

5 July 2011

Psion

Year End	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
12/09	170	4.1	2.0	3.8	37.3	5.1
12/10	174	(1.9)	(0.9)	4.0	N/A	5.4
12/11e	185	1.7	0.9	4.2	80.3	5.8
12/12e	200	6.8	3.8	4.4	19.8	5.9

Note: Note: *PBT, EPS and P/E are adjusted excluding intangible amortisation, exceptionals and share based payments and adjusting for net capitalised R&D.

Investment summary: Legacy still hurting

Psion has warned its H1 loss will be c £4m vs a £0.7m profit last year, as a result of supply chain issues for a legacy product and ongoing investment in new product launches. A growing order book and the contribution of new modular products should drive a significantly improved H2, but not enough to offset the shortfall in H1. While this set-back does not significantly change the fundamental turnaround story, it will be well into H2 until we get much visibility on whether it is delivering results.

Profit shortfall in H1

H1 sales are expected to be 4% below last year, on unit shipments that are up 3%. A supply chain issue (relating to faulty screens) on a legacy product late in the period was the primary reason for the weakness, although stronger sterling also had a translational impact. The issue has been resolved, but the cost of solving these issues, development and launch costs for the new EP10 PDA and some moderate restructuring will result in an H1 normalised PBT loss of £4m (£0.7m profit last year).

More encouraging pointers for H2

While not offsetting the H1 shortfall in our estimates, there are some more encouraging pointers for H2, with the order book up 16% y-o-y and bookings for 9,000 EP10s (worth c £7m) already taken. The launch of the CDMA product is still scheduled for Q3 and should open up large tracts of the US market, with an update for the Omni scheduled for Q4. The company expects FY sales to be up 5-8% y-o-y, suggesting 13-19% y-o-y growth in H2.

Valuation: Hinges on margin recovery

The weakness in H1 is clearly disappointing, but primarily a result of legacy product issues, combined with ongoing investment in the turnaround. Our estimate changes are detailed overleaf, with both FY PBT and EPS moving back by 66% for 2011 and by 36% for 2012. On these estimates, the rating of 20x 2012 normalised earnings (16x ex-cash) is not compelling, although the EV/sales ratio of 0.4x and a dividend yield of 5.9% (currently uncovered) highlight the upside potential from a margin recovery.

Price 74.25p
Market Cap £104m

Share price graph



Share details

Code PON
Listing FULL
Sector IT Hardware and Equipment
Shares in issue 140.5m

Price

52 week High 102.8p Low 71.8p

Balance Sheet as at 31 December 2010

Debt/Equity (%) N/A
NAV per share (p) 127
Net cash (£m) 36.9

Business

Psion designs and sells ruggedised mobile computers, which are used by field workers and in supply chain and logistics functions.

Valuation

	2010	2011e	2012e
P/E relative	N/A	757%	206%
P/CF	N/A	49.3	11.7
EV/Sales	0.4	0.4	0.4
ROE	2%	3%	5%

Geography based on revenues (2010)

	EMEA	Americas	RoW
60%		32%	8%

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Revised estimates

Our estimate changes are shown below. Given the current thin margins and operational gearing within the business, the fragility of earnings is highlighted by the 66% cut to our FY normalised PBT from £4.9m to £1.7m. Approximately £1m of this reduction is a result of the reduced top line, with the balance from a cut to the gross margin from 41% to 38%. The significant swing in profitability H2 on H1 is a result of operational gearing combined with some additional cost savings (H2 opex forecast to be £1m lower than H1). Our earnings reductions for 2012 primarily reflect a more cautious stance on gross margin expansion. Longer term, we retain our base case view that high single-digit margins (vs 5% estimated for 2012) should be achievable for Psion, once operating with a refreshed product set and optimised operational structure.

We have retained a dividend forecast, although it is clearly not covered in 2011 and marginally covered in 2012 (0.85x coverage on a normalised basis, adjusting for capitalised R&D, 1.35x covered when not). A recovery to 8% plus margins would be required for the dividend cover to fall to a more comfortable sub 50% level.

The reduction in our year-end net-debt figure reflects both lower profitability and outgoing £3.9m payment for settlement with the largest claimants in the ongoing litigation process in Japan. The remaining contingent liability on the litigation now stands at c £1.7m versus £15.4m at year end 2010.

Exhibit 1: Estimate changes

Year end 31 December	2010	%	2011e	2011e	%	2012e	2012e	%
	Actual	Change	Old	New	Change	Old	New	Change
Revenue	174.5	0%	186.3	184.6	-1%	202.1	200.3	-1%
Gross margin (%)	38%		41%	38%		42%	39%	
Op profit normalised (net capitalised R&D)	(1.9)	N/A	4.7	1.5	-69%	10.4	6.6	-37%
Net benefit from R&D capitalisation	7.8		5.9	5.9		3.9	3.9	
Op Profit adj (pre SBP & except.)	5.9	27%	10.6	7.4	-30%	14.3	10.5	-27%
Profit Before Tax (norm)	(1.9)	N/A	4.9	1.7	-66%	10.6	6.8	-36%
Net benefit from capitalised R&D	7.8		5.9	5.9		3.9	3.9	
Profit Before Tax (adjusted)	5.9	21%	10.8	7.6	-30%	14.5	10.7	-26%
EPS - normalised fully diluted (p)	(0.9)	N/A	2.7	0.9	-66%	5.8	3.8	-36%
EPS adj diluted (p)	2.8	18%	6.0	4.2	-30%	8.1	6.0	-26%
EPS - FRS 3 (p)	2.7	14%	6.0	1.4	-77%	8.1	6.0	-26%
Dividend per share (p)	4.0	0%	4.2	4.2	0%	4.4	4.4	0%
Closing net debt/(cash)	(36.9)	0%	(32.3)	(25.9)	-20%	(29.5)	(20.3)	-31%

