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Murgitroyd Group plc 290.5p Successful Integration Leads to Results Exceeding Expectations 4 September 2006



Murgitroyd has produced an excellent full year result for the year ended 31 May 2006 growing both revenues and earnings per share by around 30%.

The company produced a net profit before tax figure which exceeded our expectations by close to 10%. This reflected Murgitroyd's success in both integrating the business of Castles, acquired last year and continuing strong organic growth.

The company continues to produce good cash flow, its working capital position has improved dramatically and an increased proposed dividend has been announced.

During the year Murgitroyd opened an office in York and secured direct representation rights in Austria and Switzerland. The company already has such representation rights in the UK, Ireland, France, Germany, Monaco and the Netherlands.

An agreement has been entered into with Coats plc, whereby Murgitroyd has taken over the function of Coats' Trade Mark department and 7,000 Trade Mark files have transferred to Murgitroyd.

Post balance date Murgitroyd acquired Glasgow based Fitzpatrick's Group Limited for a consideration of £1.7m including deal fees. The consideration paid was an attractive 3.0x EBITA. As a result of this acquisition we expect Murgitroyd to move up the rankings of Intellectual Property practices in Europe – from number 19 to number 16.

The company continues to trade at a discount to what is commonly thought of as its closest AIM listed comparator, RWS Holdings and we see no reason as to why its shares should not be trading nearer the 330p mark.

Share Price: 290.5p
12m High: 298p
12m Low: 161p
Market Cap: £24.1m
Shares in Issue: 8.28m
NAV/Share: 26p (excl. intangibles)
Gearing: 33% (incl. intangibles)
Interest Cover: 11x
EPIC Code: MUR
SEDOL No: 3106745
Sector: Support Services
Market: London AIM
PR: Cardew Group
Website: murgitroyd.com
Previous Research Note: 16.1.2006
"Strong interims prompt another upgrade"

Analyst: Rae Ellingham

	Sales	Declared	Adjusted	Adjusted	P/e ratio	Divi p.	Yield
May	£m	Profit £m	Profit £m	Eps p.	Adj		%
2005A	14.5	0.9	1.4	11.4	25.5	3.3	1.1
2006A	18.8	1.4	1.9	14.7	19.8	4.7	1.6
2007E	25.0	2.1	2.6	21.9	13.3	6.9	2.4
2008E	27.9	2.4	3.0	24.8	11.7	7.9	2.7

Full Year Results to 31 May 2006

Murgitroyd produced a full year result for the year to 31 May 2006 with net profit before tax exceeding our expectations by close to 10%. Earnings per share for the year grew by 29.1% over the previous year.

While revenues were marginally lower than we had anticipated the company has done an excellent job in integrating Castles, the London based Patent and Trade Mark Attorney that Murgitroyd acquired in January 2005. Overall group turnover increased by 30.3%. Stripping out Castles sales suggests that Murgitroyd's own organic growth remains strong at around 15%.

Historically Murgitroyd has had gross margins of 67% whereas Castles had gross margins of closer to 50%. Following Murgitroyd's interim results release in January we had estimated that Murgitroyd would achieve gross margins of 63% in the second half of the financial year for a full year gross margin of 61.7%. Gross margins for the full year were in fact 62.8% which implies a 65.2% gross margin in the second half.

Murgitroyd has been able to achieve this through a combination of continuing price alignment, economies of scale and tight cost controls.

Administration expenses were also marginally lower than we had expected. Overall the result is an improvement in operating margins from 10.4% in 2005 to 11.2% in the 2006 year.

These ongoing improvements were offset by a one-off higher than expected deferred tax charge and this brought Murgitroyd's net profit after tax very much into line with our estimates.

In terms of Murgitroyd's balance sheet the company's working capital management continues to improve. The number of debtor days outstanding has decreased by just over three weeks to 107 days by our calculation. The trade creditors position has improved dramatically – falling as a percentage of cost of services sold from 143 days in 2005 to just 91 days in 2006.

As with its half year result Murgitroyd continues to generate good cash flow with operating cash inflow equating to 82% of operating profit. A final dividend of 4.65p per share has been proposed. This equates to 31.7% of adjusted post tax earnings – an uplift of 8.5% over the 29% pay-out ratio made in the previous year.

The company now has offices in the UK, Ireland, France and Germany. It has representation rights in the UK, Ireland, France, Germany, Monaco, the Netherlands, Austria and Switzerland.

Coats Plc Outsourcing

In March 2006 Murgitroyd agreed to take over the function of Coats' Trade Mark department. Coats plc - a market leader in sewing, thread and needlecraft products – employs 25,000 staff worldwide and has a presence in over 60 countries. Under the agreement three staff have transferred to Murgitroyd along with 7,000 Trade Mark files.

