

26 June 2009

WorkPlace Systems International

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/08	10.8	1.2	0.9	0.2	4.3	7.5
03/09	9.6	(0.4)	(0.3)	0.0	N/A	N/A
03/10e	9.6	0.9	0.5	0.2	7.0	7.5
03/11e	11.7	1.4	0.8	0.2	4.8	7.5

Note: *PBT and EPS are normalised, excluding goodwill amortisation and exceptional items.

Investment summary: Cautious optimism

While management is beginning to sense renewed interest in the traditional software business, purchases have been small and we have yet to see a revival in any major orders. However, WorkPlace has been seeing a healthy interest in its new SaaS product – WorkPlace OnLine. This web-based application has generated encouraging demand, with mid-sized business such as multi-format stores and security firms buying the service.

Preliminary results: In line with our expectations

FY09 revenues of £9.6m and an operating loss of £0.5m are in line with the forecasts we revised in early March. Disciplined cash management kept net cash at £2.4m, or £0.4m above our forecasts. The company has written off £1.5m of goodwill from the carrying value of WSI, the US retail consultancy acquired in 2005.

Healthy launch for SaaS product

WorkPlace has been evolving its new software-as-a-service (SaaS) product for small and mid-sized companies. Having completed successful pilots, WorkPlace has made four sales since the year end. Interest has been driven not only by sales but also from companies approaching WorkPlace. SaaS opens up a new market for WorkPlace as smaller businesses have not been typical WorkPlace customers in the past.

Forecasts: Maintained on uncertain economic outlook

We are maintaining our forecasts, given the ongoing uncertain economic outlook. We note the nascent SaaS business will take some time to have an impact on the bottom line, due to the deferred nature of the SaaS business model.

Valuation: Trading less the 1x the maintenance book

Following recent declines the stock is trading again at late-2007 lows. WorkPlace has a market capitalisation of just £5.5m and £2.4m cash while its annual maintenance revenues are c £4m – this implies the stock is trading at just 0.8x the maintenance book. The shares are trading at 0.3x our FY10 forecast revenues and 3.3x EBITDA.

Price 3.75p
Market Cap £6m

Share price graph



Share details

Code WSI
Listing AIM
Sector Software & Computer Services
Shares in issue 147.5m

Price

52 week High 10.5p Low 3.25p

Balance Sheet as at 31 March 2009

Debt/Equity (%) N/A
NAV per share (p) 2.6
Net cash (£m) 2.4

Business

WorkPlace Systems International is a world leader in the development and supply of software products for workforce management.

Valuation

	2009	2010e	2011e
P/E relative	N/A	57%	46%
P/CF	7.1	7.0	4.0
EV/Sales	0.3	0.3	0.3
ROE	N/A	19%	23%

Revenues by geography (FY09)

UK	Europe	US	Other
57%	34%	6%	3%

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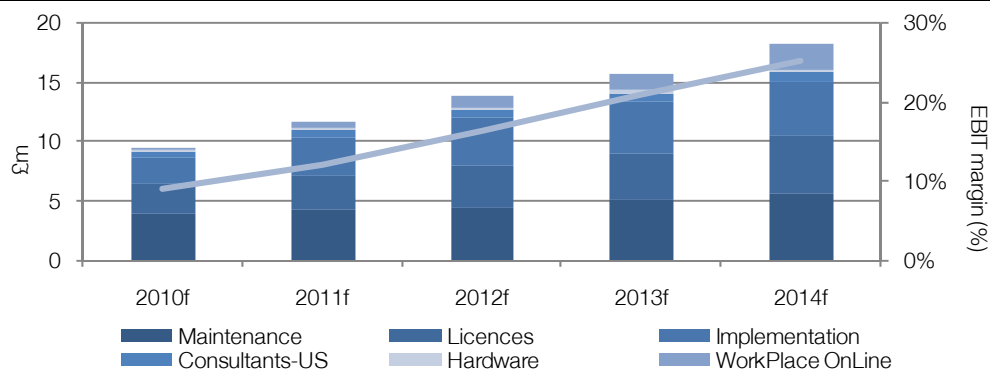
Company description: Workforce optimiser

Develops, supplies, implements workforce management software

WorkPlace is a leader in the development and supply of software products for workforce management. Its modules address all areas of staff planning and tracking based on an underlying proprietary software algorithm and around two core software platforms focused at the retail and transport/media sectors. The group has 117 employees and operates out of four offices – Milton Keynes, Reading and Rossendale, Lancashire in the UK and St Louis, Missouri, in the US.

