

Stock Market Review



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Crimsonwing continues on its recovery path

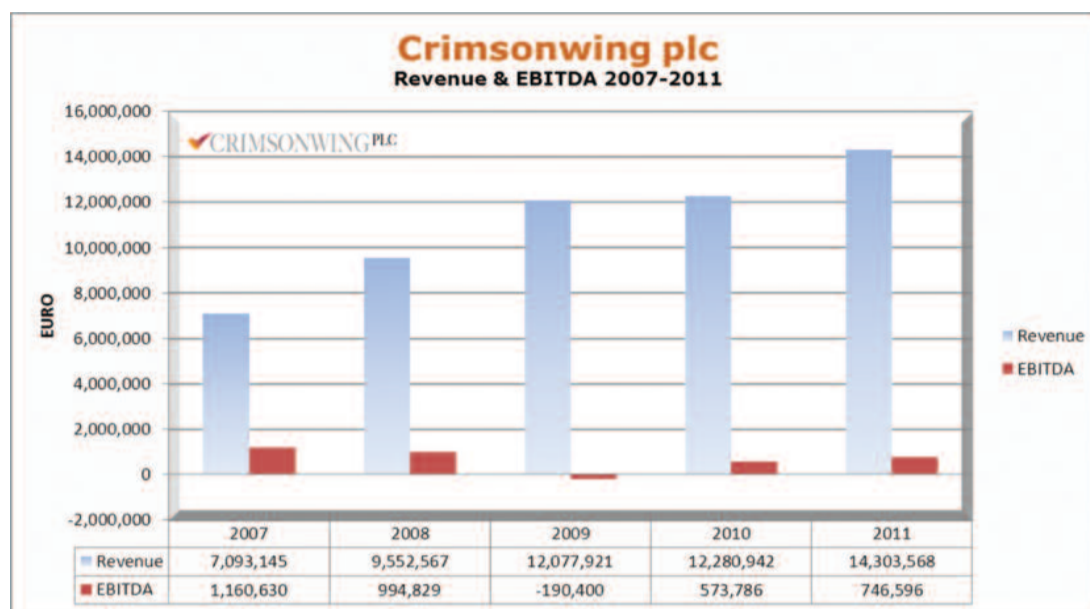
Crimsonwing plc published its March 2011 full-year results on Tuesday afternoon and the announcement was immediately followed by a brokers' meeting with the chairman Philip Crawford and CEO David Walsh.

The Crimsonwing Group provides software solutions and IT professional services mainly to clients in the UK and the Netherlands, but also to companies operating in Italy, Germany and Malta. Crimsonwing reported an increased number of local clients but the main function of the local operation is the support provided for the delivery of client projects and solutions, including a research and development unit.

During the 12 months to March 31, 2011, Crimsonwing reported a 16.5 per cent increase in revenue to a record figure of €14.3 million with the main contributor being the UK with a 17 per cent increase to €7.4 million. Earnings before interest, tax, depreciation and amortisation (EBITDA) also showed good progress during the past financial year. Crimsonwing registered a 30 per cent growth in EBITDA to €0.75 million. However, the overall level of EBITDA is still below the levels achieved in earlier years as is clearly visible in the five-year graph. This is partly due to exchange rate differences and the continuing effects of the international economic environment, but mainly due to the serious difficulties that were faced in the Netherlands and the costs necessary to implement an effective turnaround at this business unit.

The March 2011 annual report reveals the breakdown of EBITDA contributions across the main business units. An analysis of EBITDA generation across the group provides a good overview of the business patterns during the year. This formed the basis of the discussion with the chairman and the CEO. Since the Malta unit 'charges' the UK subsidiary for the work performed on its behalf to fulfill the client requests in the UK, the combined EBITDA of the Malta and UK business provides a better comparison.

EBITDA generated from Malta and UK was marginally unchanged at €1.1 million. Although Crimsonwing Malta registered excellent progress in increasing its local customer base in Malta, the overall contribution to group turnover from the local



contracts is still not significant compared to overall revenue figures. Moreover, during the second half of the year, Crimsonwing UK began to benefit from an increased contribution of the new contract announced last year with one of its major clients.

The revised pricing terms of this contract which commenced in June 2010 for a three-year period provides an overall incremental benefit valued at circa €750,000 over the term of the contract. However, the increased business in the UK and Malta was offset by a major investment in the e-business area through the Magento platform. Crimsonwing's CEO reported that the e-commerce solution is growing very rapidly (+50 per cent) as more businesses are adopting a multi-channel sales strategy and in response to this, a number of specialised personnel were recruited by Crimsonwing mainly in Malta.

Magento (which was recently fully taken over by eBay Inc) is the fastest growing e-commerce platform on the market and Crimsonwing is one of the partners enabling the development and delivery of Magento-based e-commerce solutions to customers.

In the Netherlands, Crimsonwing operates via Crimsonwing Promentum as well as the VDA business which was acquired in 2008. The chairman reported that Crimsonwing's shareholding in the Promentum subsidiary increased from 50 per cent to 62.5 per cent during the year. This business performed a remarkable turnaround following the difficult conditions in the aftermath of the international economic recession and generated total EBITDA of €0.36 million.

The CEO described the situation in the VDA business as a 'Perfect Storm'. This business registered a negative contribution of over €600,000. Mr Walsh explained that in July 2010, the two directors who were responsible for the VDA business were removed due to the company's poor performance and a number of complaints from clients.

Although the directors were removed from office, the salaries were still paid due to them in view of the rules of settlement and notice periods applicable in the Netherlands. Mr Walsh personally stepped in to take over the running of the business in the Netherlands to ensure that the complaints were seen to and the projects were delivered appropriately to clients.

The remedial action taken to address the complaints involved a substantial amount of work which could not be invoiced. To make matters worse, an old client made a very high claim for damages and although Crimsonwing won the case, it incurred a high amount of legal costs. The CEO indicated that the one-off costs in the Netherlands related to the salaries of the previous directors and the legal fees amounted to circa €400,000. Mr Walsh reported that more employees were recruited in the Netherlands to support growing e-commerce requests and progress is being achieved to enable the business to start generating positive contributions once again to the overall group results.

The March 2011 annual report published earlier this week also makes reference to the objective of achieving an overall revenue figure of €20 million, which is significantly higher than the €14.3 mil-

lion registered during the last financial year. During the meeting with the financial community, the chairman indicated that this reflects the projected figure being targeted by Crimsonwing solely through organic growth over a three-year period.

Both the chairman and the CEO mentioned that €20 million in revenue is an important benchmark in the IT services industry. Mr Crawford also indicated that due to other personal involvements in the IT sector, he is following the developments in mergers and acquisitions to understand the potential valuation for similar-sized companies. The chairman indicated that the ultimate objective of the two major shareholders (David Walsh and Philip Crawford individually own almost 75 per cent of Crimsonwing) is to create shareholder value and the top-line growth of the company is instrumental in this respect.

Although both major shareholders are seeking to achieve overall revenue growth in order to maximise shareholder value, the CEO also indicated that the profitability of the entire group should now also recover once the problems within the Netherlands have been dealt with and a large part of the losses incurred relate to one-off costs.

The achievement of more meaningful profitability levels will also enable the company to reinstate dividends to shareholders. David Walsh and Philip Crawford acknowledged the importance that dividends should be reinstated in the short-term to maintain shareholder loyalty from the over 300 investors who participated in their IPO a few years ago.

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