Newmark Security

Securing long-term growth

Re-initiation of coverage

Industrial support services

Newmark Security's recent results show that the group is in excellent shape. International sales of OEM time and attendance (T&A) terminals, which made a material contribution to FY13, and sales of SATEON, the group's next-generation access control system, underpin longer-term growth. Two major contracts from the Post Office boosted FY13 numbers, with follow-on orders expected in FY14 and FY15. There is a cash-rich balance sheet. The shares are trading at a substantial discount to peers and to net assets. We see fair value at 3.6p/share, double the current level.

Year end	Revenue (£m)	PBT* (£m)	EPS* (p)	DPS (p)	P/E (x)	Yield (%)
04/12	13.1	0.4	0.12	0.00	12.7	N/A
04/13	18.3	2.3	0.54	0.03	2.8	2.2
04/14e	17.2	1.2	0.26	0.04	5.9	2.4
04/15e	18.5	1.7	0.34	0.04	4.5	2.6

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Product innovation driving long-term growth

The group has the dominant share of its niche in the asset protection market, but as this is fairly mature, management is seeking long-term growth through new product introduction and geographic expansion. SATEON has gained customer acceptance in the UK and will be introduced to international markets in FY14. The group is beginning to sell T&A terminals to OEMs in Eastern Europe. Results from field trials of the group's innovative cash-in-transit protection product are encouraging. Sales of cash-in-transit products represent upside to our estimates.

FY13 results boosted by Post Office contracts

FY13 group sales rose by 39.9%, boosted by two large orders for the Asset Protection division from the Post Office. Group adjusted profit before tax rose by £1.9m (443%) to £2.3m and the board reintroduced the dividend. The Electronic division's performance was held back by customers waiting for SATEON versions with more advanced features to be available and the cost of developing international markets. Reported results included an exceptional £2.3m write-down of goodwill and capitalised development costs. The balance sheet is strong, with net cash of £0.7m at end-FY13. Our estimates assume it will take time for all the Post Office equipment ordered in FY13 to be installed and follow-on orders placed, so we model a dip in revenues and adjusted profits in FY14. This effect masks the growth in sales of SATEON and the roll-out of T&A terminals in Eastern Europe.

Valuation: Trading at a discount to peers

Newmark Security is trading at a significant discount to its peers on all metrics. Based on the current year average, peer EV/EBITDA leads to our fair value of 3.6p/share. Additionally, the shares are trading at an 83% discount to current year peer EV/sales, and a 37% discount to net assets.

9 September 2013

Price	**1.525p**
Market cap	**£7m**
Net cash (£m)	0.7
Shares in issue	450.4m
Free float	37%
Code	NWT
Primary exchange	AIM
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	1.7	(7.6)	134.6
Rel (local)	2.4	(11.3)	102.7
52-week high/low		1.68p	0.65p

Business description

Newmark Security provides electronic and physical security systems which focus on the safety and security of a company's personnel and its assets.

Next events

AGM	12 September 2013

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Edison profile page

Newmark Security is a research client of Edison Investment Research Limited

Investment summary

Company description: Keeping personnel and assets secure

Newmark Security is an established niche provider of electronic and physical security systems to blue-chip customers, predominantly in the UK. In a typical year, half its revenues are from asset protection products, including fixed and rising security screens, of which it is the dominant provider. The other half is from the sale of time and attendance (T&A) terminals to OEMs, where it also benefits from high UK market share, and from the sale of access control systems. This market is more competitive. The markets served are fairly mature, so management seeks long-term growth through new product introduction. SATEON, the group's next-generation, browser-based access control system, has multi-lingual capabilities unlike its predecessor. Having now gained customer acceptance in the UK, it will be introduced to international markets during FY14. Internal trials of the group's innovative cash-in-transit protection product have successfully proved the concept and the product is currently undergoing field trials with Loomis, one of the UK's major cash-in-transit service providers. In addition, it has begun to sell T&A terminals to OEMs in Eastern Europe.

Financials: Product innovation for long-term growth

FY13 group sales rose by 39.9% to £18.3m, flattered by two large orders for the Asset Protection division from the Post Office. Group adjusted profit before tax rose by £1.9m (443%) to £2.3m. The Electronic division's performance was held back by customers waiting for SATEON versions with more advanced features to be available and the development of international markets. Given the level of profitability, the board decided to reintroduce the payment of a dividend of 0.0333p/share.

As it will take time for all the equipment already purchased by the Post Office to be installed, our estimates assume that follow-on orders from the Post Office in FY14 will not be at FY13 levels. Consequently, although we model growth in the Electronic division, group revenues are expected to dip in FY14 before returning to FY13 levels in FY15, and adjusted profit before tax to fall by £1.2m to £1.2m in FY14, before rising to £1.7m in FY15. We model a progressive dividend and treat any contribution from sales of cash-in-transit products as upside to our estimates. The balance sheet is strong, with net cash of £0.7m at end-FY13. Net cash is expected to rise to £1.8m (26% of current market capitalisation) by end-FY15.