- Traditional target customers:** Major application modules include: Labour Budgeting, Workload Demand Forecasting, Staff Scheduling, Roster Management, Time and Attendance, Work Planning and Tracking, Performance and Productivity, Mobile Working and Advanced Planning System for the manufacturing sector. WorkPlace differentiates its solutions with a sole focus on workforce management, sophisticated multi-country and multi-language functionality and high level consulting. Customers include Argos, BA, BAe Systems, Focus (DIY) Ltd, Metro Cash & Carry, Rank Leisure, Next, Severn Trent, Wickes/Travis Perkins and Whitbread.
- US expansion.** WorkPlace acquired Labour Systems International Inc (LSI) – a US consultancy firm specialising in retail consultancy – in 2005 with the goal of establishing a worldwide workforce management consultancy business. LSI's retailing knowledge was instrumental in winning two US software customers in 2008. LSI is now being refocused to shift emphasis back to the core software business. In November 2008 WorkPlace purchased a 25% stake in EASE Inc, a California-based Labour Standards software company with which WorkPlace has worked for a number of years in US retail markets. The investment also secured global distribution rights of EASE's business standards product.
- Evolving SaaS business.** The group acquired a 25% stake in Australia-based WorkBuddy Solutions Pty Ltd in late 2007 and took its interest to 50% last month. Additionally, WorkPlace holds the global rights to WorkBuddy's workforce management software, which can be delivered over the internet as a SaaS product. WorkPlace has branded its new SaaS product WorkPlace OnLine and has made four initial sales since the year end.

Exhibit 1: Group revenue and margin forecasts



Source: Edison Investment Research

Preliminary results: In line with expectations

Given the sharp deterioration in the economic backdrop during the second half, revenue fell by 12% to £9.6m and the operating result slipped to a £0.5m loss (£1.1m profit). The resumption of dividends in FY08 was short-lived, due to the unprecedented economic conditions, and the group is now focusing on conserving cash. While management is beginning to see a turn, purchases continue to be small with customers remaining very cautious about implementing any major capital spending. Rollouts have stabilised and the company anticipates a pickup in the second half of the current financial year.

North America: Converting the pipeline is challenging

The group has a considerable new business pipeline in the US, which includes a number of tier 1 retailers. However, WorkPlace has not managed to convert any of these potential tier 1 customers in FY09, reflecting the weak economic conditions in the US. The two customer wins in the US have been smaller retailers (Armani Exchange and Tacoma Goodwill), and these names provide the group with strong references for further sales. However, winning a tier 1 customer would be a major step change for the group in a major market.

UK and Europe: Pace of roll-outs slows

Software was deployed in several new countries for retail sector customers and additional modules were delivered in existing countries. However, the pace of customer rollouts in Europe slowed significantly over the year. The new Task Management was launched, completing the product range of modules for the retailing sector – it was delivered to Metro in the period.

A large deployment was made at the BBC while in the emergency services sector, the sale of a software solution to Strathclyde Fire Services was the group's first software sale in the sector.

The group's new SaaS solution, WorkPlace OnLine, was launched in wake of successful pilots with several customers and four sales have been made since the end of the period.

Exceptional items: Annual costs of £1.4m are cut

Management has prudently reacted to the reduced revenue expectations by cutting £1.4m of costs from the business. These savings will be recognised in FY10 and are mainly headcount reductions. Cuts were made in consultancy, support and marketing – 17 jobs were cut leaving around 117 employees. Cash costs relating to the restructuring were £0.48m, of which half was expended in FY09 and the balance has already been substantially expended in the current year.

WorkPlace has written down the £1.5m of goodwill relating to the purchase of LSI in 2005. The group has been reducing its labour standards work to focus on its core software businesses.

Cashflow and balance sheet: Group continues to generate cash

In FY09 operating cashflow rose to £0.8m (£0.0m), helped by a £1.4m reduction in working capital. The group capitalises and amortises development expenditure as required under certain circumstances by IFRS – £0.5m was capitalised in FY09, largely relating to work on the new Task Management module and also the development of WorkPlace OnLine. Free cash flow remained positive at £0.3m (£1.0m) but investments of £0.2m, dividends of £0.3m and currency movements resulted in year end net cash slipping by £0.4m to £2.4m.

Investment case: Wide end market possibilities

WorkPlace's customer base is spread across a range of sectors from emergency services and healthcare to manufacturing, retail, transport and utilities. While there is no limit to the sectors that the software can be marketed to, the product is most effectively targeted at industries with large workforces. The company itself is limited by the size of its sales force and consultants.

