

FARMHOUSE EQUITY RESEARCH, LLC

RESEARCH REPORT

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(972) 562-0429
 ENTERPRISE SOFTWARE

NIKU CORP. (NIKU – \$6.74)

Hitting an Inflection Point; Initiating at Strong Buy

EPS (\$)						REVENUES (\$000)			
Fiscal Year:									
January	2003A	2004E	Prev.	2005E	Prev.		2004E	2005E	YOY Change
Q1	(\$0.54)	\$0.02A		\$0.04		Q1	9,839A	11,400	16%
Q2	(\$0.91)	\$0.01A		0.05		Q2	10,008A	11,900	19%
Q3	\$0.17	\$0.07		0.07		Q3	11,650	12,850	10%
Q4	\$0.74	\$0.06		0.13		Q4	11,600	14,300	23%
Year	(\$0.38)	\$0.16		\$0.29		Year	43,097	50,450	18%
P/E	NM	42.2x		23.2x		Mkt Cap/Revs	1.9x	1.6x	
52-Week Range:						Proj. 3-Year Revenue Growth:			
Market Cap. (\$Millions):						Dividend/Yield:			
Est. Shares Out. (000):						EV/ FY05 Revs:			
Estimated Float (000):						Cash/Share (7/03)			
Est. Insider Holdings:						Debt/Equity (7/03)			
Est. Institutional Holdings:						2005 PE, Excluding Cash			
10-Day Average Volume:						12-Month Price Target:			
Next EPS Report:						Rating			

- **We are initiating Niku Corp., with a Strong Buy rating.** Driven by a strong flagship product, we believe that NIKU, based in Redwood City, California, is beginning to take market share at just the opportune time. The Enterprise Portfolio Management (EPM) space is entering an inflection point of enterprise adoption as comprehensive, integrated suites from vendors such as Niku promise to control and reduce costs related to IT projects and personnel, one area of cost control that to-date has not been successfully automated by vendors and/or enterprises. IT expenses can consume up to 5% to 7% of total revenues and up to 20% of employees at most large companies, so this is an important potential cost savings opportunity for enterprises. Additionally, it has shored up its balance sheet and has been profitable four quarters in a row, and most likely has a fifth in the bag.
- **Our favorable rating is largely driven by our customer conversations.** We have spoken with many Niku customers and consultants who have labeled Niku 6 a “quantum leap”. This gives us comfort that Niku 6 is a significant step ahead of the competition. The Company has over 200 customers on Niku 6 (it was released in October 2001), and 600 overall, providing sizable upgrade potential. Furthermore, the Company also just closed the largest deal in its history (at \$2 million plus), which will hit revenues in the current quarter, creating robust EPS and revenue growth in 3Q. This also reflects the possibility that many of its customers who have been “phasing” it in could be ready to make more significant purchases.

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- **NIKU's investment thesis also meshes nicely with our macro-theme:** Enterprises are currently focused on software that manages expenses (vs. enhancing revenues), and that enable employees to do more with less. The IT space is one area that has not been addressed in an enterprise-wide fashion to this point in the history of software. NIKU is our application play on this space, and we believe the potential in the NIKU story is just now being recognized.
- **Niku already successfully sells to large enterprises.** Customers with over 1,000 users include British Telecom, Best Buy, GE Medical Systems, Target, TRW Automotive, and the major global bank mentioned in the 2Q04 conference call.
- **Niku has above average, even significant earnings potential.** On projected revenue growth of 17% next year (which is still hampered by the downturn), we model FY05 (FY: January) EPS of \$0.29. Our initial 2004 estimate is \$0.16. The Company has now been profitable for four consecutive quarters, and has \$1.91 in cash. Our price target based on next year's EPS plus cash per share of \$1.91 is \$10.

The Company has Solid Positioning and Has Reached a Turning Point

NIKU's new product release sets it apart from the competition and provides solid competitive positioning. NIKU 6.0 has enabled the Company to go enterprise-wide, by being the first comprehensive, suite of EPM modules offered in the space. With 5% to 7% of enterprise revenues being spent on IT, there are at least 10 separate functions in IT management that have not adequately been addressed. Many have called this space "ERP for IT" (but without the negative connotations – they actually meant that there is now comprehensive software for monitoring and tracking IT processes and expenditures). The EPM solution set includes software modules for resource management, financial management, project tracking, and portfolio management.