Source: Edison Investment Research, company accounts

Exhibit 2: Financials

Year end 31 December	£m	2008 IFRS	2009 IFRS	2010 IFRS	2011e IFRS	2012e IFRS
PROFIT & LOSS						
Revenue		199.4	170.0	174.5	184.6	200.3
Cost of Sales		(107.8)	(113.9)	(107.8)	(113.9)	(122.6)
Gross Profit		91.6	56.1	66.7	70.7	77.6
EBITDA		11.1	12.3	10.7	14.3	19.6
Op profit normalised (net capitalised R&D)		6.1	4.0	(1.9)	1.5	6.6
Net benefit from R&D capitalisation		0.0	3.5	7.8	5.9	3.9
Op Profit adj (pre SBP & except.)		6.1	7.5	5.9	7.4	10.5
Exceptionals		(14.9)	(10.6)	(0.2)	(4.0)	0.0
Other		0.0	0.0	0.0	0.0	0.0
Operating Profit		(8.8)	0.4	13.5	9.3	14.4
Net Interest		1.2	0.1	(0.0)	0.2	0.2
Profit Before Tax (norm)		7.2	4.1	(1.9)	1.7	6.8
Profit Before Tax (adjusted)		7.2	7.6	5.9	7.6	10.7
Profit Before Tax (FRS 3)		(7.7)	(3.0)	5.7	3.6	10.7
Tax		(2.7)	(4.8)	(1.9)	(1.7)	(2.4)
Profit After Tax (norm)		5.1	(1.6)	3.6	2.9	0.5
Profit After Tax (adjusted)		5.1	5.3	4.0	5.9	8.4
Profit After Tax (FRS 3)		(10.3)	(7.8)	3.8	1.9	8.4
Average Number of Shares Outstanding (m)		139.8	140.6	140.7	140.6	140.7
EPS - normalised fully diluted (p)		3.6	2.0	(0.9)	0.9	3.8
EPS adj diluted (p)		3.6	3.8	2.8	4.2	6.0
EPS - FRS 3 (p)		(8.6)	(5.1)	2.7	1.4	6.0
Dividend per share (p)		3.7	3.8	4.0	4.2	4.4
Gross Margin (%)		45.9	33.0	38.2	38.3	38.8
EBITDA Margin (%)		5.6	7.2	6.1	7.7	9.8
Operating Margin (before GW and except.) (%)		3.0	4.4	3.4	4.0	5.2
BALANCE SHEET						
Fixed Assets		136.7	122.9	134.6	140.9	146.4
Intangible Assets		113.9	105.4	118.5	124.3	128.1
Tangible Assets		11.2	9.9	11.5	12.9	14.6
Investments		11.6	7.5	4.6	3.7	3.7
Current Assets		137.9	113.0	103.1	94.3	94.2
Stocks		37.1	18.4	18.2	21.6	23.3
Debtors		57.7	45.6	47.4	46.1	50.1
Cash		41.3	45.3	36.9	25.9	20.3
Other		1.9	3.7	0.6	0.6	0.6
Current Liabilities		(56.2)	(53.4)	(55.7)	(58.1)	(61.4)
Creditors		(52.7)	(50.9)	(53.4)	(55.6)	(58.9)
Other		(3.5)	(2.5)	(2.3)	(2.5)	(2.5)
Long Term Liabilities		(7.3)	(4.9)	(3.5)	(3.5)	(3.5)
Long term borrowings		0.0	0.0	0.0	0.0	0.0
Other long term liabilities		(7.3)	(4.9)	(3.5)	(3.5)	(3.5)
Net Assets		211.1	177.6	178.5	173.6	175.8
CASH FLOW						
Operating Cash Flow		1.1	18.2	0.0	2.1	8.9
Net Interest		(1.0)	0.1	(0.1)	0.2	0.2
Tax		(4.8)	(3.3)	1.6	(1.7)	(2.4)
Capex		3.5	(3.4)	(4.2)	(5.7)	(6.2)
Acquisitions/disposals		0.0	0.0	0.0	0.0	0.0
Financing		1.0	0.0	0.1	0.0	0.0
Dividends		(5.2)	(5.3)	(5.5)	(5.9)	(6.2)
Net Cash Flow		(5.3)	6.3	(8.1)	(11.0)	(5.6)
Opening net debt/(cash)		(38.3)	(41.3)	(44.4)	(36.9)	(25.9)
HP finance leases initiated		0.0	0.0	0.0	0.0	0.0
Other		8.3	(3.2)	0.5	0.0	(0.0)
Closing net debt/(cash)		(41.3)	(44.4)	(36.9)	(25.9)	(20.3)

Source: Edison Investment Research, company accounts

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