Drivers of WorkPlace's growth include:

- **Cutting customers costs:** In difficult economic times, retailers recognise the need to reduce costs, and WorkPlace's solutions typically help cut staff overheads by 3-7%. WorkPlace believes its solutions can help increase revenue typically by 1% and improve staff retention and significantly reduce queue length. Nevertheless, in the recession, tighter budget constraints have substantially neutralised the case for cost reduction, as many businesses have found themselves under intense financial pressure and capital investment was curtailed. Within the key retail sector, large players have generally held up investment, while smaller retailers have had to be vigilant on spending. However, when economies begin to recover and budgetary constraints are loosened we believe WorkPlace could potentially receive a healthy influx of business if it can successfully convert its sizeable pipeline.
- **Limited penetration:** Only some 20% of retailers have a scheduling solution and 50% have a time and attendance solution and they typically have little in-house expertise. A very significant number of companies still manage their workforces using spreadsheets. Within emergency services, the software sale to Strathclyde Fire Services is WorkPlace's first sale of Staff Tracker/Work Tracker to the emergency services; we note the company has 17 fire services that take its consultancy services and hence the potential for further sales is significant in our view.
- **Specialist skills required:** A scheduling module is difficult software to implement and WorkPlace has established considerable expertise in this field. This is because it has developed labour standards know-how across many countries and has the experience of implementing its solutions in many languages and legislations.
- **Geographic and industry expansion:** As we point out above there is no limit to the sectors that the software can be marketed to, but the product is most effectively targeted at industries with large workforces. From a geographic perspective, last year's licence sales in the US highlight the potential in the huge North American market.
- **Other investment:** The group has purchased 25% of EASE Inc, a US labour standards software company, and has secured the distribution rights of the entire EASE product range in the UK and Europe.
- **Management strength.** Paul Wright joined the group in September 2008 as finance director, bringing many years of experience in similar posts at both publicly and privately owned companies. Alex Davis joined WorkPlace earlier this year as chief technology officer, having worked in a variety of roles developing and deploying application software over the past 30 years.

- **Strong balance sheet.** A number of the group's competitors have been acquired in recent years, in debt-financed deals. In our view, WorkPlace's healthy cash position and debt free balance sheet gives the group an advantage.

WorkPlace OnLine extends the opportunity

The group has recently launched WorkPlace OnLine to address small format stores (less than 50 staff) in retail and hospitality markets. These are markets that previously have not been targeted and WorkPlace is finding the solution is appealing to companies wishing to switch their costs from capital expenditure to operating expenditure. The start up costs of this business have been very low, as the product has already been substantially developed by Australian-based WorkBuddy, prior to its purchase by WorkPlace.

- **Technological platform.** WorkPlace OnLine is a pure SaaS offering – it is a multi-tenant application hosted by WorkPlace for its customers. The multi-tenant capability means multiple instances of the same application can run over the internet. Hence, WorkPlace can tailor the product to multiple customers without major implementation cost or infrastructure. Hosting by WorkPlace means its customers do not require any major capital expenditure to install the applications or IT personnel to support the software. Multi-tenant architecture means customer support is minimal, and it takes only a matter of days to have the software up and running for a customer (it can take several months to roll out Time & Attendance software at a major customer).
- **Target market.** The SaaS product was initially intended to be targeted at small businesses such as single shops or small chains of stores, but the company has also seen strong interest from the broader small store format retail chains, security firms and a nightclub chain. This is because the payment terms have strong appeal with customers who are not interested in making (or unable to make) a major capital investment and prefer a pay as you go (PAYG) model. These new customers represent new markets for the company as none have been typical WorkPlace customers in the past. Once installed, the business is relatively sticky as it would require significant work and inconvenience for a customer to change its software supplier.
- **Business model.** We estimate target customers represent around half of the total workforce on the high street. We estimate a typical small customer could spend up to £20k per annum on the product while a large customer might generate £500k in revenues. We would anticipate gross margins for this SaaS business to be around 80% while operating costs would be relatively modest – we would expect opex in the short-term to remain below £0.2m and would be unlikely to scale beyond £1m in the longer term. As with any typical SaaS business, WorkPlace OnLine is highly scalable.

WorkPlace intends to launch the SaaS offering in the US later in the year. Further out we would expect the company to target other sectors with significant human resources costs.

Forecasts: Key assumptions are quite conservative

Our FY10 forecasts are supported by c £4m of recurring maintenance revenues. An expected visible further £2m of income from existing customers and c £60-70k per month of small orders puts a base on the FY10 forecasts at c £7.5m. We assume further licence sales (one new customer, rollouts to existing customers and additional modules), consultancy work, some hardware sales (clocks) and initial revenues from the nascent WorkPlace OnLine business will take revenues to £9.6m in FY10. The numbers could be conservative if customer budgets are relaxed quicker than we are expecting and pipeline conversion can improve.