The Company's most recent earnings report was a turning point, in our opinion. The company announced that it had been profitable for the fourth quarter in a row, and it also announced the largest deal in the Company's history (to one of the largest global banks). It consisted of 20,000 seats, and was the result of the Company's "phased adoption" strategy in which a customer tests the software in small trials and then expands the implementation if positive metrics are recorded. Additionally, the stock has moved well above \$5 and can now be purchased by larger institutions. This large bank deal may also push other customers on previous platforms to upgrade to Niku 6 (not to mention the potential for other large new customers in the future).

- Customers we spoke with had several driving points that make us optimistic:
 1. One large customer was using it to manage the outsourcing of labor to India. Using NIKU, they can track time, milestones, and assets as they manage their global development team.
 2. Others are using it to maintain their capital requests and capital expenditures. With IT expenses representing of 5% to 7% of revenues and 20% of the employee base in many companies, managing IT is a burdensome task. With new Sarbanes-Oxley rules, IT governance also becomes more important (customers must certify their software capital expenditures under the new rules), and this type of software is likely to benefit from the added regulation.
 3. Others are using it to manage their IT systems much like an equity portfolio: What are my expected returns on this project? To get the full benefit of the expected return on Project C, do we need to lessen our investment in Project B and re-allocate to Project C?
 4. Another large user is using it to tie into their ORCL and PSFT financial packages. Even more interestingly, they are building portlets using Niku's new and improved interfaces and

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usability. Niku has strong financial reporting functionality in its suite, another competitive advantage vs. point solution vendors.

History/Background

The Enterprise Portfolio Management market has existed for awhile, with many point solutions offering pieces of the entire range of processes. Many different vendors have offered toolkits and point solutions, but we believe the primary driver in this sector is that EPM is now going mainstream behind integrated suites of applications. There are at least 10 different project processes that must be automated, and we believe Niku, with version 6.0 of its flagship, now offers the most complete, integrated (an important distinction) suite of applications in this space. Microsoft has products in this space, but most customers state that it is simplistic and not scalable enough for their needs (Niku sells to the large Global 5000 customers). In fact, several customers we spoke with interface Niku with MSFT, but will not use MSFT for the more important, process-heavy functions.

Competition

As we stated, Microsoft has “toolset” functionality (and a couple of customers even told us that the low-end tools in NIKU’s product portfolio were also even better than Microsoft’s). However, we never completely write off Microsoft because of their bulk and ability to even “freeze” the market with a new product press release. Lawson software has a product in this area, as do PeopleSoft and Oracle. In our opinion, NIKU remains well-ahead of any of these for reasons listed previously. Several customers have told us that Siebel and PeopleSoft are attempting to enter this market, but that PSFT, for example, is doing it from its financial perspective and not wrapping other IT processes into its solution.

Private competitors include Primavera, Kintana, and PlanView. Kintana was recently acquired by Mercury Interactive for about 5x revenues, a significant sign that this market has potential.

NIKU went public during the tail-end of the boom, in February 2000 and has had a senior management turnover, a reverse stock split, and a recent VC infusion of funds. We believe that the new management additions have been beneficial, and the significant investment in the Niku 6 product is turning the Company around. The Company has initiated several rounds of cost-cutting which has enabled the Company to be profitable for four quarters in a row.

Management Team

Joshua Pickus, President, CEO, and Chairman of the Board: He joined the Company in 1999 from Bowman Capital Management and was promoted to CEO in January, 2003. He previously served as the Company’s CFO (2/01-1/03) and President of Worldwide Business Relations (11/99-1/01).

Michael Shahbazian, CFO: Mr. Shahbazian has served as CFO since January, 2003. Previously, he was the CFO of ANDA Networks (11/00-11/02). Before that he was CFO of Inventa Technologies (2/00-11/00) and Walker Interactive (4/99-1/00).

Michael J. Sayer, EVP of Worldwide Sales: Mr. Sayer recently joined Niku, in August 2003. He has over 20 years of global software experience and increased Remedy’s European business from nothing to \$60 million.

Mark Moore, EVP of Products and Services: Mr. Moore has 16 years of application and database design. He was a co-founder of Listen.com and is the corporate IT architect. He has been with NIKU for over three years and spent several years on Oracle’s database design team.

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Products/Processes

Exhibit 1 demonstrates Niku's product offering. Again, customers we spoke with were very impressed with NIKU 6. Even more importantly, it seemed that every customer was using it differently and had different priorities. Table 1 is an overview of Niku's product offerings.

