Edison investment research

10 June 2009

Focus Solutions Group

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
03/07	7.9	1.2	4.1	0.0	7.1	N/A
03/08	8.6	1.7	4.2	0.0	6.9	N/A
03/09	9.6	1.9	5.4	0.0	5.4	N/A
03/10e	11.0	2.2	4.8	0.1	6.0	0.3

Note: *PBT and EPS are normalised, excluding goodwill amortisation and exceptional items. EPS in FY08 and FY09 excludes the impact of recognition of tax losses

Investment summary: Regulation still the driver

A record set of annual results from Focus with reported figures generally in-line with market expectations. Although not immune from the impact of the wider issues in the financial services market, the over-riding need for regulatory compliance continues to be a key driver. The valuation is attractive on a number of levels and there are considerable opportunities for organic and acquisition led growth.

Annual results: Broadly in-line

A series of significant new contract wins throughout FY09 helped propel the top line by +12% to £9.6m. Meanwhile, normalised profit before tax rose 13% to £1.88m and operating profit before exceptional costs increased 17% to £1.71m. While revenue and PBT were towards the lower end of expectations, both cash and EBITDA were in-line or ahead; in the wider context, these represented very credible figures. Net cash rose substantially from £1.03m in the previous year to £4.0m at the end of FY09 reflecting a fundamentally cash generative business model and the contribution of two major projects in particular.

Outlook and forecasts: Regulation, regulation, regulation

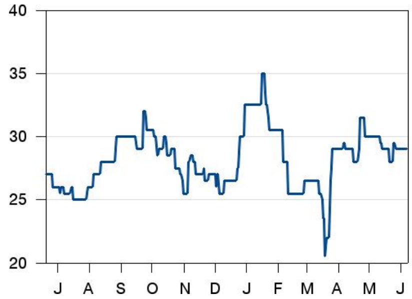
The over-riding need for the financial services sector to comply with an increasing web of industry regulation bodes well for Focus's longer-term prospects. This backdrop underpins an encouraging outlook for FY10, albeit management do remain cautious given unprecedented trading conditions have impacted medium term visibility; the group is currently trading "in-line" with expectations.

Valuation and conclusion

Based on the yardstick of adjusted fully diluted earnings – to remove the impact of prior year tax losses – EPS in FY09 would have risen to 5.43p from 4.24p. At a share price of 29p this equates to a P/E multiple of just 5.4x. A DCF value of 51p reflects the cash generative nature of the business model, and above average prospects for long term growth. On either benchmark the shares appear undervalued.

Price	29.0p
Market Cap	£9m

Share price graph



Share details

Code	FSG
Listing	AIM
Sector	Software & Computer Services
Shares in issue	29.46m

Price

52 week	High	Low
	34.5p	20.5p

Balance Sheet as at 31 March 2009

Debt/Equity (%)	N/A
NAV per share (p)	24.8
Net cash (£m)	4.0

Business

Focus Solutions is a Supplier of component based software and business services, predominantly to the Financial Services sector.

Valuation

	2008	2009	2010e
P/E Relative	60%	48%	64%
P/CF	N/A	2.5	5.4
EV/Sales	1.1	0.7	0.6
ROE	27%	23%	16%

Geography based on revenues

UK	Europe	US	Other
100%	0%	0%	0%

Analysts

Jason Holden 020 7190 1755
jholden@edisoninvestmentresearch.co.uk

Andrew Bryant 020 3077 5729
jholden@edisoninvestmentresearch.co.uk

Focus Solutions Group is a research client of Edison Investment Research Limited

Annual results 2009

Exhibit 1: Summary of annual results for the 12 months to 31 March 2009

£m	2009 12 mths to 31 March	2008 12 mths to 31 March	% change
Turnover	9.6	8.6	+12
Operating margin (%)	17.8	17.0	+
Operating profit	1.71	1.46	+17
Profit/(loss) before tax (norm)	1.88	1.67	+13
Adj EPS for tax losses (p)	5.43	4.24	+28
Net Cash balances	4.0	1.0	++

Source: Focus Solutions

Financial review

The table above confirms a record set of results for Focus which, given the tough macro backdrop, represents a very creditable outcome. Turnover grew by 12% to £9.6m on the back of a series of major contract wins described below, while pre-exceptional operating profits rose 17% to £1.71m, reflecting a 0.8% point rise in margins to 17.8%.

The strongly cash generative nature of the business model was reflected in a net cash position of £4.0m at the year end – significantly above the £1.03m of the previous year – and in large part due to the contribution of two major projects during the year.

Reported EPS reflects the impact of a deferred tax credit last year replaced by a deferred tax charge in FY09. Stripping out the recognition of tax losses produces, an adjusted fully diluted EPS of 5.43p, an increase of 28% on the previous year

Operational review

Both new and existing clients have provided an impetus behind the performance in FY09 which reflected a significant contribution from the group's largest customer, HSBC. The launch of the focus:360° suite of solutions in May last year also led to major new contract wins including Towergate Financial Services and Bank of Ireland Life.

Focus continues to highlight four key markets and each has a strong regulatory component: large IFAs, life and pension providers, wealth managers and global retail banks. In each case, the focus:360° products can aid compliance; for instance within the IFA segment, there is a need for businesses to adopt new IT systems to support the move from a commission to fee based structure. Similar examples exist in each of the other categories and within retail banking for instance, this is evidenced by £5.7m of further business from HSBC.

