Review

Edison investment research

27 November 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	7.9	2.8
03/09	9.6	(0.4)	(0.3)	0.0	N/A	N/A
03/10e	9.6	0.9	0.6	0.2	12.7	2.8
03/11e	11.7	1.4	1.0	0.2	7.8	2.8

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

Investment summary: SaaS gains momentum

Interim figures were encouraging, with a return to profit helped by a stronger customer backdrop in Q2. Importantly, the group made a significant SaaS (software-as-a-service) sale during the period, which we believe could have very positive medium-term implications for the group's business model. The shares, trading on around 5x EBITDA, look undervalued on our unchanged FY10 forecasts, but the SaaS offering, WorkPlace OnLine, has the potential to significantly increase the scalability and gearing of the P&L over the next few years.

Interim results: In-line with expectations

The group experienced a significant recovery in the second quarter, and while H110 revenues were down 18% on the corresponding half, they were up 3% on H209. Further, the group moved back into profitability from the loss it made in H209 as it benefited from the late 2008/early 2009 restructuring. Cash balances slipped in H1, as we forecasted in our note in June, on the back of working capital expansion.

Forecasts: Maintained for now

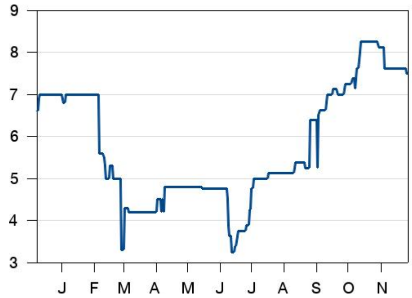
We are maintaining our forecasts, which imply a 24% jump in revenues in the second half, with further healthy gains in FY11. There is scope for upgrades if the WorkPlace OnLine momentum continues and we will next review the numbers when the company updates on trading early in the new year. Cash balances were £1.7m as at 30 September; we expect the H1 working capital expansion to partly unwind in H2 and, with the help of improved H2 profitability, for cash to finish the year at £2.5m.

Valuation: Trading at less than 1x revenues

The US deal is a major step forward for the group as it highlights the potential to sign scalable and profitable SaaS deals with new large customers across the globe. In spite of doubling since June, the shares remain modestly valued at 0.7x our FY11 forecast revenues and 5.6x EBITDA. We continue to believe this undervalues the short-term profit potential of the business as well as the medium-term potential for WorkPlace OnLine to accelerate top-line growth.

Price	7.5p
Market Cap	£11m

Share price graph



Share details

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

Price

52 week	High	Low
	8.25p	3.25p

Balance Sheet as at 30 September 2009

Debt/Equity (%)	N/A
NAV per share (p)	2.6
Net cash (£m)	1.7

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	82%	N/A	85%
P/CF	387.8	14.2	22.5
EV/Sales	0.7	0.9	0.9
ROE	19%	N/A	20%

Revenues by geography (FY09)

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

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WorkPlace Systems International is a research client of Edison Investment Research Limited

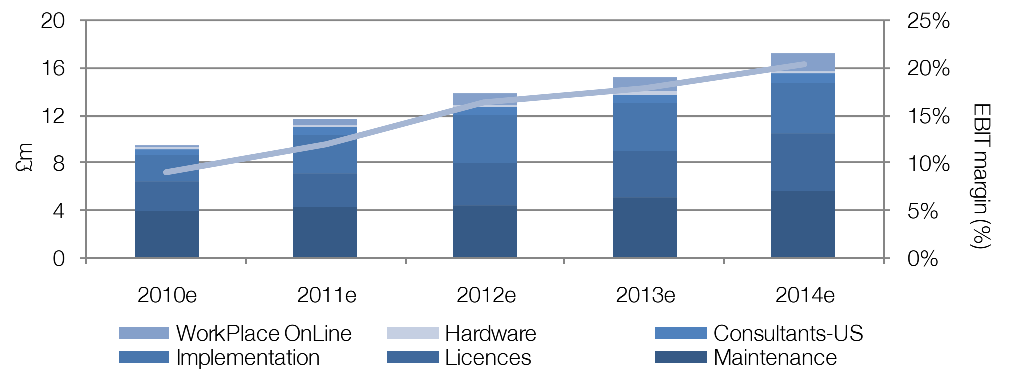
Company description: Workforce optimiser

Develops, supplies and implements workforce management software

WorkPlace Systems 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 two core software platforms focused on the retail and transport/media sectors. The group has 120 employees and operates out of four offices – Milton Keynes, Reading and Rossendale, Lancashire in the UK and, from January, Chicago, Illinois, 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's US retail consultancy business has been refocused to shift emphasis back to the core software business. Further, in late 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% in May. Additionally, WorkPlace owns the IP and 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 this is being piloted with a number of companies – and several sales were made in H1, including with a major US retailer.