Cash flow and balance sheet forecast assumptions

We are forecasting operating cash flow to remain at similar levels in FY10 to FY09 – as EBIT recovery is balanced by increasing working capital and c £0.24m of FY09 restructuring costs expended. We expect capitalised development expenditure to be lower in FY10 and to run at 3% of sales going forward and be amortised over five years. We expect cash deposits to decline slightly in H1 and rebound in the second half. We reach forecast year end net cash of £2.8m in FY10 and £3.3m in FY11.

Sensitivities

- **Business cycle.** There is some evidence that an economic downturn may encourage companies to more actively seek ways to reduce costs and effectively manage their workforces. However, as we have seen, a severe downturn is likely to induce customers to slash investment and will put greater limitations on their IT budgets.
- **Technological risks.** Competitors might succeed in developing superior products.
- **Other competitive factors.** US majors might seek more actively to move into Europe.
- **Staff issues.** The gain or loss of key staff could have a significant impact on this business. The company could have challenges recruiting in Milton Keynes and St Louis.
- **Customer roll-outs.** Our forecasts are dependent upon the pace of customer roll-outs of WorkPlace software.
- **Legal risks.** There are general legal risks in respect of doing business in the US. Widening the model to license software could be expected to increase these risks.
- **Cannibalisation.** The SaaS product may gain appeal with traditional customers.

Valuation: Trading less than 1x the maintenance book

The weak economic environment has resulted in downgrades in recent months. In June 2008 we were forecasting revenues of £13.5m and £15.1m for FY10 and FY11, respectively; these numbers have fallen to £9.6 and £11.7m, respectively. However, much of the revenue reductions have simply been deferred rather than definitively lost and when the economic backdrop recovers, this could result in an acceleration of orders as customer budgets are relaxed. Hence, in our view the company's current enterprise value of just c £3.1m offers investors a fairly clear opportunity for exposure to an early-cycle (supported by the cost benefits of the software) economic recovery.

- **Strong recurring revenues.** The group has a maintenance book of £3.9m, which expands as it sells licences. At current prices, the stock is trading at just 0.8x the maintenance book. Recurring revenues will get a further boost as the nascent SaaS business gathers pace.

- **Strong balance sheet and cash generation.** The group has £2.4m net cash as at 31 March 2009, representing c 40% of its equity market capitalisation. The group has the potential to generate strong cash flows – it generated free cash flow of £1m in FY08 and £0.3m in FY09 – and we forecast free cash flow of £0.4m in FY10 rising to £0.8m in FY11.
- **Discounted cash flow valuation.** Based on our forecasts and a weighted average cost of capital (WACC) of 15%, our DCF model values the shares at 12.2p, well above the current share price. However, discounting back from our forecasts, the market is attributing a very high break-even WACC (57%) to the stock (see Exhibit 3, Group DCF Scenarios).
- **Traditional valuation measures.** In traditional valuation terms, the stock trades on 7.0x our forecasts in FY10 falling to 4.8x in FY11. The stock trades on just 0.3x FY10 revenues, and 3.3x FY10 EBITDA, which are attractive valuation ratios compared with the company's peers and its own historical trading patterns.

Exhibit 2: Valuation

DCF valuation	% owned	£m	-- Per share --	Assumptions				
WorkPlace Systems	100.0%	15.6	10.6p	WACC: 15%				
				Number of shares		147.5m		
				Share price		3.8p		
				Market capitalisation		£5.5m		
Group Enterprise Value		15.6	10.6p					
Less: Adjusted net (debt)/add cash		2.4	1.6p					
Group Equity Value (£m)		17.9	12.2p	Up / (down)side from current price			225%	
Ratio Analysis	2010f	2011f	Grp DCF Scenario's		-----Terminal growth rate-----			
					3.00%			
EV/Sales	0.3	0.3						
EV/EBITDA	3.3	2.0		60.00%				3.5p
EV/EBIT	3.6	2.2		55.00%				3.9p
Price/Book	1.4	1.1		50.00%				4.3p
Price/Earnings	7.0	4.8		45.00%				4.8p
Price/Op Cash Flow	7.0	4.0		40.00%				5.6p
ROE	19%	23%						
Gearing	(58%)	(47%)						
Interest Cover	(48.5)	(40.8)						
				Breakeven WACC		56.7%		
Peer comparison (Year 2)	EV/Revs	EV/Ebitda	Revenue sensitivity					
---Human capital mgmt software---								
Allocate Software	1.4	11.2	Multiple	0.1x	0.3x	0.5x	0.7x	0.9x
Bond International Software	0.8	5.0						
ServicePower	0.4	14.6	Revenue Y2 (£m)	9.6	9.6	9.6	9.6	9.6
---Retail sector software---								
Clarity Commerce	0.7	5.4	Implied EV (£m)	1.0	2.9	4.8	6.7	8.6
K3	0.8	3.8	Net (debt)/cash (£m)	2.4	2.4	2.4	2.4	2.4
Prologic	0.2	3.2						
Median	0.7	5.2	Grp equity value (£m)	3.3	5.2	7.2	9.1	11.0
Mean	0.7	7.2						
WorkPlace Systems	0.3	2.0	Per share (p)	2.3	3.6	4.9	6.2	7.5