Table 1: Niku's Product Breadth

<u>Product Name</u>	<u>Processes Automated</u>	<u>Comments</u>
<i>Portfolio Manager</i>	Allocation and measurement of ROI on IT projects	Do we need to take some money out of Project X and move it to Project Y to improve our returns? Are my resources aligned with our corporate strategies?
<i>Resource Planner</i>	Aligning skills with projects	20% of large companies are IT employees - a very large number. This module enables corporations to match people to projects.
<i>Financial Manager</i>	Accounting & expenses	Tracking costs and capital expenditures. Sarbanes-Oxley is a driver for this module.
<i>Niku Project</i>	Project Management	Collaboration, milestone tracking, etc. Time tracking, collaboration.
<i>Niku Workbench</i>	Project Management	Desktop scheduling and management
<i>Niku Studio</i>	Personalization	Tools for customization and portlets High-level and easy access to necessary information.
<i>Niku Author</i>	Methodologies	Six Sigma and best practices
Underlying these products is a strong Web-native architecture and an open, easily integrated platform.		

Source: The Company

Financials and Valuation

Though we do not expect much growth this year, we do project an inflection point occurring this year market and some uptick next year. Additionally, Niku has significant earnings leverage, and EPS could be \$0.16 in FY04 (YE: January), and \$0.29 in FY05. These are based on revenue projections of \$43.1 million and \$50.5 million, respectively, for 2004 and 2005. With \$21.7 million in unrestricted cash, the Company is trading at a PE of 25.9x based on 2005, but more importantly, only at an enterprise value/revenues ratio of only about 1.2x based on 2005 estimates, a fairly inexpensive way to play this predicted market growth.

The Company closed its largest deal in its history in Q3, which will provide a nice sequential bump, and we project revenues of \$11.9 million in Q3 and EPS of \$0.07. However, we do not believe there is a transaction that large in the pipeline for Q4 (but there is a solid pipeline), and so it is possible that Q4 will be down, which we have projected. We believe overall growth will return next year, driven by the reasons we have put forward in this report.

Price Target

After taking out the \$1.91 in cash per share, the stock is only trading at 16.7x next year's EPS estimate. We believe Niku has potential three-year earnings CAGR of 40% (taking into account the significant earnings leverage the Company possesses) and that it has earnings power of \$0.45 to \$0.55 in FY06. With this earnings potential, we believe a \$10 price target is achievable. This equates to a FY05 PE of

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34.5x, a slight discount to our 40% projected earnings growth rate. This also equates to an EV/Revs multiple of 2.0x, a very fair multiple for a market leader with competitive advantage.

Additionally, we are very optimistic upon seeing DSOs of 41 in the most recent quarter. While they may not stay there, this is a robust sign that the Company has cash generation potential. These DSOs were one of the best scores in the software industry in the quarter, but they may revert to the mid-50's.

Risks

Among the risks in buying shares of Niku are:

1. **Competition is almost always the largest risk in a software story.** However, we do believe Niku's most recent product release solidifies it as a market leader, but larger heavyweights could market their way into the space without the functionality of Niku. Additionally, its main competition is smaller private companies. There are not many public pure-plays that can afford to invest in the marketing, research, and infrastructure to compete with Niku as there are in other software sectors, such as in application servers, EAI, or supply chain management.
2. **Past Corporate Governance Warts.** The previous management team may not have ranked as the most shareholder-friendliest. The Company in the past has repriced stock options, forgiven loans, and used warrants to vacate leases. We are comfortable that this is mostly a relic from the previous upper management team, but any sign of governance issues that re-surface from here will be worrisome and may affect our thinking.
3. **This type of solution is not "must-have" but "very nice-to-have".** While companies are definitely looking to IT expenses as a route to achieve cost savings, spending in the downturn may remain hampered. We have built in some organic growth and some growth related to a better spending environment in our models. If software spending does not slightly improve, Niku will most likely not grow as much as we project.

Publicly trade companies mentioned in this report:

Computer Associates (NYSE: CA, \$27.27, Not Rated)

Lawson Software (NASDAQ: LWSN, \$7.78, Not Rated)

Microsoft (NASDAQ: MSFT, \$28.37, Not Rated)

Siebel (NASDAQ: SEBL, \$10.87, Not Rated)

PeopleSoft (NASDAQ: PSFT, \$18.82, Not Rated)

Unless otherwise noted, prices are as of the close September 9, 2003.

