

A Clever Company

Ever since the time Prime Minister Bob Hawke coined the phrase, Australia has sought to become a clever country. This was essentially a way to compete against emerging economies, which have far lower manufacturing labour costs than would be acceptable in this country. Data#3 (DTL) is a company that has as its mission the provision of information and communication technology products and services that add value by offering industry and government better ways to do things.

Data#3 is a relatively small listed company with a capitalisation of about \$85 million, with origins and head office in Queensland. It evolved from Powell Clark and Associates in 1984 and listed on the Australian Securities Exchange in December 1997. It has expanded to have over 350 employees with a revenue base in 2005/6 of \$240 million and still growing. Data#3 now supplies products and services throughout Australia and to Asia Pacific countries from offices in Sydney, Melbourne, Canberra, Townsville, Rockhampton, Gladstone and New Caledonia.

Company Profile

It is not always easy for people who do not work in the information and communication technology industry, with its plethora of technical and management jargon, to understand what a company like Data#3 actually does. Data#3 divides its business into two broad sections, products and services. This is further split into five areas of specialisation.

The larger of the two broad areas of activity revolves around the supply of products. This activity area accounted for 77.4% of revenue in 2005/6. It comprises three product categories:

Software licensing and software asset management (34% of revenue).
These products help customers purchase and operate software under licensing agreements with global software suppliers including Microsoft, IBM, Symantec, Computer Associates and Citrix.

Information and Communications Technology Products (31.8% of revenue).
Data#3 provides expertise in providing products that meet customer needs, while being of high quality, competitively priced and user friendly.

Enterprise Infrastructure Products (11.6% of revenue).
This involves combining consulting and support services expertise in selecting and installing data storage and processing hardware and software in partnership with IBM, HP and Cisco Systems.

The smaller of the two broad areas of activity involves the supply of services, which accounted for 22.6% of revenue in 2005/6 and falls under two headings:

Information and communication technology services (12.3% of revenue).

These products involve the design, deployment and support of secure high performance network and communications infrastructure, backed with Data#3's certification by Cisco Systems and Microsoft.

Recruitment (10.3% of revenue).

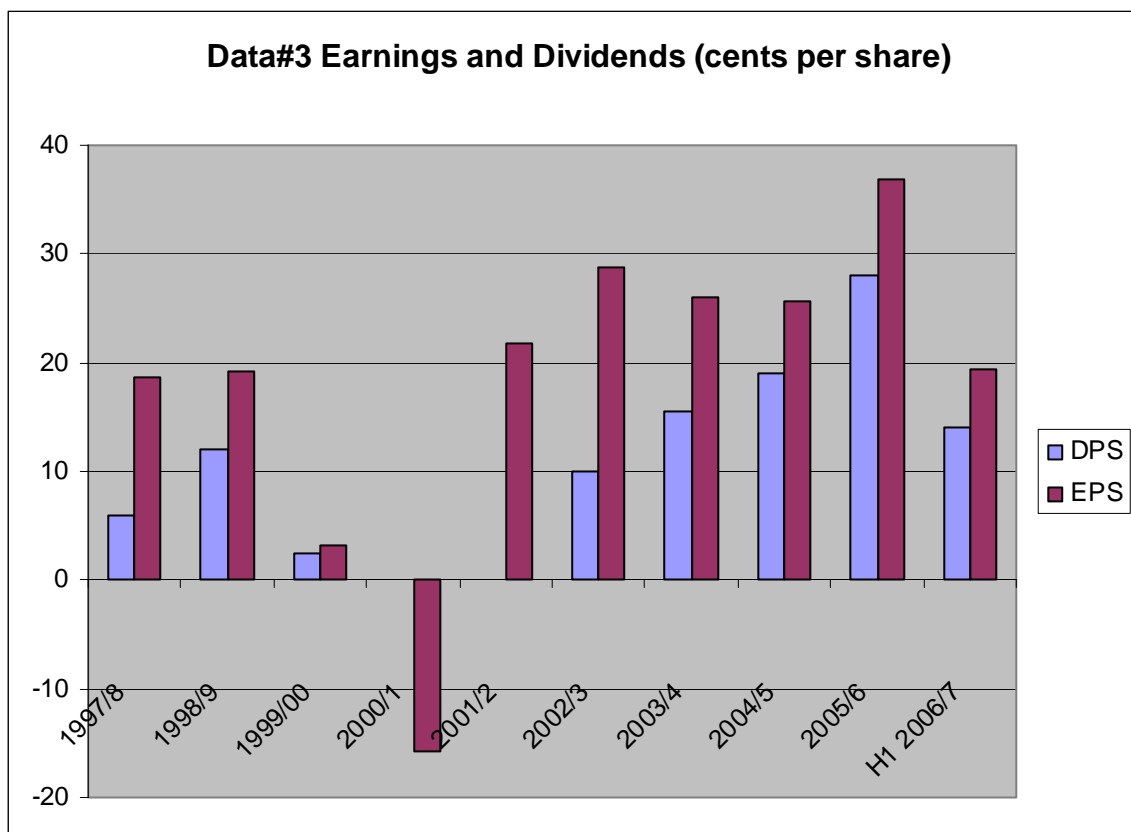
Data#3 recruits suitable contract and permanent staff for customers from an extensive database.