The outlook in the current tough trading environment is characterised by a distinct lack of visibility but the order pipeline is encouraging and the company has clear strategic goals; 1. Becoming the vendor of choice for multi-channel product distribution projects for global retail banks. 2. Increasing penetration of the wealth management market in the UK and Europe. 3. Market leadership in "direct to consumer" propositions. 4. Becoming an Application Service Provider (ASP) to service organisations with less than 50 users. 5. Building the proportion of sales from annually recurring licence and support revenues.

Valuation and conclusion

Earnings benchmark

The issue of the recognition of prior year deferred losses muddies the water somewhat so far as EPS is concerned. However, on the company's preferred measure of adjusted fully diluted earnings, to remove the impact of the losses, EPS in FY09 would have risen to 5.43p from 4.24p. At a share price of 29p this equates to a P/E multiple of just 5.4x

Assuming the adoption of a standard tax charge in FY10, our estimate of normalised EPS would be 4.8p which still represent an attractive multiple of 6.0x. There is also the possibility of a maiden dividend in FY10 to potentially widen the appeal of the shares.

DCF analysis

Despite our typically aggressive discount rate of 15%, the summary of our DCF analysis below still reveals significant upside in the stock price. An equity value of 51p reflects the cash generative nature of the business model, low capital intensity and above average prospects for long term growth via the consequences of ongoing regulatory changes in the financial services sector.

Exhibit 2: Summary of DCF valuation based on WACC of 15%

Discount rate %	15
NPV enterprise value £m	12.7
Growth rate in perpetuity %	5
Net cash 2009 £m	4.0
Equity value £m	16.7
Equity value per share (p)	51p

Source: Edison Investment Research

Exhibit 3: Financials

£'000s	2006	2007	2008	2009	2010e
Year end 31 March					
PROFIT & LOSS					
Revenue	6,585	7,908	8,600	9,601	11,000
Cost of Sales	(2,055)	(2,441)	(3,851)	(4,477)	(4,400)
Gross Profit	4,530	5,467	4,749	5,124	6,600
EBITDA	448	1,275	1,587	2,007	2,440
Operating Profit (before GW and except.)	367	1,199	1,461	1,706	2,090
Goodwill Amortisation	0	0	0	0	0
Exceptionals	(273)	(209)	(270)	(106)	(100)
Other	0	0	0	0	0
Operating Profit	94	990	1,191	1,600	1,990
Net Interest	18	45	209	177	100
Profit Before Tax (norm)	385	1,244	1,670	1,883	2,190
Profit Before Tax (FRS3)	112	1,035	1,400	1,777	2,090
Tax	0	532	576	(54)	(613)
Profit After Tax (norm)	385	1,244	1,670	1,829	1,577
Profit After Tax (FRS3)	112	1,567	1,976	1,723	1,477
Average Number of Shares Outstanding (m)	28.9	30.0	33.0	32.7	32.7
EPS - normalised (p)	1.3	4.1	5.1	5.6	4.8
EPS - FRS3 (p)	0.4	5.2	6.0	5.3	4.5
Dividend per share (p)	0.00	0.00	0.00	0.00	0.10
Gross Margin (%)	68.8%	69.1%	55.2%	53.4%	60.0%
EBITDA Margin (%)	6.8%	16.1%	18.5%	20.9%	22.2%
Operating Margin (before GW and except.) (%)	5.6%	15.2%	17.0%	17.8%	19.0%
BALANCE SHEET					
Fixed Assets	135	889	2,579	3,602	4,240
Intangible Assets	0	58	746	2,083	2,500
Tangible Assets	135	831	1,833	1,519	1,740
Investment in associates	0	0	0	0	0
Current Assets	4,270	6,630	5,379	6,673	8,712
Stocks	0	0	0	0	0
Debtors	4,147	3,625	4,352	2,669	4,200
Cash	123	3,005	1,027	4,004	4,512
Current Liabilities	(2,056)	(3,475)	(1,817)	(2,147)	(3,200)
Creditors & other liabilities	(2,056)	(3,475)	(1,817)	(2,147)	(3,200)
Short term borrowings	0	0	0	0	0
Long Term Liabilities	0	0	0	0	0
Long term borrowings	0	0	0	0	0
Other long term liabilities	0	0	0	0	0
Net Assets	2,349	4,044	6,141	8,128	9,752
CASH FLOW					
Operating Cash Flow	(833)	2,799	(1,368)	4,189	1,962
Net Interest	18	45	209	177	100
Tax	0	82	0	0	(54)
Capex	(79)	(159)	(853)	(1,287)	(1,200)
Acquisitions/disposals	0	0	0	(104)	(300)
Financing	10	115	34	2	0
Dividends	0	0	0	0	0
Net Cash Flow	(884)	2,882	(1,978)	2,977	508
Opening net debt/(cash)	(1,007)	(123)	(3,005)	(1,027)	(4,004)
HP finance leases initiated	0	0	0	0	0
Other	0	0	0	0	0
Closing net debt/(cash)	(123)	(3,005)	(1,027)	(4,004)	(4,512)

Source: Company accounts/Edison Investment Research

Edison Investment Research

Lincoln House, 296-302 High Holborn, London, WC1V 7JH ■ tel: +44 (0)20 3077 5700 ■ fax: +44 (0)20 3077 5750 ■ www.edisoninvestmentresearch.co.uk
Registered in England, number 4794244. Edison Investment Research is authorised and regulated by the Financial Services Authority.