Acquisition of Fitzpatrick's – Post 30 June

On 30 June 2006 Murgitroyd completed its acquisition of Fitzpatrick's Group Limited. The acquisition of Fitzpatrick's (established 1887) strengthened the Murgitroyd team and brought total staff to 191. Importantly, for enhanced future economies, Fitzpatrick's was also Glasgow based.

Fitzpatrick's fits well with Murgitroyd and brings with it several notable clients. Its Attorneys work across four divisions – Patents (specialising in chemicals/bioscience, electronics and computing, and engineering and physical sciences), Trade Marks, Design and Copyright, and Renewals.

Under the acquisition agreement Murgitroyd is paying a consideration of £1.3m for the share capital of Fitzpatrick's and an additional estimated £240,000 for net assets. The total consideration including deal fees is therefore estimated at £1.7m. We understand that £700,000 was paid upfront in cash on completion of the deal along with deal fees and related financing charges – the remaining £840,000 will be paid over the following two years – the deferred consideration is to be financed through two bank guaranteed Loan Notes, payable after one and two years. Notional interest on the Loan Notes is chargeable at 4.75% per annum and a 1% per annum guarantee charge applies to outstanding Loan Notes.

Fitzpatrick's turnover for the year to 31 December 2004 was £3.9m. Earnings before interest, tax and amortisation was £32,000. The acquisition price was therefore on the face of it a hefty one at 40.6x earnings.

However, immediate payroll savings (estimated at £400,000) will be generated by the departure of several staff at completion, including six senior staff – Fitzpatrick's ex-Managing Director, its Board Chairman, Chief Operating Officer, IT Manager, Business Development Manager and Finance Director. After adjusting for these payroll savings the acquisition price falls to an attractive 3.0x earnings. Murgitroyd itself is currently trading at around 7x EBITA.

Outlook and Forecasts

While growth was slightly down on the previous year (7% compared to 9.8%) the market for Patents and Trade Marks continues to evidence healthy growth. The space also continues to remain a competitive one with demand for Patent and Trade Mark Attorneys outstripping supply.

Historically Murgitroyd has grown its business through a combination of acquisitions and organic growth. The company has successfully integrated and improved gross margins following its acquisition of the Cabinet Bonneau and Castles businesses and we would expect to see a similar result with the Fitzpatricks acquisition over time. Importantly, Fitzpatricks is the first acquisition that the company has actively pursued, as opposed to prior acquisitions, where Murgitroyd has been sought out.

The company is also in advanced discussions with regard to opening an office in Italy which should lead to further organic growth.

Having adjusted our forecasts for the Fitzpatricks acquisition we now expect to see revenues of close to £25.0m in the 2007 year, an increase of 32.7% over the previous year.

We understand that gross margins at Fitzpatricks have historically been around 50% in contrast to Murgitroyd's historical gross margins of close to 67%. There are two reasons for the substantially lower gross margins. Firstly, a majority of Fitzpatricks business has been in Trade Marks which are lower margin than Patents. Secondly, Fitzpatricks had positioned themselves as a lower cost provider. As a result of the acquisition of this lower gross margin business we expect Murgitroyd's gross margins in the 2007 year to be slightly lower than in the prior year, at close to 62%. Over time as the Fitzpatricks business is integrated into Murgitroyd's business we would expect margins to again pick up moving nearer toward Murgitroyd's historical levels. We understand that it takes between six to 18 months to fully integrate an acquisition and bring pricing into line with Murgitroyd's own.

After adjusting for the immediate payroll savings to be achieved following the departure of several of Fitzpatricks' key staff we calculate that the Fitzpatricks business had a slightly lower operating margin than Murgitroyd. As a result we are anticipating a slightly lower operating margin for Murgitroyd in the full 2007 year than was achieved in the past six months. The operating margin of 11.5% is still, however, an improvement over the prior year.

This may be on the conservative side. We understand that immediately following completion of the Fitzpatricks acquisition Fitzpatricks staff were relocated into Murgitroyd's own offices. With a lease on the Fitzpatricks offices to potentially be saved and other likely efficiencies the margin could well be higher.

While Murgitroyd's gearing will increase as a result of the acquisition it remains at a comfortable level and the company's operating profits easily cover interest payments.

As Murgitroyd is not a capital intensive business and we are not aware of any major upcoming expenses we are expecting capital expenditure in 2007 to be in line with the prior year.

In 2006 Murgitroyd increased its dividend pay-out ratio to 29% of profit after tax, up from 25%. This year Murgitroyd has surprised on the upside paying out 31.7%. At this stage we anticipate that the company will maintain this pay-out ratio going forward. We believe that as before the dividend will be paid in full as a final dividend, however company management continues to consider whether an interim dividend could be introduced.

Valuation Update

Murgitroyd's commonly thought of comparator, RWS Holdings, trades on 18.3x 2007E EPS (September year-end). This is a 27% premium to Murgitroyd which is currently trading on 13.2x 2007E EPS (May year-end) despite Murgitroyd having a better earnings profile.