Exhibit 1: Group revenue and margin forecasts



Source: Edison Investment Research

Interim results: Positive momentum continues

WorkPlace saw a pick-up in demand in the second quarter and the group reached break-even for the first half, as it also benefited from the US/UK restructuring undertaken in late 2008/early 2009. WorkPlace won a number of new contracts during the period and gained 11 new customers. A range of solutions were sold including the SaaS product, which was launched in the US during the period.

Revenues and costs: Benefiting from new orders and cost cutting

Revenues of £4.4m were down 18% on the corresponding half, but were up 3% on the second half of 2009. Operating profit at £31k was also down on H109 but up £0.5m on H209.

Recurring maintenance revenues from Annual Use Licences edged higher to £1.8m (H109: £1.7m). The group benefited from the US cost-cutting, which removed £1.4m of annual costs from the business and annualised group overheads now stand at £3.9m (H109: £4.8m).

Cashflow and balance sheet: Renewed working capital investment

In the first half of FY10 there was an operating cash out-flow of £0.6m (£0.4m inflow), due to working capital expanding by £0.8m (£0.3m expansion). Investment of £0.1m and other minor flows resulted in the group's cash balances falling by £0.7m to £1.7m.

SaaS: Major US contract

In September WorkPlace won a very significant deal for a SaaS-based solution with a major US retailer. Workplace won a competitive pilot after going live with time and attendance in 99 stores in just four weeks. WorkPlace has already rolled-out the product in over 3,000 of the customer's stores in just eight weeks with a further c 1,250 expected to be rolled-out by early next year. The retailer is paying a fee depending on the number of employees being tracked by the software. Most of the revenue will be recognised in the second half and beyond.

The deal highlights the shortening sales cycle as this was a major order won in under six months and supported by an accelerated pilot programme. Further, this major customer became excited by the SaaS option while looking for a workforce management solution – illustrating the new market opportunity for WorkPlace – and the deal adds significantly to the group's recurring revenue profile.

WorkPlace is increasing investment in its support teams to provide 24/7 support for the growing OnLine customer base. Management also plans to invest more in hosting and hardware as well as accelerating marketing.

Exhibit 2: Interim results breakdown

Half-by-Half Analysis		2009			2010e		2011e
	H1	H2	Yr	H1	H2	Yr	Yr
Revenue	5,341	4,220	9,561	4,365	5,219	9,584	11,729
Operating Profit	356	(836)	(480)	31	835	866	1,403
Operating Margin	*6.7%*	*(19.8%)*	*(5.0%)*	*0.7%*	*16.0%*	*9.0%*	*12.0%*
Net Interest	66	24	90	2	5	7	16
Profit Before Tax (norm)	422	(812)	(390)	33	839	872	1,419
Exceptional items		(1,976)	(1,976)				
Profit Before Tax (FRS 3)	422	(2,788)	(2,366)	33	839	872	1,419

Source: Edison Investment Research, WorkPlace Systems

WorkPlace OnLine – the dawn of a new era

SaaS target market: Evolving, broadening

SaaS has opened a new market for WorkPlace – the customers that the online product has been attracting have not been customers historically. While traditional customers typically sought 100% of the benefits from a solution and happily waited for a tailored solution to be developed and rolled-out over time, a SaaS customer will accept 80% of benefits now while also accepting they will never achieve the maximum benefits with the online product. They also benefit from a product that is simple to use, requiring little training, but which also involves a different way of thinking about managing schedules. One of the key drivers of the traditional products has been their complexity and we expect such demand will remain, particularly for StaffPlanner.

While the initial the plan was to target smaller customers with the SaaS offering, now WorkPlace is finding some potential customers are bigger than its typical traditional customers are. The product does not yet have multi-language capabilities; hence the target market is initially English-speaking countries.

Industry drivers: Cutting customers' costs

In the past we have noted a range of drivers for work force management software and highlight the following as particularly relevant to the SaaS product:

- Cutting customers costs: WorkPlace's solutions typically help cut staff overheads by 3-7%. WorkPlace believes its solutions can help increase revenue typically by 1%, improve staff retention and significantly reduce queue length. Some potential customers may have been discouraged by the costs of implementing an on-premise solution but might find a SaaS solution attractive.
- 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.
- Geographic and industry expansion: WorkPlace's traditional 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 has been limited by the size of its sales force – SaaS makes the markets much more readily addressable.

The benefits of SaaS: Scalability, simplicity and swift deployment

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 for 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).

