

24 April 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	26.6	N/A
12/09e	9.7	0.5	3.3	0.0	12.1	N/A
12/10e	10.6	0.9	5.9	0.0	6.8	N/A

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

### Investment summary: Solid results

A solid set of annual results; a profitable H208 has resulted in an overall pre-tax profit of £201k for the full year. Westminster is demonstrating the scalability of its business model and we are forecasting profitable growth going forward. As the group moves into the 'black', the valuation starts to look attractive from an EPS multiple (c 12x FY09), as well as a DCF (97p) perspective.

### Annual results: Broadly in-line

Group turnover doubled during FY08 to £5.5m buoyed by the significant contribution from the contract at Juba Airport of c \$4.7m. Despite a rise in admin expenses of 29% to £1.74m – largely due to the investment of £350k in the Dubai office – H208 saw Westminster record its first operating profit as a public company and a maiden PBT for the full year. Group net cash balances fell a little more than expected to £0.6m from £1.6m largely as a consequence of working capital movements and higher than expected receivables.

### Outlook and forecasts: Good visibility

At 31 December 2008, the group's order book stood at £4.2m – 180% higher than the previous year end. However, including the recent €2m contract award in Egypt, there have been incremental new wins of £3.3m since the year end which lends significant support to estimates that we have left broadly unchanged.

### Valuation: Upside potential

Westminster has an established niche market position – particularly in the developing world – and a distinct competitive advantage in a fragmented marketplace. Earnings per share of 3.3p in FY09 represent a multiple of c 12x and growth in FY10 is expected to reduce this to c 7x – an attractive starting point in its own right. In addition, and as we have highlighted previously, converting just 5% of the cumulative quote bank of £300m could produce EPS of 7.1p and a share price of over 70p based on a multiple of 10x. The DCF value of 97p is more than twice the current share price.

Price 40p  
Market Cap £6m

#### Share price graph



#### Share details

Code WSG  
Listing AIM  
Sector Support Services  
Shares in issue 14.02m

#### Price

52 week High 56.75p Low 31.50p

#### 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	262%	120%	79%
P/CF	N/A	N/A	6.6
EV/Sales	0.9	0.6	0.5
ROE	6%	14%	20%

#### Geography based on revenues FY08

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

#### Analyst

Jason Holden 020 3077 5730  
jholden@edisoninvestmentresearch.co.uk

## Investment summary: Solid results

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### Company description: Niche operator in security and surveillance

Westminster is an established niche player in the provision of advanced technical security solutions to a customer base in the UK and overseas, a core activity that represented 72% of sales in FY08. The balance of turnover comprises the supply of various low voltage systems to the commercial and residential property sectors in the UK and, although clearly cyclical, there have been some encouraging new contract wins.

Crucially, Westminster has a heavyweight board for what is currently a small business. CEO Peter Fowler has almost 40 years of experience in the security industry and the FD, Nicholas Mearing-Smith, has been CFO of a company then ranked 25<sup>th</sup> by market capitalisation on the LSE. The chairman, Lieutenant Colonel Sir Malcolm Ross, also has an impressive CV, while Non-exec Sir Michael Pakenham was previously chairman of the Joint Intelligence Committee.

### Valuation

The valuation is now becoming attractive on an earnings as well as DCF basis given we are forecasting an ongoing improvement in profitability. Recent share price weakness means that although we are only expecting EPS of 3.3p in FY09, this represents a multiple of approximately 12x and with growth expected in FY10, this is an attractive starting point in its own right.

In addition and as we have highlighted previously, converting just 5% of the cumulative quote bank of £300m would deliver £15m of sales. Assuming a realistic group EBITA margin of 7% would then deliver a pre-tax number of c £1m and EPS of 7.1p – assuming the utilisation of previous years' losses results in a zero tax charge. By way of a guide to the valuation implications, this would yield a share price of over 70p based on an earnings multiple of 10x.

### Financials and outlook

H208 has revealed an operating profit for the first time since the group listed in 2007. Despite the implications of a global recession, the business or national security critical nature of Westminster's products make the company more resilient than most, while the depreciation of sterling against the US dollar has a major positive effect given how some significant contracts have been priced. The ability of the group to scale up is evidenced by the fact that as at 31 December 2008, the order book stood at £4.2m – 180% higher than the previous year end. Including the recent contract award in Egypt, there have been incremental new wins of £3.3m since the year end.

