

23 September 2009

Westminster Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/07	2.7	(0.4)	(3.2)	0.0	N/A	N/A
12/08	5.5	0.2	1.5	0.0	32.0	N/A
12/09e	9.4	0.5	2.4	0.0	20.0	N/A
12/10e	10.4	0.9	4.1	0.0	11.7	N/A

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

Investment summary: H2 is the key

Interim results reflect a healthy advance in revenues, albeit the sales mix and adverse currency movements produced an increased pre-tax loss. However, an encouraging order book lends good visibility to H2 and at this stage the company is well on track to meet forecasts. As the group continues to establish a more profitable footing, the valuation becomes more interesting and there is huge potential in the quote bank.

Interim results: Encouraging progress

Sales advanced 69% in H1 to £2.4m but due to a skew in the revenue mix towards the supply of products rather than 'system solutions', the gross margin fell 4% points to 25%. Along with the consequences of an increase in admin expenses, this led to a widened pre-tax loss of £0.7m (H108 £0.4m). The most significant revenue impact during H1 was the completion of a £0.9m order for scanning equipment from a government in Sub-Saharan Africa; the outlook for H2 should see a prominent pick-up in sales.

Outlook and forecasts: H209 weighted

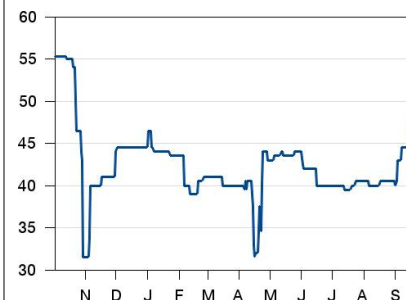
The order book stood at £5.3m at the end of H109 – up some 23% from the previous year. Assuming that – as expected – this pipeline is deliverable in H209, this goes a long way towards meeting our full year forecast. Good visibility over the outlook for H2 means we are leaving our estimates broadly unchanged which should lead to another profitable outcome and a net cash position at the year end.

Valuation: Upside potential

Westminster is still at a relatively early stage of building a profitable base and although there is no cash impact of a full provision for deferred tax, this does mean the P/E rises to almost 20x in FY09 and c 12x in FY10. However, an indication of the real upside comes from analysing the cumulative quote bank which has held steady at around £300m. Converting just 5% of quotes into deliverable orders could add something like 5p to earnings and would cut the FY10 EPS multiple to c 5x. A DCF value roughly twice the current share price gives some indication as to the potential for value creation if management can deliver on its strategic goals.

Price 48p
Market Cap £7m

Share price graph



Share details

Code WSG
Listing AIM
Sector Support Services
Shares in issue 14.92m

Price

52 week High Low
55.5p 31.0p

Balance Sheet as at 31 December 2008

Debt/Equity (%) N/A
NAV per share (p) 23.5
Net cash (£m) 0.6

Business

Westminster is predominantly an established niche player in the provision of advanced technical security solutions. Additional activities comprise the supply of low voltage systems to the property sector.

Valuation

	2008	2009e	2010e
P/E relative	317%	223%	142%
P/CF	N/A	7.1	6.7
EV/Sales	1.1	0.6	0.5
ROE	6%	8%	13%

Geography based on revenues FY08

UK	Asia & RoW	Africa	Europe
39%	3%	56%	2%

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Interim results: H1 points to positive FY09 outcome

Turnover increased substantially in H109 albeit the sales mix impacted gross margins and combined with an increase in administrative expenses, meant that the group recorded a net loss. However, a healthy order book still points to a profitable outcome for the year as a whole and there have been a number of encouraging new contract wins. Westminster would benefit from a greater capital base as it scales up and the issue of the convertible loan notes is an important step.

Exhibit 1: Interim results for the six months to 30 June 2009

£m	2008 6 months to 30 June	2009 6 months to 30 June	%
Turnover	1.4	2.4	+69
Operating profit (norm)	(0.4)	(0.7)	+57
Profit/(loss) before tax (norm)	(0.4)	(0.7)	+63
Order book	4.3	5.3	+23
Cash	1.4	1.1	-22

Source: Westminster Group

Financial and operating review

Group turnover increased by 69% in H109 which reflected a healthy trend in new contract wins from the international business supplying system solutions and products to defence and safety markets globally. 72% of sales came from non-UK based contracts although a skew in the mix towards the supply of third-party products, as opposed to system solutions, resulted in lower gross margins of 25% compared to 28% in H108 and operating losses increased by 57% to reflect this margin effect and an increase in administrative expenses to £1.26m (although, excluding foreign exchange gains and losses, administrative expenses for H109 are the same as for H208).