Source: Edison Investment Research

Exhibit 3: Financials

Year end 31 March	£'000s	2007	2008	2009	2010e	2011e	2012e
	UK GAAP	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		8,808	10,844	9,561	9,584	11,729	13,965
Cost of Sales		(334)	(300)	(276)	(300)	(350)	(400)
Gross Profit		8,474	10,544	9,285	9,284	11,379	13,565
EBITDA		(1,492)	1,276	(364)	960	1,551	2,507
Operating Profit (before GW and except.)		(1,638)	1,137	(480)	866	1,403	2,293
Goodwill Amortisation		(669)	0	0	0	0	0
Exceptionals		(594)	112	(1,976)	0	0	0
Other		0	0	0	0	0	0
Operating Profit		(2,901)	1,249	(2,456)	866	1,403	2,293
Net Interest		92	91	90	18	34	57
Profit Before Tax (norm)		(1,546)	1,228	(390)	883	1,438	2,350
Profit Before Tax (FRS 3)		(2,809)	1,340	(2,366)	883	1,438	2,350
Tax		279	27	0	(88)	(288)	(658)
Profit After Tax (norm)		(1,267)	1,255	(390)	795	1,150	1,692
Profit After Tax (FRS 3)		(2,530)	1,367	(2,366)	795	1,150	1,692
Average Number of Shares Outstanding (m)		143.5	144.8	146.8	147.5	147.5	147.5
EPS - normalised (p)		(0.9)	0.9	(0.3)	0.5	0.8	1.1
EPS - FRS 3 (p)		(1.8)	0.9	(1.6)	0.5	0.8	1.1
Dividend per share (p)		0.0	0.2	0.0	0.2	0.2	0.3
Gross Margin (%)		96.2	97.2	97.1	96.9	97.0	97.1
EBITDA Margin (%)		-16.9	11.8	-3.8	10.0	13.2	17.9
Operating Margin (before GW and except.) (%)		-18.6	10.5	-5.0	9.0	12.0	16.4
BALANCE SHEET							
Fixed Assets		3,977	3,549	2,687	2,544	2,746	2,952
Intangible Assets		2,946	2,985	1,915	2,102	2,288	2,470
Tangible Assets		1,031	215	431	442	458	482
Investment in associates		0	349	341	0	0	0
Current Assets		4,971	6,710	4,886	5,374	6,527	8,391
Stocks		0	0	0	0	0	0
Debtors		3,073	3,983	2,512	2,583	3,226	3,906
Cash		1,898	2,727	2,374	2,791	3,301	4,485
Current Liabilities		(1,583)	(3,788)	(3,793)	(3,837)	(4,250)	(4,670)
Creditors		(1,583)	(3,788)	(3,793)	(3,837)	(4,250)	(4,670)
Short term borrowings		0	0	0	0	0	0
Long Term Liabilities		(2,766)	0	0	0	0	0
Long term borrowings		0	0	0	0	0	0
Other long term liabilities		(2,766)	0	0	0	0	0
Net Assets		4,599	6,471	3,780	4,080	5,023	6,673
CASH FLOW							
Operating Cash Flow		(1,923)	28	777	793	1,375	2,367
Net Interest		92	91	90	18	34	57
Tax		0	262	86	0	(88)	(288)
Capex		(64)	599	(643)	(393)	(516)	(656)
Acquisitions/disposals		(37)	(137)	(204)	0	0	0
Financing		0	0	0	0	0	0
Dividends		0	0	(293)	0	(295)	(295)
Net Cash Flow		(1,932)	843	(187)	418	510	1,184
Opening net debt/(cash)		(3,808)	(1,898)	(2,727)	(2,373)	(2,791)	(3,301)
HP finance leases initiated		0	0	0	0	0	0
Other		22	(14)	(167)	0	0	0
Closing net debt/(cash)		(1,898)	(2,727)	(2,373)	(2,791)	(3,301)	(4,485)

Source: Company accounts/Edison Investment Research

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