A broad geographic spread reduces over dependence on one particular region although the company needs to continue to scale up revenues in order to cover the cost base. In the medium term, cash on the balance sheet, good visibility over prospects in 2009 and the potential to grow a meaningful bank of recurring revenues, provide a good basis for the investment case.

## Annual results: Solid progress

As forecast, a strong H2 has enabled Westminster to deliver a profitable outcome for the full year. This should represent an inflexion point and on the back of a healthy order pipeline, we would expect further progress in FY09. The main highlight of the results was the award of the company's largest ever contract of \$4.7m at Juba Airport and consequently sales from Africa represented more than 50% of the group total.

Exhibit 1: Annual results for the 12 months to 31 December 2008

£m	2008	2007	%
	12 months to 31 Dec	12 months to 31 Dec	
Turnover	5.5	2.7	+100
Operating profit (norm)	0.2	-0.4	+
Profit/(loss) before tax (norm)	0.2	-0.4	+
Order book	4.2	1.5	+180
Net cash	0.6	1.6	-63

Source: Westminster Group

### Financial review

Group turnover doubled during FY08 to £5.5m buoyed by the significant contribution from the contract at Juba Airport of c \$4.7m. This boosted revenues from the advanced security business which – aided by a weaker sterling – grew 110% to £4.15m. The balance of revenue is generated by the domestic low voltage business RMS, which witnessed a 74% rise to £1.33m. Gross margins fell marginally from 35.7% to 34.9% as a reflection of a slight shift in the mix between larger scale contracts and the less profitable supply of third party equipment. Net of currency gains of £249k, administrative expenses still rose substantially to £1.74m (+29%) - largely due to costs of £350k associated with the opening of the Dubai office.

H208 saw Westminster record its first operating profit as a public company which effectively reversed the first half loss and delivered a maiden pre-tax profit for the full year. This reflects the scalability of the business and an overhead structure and infrastructure which should enable operational gearing to drive profits' growth as revenues make further progress.

Group net cash balances fell a little more than expected to £0.6m from £1.6m largely as a consequence of working capital movements and higher receivables, which are expected to reverse out in the current year. The main issue is the remaining balance due from the Juba Airport contract where \$1.8m of the proceeds is still outstanding. However, the amount owing was reduced from \$2.3m by a payment of \$500k at the beginning of April and negotiations continue regarding the remainder.

### Operating highlights and geographic review

FY08 has seen the benefit of a broad spread of international new business wins driving top line growth, with the highlight being the award of the contract to supply a complete security solution at Juba Airport in Southern Sudan. This made the **Africa** region the largest contributor to the top line, with 56% of group sales from the continent. There were a number of other projects completed in Africa during the year including the supply of security, scanning and GSM interception equipment to various sub-Saharan governments.

In the **Middle East** region the business model differs slightly since the local agents tend to be bigger corporates that have the direct relationship with the customer and then sub-contract work to Westminster. The need to establish credibility with these agents led to the strategic decision to invest in offices in Dubai and Abu Dhabi which represented a write-off of £350k to the P&L in FY08. Although there was only c £100k of contracts delivered during the year, there have been a significant number of enquiries and the first tangible evidence of the success of this strategy was the award in March of a £1m contract to supply the group's recently developed 'ThruPORT' security scanning portals at airports in Iraq. These units can be swiftly deployed and – built within a specialised shipping container – can scan both baggage and people to mitigate the risks presented by explosive devices. Another recent new business win is a €2m contract to supply a high tech security net at a major new dam complex in Egypt. These contracts undoubtedly help build the reputation of Westminster in the region.

**Asia-Pacific** is a region that fits the characteristics of Westminster's core market place and although sales were only around the £100k mark in FY08, the pipeline of potential contract wins is encouraging. Similarly, the potential in **the Americas** is significant and the new international web site discussed below should help the group to gain traction.

The other major region is the **UK & Europe**, which accounted for £2.239m or 41% of group turnover in FY08. This included a significant contribution from RMS of £1.3m – up 74% over the previous year – which supplies low voltage fire and security systems principally in residential and corporate high rise buildings. Despite the slowdown in commercial and domestic new build, RMS has good visibility in its order book throughout FY09 and even into the following year. The non-RMS business in the region generated revenues from a broadening customer base, which included police forces and the Prison Service.

One further operational development to highlight is the investment in the international website, which provides a major hub for the group's activities. Significant investment was made throughout FY08 and the new platform has just been launched. From a customer perspective, Westminster believes that it is one of the largest websites of its type which provides information on security solutions across an extensive multi lingual platform. Given the extensive geographic reach of the client base and the underpinning role of the network of agents, management believes the new website will promote awareness of the company's business proposition and act as an important marketing tool.

