Stock Market Review

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RS2: Revenue target achieved but profitability slightly below projections

The 2008 full-year results published by RS2 Software plc on March 18, 2009 reveal that total revenue amounted to €8.3 million with after-tax profits of €2.6 million. While the sales figure is marginally higher than the projection of €8.15 million made by the company's directors at the time of the IPO, net profits achieved by the company fell short of the €3 million estimate.

During a stockbrokers' meeting convened on March 23, CEO Mario Schembri explained that the shortfall was as a result of higher cost of sales due to commissions paid to one of its partners in Scandinavia as well as a €0.2 million write-off with respect to work conducted for a client in Iran.

Despite coming in slightly below expectations, last year's financials were record figures for the company and represent a strong rate of growth over recent years. Revenue of €8.3 million is 33 per cent higher than the previous year. It represents a rise of 121 per cent over the sales figure achieved in 2006. Likewise, profit for 2008 is 24 per cent higher than that in 2007 and more than four times higher than the 2006 figure.

Apart from these important financial achievements, last year was an eventful year for the company in other areas too. The company launched its Initial Public Offering last May and successfully placed five million new shares at €0.80 per share. Moreover, last December, RS2 announced that it acquired a large plot of land in Mosta on which it will construct its own premises.

The new RS2 centre is expected to have an area of 3,000 sqm hosting its current operations, a new training academy and a service centre in which the company's service providers will be able to operate. This will lead to savings on current rent but more importantly will help facilitate the company's growth over the longer-term. The land was acquired for €3.6 million and the total investment is expected to reach €5 million. RS2 explained during the meeting that this property investment, which is expected to be completed in 2011, will be partly financed from the proceeds of the IPO and the balance from bank financing.

Another achievement for RS2 in 2008 was the successful conclusion of three Comprehensive Package Agreements with existing and new clients. Total revenue of €1.5 million was generated from these agreements during the year while €2.2 million came from other service fees and €1.3 million from maintenance fees. These agreements usually cover a period of three to five years providing clients with licenses, maintenance and a specified level of services against an annual predetermined fee thus ensuring a constant stream of revenue to the company. Apart from new revenue generated from these Comprehensive Package Agreements the increase in turnover during the year was also due to substantially higher licence fees, which surged to just under €3 million from €1.4 million in 2007.

RS2 concluded the sale of two new licenses in the first half of the year - one of €600,000 with Transworks LLC of New York and the other relating to the licence element incorporated in one of the Comprehensive Package Agreements. Apart from these two licenses, other license sales were made during the year for additional modules to existing clients including the BankWorks Web contract in the Middle East.

The proceeds from the IPO were also intended to establish a number of regional offices in order to strengthen the company's marketing activities and support services. At the time of the IPO, the company had earmarked such offices in Jordan, Scandinavia and the US and during the recent stockbrokers' meeting RS2's CEO confirmed that the Jordanian office is currently in operation and the necessary legal requirements to set up a joint-venture company with its partners in the Middle East are in the process of completion.

While providing an update on the structured office expansion, the CEO said that the need was felt to open an office in the Philippines to serve as a bridge to the Asian market. Construction of this office commenced in the second half of last year and is shortly expected to be inaugurated. The office in the Philippines is also intended to serve as a cost-effective support centre while the product development will continue to take place from the Malta head office. On the other hand RS2 decided not to proceed with establishing an office in Scandinavia since the company's requirements in Scandinavia are being serviced through the offices of RS2's majority shareholder ITM situated in Germany.

RS2's CEO said that despite the current financial crisis the company has continued to receive "Requests for Proposals". In fact, apart from the current four CPAs in force, RS2 confirmed that it is currently negotiating with another two clients - one in the Middle East and another in Scandinavia. Once a CPA is signed, the effect on RS2's revenue is not immediate as this is evenly spread on a monthly basis throughout the term of the agreement.

In fact, RS2 concluded a new CPA last November with a Kuwaiti service provider and the full benefits of this will show up for a full 12-month period this year.

The current CPA's in force account for just under 85 per cent of the company's yearly cost base and provide a very comfortable cushion to withstand any business downturn. Despite the current economic environment, RS2 is of the view that demand for its products will remain strong as banks will maintain card programmes. However RS2 is increasing its marketing initiatives by expanding its network of offices in locations with high client concentration and increasing participation in key overseas events in various parts of the world in order to seek further licence sales this year and beyond.

The company's management is presently re-evaluating its projections for the current financial year due to possible delays in concluding new licence sales as a result of the ongoing international economic turmoil. RS2 will no longer benefit from reduced tax rates under the Business Promotion Act with effect from the current financial year and, therefore, the tax charge is set to increase from the current advantageous rates to the normal 35 per cent rate. However, RS2 still has a balance of investment tax credits which should enable the company to pay tax free dividends in future years from the accumulated tax credits for the benefit of its shareholders.

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