Management have been successful in implementing its strategy of growing by a combination of organic growth and acquisitions and we would expect to see more of the same going forward.

The company last ranked at Number 19 in the 2005 "Managing Intellectual Property" magazine survey of the largest Intellectual Property practices in Europe with 55 fee earners. Post this acquisition we would expect to see Murgitroyd with 67 fee earning staff and ranked at Number 16.

In our view Murgitroyd is trading on an undemanding multiple and we can easily see sizeable upside to these shares. We have previously suggested that Murgitroyd's discount reflects a lack of liquidity in Murgitroyd shares. Just over fifty percent of the company's shares are held by the company's founder Ian Murgitroyd and family. We also believe that a lack of awareness by investors of this company is a contributor to the share price performance. With its past performance and the outlook ahead we see no reason as to why Murgitroyd should not be trading at nearer to the 330p mark.

Profit and loss, year to 31 May £000	2003A	2004A	2005A	2006A	2007E	2008E
Turnover	10,561	12,287	14,456	18,837	24,997	27,864
sales change %	16.6%	16.3%	17.7%	30.3%	32.7%	11.5%
cost of sales	(3,403)	(4,087)	(4,784)	(7,012)	(9,469)	(10,235)
Gross profit	7,158	8,200	9,672	11,825	15,528	17,629
Gross profit margin %	67.78%	66.70%	67%	62.8%	62.1%	63.3%
administrative expenses	(6,401)	(7,168)	(8,170)	(9,711)	(12,648)	(14,401)
Operating profit	757	1,032	1,502	2,114	2,880	3,228
operating margin	7.2%	8.4%	10.4%	11.2%	11.5%	11.6%
net interest payable	(54)	(62)	(126)	(201)	(233)	(228)
interest cover X	14	17	12	11	12	14
Net profit before tax	703	970	1,376	1,913	2,647	3,000
tax	(189)	(313)	(434)	(697)	(832)	(943)
effective tax rate %	27%	32%	32%	36%	31%	31%
Net profit after tax	514	657	942	1,216	1,815	2,057
dividends	(130)	(165)	(275)	(385)	(575)	(652)
Goodwill amortisation	(351)	(360)	(430)	(527)	(592)	(592)
Adjusted Earnings Per Share	6.2	7.9	11.4	14.7	21.9	24.8
Dividend Per Share	1.57	2.0	3.32	4.65	6.95	7.88

Cashflow year to 31 May £000	2003A	2004A	2005A	2006A	2007E	2008E
Operating profit	757	1,032	1,502	2,114	2,880	3,228
Depreciation	181	176	194	189	210	220
Working Capital	(662)	(362)	(365)	(563)	(1,150)	(526)
Operating cash flow	276	846	1,331	1,740	1,940	2,923
Interest	(54)	(49)	(97)	(121)	(186)	(182)
Tax	(179)	(284)	(432)	(578)	(749)	(849)
Net Capex	(246)	(191)	(160)	(203)	(213)	(220)
Free cash flow	(203)	322	642	838	792	1,672
Acquisitions and disposals		(194)	(1,099)	(692)	(1,150)	(870)
Dividends	(110)	(130)	(165)	(275)	(385)	(575)
Other	(48)	(30)	(1,698)	(79)	(160)	
Increase/decrease in net debt	(361)	(32)	(2,320)	(208)	(903)	226
Opening net debt	(496)	(857)	(889)	(3,209)	(3,417)	(4,320)
Closing net debt	(857)	(889)	(3,209)	(3,417)	(4,320)	(4,094)

Balance Sheet, Year to 31 May	2003A	2004A	2005A	2006A	2007E	2008E
£000						
Fixed Assets						
Intangible Assets	6,501	6,340	9,211	8,695	9,253	8,661
Tangible Assets	1,988	2,075	2,180	2,252	2,282	2,062
Investments	9					
Current Assets						
Work in Progress	230	265	434	317	575	641
Trade Debtors	4,320	4,394	4,893	5,533	7,374	8,220
Other Debtors	283	227	447	448	448	448
Cash	106	344	477	298	298	298
Current Liabilities						
Short term debt	(739)	(1,071)	(829)	(1,216)	(1,216)	(990)
Trade creditors	(2,098)	(1,679)	(1,873)	(1,752)	(2,604)	(2,815)
Other creditors	(709)	(927)	(2,021)	(1,168)	(1,265)	(1,440)
Total assets less current liabilities	9,891	9,968	12,919	13,407	15,145	15,085
Provisions	(10)	(1)		(73)		
LT debt	(224)	(162)	(2,857)	(2,499)	(3,402)	(3,402)
Shareholders' Funds inc. Intangibles	9,657	9,805	10,062	10,835	11,743	11,683
Year-end Shares In Issue, No. 000	8280	8280	8280	8280	8280	8280
NAV/Share inc Intangibles,p.	117	118	122	131	142	141
NAV/Share ex Intangibles	38	42	10	26	30	36

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