## Outlook

Westminster operates in a vast international market place with huge opportunities while its focus for growth on developing economies also has the potential to deliver significant progress. The business model is based around a highly scalable and extensive network of over 70 locally based agents, which essentially provide local labour and ongoing service and maintenance once a contract has been secured.

The macro backdrop to the prospects for the overall market has a number of drivers, but includes the necessity of protecting the integrity of national borders and with it the security of both

infrastructure and personnel. The ever present and growing threat of international terrorism only serves to heighten these issues.

## Strategic acquisition

In February this year, Westminster announced the acquisition of Longmoor Services – a niche security company, specialising in the provision of security risk management solutions. It has a scalable business model, employing staff on a flexible contract basis, and will provide cross-selling opportunities across the group's network of 70+ agents in over 45 countries. Founded in 2005, the business is organised across four divisions: Training, Security & Protection, Risk Management and Special Projects.

We are conservatively forecasting an incremental £600k of revenues in FY09 and a break-even outcome given a gross margin of c 40% and annualised operating costs of £240k. The initial consideration is £0.4m and we would expect the acquisition to make further significant progress in FY10. At this stage our estimates do not forecast that the maximum earn-out potential of £2m payable in cash or shares, and calculated on 50% of net profits in each of the next two years, will be triggered.

## Forecasts and valuation

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**Westminster has only just tipped the scales into profitability and as such the business case is still at a fairly nascent stage. Nonetheless the strength of the order book lends increasing confidence to the potential for growth and our estimates reflect some of this upside. The huge opportunity for any substantial wins from the quote bank is not reflected in forecasts and our valuation analysis suggests substantial upside on either an earnings or DCF basis.**

### Forecasts: Upside from quote bank not reflected

Exhibit 2 illustrates the expected growing scale and profitability of Westminster, with the company having had both a profitable H208 and full year outcome. We are expecting further progress on both sales and margins in FY09, underpinned by a healthy order book and good visibility over contracts within the domestic RMS business; our forecasts are broadly unchanged since we last published in February.

Evidence of the group's ability to scale up is provided by the fact that as at 31 December 2008 the order book stood at £4.2m – 180% higher than the previous year end. Including the recent contract in Egypt, there have been incremental new wins of £3.3m since the year end. The expansion of the contract pipeline reflects the success management has had in building a market presence across an extensive and diverse landscape.

Some of the potential dramatic upside for the business is not, however, captured by the fairly robust nature of the order book but instead can be garnered from a quote bank that represents potential business that Westminster has bid for. For some time now this has had a 12-month running cumulative total of around £300m, which clearly dwarfs the current revenue profile of the group and does not play a part in our forecasts.

**Exhibit 2: Summary of results and forecasts by business activity 2008-2010e**

Year end December	H108		H208		2008		2009e		2010e	
Revenue					Yr	Change	Yr	Change	Yr	Change
Advanced tech	845	172%	3,303	98%	4,148	110%	7,859	75%	8,645	10%
Low voltage	555	41%	774	111%	1,329	74%	1,794	35%	1,974	10%
Unallocated	0		0	(100%)	0	(100%)	0	0%	0	0%
<b>Total</b>	<b>1,400</b>	<b>98%</b>	<b>4,077</b>	<b>100%</b>	<b>5,477</b>	<b>100%</b>	<b>9,653</b>	<b>76%</b>	<b>10,618</b>	<b>10%</b>
<b>Gross Margins</b>										
Group	28%		37%		35%		30%		30%	
<b>Gross Profit</b>										
Group	387		1,522		1,909		2,896		3,186	
<b>EBITA</b>										
Advanced tech	(43)		766		723		943	30%	1,297	38%
Low voltage	84		(115)		(31)		126	-505%	197	57%
Unallocated	(470)		(56)		(526)	45%	(600)	14%	(650)	8%
<b>Total</b>	<b>(429)</b>		<b>595</b>		<b>166</b>	<b>(138%)</b>	<b>469</b>		<b>844</b>	<b>80%</b>
<b>EBITA Contribution Margin</b>										
Advanced tech	(5%)		23%		17%		12%		15%	
Low voltage	15%		(15%)		-2%		7%		10%	
Unallocated										
<b>Total</b>	<b>(31%)</b>		<b>15%</b>		<b>3%</b>		<b>5%</b>		<b>8%</b>	
Unallocated Costs	0				0		0		0	
<b>EBITA</b>	<b>(429)</b>				<b>166</b>	<b>(138%)</b>	<b>469</b>		<b>844</b>	<b>80%</b>
Amortisation of intangibles	0				0		0		0	
Share options	0				0		0		0	
<b>EBIT</b>	<b>(429)</b>				<b>166</b>		<b>469</b>		<b>844</b>	
Exceptional Items	0				0		0		0	
Net Interest	17				35		30		30	
<b>PBT</b>	<b>(412)</b>				<b>201</b>		<b>499</b>		<b>874</b>	