The Farmhouse Equity Research, LLC Rating System:

Strong Buy: We believe that shares of this stock are significantly undervalued and should be acquired immediately. Over the next 12 months, we believe that the share price will increase more than 50% on a sustained basis. As of 6/26/03, of the 13 companies we have under coverage, 4 are rated as Strong Buy.

Buy: We believe that shares of this stock are relatively undervalued and should be acquired on an opportunistic basis. Over the next 12 months, we believe that the share price will increase more than 25% on a sustained basis. As of 6/26/03, of the 13 companies we have under coverage, 5 are rated as Buy.

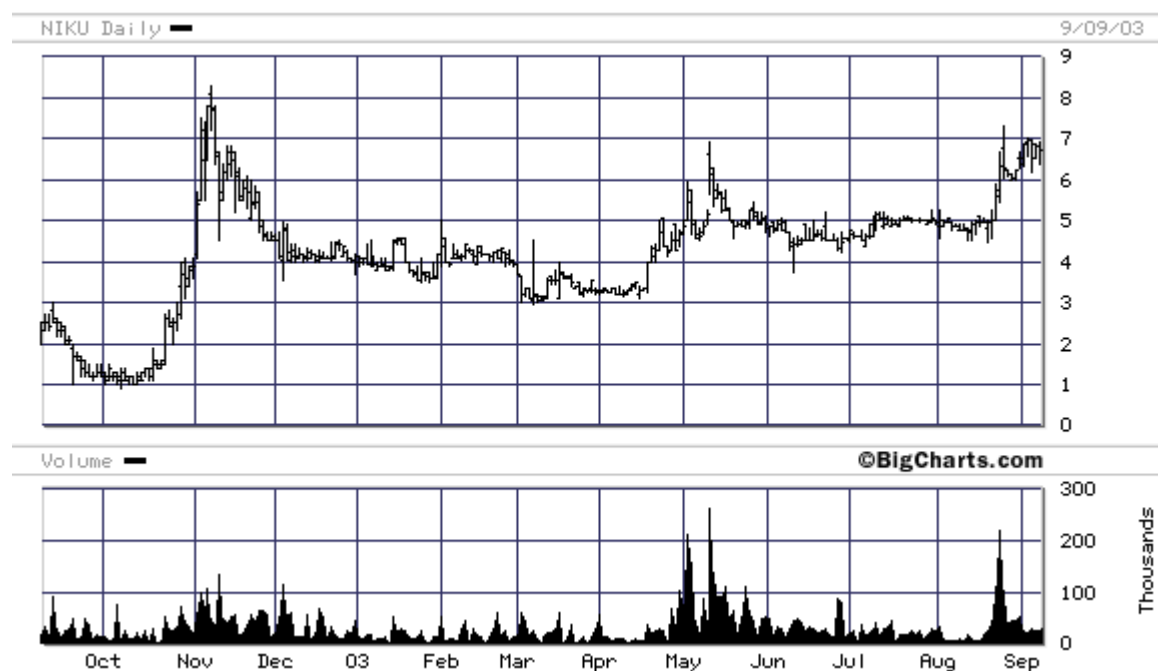
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Market Perform: We believe that shares of this stock are fully and fairly valued. Over the next 12 months, we believe that the share price will track with the overall market. As of 6/26/03, of the 13 companies we have under coverage, 2 are rated as Market Perform.

Market Underperform: We believe that shares of this stock are relatively overvalued and should be sold on an opportunistic basis. Over the next 12 months, we believe that the share price will decrease more than 25% on a sustained basis. As of 6/26/03, of the 13 companies we have under coverage, 2 are rated as Market Underperform.

Sell: We believe that shares of this stock are significantly overvalued and should be sold or sold short immediately. Over the next 12 months, we believe that the share price will decrease more than 50% on a sustained basis.

For the complete version of this report, please contact your CAPIS salesperson at 800.247.6729 or 214.720.0055 or Farmhouse Equity Research, LLC at 972.562.0429.



Source: Bigcharts.com

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Farmhouse Equity Research

Niku Corp.