Data#3 customers represent a wide cross-section of industries including banking and finance, mining, tourism and leisure, legal, healthcare, manufacturing, distribution, government and utilities.

Earnings and Dividends

In the first half of 2006/7, Data#3 revenue increased by 20%, with very strong contributions from licensing (up 24%), information and communications technology products (up 22% and recruitment (up 61%). Earnings per share were up 15.5% and dividends were increased by 27%.

A driver for the increases in earnings over the last three years has been a steady reduction in staff costs and operating expenses from 91.8% of gross margin to 84.5%. This appears to reflect good management, high levels of demand and strong growth in more profitable services revenue.



Although Data#3 has been running very well for the last four years, the table of earnings and dividends illustrates that information and communication technology can be a volatile and cyclical industry sector. Data#3 reduced its dividend in 1999/2000 and passed their dividends entirely in the following two years.

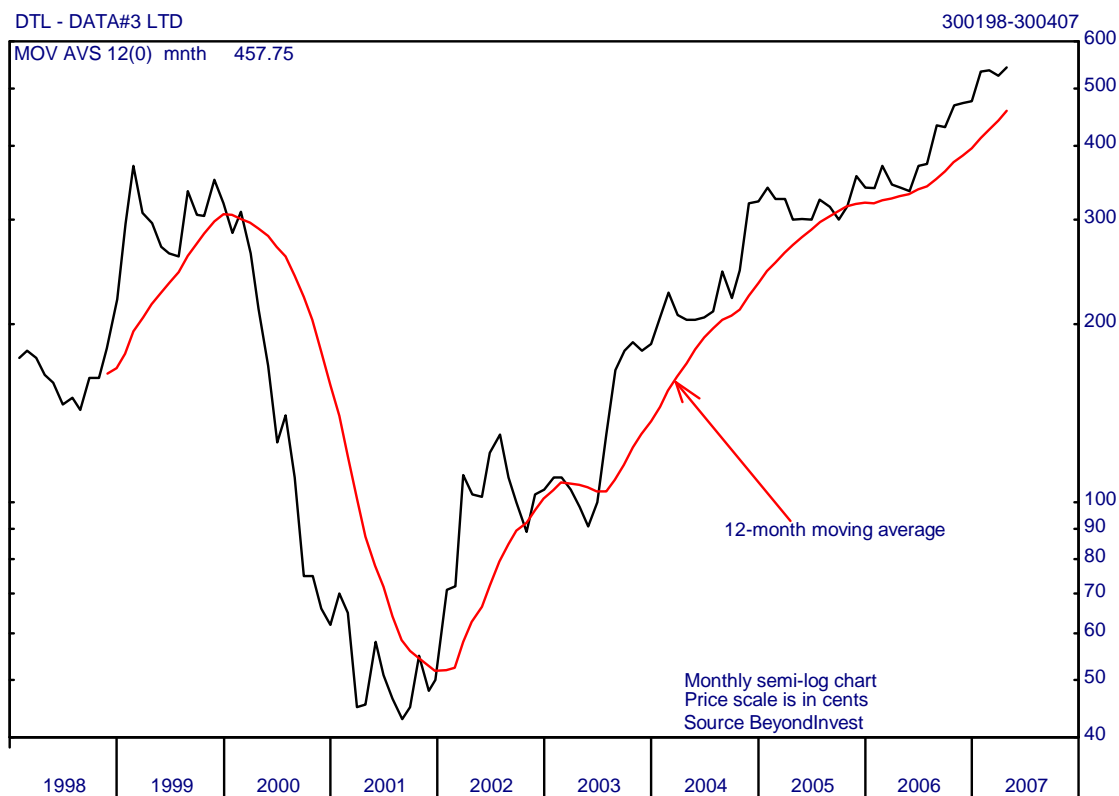
Value and Risks

As of early April 2007, Data#3 had a dividend yield of 5.7% and its price was 13.7 times earnings. Both measures represent good value compared to the market (3.7%, 14.3 times) and information technology sector (1.9%, 26.4 times) averages and other listed small information technology stocks.

While Data#3 certification by and partnerships with major global suppliers is evidence of its strengths, the information and communication technology industry is competitive and is also cyclical in the sense that technology spending is often one of the first things to be deferred in recessions. Smaller companies are often more vulnerable to the loss of one or two major clients.

The Data#3 strategy of growing services income has the dual objective of increasing margins and providing better ongoing relationships with customers. Part of this is an explicit policy of seeking additional cross-selling opportunities in all its operations.

Chart Analysis



Data#3 listed on the ASX at \$1.68 in December 1997. After slipping briefly to \$1.30 in 1998, its price climbed strongly to two identical peaks of \$4 in 1999. The