We highlight the following benefits of the SaaS model:

- More than just hosting. WorkPlace looks after the application, network and service monitoring. The utilisation of modular-based SOA enables WorkPlace to scale, adapt and version the software in a very efficient manner (although SaaS applications, while being configurable, are not customisable). Further, SOA has enabled the single instance one-to-many delivery method and the modular approach enables far more efficient development and maintenance of web-native applications.
- Highly scalable. Multi-tenant architecture not only means a customer has its own version of an application, but also that the application and the physical back end hardware infrastructure can be shared with many other customers. This means SaaS applications are highly scalable.
- Internet improvements. Faster data rates, falling bandwidth costs and a more stable internet environment have made it more feasible for companies to operate applications over the internet. Advances in low-cost wireless internet could further strengthen the case for SaaS delivery.
- Cost is linked to usage. The SaaS model normally involves recurring subscription charges. Contract lengths can be long-term. WorkPlace will typically charge a fee depending on the number of employees being tracked by the software. The customer is not required to deploy any hardware and can run the application over existing internet infrastructure. In exchange for the recurring subscription charges WorkPlace deals with all the training, support, security and infrastructure issues.
- Widest possible delivery. SaaS applications can be delivered anywhere and anytime. WorkPlace employs infrastructure, support teams etc to meet these demands.
- Time savings. There are no delays resulting from the need for internal IT organisations to perform development, enhancement or deployment of the application. The deployment of the software in 3,000+ customer stores in just eight weeks is a sea change in comparison with the traditional roll-out over months and years.
- Reduced customer risks. A customer can test a SaaS product on the job and if they are not satisfied or find a superior product can switch vendor with relative ease. Under the traditional model, a perpetual licence fee is lost money if a customer makes the wrong decision or if the product falls behind competitors' products.
- Simple upgrade cycle. WorkPlace installs the upgrades, lowering support costs for enterprises. Its customers can be sure that all employees have the same, if not the most recent, version of the software product. SaaS has a key competitive advantage over traditional software in that it can be continually upgraded as vendors improve their product knowledge and respond to feedback from their customers. Modular-based SOA means it is easy for developers to make changes.
- Lower cost of ownership. A major factor in a customer's choice of taking a SaaS solution over an equivalent traditional application is the relative cost of ownership. A comparison can be tricky as it can involve many issues including hidden costs and intangible factors. Traditionally, workforce management software has been rolled out across companies, such as large retailers, over months or years and the time and associated costs may have discouraged some potential customers.

Sensitivities: IT budgets squeezed in downturns

WorkPlace could arguably be viewed as having counter-cyclical characteristics, as falling profitability might encourage potential customers to seek to improve the efficient utilisation of their staff. However, the key risk to our forecasts is that an economic downturn squeezes IT budgets and leads to delays or cancellations in orders. Other sensitivities include:

- The 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: SaaS benefits are not yet in the numbers

The weak economic environment resulted in several downgrades. In June 2008 we were forecasting revenues of £13.5m and £15.1m for FY10 and FY11, respectively; these numbers have now steadied at £9.6m and £11.7m, respectively. Much of the revenue reductions have simply been deferred rather than definitively lost and as the economic backdrop recovers, this could result in an acceleration of orders as customer budgets are relaxed.

Further, the group is set to benefit from the gradual build of high-quality recurring SaaS revenue. We expect the new large SaaS customer to have a bigger impact on H2 numbers, since roll-out began late in H1, while making a full contribution from H1 next year.

We maintain our view that the company's current enterprise value of c £9m offers investors a fairly clear opportunity for exposure to an early-cycle (supported by the cost benefits of the software) economic recovery, with significant upside if the SaaS product can maintain its momentum.

- Strong recurring revenues. The group has a maintenance book of c £4m, which expands as it sells licences. At current prices, the stock is trading at c 2x 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 £1.7m net cash as at 30 September 2009 and we forecast this to rise to £2.8m as at 31 March 2010. WorkPlace 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 £0.1m in FY10 rising to £0.9m 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 13.4p, well above the current share price. However, discounting back from our forecasts, the market is attributing a very high break-even WACC (26.1%) to the stock (see Exhibit 3, Group DCF Scenarios).
- **Traditional valuation measures.** In traditional valuation terms, the stock trades on 12.7x our forecasts in FY10 falling to 7.8x in FY11 and 4.7x in FY12; however, we do not expect the company to charge for corporation tax until FY13 and our FY10 and FY11 EPS numbers have edged higher on this assumption. The stock trades on just 0.7x FY10 revenues, and 5.6x FY10 EBITDA, which are roughly in line with its peers.