C. Gregg Speicher, CFA

Income Statement (U. S. Dollar in Thousands, except per share amounts)
9/8/2003

(972) 562-0429

Fiscal Year End: 1/31	2002A Jan-02	1Q03A Apr-02	2Q03A Jul-02	3Q03A Oct-02	4Q03A Jan-03	2003A Jan-03	1Q04A Apr-03	2Q04A Jul-03	3Q04E Oct-03	4Q04E Jan-04	2004E Jan-04	1Q05E Apr-04	2Q05E Jul-04	3Q05E Oct-04	4Q05E Jan-05	2005E Jan-05
Composition of Revenues																
Licenses	31,974	5,691	3,961	4,857	4,203	18,712	3,213	3,131	5,250	4,700	16,294	4,300	4,600	5,200	6,400	20,500
% Total Revenues	47.4%	40.3%	37.7%	41.3%	35.0%	38.7%	32.7%	31.3%	45.1%	40.5%	37.8%	37.7%	38.7%	40.5%	44.8%	40.6%
Services	35,492	8,436	6,533	6,917	7,812	29,698	6,626	6,877	6,400	6,900	26,803	7,100	7,300	7,650	7,900	29,950
% Total Revenues	52.6%	59.7%	62.3%	58.7%	65.0%	61.3%	67.3%	68.7%	54.9%	59.5%	62.2%	62.3%	61.3%	59.5%	55.2%	59.4%
Total Revenues	67,466	14,127	10,494	11,774	12,015	48,410	9,839	10,008	11,650	11,600	43,097	11,400	11,900	12,850	14,300	50,450
Cost of Prod. Licenses	1,726	316	303	179	160	958	(24)	150	230	200	556	185	197	210	269	861
% Product Licenses	5.4%	5.6%	7.6%	3.7%	3.8%	5.1%	-0.7%	4.8%	4.4%	4.3%	3.4%	4.3%	4.3%	4.0%	4.2%	4.2%
Cost of Services	24,369	3,766	3,517	2,871	2,627	12,781	2,650	2,791	2,700	2,780	10,921	2,840	2,915	3,120	3,200	12,075
% Services	68.7%	44.6%	53.8%	41.5%	33.6%	43.0%	40.0%	40.6%	42.2%	40.3%	40.7%	40.0%	39.9%	40.8%	40.5%	40.3%
Cost of Revenues	26,095	4,082	3,820	3,050	2,787	13,739	2,626	2,941	2,930	2,980	11,477	3,025	3,112	3,330	3,469	12,936
Gross Profit	41,371	10,045	6,674	8,724	9,228	34,671	7,213	7,067	8,720	8,620	31,620	8,375	8,788	9,520	10,831	37,514
Gross Margin	61.3%	71.1%	63.6%	74.1%	76.8%	71.6%	73.3%	70.6%	74.8%	74.3%	73.4%	73.5%	73.8%	74.1%	75.7%	74.4%
Sales & Marketing	70,927	8,147	7,414	3,438	4,103	23,102	3,582	3,364	4,000	4,000	14,946	4,000	4,100	4,400	4,700	17,200
% Revenue	105.1%	57.7%	70.6%	29.2%	34.1%	47.7%	36.4%	33.6%	34.3%	34.5%	34.7%	35.1%	34.5%	34.2%	32.9%	34.1%
Product Development	34,856	4,029	3,993	1,967	1,907	11,896	1,897	1,817	1,920	1,940	7,574	2,000	2,100	2,200	2,300	8,600
% Revenue	51.7%	28.5%	38.1%	16.7%	15.9%	24.6%	19.3%	18.2%	16.5%	16.7%	17.6%	17.5%	17.6%	17.1%	16.1%	17.0%
G & A	15,205	2,207	2,331	2,232	1,664	8,434	1,537	1,531	1,820	1,840	6,728	1,800	1,900	2,000	2,100	7,800
% Revenue	22.5%	15.6%	22.2%	19.0%	13.8%	17.4%	15.6%	15.3%	15.6%	15.9%	15.8%	15.8%	16.0%	15.6%	14.7%	15.5%
Total Op. Exp.	120,988	14,383	13,738	7,637	7,674	43,432	7,016	6,712	7,740	7,780	29,248	7,800	8,100	8,600	9,100	33,600
Operating Income	(79,617)	(4,338)	(7,064)	1,087	1,554	(8,761)	197	355	980	840	2,372	575	688	920	1,731	3,914
