

## Stock Market Review



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# RS2 Software plc on the road to recovery

## Half-year profits up 41 per cent to €286,000

**R**S2 Software plc published its half-year results last week and although revenues only increased by 5.7 per cent, group profit for the period climbed 41.4 per cent to €286,708 mainly due to a sharp rise in 'other income' of €120,395. Other income primarily consists of foreign exchange gains on receivables, some of which were realised at the reporting date.

The main areas of activity of the RS2 Software Group include the development, implementation, and marketing of specialised computer software for financial institutions under the trade mark of Bankworks.

In 2009, RS2 also entered the field of processing of payment transactions through the investment in a company in the US, Transworks LLC. RS2 acquired a 26 per cent shareholding in Transworks for €750,000 in June 2009 and despite this minority shareholding, the financial results of the US company are consolidated on a line-by-line basis since RS2 and its majority shareholder ITM Holding Ltd have overall control of the board of directors of Transworks.

Although this company is still in its early stages of development and incurring losses, increased marketing efforts are being deployed to attract new clients. The introduction of the processing of transactions as part of RS2's overall portfolio of services is an important new development for the group.

RS2 also intends to carry out such processing activities in Malta once the group's new head office in Mosta is built. The plot of land in Mosta was acquired in December 2008 for €3.26 million and was mainly funded through a bank loan.

Earlier this year, at the time of the publication of the 2009 full-year results, the RS2 directors had warned shareholders that the decline in service requests from existing clients may persist for the medium-term. They had also indicated that in their view it will take some time before the previous momentum is regained.

However, in the recent interim statement published on May 18 and in last week's half-year report, the directors seem to be more optimistic as a result of the additional requests being received. In the interim statement, RS2 had revealed that the year started on a positive note with the

successful conclusion of a licence contract with a new client while the company was informed by one of its major clients that they intended to migrate all their operations onto the Bankworks platform.

Although this contract could not be quantified at the time, it could represent substantial new income in the coming reporting periods. Moreover, RS2's directors commented in the recent half-year report that banks in various regions are showing positive interest in Bankworks with potential clients being lined up.

After the record performance in 2008 when RS2 registered a profit after tax of €2.55 million, the group had a very disappointing year in 2009 and the improvement in the first half of 2010 must also be viewed in this perspective. The profitability in 2008 had also been boosted by the sale of licences in that year. The company has since changed strategy to focus on engaging new clients on a comprehensive package basis, as opposed to separate licensing, maintenance and service agreements. This new pricing model has the effect of smoothening revenue recognition over the term of the contract, eliminating any significant fluctuations previously created by recognition of licence fees in the first year of signing the contract.

In 2009, RS2 concluded two comprehensive package agreements with new clients in Scandinavia and the Middle East, and one with a client in Egypt. In the first half of 2010, another licence agreement was won by the company.

At the time of the IPO in May 2008, it was evident that the company's policy was that of ensuring an adequate dividend through an annual distribution to shareholders. In March 2009, at the time of the publication of the 2008 full-year results the company recommended the payment of a dividend of €825,000 (equivalent to €0.022 per share) for 2008.

Although profitability declined markedly in 2009, the dividend was maintained earlier this year clearly indicating support in respect of an annual dividend payment to shareholders. The dividends paid by RS2 were distributed from tax free profits as a result of the investment tax credits eligible to the company under the Business Promotion Act. As such, the dividend of €0.022 per share represented a net dividend to shareholders of 3.93 per cent on the last traded price of €0.56 or 2.75 per cent on the IPO price of €0.80 per share. This tax benefit is expected to continue in future years.

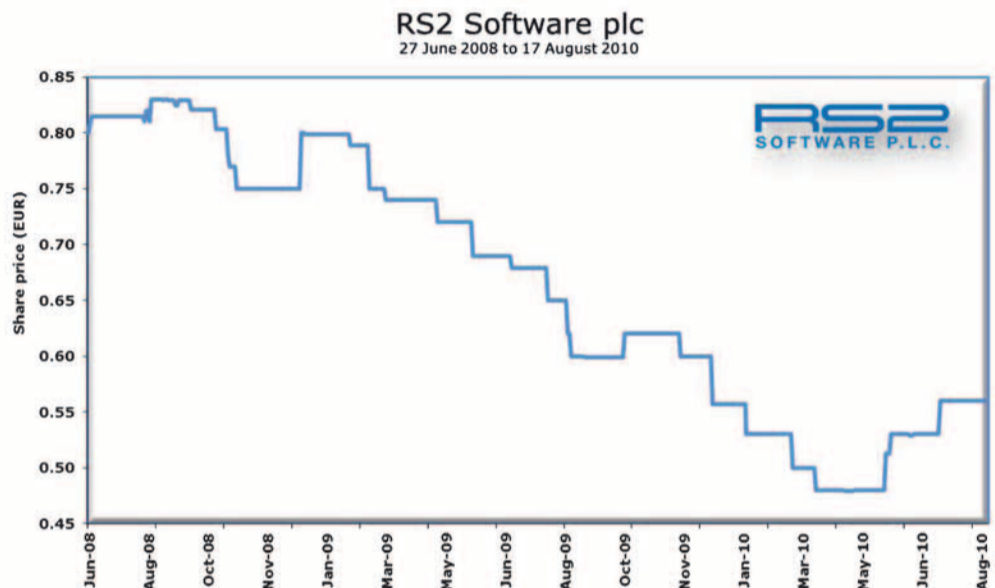
The historic performance of RS2's share price since its IPO at €0.80 clearly reflects the disappointing financial results in 2009 with the equity dropping to a low of €0.47 earlier this year before recovering slightly to €0.56. RS2's share price has been inactive since July 8 and offers are available in the market at €0.48.

The sharp downturn in the company's share price presumably reflects the fact that RS2 missed its financial projections published at the time of the IPO. This was mainly

because services requested by clients were at a lower level as banks curtailed their budgets in the wake of the financial crises. An important income component for the company in the form of service fees charged per 'man day' shrank in 2009, however the company believes this is not "lost business" but "business postponed to the future" as clients will eventually need to undertake the investment in their card processes in line with new technological requirements.

Despite the company not achieving the financial results it was expecting following its IPO, it has continued to pursue its stated strategy and was successful in the setting up of two regional offices in Jordan and the Philippines which were at the core of the future strategic direction. It also entered into the area of processing of payment transactions through the important shareholding in Transworks. This should prove beneficial in the longer term.

RS2 had been greeted with enthusiasm on the stock market in 2008 with over 750 investors participating in the IPO. The company should ensure these shareholders are kept updated as often as possible on developments affecting its business prospects. An improved information flow should help retain shareholder loyalty and create more awareness on the prospects of a recovery in its financial performance. This, in turn, may help to increase trading activity in RS2 shares for the benefit of all shareholders.



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