The group still had cash reserves of £1.1m at the end of H1 although treating the five-year convertible loan stock issued in June as 'debt' would reduce the net position to a small negative. We would expect cash balances to rise throughout H2 due to a profitable trading outcome and the receipt of the outstanding balance of \$1.8m from the Juba airport contract; management remains confident that payment will be received in full to enable the next stage of the contract to progress, following regular communication with the government of Southern Sudan.

Operating highlights

Two of the principal highlights of H109 were the orders for the supply of ThruPORT scanning portals from Iraq worth £1m to be delivered in H2 and the €2m+ contract to supply and install an advanced security net across the river Nile at the Nagaa Hammadi dam. The largest contract completed during H1 was a £0.9m order for scanning equipment from a government in Sub-Saharan Africa.

H2 has already witnessed considerable progress on new order wins and particularly noteworthy is a rolling 12-month contract worth over £0.5m to Longmoor, the close protection business acquired in February. The contract is for the protection of a high net worth individual and his family based in the Middle East and is the largest it has ever received. This represents Longmoor's first major success since the acquisition and the potential pipeline of new orders looks encouraging.

Outlook and forecasts

Overall, an order book of £5.3m helps underpin full year estimates and assuming that – as expected – these are deliverable in H2, only approximately £2m of further new business would be required to see Westminster achieve current forecasts. A better margin in H2 due to the supply of more contracts with a ‘system solution’ component, will also boost profitability and should see an uplift on FY08 reported earnings. To a degree the uplift in EPS will be mitigated by a rise in the reported tax charge to 28%, albeit this represents full provision for deferred tax and there is unlikely to be any ‘cash tax’ payable.

Overall therefore, boosted by rising margins, our forecasts remain broadly unchanged – with the exception of the tax charge – even allowing for the impact of the convertible loan stock on net interest. The convertible itself strengthens the capital base of the group and puts Westminster in a better position to win new business. Looking further out, enquiry levels have moved to a higher basis since the re-launch of the new website in April which bodes well for future order flow. Enquiries are now running at something like 250 a month compared to c 100-150 in 2008 and at least in part reflect the fact that the number of products featured on the site has risen from 150 to 600.

Valuation

Exhibit 2 reveals our discounted cashflow (DCF) based analysis produces a value of 100p – roughly twice the current share price – and also assumes the convertible loan is treated as debt. However, a P/E of almost 20x in the current year gives an indication as to how volatile the valuation metrics can be, given the group only moved into profitability in FY08. Of more strategic interest is the potential in a cumulative quote bank which still stands at around £300m. Translating only 5% of these quotations into firm orders would produce sales of c £15m and given a realistic group EBITA margin of 7%, would imply PBT of approximately £1m and EPS of 5.1p on a full tax charge. In FY10 this would increase EPS to 9.2p and produce an earnings multiple of only c 5x.

Exhibit 2: Summary of DCF and valuation metrics

DCF valuation	% owned	£m	Per share	EV/EBITDA	EV/Sales	Assumptions			
Westminster	100.0%	13	90	21.1x	1.3x	WACC: 15%	No of shares	14.0m	
							Shr price	48.00p	
							Mkt cap	£6.7m	
Group Enterprise Value		13	90						
Add: Net Cash		1.4	10						
Group Equity Value £m		14	100				Up / (down)side from current price	108%	
Ratio Analysis	2008	2009f	Grp DCF Scenarios			Terminal growth rate			
						3.00%	5.00%		
EV/Sales	1.1	0.6			14.00%	113p	123p		
EV/EBITDA	29.9	9.7							
EV/EBIT	37.1	10.4			13.00%	130p	143p		
Price/Book	2,040.2	1,549.8			12.00%	151p	171p		
Price/Earnings	33.6	20.3			11.00%	178p	209p		
Price/Op Cash Flow	(9.3)	7.1			10.00%	215p	264p		
ROE	6%	8%							
					Break-even WACC	24.2%			
						Revenue sensitivity			
					Multiple	0.5x	1.0x	1.5x	2.0x
					Revenue Y1 £m	9.4	9.4	9.4	9.4
					Implied EV £m	4.7	9.4	14.2	18.9
					Net (debt)/cash £m	.18	.18	.18	.18
					Group equity value £m	4.9	9.6	14.3	19.1
					Per share (p)	35	69	102	136