Source: Edison Investment Research

A selection of outstanding quotes is highlighted in Exhibit 3 and includes the massive \$50m pipeline security tender for an oil company in the Ukraine. This would cover 4,000km of pipeline, with the customer motivated by the loss of some \$60m of crude oil to theft on an annual basis. Discussions are still ongoing and even if the deal proves elusive, it nonetheless gives an indication as to the growing credibility Westminster has in the international security and surveillance markets.

**Exhibit 3: Selection of outstanding quotations**

Customer	Region	Project	Value
Oil Company	Eastern Europe	Pipeline security	\$50m
Government	Africa	Interception systems	\$8m
Government	Middle East	Pipeline security	\$20m
Government	South Asia	Armoured personnel carriers	\$4m
Oil Company	South America	Pipeline security	\$2m

Source: Westminster Group

**Valuation**

Although H208 cannot be taken as a marker of a definitive shift into the black, nonetheless it does represent an important step, with the group having tipped the scales into profitability. Given that we expect the momentum to be maintained in the current year, an earnings based multiple now starts to become more helpful as one of the benchmarks for valuation.

Following recent share price weakness, although we are only forecasting EPS of 3.3p in FY09, this represents a multiple of approximately 12x. With growth in FY10 expected to reduce this to c 7x, this is an attractive starting point in its own right.

However, these multiples still do not reflect the potential to convert even a small proportion of the cumulative quote bank, which has been fairly consistent at around £300m. As we have highlighted previously, converting just 5% of these quotations would deliver £15m of sales, with the vast majority of turnover in the 'Advanced Technological' division. Assuming a realistic group EBITA margin of 7% would then deliver a pre-tax number of c £1m and EPS of 7.1p – assuming the utilisation of previous years' losses results in a zero tax charge. By way of a guide to the valuation implications, this would yield a share price of over 70p based on an earnings multiple of 10x.

## DCF

The earnings based assessment above is supported by our DCF model, which even using an aggressive WACC of 15% – and not allowing for the major potential in the quote book – still produces a value of 97p. The break-even WACC would have to rise to a massive 26% before the shares were fully valued. At the current share price, the ratio analysis below highlights that Westminster is trading on a forecast EV/sales multiple of 0.5x in FY09, but that even 1x sales would produce a value of 73p.

### Exhibit 4: Summary of DCF and valuation metrics

DCF valuation	% owned	£m	Per share	EV/EBITDA	EV/Sales	Assumptions			
Westminster	100.0%	13	92	25.5x	1.3x	WACC: 15%	No of shares	14.0m	
							Shr price	33.50p	
							Mkt cap	£4.7m	
Group Enterprise Value		13	92						
Add: Net Cash		1	4						
<b>Group Equity Value £m</b>		<b>14</b>	<b>97</b>			<b>Up / (down)side from current price</b>		<b>188%</b>	
Ratio Analysis	2008	2009f	Grp DCF Scenario's		-----Terminal growth rate-----				
						3.00%	5.00%		
EV/Sales	0.8	0.5	WACC	14.00%		111p	121p		
EV/EBITDA	20.0	9.2		13.00%		129p	143p		
EV/EBIT	24.9	10.0		12.00%		152p	173p		
Price/Book	1.3	1.2		11.00%		182p	214p		
Price/Earnings	23.4	10.2		10.00%		222p	274p		
Price/Op Cash Flow	(6.5)	(41.1)							
ROE	6%	12%							
					Breakeven WACC	26.3%			
						Revenue sensitivity			
					Multiple	0.5x	1.0x	1.5x	2.0x
					Revenue Y1 £m	9.7	9.7	9.7	9.7
					Implied EV £m	4.8	9.7	14.5	19.3
					Net (debt)/cash £m	.57	.57	.57	.57
					Group equity value £m	5.4	10.2	15.1	19.9
					<b>Per share (p)</b>	<b>39</b>	<b>73</b>	<b>107</b>	<b>142</b>