Operating Margin	-118.0%	-30.7%	-67.3%	9.2%	12.9%	-18.1%	2.0%	3.5%	8.4%	7.2%	5.5%	5.0%	5.8%	7.2%	12.1%	7.8%
Net Other Income	2,468	120	312	184	5,120	5,736	(34)	(273)	(90)	(90)	(487)	(50)	(35)	(20)	25	(80)
Pretax income	(77,149)	(4,218)	(6,752)	1,271	6,674	(3,025)	163	82	890	750	1,885	525	653	900	1,756	3,834
Pretax Margin	-114.4%	-29.9%	-64.3%	10.8%	55.5%	-6.2%	1.7%	0.8%	7.6%	6.5%	4.4%	4.6%	5.5%	7.0%	12.3%	7.6%
Income Taxes	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Net Income	(77,149)	(4,218)	(6,752)	1,271	6,674	(3,025)	163	82	890	750	1,885	525	653	900	1,756	3,834
Shares Outstanding	7,438	7,766	7,413	7,312	9,023	7,879	10,678	11,907	12,350	12,600	11,884	12,800	13,100	13,500	13,900	13,325
EARNINGS PER SHARE	(10.37)	(0.54)	(0.91)	0.17	0.74	(0.38)	0.02	0.01	0.07	0.06	0.16	0.04	0.05	0.07	0.13	0.29
Stock Comp	4,685	(3,646)	(301)	165	135	(3,647)	61	74	50	50	235	50	50	55	65	220
In-process R&D charge			425	75		500										
Restructuring	3,092	(838)	30,405	7,469	880	37,916		1,648	0	500	2,148		230		240	470
Tax Adjust.	(3,540)	0	0	0		0	0	0	0	0	0	0	0	0	0	0
Non-op Net Income	(82,622)	266	(37,281)	(6,438)	5,659	(37,794)	102	(1,640)	840	200	(498)	475	373	845	1,451	3,144
GAAP EPS	(11.00)	0.03	(5.03)	(0.88)	0.63	(4.80)	0.01	(0.14)	0.07	0.02	(0.04)	0.04	0.03	0.06	0.10	0.24
Year-Over-Year %	Yr-Yr	1Q03A	2Q03A	3Q03A	4Q03A	2003E	1Q04A	2Q04A	3Q04E	4Q04E	2004E	1Q05E	2Q05E	3Q05E	4Q05E	2005E
Product Licenses		-29.3%	-43.6%	-22.2%	-60.5%	-41.5%	-43.5%	-21.0%	8.1%	11.8%	-12.9%	33.8%	46.9%	-1.0%	36.2%	25.8%
Services		-10.4%	-36.0%	-16.0%	2.4%	-16.3%	-21.5%	5.3%	-7.5%	-11.7%	-9.7%	7.2%	6.2%	19.5%	14.5%	11.7%
Total Revenues		-19.1%	-39.1%	-18.7%	-34.3%	-28.2%	-30.4%	-4.6%	-1.1%	-3.5%	-11.0%	15.9%	18.9%	10.3%	23.3%	17.1%
Cost of Revenues		-58.6%	-47.9%	-37.0%	-31.2%	-47.4%	-35.7%	-23.0%	-3.9%	6.9%	-16.5%	15.2%	5.8%	13.7%	16.4%	12.7%
Gross Profit		32.1%	-32.6%	-9.5%	-35.1%	-16.2%	-28.2%	5.9%	0.0%	-6.6%	-8.8%	16.1%	24.4%	9.2%	25.6%	18.6%
Operating Income		-89.7%	-67.7%	-107.4%	-247.3%	-89.0%	-104.5%	-105.0%	-9.8%	-45.9%	-127.1%	191.9%	93.8%	-6.1%	106.1%	65.0%
Pre-Tax Income		-89.7%	-67.5%	-108.8%	-734.4%	-96.1%	-103.9%	-101.2%	-30.0%	-88.8%	-162.3%	222.1%	696.3%	1.1%	134.1%	103.4%
Net Income		-89.7%	-67.5%	-108.8%	-734.4%	-96.1%	-103.9%	-101.2%	-30.0%	-88.8%	-162.3%	222.1%	696.3%	1.1%	134.1%	103.4%
Earnings Per Share		-90.0%	-67.0%	-108.9%	-612.7%	-96.3%	-102.8%	-100.8%	-58.5%	-92.0%	-141.3%	168.7%	623.8%	-7.5%	112.2%	81.4%

Source: Company Financial Documents and Farmhouse Equity Research, LLC Estimates

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