Source: Edison Investment Research

Exhibit 3: Financials

Note: Our estimates have treated the convertible loan stock as debt for the calculation of the net cash position in FY09 and FY10

Year end 31 December	£'000s	2006 IAS	2007 IAS	2008 IAS	2009e IAS	2010e IAS
PROFIT & LOSS						
Revenue		2,011	2,744	5,477	9,446	10,390
Cost of Sales		(1,404)	(1,765)	(3,568)	(6,518)	(6,962)
Gross Profit		607	979	1,909	2,928	3,429
EBITDA		(200)	(399)	206	599	1,018
Operating Profit (before GW and except.)		(240)	(436)	166	559	978
Goodwill Amortisation		0	0	0	0	0
IFRS 2 charges		(343)	0	0	0	0
Other		0	0	0	0	0
Operating Profit		(583)	(436)	166	559	978
Net Interest		(46)	12	35	(60)	(120)
Profit Before Tax (norm)		(286)	(424)	201	499	858
Profit Before Tax (FRS 3)		(629)	(424)	201	499	858
Tax		107	71	3	(140)	(240)
Profit After Tax (norm)		(179)	(353)	204	359	618
Profit After Tax (FRS 3)		(522)	(353)	204	359	618
Average Number of Shares Outstanding (m)		7.1	11.2	14.0	14.9	14.9
EPS - normalised (p)		(2.5)	(3.2)	1.5	2.4	4.1
EPS - FRS 3 (p)		(7.4)	(3.2)	1.5	2.4	4.1
Dividend per share (p)		0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		30.2	35.7	34.9	31.0	33.0
EBITDA Margin (%)		(9.9)	(14.5)	3.8	6.3	9.8
Operating Margin (before GW and except.) (%)		(11.9)	(15.9)	3.0	5.9	9.4
BALANCE SHEET						
Fixed Assets		1,092	1,241	1,332	1,763	1,763
Intangible Assets		0	0	0	39	39
Tangible Assets		1,092	1,241	1,332	1,332	1,332
Goodwill		0	0	0	392	392
Other		0	0	0	0	0
Current Assets		427	2,533	3,570	6,037	6,529
Stocks		86	61	186	253	266
Debtors		340	884	2,796	2,809	2,949
Cash		1	1,588	588	2,577	3,156
Current Liabilities		(861)	(481)	(1,500)	(1,980)	(2,184)
Creditors		(255)	(467)	(1,484)	(1,980)	(2,184)
Short term borrowings		(606)	(14)	(16)	0	0
Long Term Liabilities		(80)	(52)	(103)	(1,200)	(1,200)
Long term borrowings		(16)	0	0	0	0
Other long term liabilities		(64)	(52)	(103)	(1,200)	(1,200)
Net Assets		578	3,241	3,299	4,620	4,908
CASH FLOW						
Operating Cash Flow		(230)	(612)	(726)	1,015	1,069
Net Interest		0	(2)	0	(60)	(120)
Tax		(2)	(71)	(3)	0	(140)
Capex		(60)	(112)	(273)	(150)	(150)
Acquisitions/disposals		(13)	0	0	0	(80)
Financing		0	2,802	0	0	0
Dividends		0	0	0	0	0
Net Cash Flow		(305)	2,005	(1,002)	805	579
Opening net debt/(cash)		323	621	(1,574)	(572)	(1,377)
HP finance leases initiated		0	0	0	0	0
Other		7	190	0	0	0
Closing net debt/(cash)		621	(1,574)	(572)	(1,377)	(1,956)

Source: Company accounts/Edison Investment Research

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