world-wide. Pronet Analytics is the Group's currency research firm, whilst Independent Financial Markets Research offers a US based research service on non-US companies (primarily those with ADRs).

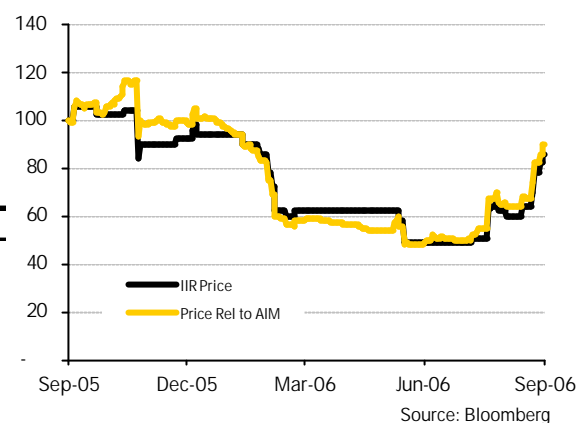
Profit & Loss forecasts

Year to 28 Feb (£'000s)	2005	2006	2007E	2008E
Turnover	683	914	1,089	1,564
Operating profit	(283)	(194)	(31)	221
Margin (%)	(41)	(21)	(3)	14
EBITDA	(123)	(104)	14	271
Exceptionals	0	0	0	0
Net interest	(10)	(13)	(7)	(4)
Pretax profit	(293)	(207)	(38)	217
Pretax profit IdB	(293)	(207)	(18)	238
Tax	(10)	0	0	0
Tax rate (%)	(3.4)	0.0	0.0	0.0
Av. No. shares diluted (m)	15,826	19,595	28,856	31,931
EPS (p)	(1.9)	(1.1)	(0.1)	0.9
IdB EPS (p)	(1.9)	(1.0)	(0.1)	0.7
Growth rate (%)	n/a	n/a	n/a	n/a
DPS (p)	0.0	0.0	0.0	0.0

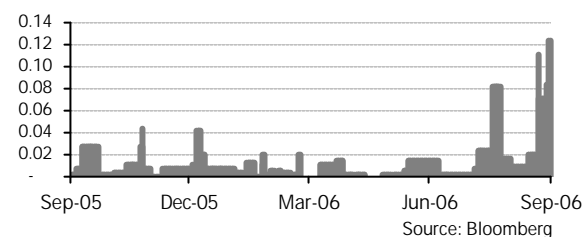
Cash Flow forecasts

Year to 28 Feb (£'000s)	2005	2006	2007E	2008E
Operating profit	(283)	(194)	(31)	221
Depreciation	160	81	26	30
Amortisation	0	9	20	20
Change in working capital	48	200	(150)	(38)
Other	0	0	0	0
Operating cash flow	(75)	96	(136)	233
Net interest	(10)	(13)	(7)	(4)
Tax paid	26	0	0	0
Other	0	0	0	1
Free Cash Flow (FCF)	(59)	83	(143)	231
Dividends	0	0	0	0
Capex	(11)	(5)	(30)	(30)
Acquisitions	0	(5)	0	0
Disposals	0	0	0	0
Equity issued	0	99	0	0
Other	0	0	0	(1)
Increase in funds	(70)	172	(172)	200
Net debt (cash)	(174)	(2)	(174)	26
Shareholders funds	(322)	(30)	(68)	149
Gearing (%)	(54)	(7)	(257)	(17)
Interest cover (x)	(7.5)	7.4	(19.2)	62.7

Relative share price performance



Trading volume (m)



Other information

	%
Current price (p)	10.8
12 month high (p)	13.25
12 month low (p)	6.13
12m average volume	10,892
Market capitalisation (£m)	1.9

Major shareholders

	%
Shane Smith (CEO)	65.4%
Roy Nominees Ltd	5.7%
PPMV Nominees Ltd	5.9%
Richard Hutchinson (FD)	5.8%
K Moody	3.5%
Squaregain	2.5%

Previous results

Preliminary results	26-Jul-06
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Next results

Interims (estimate)	29-Sep-06
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■ Fundamental coverage

Fundamental **Buy** and **Sell** recommendations for companies under 'full coverage' implies that we anticipate a price appreciation (or depreciation) +10% (-10%) or more over a 12 horizon. For **Hold** recommendations, we do not expect the price to move by much more than +/-5% over the same period. We maintain forecast and valuation models for companies under fundamental coverage. Target prices, subject to change in future publications, are also on an assumed investment horizon of 12 months. In accordance with Insinger de Beaufort's research policy, research is independent and objective.

Recommendation	Expected 12 month absolute price appreciation (depreciation)
Buy	+ 10% or more
Hold	+/- 5%
Sell	- 10% or more

Source: Insinger de Beaufort

Note: in accordance with Insinger de Beaufort's research policy, no recommendations are made on "House Stocks".

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