Exhibit 3: Valuation

DCF valuation	% owned	£m	-- Per share --	Assumptions		
WorkPlace Systems	100.0%	17.2	11.7p	WACC: 15%	Number of shares	147.5m
					Share price	7.5p
					Market capitalisation	£11.1m
Group Enterprise Value		17.2	11.7p			
Less: Adjusted net (debt)/add cash		2.5	1.7p			
Group Equity Value (£m)		**19.8**	**13.4p**	**Up / (down)side from current price**	**79%**	

Ratio Analysis	2010f	2011f
EV/Sales	0.9	0.7
EV/EBITDA	8.9	5.5
EV/EBIT	9.9	6.1
Price/Book	2.6	2.1
Price/Earnings	12.7	7.8
Price/Op Cash Flow	22.5	8.0
ROE	20%	26%
Gearing	(58%)	(47%)
Interest Cover	(130.5)	(90.1)

Grp DCF Scenarios	------------------Terminal growth rate------------------
WACC	3.00%
29.00%	6.7p
25.00%	7.8p
21.00%	9.4p
17.00%	11.7p
13.00%	15.6p
Breakeven WACC	26.1%

Peer comparison (Year 2)	EV/Revs	EV/Ebitda
---Human capital mgmt software-		
Allocate Software	1.1	5.8
Bond International Software	0.8	6.0
ServicePower	0.4	N/A
---Retail sector software---		
Clarity Commerce	0.8	5.8
K3	0.9	4.5
Prologic	0.2	3.2
Median	0.8	5.8
Mean	0.7	5.1
WorkPlace Systems	**0.7**	**5.6**

Revenue sensitivity					
Multiple	0.7x	0.9x	1.1x	1.3x	1.5x
Revenue Y2 (£m)	9.6	9.6	9.6	9.6	9.6
Implied EV (£m)	6.7	8.6	10.5	12.5	14.4
Net (debt)/cash (£m)	2.5	2.5	2.5	2.5	2.5
Grp equity value (£m)	9.2	11.1	13.1	15.0	16.9
Per share (p)	**6.3**	**7.6**	**8.9**	**10.2**	**11.5**

Source: Edison Investment Research

Exhibit 4: Financials

£'000s Year end 31 March	2007 UK GAAP	2008 IFRS	2009 IFRS	2010e IFRS	2011e IFRS	2012e 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	7	16	43
Profit Before Tax (norm)	(1,546)	1,228	(390)	872	1,419	2,336
Profit Before Tax (FRS 3)	(2,809)	1,340	(2,366)	872	1,419	2,336
Tax	279	27	0	0		
Profit After Tax (norm)	(1,267)	1,255	(390)	872	1,419	2,336
Profit After Tax (FRS 3)	(2,530)	1,367	(2,366)	872	1,419	2,336
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)	0.6	1.0	1.6
EPS - FRS 3 (p)	(1.8)	0.9	(1.6)	0.6	1.0	1.6
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 (%)	N/A	11.8	N/A	10.0	13.2	17.9
Operating Margin (before GW and except.) (%)	N/A	10.5	N/A	9.0	12.0	16.4
BALANCE SHEET						
Fixed Assets	3,977	3,549	2,687	2,748	2,950	3,156
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	204	204	204
Current Assets	4,971	6,710	4,886	5,396	6,686	8,895
Stocks	0	0	0	0	0	0
Debtors	3,073	3,983	2,512	2,883	3,593	4,343
Cash	1,898	2,727	2,374	2,513	3,093	4,552
Current Liabilities	(1,583)	(3,788)	(3,793)	(3,836)	(4,246)	(4,663)
Creditors	(1,583)	(3,788)	(3,793)	(3,836)	(4,246)	(4,663)
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	4,308	5,390	7,388
CASH FLOW						
Operating Cash Flow	(1,923)	28	777	492	1,375	2,368
Net Interest	92	91	90	7	16	43
Tax	0	262	86	0	0	0
Capex	(64)	599	(643)	(393)	(516)	(656)
Acquisitions/disposals	(37)	(137)	(204)	(1)	0	0
Financing	0	0	0	35	0	0
Dividends	0	0	(293)	0	(295)	(295)
Net Cash Flow	(1,932)	843	(187)	140	580	1,459
Opening net debt/(cash)	(3,808)	(1,898)	(2,727)	(2,373)	(2,513)	(3,093)
HP finance leases initiated	0	0	0	0	0	0
Other	22	(14)	(167)	()	0	()
Closing net debt/(cash)	(1,898)	(2,727)	(2,373)	(2,513)	(3,093)	(4,552)

Source: Company accounts/Edison Investment Research