fall from the second of these peaks completed a double top reversal pattern and the price fell away sharply as the 1990s technology and internet boom unravelled in spectacular fashion. As Data#3 slipped into losses, its price reached a low point of only 31c in September 2001. This fall of 92% from the peak, while the market overall only fell 23%, highlights the potential dangers in holding shares in cyclical and thinly traded companies through market slumps.

However, unlike many other technology and internet stocks, Data#3 was a survivor and 2002 saw the price bounce back to a high of \$1.40. The price then formed a large symmetrical triangle pattern over the next twelve months. These patterns can break in either an upward or a downward direction. The direction of the breakout tends to indicate the direction of the next trending move.

Fortunately, the July 2003 breakout was upward. The price climbed steadily to a peak of \$3.55 in February 2005. This move had taken Data#3 back to the area of the 1999 double top pattern. These past trading areas, especially old all-time peaks, tend to be strong resistance zones. This is for a number of reasons.

Firstly, some holders fear a repeat of the old top and begin taking profits. Secondly, some of the holders who purchased back in 1999 and had ridden the stock down the slide and up the wall of worry will sell, taking the chance to get out after four years of pain and regret. Finally, buyers will tend to hold off and sellers tend to try to get out, just in case the old top is repeated and because the other groups have weakened the market.

The result was therefore fairly predictable. Data#3 churned sideways until July 2006. This sideways pattern could have been a new top pattern in formation. It was close to a rectangle-type pattern, though it was not perfect because of the failed attempt to breakout upwards in February 2006.

The decisive upward breakout came in August 2006. The expectation was then that a new leg of the upward trend would unfold. Data#3 has continued to rise and recently made a new high of \$5.50.

The failure level in the big picture for investors is the June 2006 low of \$3.14. In the shorter term, traders might become concerned if the price were to slip back below the March 2007 low of \$5.

Colin owns shares in Data#3