

## Stock Market Review



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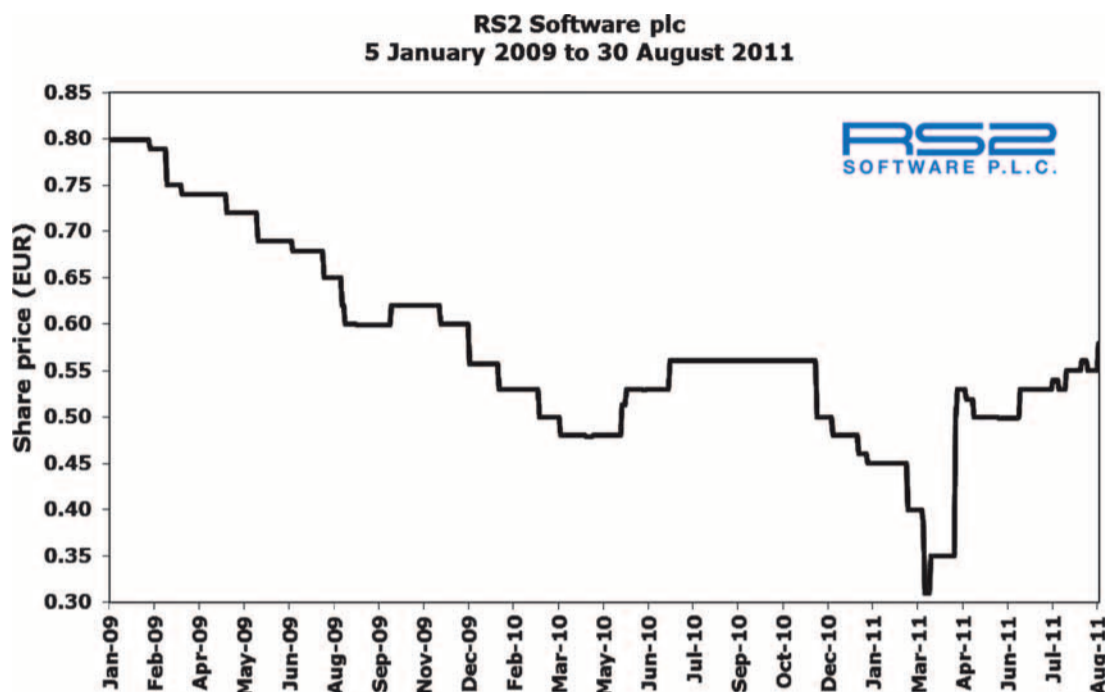
# New licences lead to surge in profits at RS2 Software plc

Earlier this week, the IT company RS2 Software plc published its financial statements for the first half of 2011 showing a 67 per cent increase in revenue to €4.7 million. The surge in income during the first six months of the year is mainly attributable to four new licences awarded to RS2. In recent months, RS2 had announced that it was awarded new contracts from clients in Germany, USA, Greece and the Philippines. RS2 has been in operation for over 25 years and following the new clients signed up in the first half of 2011, RS2's product 'Bankworks' is now being used in more than 28 countries around the world.

The market ought to have anticipated this strong rate of growth in new licences as the company had announced in its recent interim statement of May 16 that it had already met its targets in terms of new licences for 2011. Income from new licences is normally recognised immediately by RS2 once the contract is signed up. In the half-year report, the company reveals that licence fees carry higher profit margins than those from other sources of revenue such as the annual retainer income and service fees. In fact, the gross profit margin climbed to 45.7 per cent from a significantly lower level of 20.2 per cent in June 2010. Likewise, the pre-tax profit of RS2 surged to €1.6 million during the first six months of 2011.

After a weak start last year following the slowdown experienced in 2009, RS2 registered considerable improvements in its financial performance since June 2010. In fact, it may be best to compare the 2011 interim results to the financial performance in the second half of 2010. Such a comparison reveals that overall revenue was maintained at €4.7 million and operating profit was very much in line with the second half of last year at €1.5 million. In essence, during the 12 month period from June 2010 to June 2011, RS2 generated total revenue in excess of €9.4 million with pre-tax profits of €3 million. The strong momentum from the second half of 2010 was clearly maintained in the first half of 2011.

While revenue and profitability levels fluctuate in line with the recognition of new licence income, the retainer income at



RS2 in the form of the comprehensive package agreements and maintenance fees are important revenue streams for the company and ensures a sustainable financial performance. This was very evident in 2009 when despite a slowdown in the industry as a result of the global financial crisis, RS2 still remained profitable due to the annual retainer income generated from their vast client base.

During the recent annual general meeting which was held on June 14, RS2 announced succession plans involving the roles of the chairman and the CEO. The current CEO Mario Schembri will take over the chairmanship in January 2012 as this is being relinquished by the current majority shareholder and one of the original founders Reinhold Schäffter.

Mr Schäffter will remain active by focusing mainly on the Asian region following their success in the Philippines as RS2 signed up its first client at the start of 2011. Meanwhile, Radi El Haj who is responsible for RS2's business development and who has been with the company for the past 15 years, will take on the role of chief executive officer.

In his first speech to shareholders, the CEO designate who has extensive knowledge of the card industry and was very much responsible for the company's expansion in new markets especially in the US, outlined RS2's vision for the coming years. Mr El Haj emphasised the importance of the Chinese and the US mar-

kets and confirmed that RS2 will place the required focus on seeking expansion into these sizeable markets in the near future.

The CEO designate explained that the Chinese card payment market is still in its infancy and the shift from the use of cash towards cards and online payment provides an opportunity for RS2 to market Bankworks in this market.

In reply to questions from the floor at the annual general meeting, Mr El Haj also indicated that RS2 is seeking to enter the Chinese market through one of its clients in the US. However, no further information on this development was included in this week's half-year report.

On the other hand, RS2's directors provided a cautious outlook for the second half of the year indicating that the same rate of growth is unlikely to be repeated in the second half of 2011.

However, RS2 is set to benefit from a higher level of service fees as well as retainer income and possibly also from further investment tax credits.

RS2 is eligible to tax credits under the Business Promotion Act and the overall level of these tax credits is based on the investments carried out and the expected future financial performance of the company. The 2010 annual report revealed that as at December 31, 2010, the outstanding level of tax credits amounted to €2.69 million which can be utilised against taxable profits in future years. At a tax

rate of 35 per cent, this balance has the potential of relieving up to €7.7 million of future taxable profits. As a result of the investments being undertaken in the head office in Mosta and upgrades to the Bankworks product, RS2 and its shareholders should continue to benefit from this favourable tax scenario also in 2011.

Evidently the company is on track for another strong performance in 2011. This should enable the directors to at least maintain last year's net dividend of €1.2 million, equivalent to €0.032 per share.

RS2's equity had rebounded strongly in April 2011 following the publication of the 2010 financial statements and the dividend declaration.

Last Tuesday the share price advanced by a further 5.3 per cent to a 20-month high of €0.579 in reaction to the interim results publication. Despite the substantial recovery in the share price over recent months, the equity is still trading on a low historic price to earnings multiple of 7.6 times (the lowest among local shares) and the highest net dividend yield of 5.5 per cent.

RS2 shares have been among the most active of the smaller capitalised companies in recent months.

Trading activity in the shares should remain healthy following the encouraging financial performance in the first half of 2011 and in anticipation of another strong dividend declaration to shareholders.

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