Source: Edison Investment Research

**Exhibit 5: Financials**

Year end 31 December	£'000s	2007 IAS	2008 IAS	2009e IAS	2010e IAS
<b>PROFIT &amp; LOSS</b>					
<b>Revenue</b>		<b>2,744</b>	<b>5,477</b>	<b>9,653</b>	<b>10,618</b>
Cost of Sales		(1,765)	(3,568)	(6,757)	(7,433)
Gross Profit		979	1,909	2,896	3,186
<b>EBITDA</b>		<b>(399)</b>	<b>206</b>	<b>509</b>	<b>884</b>
<b>Operating Profit (before GW and except.)</b>		<b>(436)</b>	<b>166</b>	<b>469</b>	<b>844</b>
Goodwill Amortisation		0	0	0	0
IFRS 2 charges		0	0	0	0
Other		0	0	0	0
<b>Operating Profit</b>		<b>(436)</b>	<b>166</b>	<b>469</b>	<b>844</b>
Net Interest		12	35	30	30
<b>Profit Before Tax (norm)</b>		<b>(424)</b>	<b>201</b>	<b>499</b>	<b>874</b>
<b>Profit Before Tax (FRS 3)</b>		<b>(424)</b>	<b>201</b>	<b>499</b>	<b>874</b>
Tax		71	3	0	0
<b>Profit After Tax (norm)</b>		<b>(353)</b>	<b>204</b>	<b>499</b>	<b>874</b>
<b>Profit After Tax (FRS 3)</b>		<b>(353)</b>	<b>204</b>	<b>499</b>	<b>874</b>
Average Number of Shares Outstanding (m)		11.2	14.0	14.9	14.9
EPS - normalised (p)		(3.2)	1.5	3.3	5.9
EPS - normalised fully diluted (p)		(3.1)	1.4	3.3	5.8
EPS - FRS 3 (p)		(3.2)	1.5	3.3	5.9
Dividend per share (p)		0.0	0.0	0.0	0.0
Gross Margin (%)		35.7	34.9	30.0	30.0
EBITDA Margin (%)		(14.5)	3.8	5.3	8.3
Operating Margin (before GW and except.) (%)		(15.9)	3.0	4.9	7.9
<b>BALANCE SHEET</b>					
<b>Fixed Assets</b>		<b>1,241</b>	<b>1,332</b>	<b>1,332</b>	<b>1,332</b>
Intangible Assets		0	0	0	0
Tangible Assets		1,241	1,332	1,332	1,332
Goodwill		0	0	0	0
Other		0	0	0	0
<b>Current Assets</b>		<b>2,533</b>	<b>3,570</b>	<b>4,452</b>	<b>5,365</b>
Stocks		61	186	257	270
Debtors		884	2,796	3,862	4,055
Cash		1,588	588	333	1,040
<b>Current Liabilities</b>		<b>(481)</b>	<b>(1,500)</b>	<b>(1,990)</b>	<b>(2,219)</b>
Creditors		(467)	(1,484)	(1,990)	(2,219)
Short term borrowings		(14)	(16)	0	0
<b>Long Term Liabilities</b>		<b>(52)</b>	<b>(103)</b>	<b>(103)</b>	<b>(103)</b>
Long term borrowings		0	0	0	0
Other long term liabilities		(52)	(103)	(103)	(103)
<b>Net Assets</b>		<b>3,241</b>	<b>3,299</b>	<b>3,691</b>	<b>4,375</b>
<b>CASH FLOW</b>					
<b>Operating Cash Flow</b>		<b>(612)</b>	<b>(726)</b>	<b>(122)</b>	<b>907</b>
Net Interest		(2)	0	30	30
Tax		(71)	(3)	3	0
Capex		(112)	(273)	(150)	(150)
Acquisitions/disposals		0	0	0	(80)
Financing		2,802	0	0	0
Dividends		0	0	0	0
Net Cash Flow		2,005	(1,002)	(239)	707
<b>Opening net debt/(cash)</b>		<b>621</b>	<b>(1,574)</b>	<b>(572)</b>	<b>(333)</b>
HP finance leases initiated		0	0	0	0
Other		190	0	0	0
<b>Closing net debt/(cash)</b>		<b>(1,574)</b>	<b>(572)</b>	<b>(333)</b>	<b>(1,040)</b>

Source: Company accounts/Edison Investment Research

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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](http://www.edisoninvestmentresearch.co.uk)  
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