Valuation: Trading at a substantial discount to peers

A comparison with other listed companies offering security systems shows that Newmark Security is trading at a significant discount on all metrics. Applying average current-year peer EV/EBITDA and a 25% discount to reflect the low market capitalisation and relatively low free float, gives fair value at 3.6p/share. In addition, the shares are trading at an 80% discount to current-year peer EV/sales and a 37% discount to net assets.

Sensitivities

- The company's financial performance in future could be hampered by a slower-than-expected economic recovery and protracted curbs on government spending.
- Uncertainty regarding the timescales associated with the installation of cash-handling equipment for the Post Office and associated follow-on orders.
- Rate of adoption of the new SATEON access control system in new international markets.
- Uptake of the cash-in-transit product, which we treat as upside to our estimates.
- Concentrated share ownership structure: 29.9% Dwek family and 29.2% the Reid estates.
- Dependence on mainland European suppliers of cash-handling equipment.

Company description: Securing personnel and assets

Newmark Security provides electronic and physical security systems, which focus on the safety and security of a company's personnel and assets. The company has two wholly owned divisions: Electronic and Asset Protection, which accounted for 36% and 64% of FY13 revenues respectively. The Electronic division, ie Grosvenor Technology and Newmark Technology, provides state-of-the-art open architecture solutions for access control and workforce management terminals for use with time and attendance systems. The Asset Protection division, ie Safetell and ATM Protection (UK), provides fixed and reactive security screens, reception counters, cash management systems and associated security equipment.

Newmark Security listed on AIM in 1997. In 2000, the group acquired Safetell, which was founded in 1984 and has been supplying rising security screen systems since 1987. In 2002, it acquired Grosvenor Technology, which was founded in 1989 to develop access control and security management systems. It acquired Custom Micro Products in 2004. This was merged with Grosvenor, complementing the latter's existing capability with customised hardware for OEMs. In April 2010, the group took a 60% stake in ATM Protection (UK), which had developed a prototype for a cash-in-transit protection system. This shareholding was increased to 86.7% in FY13.

Both divisions sub-contract their manufacturing, Grosvenor to specialist electronic manufacturing companies in Hungary and Poland, Safetell to operations in the UK. Grosvenor's main site for development of access control systems is in Bishop's Stortford. Its workforce management product facility and UK distribution centre for all Grosvenor products is in Poole, with an office in Florida. Safetell is based in Dartford. The group as a whole employs over 130 people.

Electronic division (36% revenues FY13, 46% FY12)

Grosvenor Technology provides access control solutions and data collection products for workforce management and time and attendance (T&A) applications. Grosvenor designs and sells complete access control solutions, which include Intelligent Door Controllers (IDCs) and management software modules, as well as lower margin cards and readers, which it purchases from third parties to create a complete solution for customers.

Access control products

JANUS

JANUS has been Grosvenor's flagship product for more than 20 years and has been installed at nearly 10,000 sites. The core software controls networks of IDCs, which may number 1,000 or more in a large system. It provides access control functions, alarm monitoring, and incident and engineering logs. It can be integrated with CCTV switching, digital and network video recording, T&A functionality, intruder and other critical business systems, to become an integral part of electronic security across a wide corporate environment. It is sold as a package combining software and Grosvenor's IDCs. The JANUS architecture means it is very difficult to develop browser-based and non-English variants, so a next-generation product, SATEON, has been developed. Ultimately SATEON is expected to become Grosvenor's main access control brand as JANUS customers gradually upgrade to take advantage of SATEON's newer technology and richer feature set, although the JANUS software brand will continue to be sold and supported for many years.

Historically, JANUS has targeted the middle and high end of the access control market, serving more demanding requirements, although Grosvenor has begun to address the lower end to expand its potential market. End-user clients for JANUS include BAE Systems, BSkyB, Bank of America/Merrill Lynch, Morrisons, the Ministry of Defence, Network Rail, Tyco and numerous universities. The route to market involves a network of dealers and specialist security installers.

SATEON

SATEON is multi-lingual, so it can be easily installed in geographies where English is not the native language. It is 100% browser-based, thus appealing to larger corporations that do not permit applications to be installed on client PCs, and is easily scalable. Its modern graphical user interface supports features such as navigable graphic maps showing the location of events and incidents. It runs on an SQL database platform, making it easier to integrate into third-party applications. It is more cost-competitive than JANUS, which is helpful in tender situations.

The first commercial version of SATEON was released in autumn 2011, following delays related to difficulties in developing with Microsoft Silverlight. It has taken time for integrators to start deploying the product, as the majority of systems have needed the later software versions that offer graphical alarm maps and other built-in interfaces to products such as CCTV management systems, intruder systems and fire systems. Now that this functionality is available, SATEON has been selected as the new access control system for end-users including East Sussex Council, Mitsubishi Electrics, 30 St Mary's Axe (the Gherkin) and Gateway College Leicester. SATEON continues to be developed. Version 2.6, which was released in September 2013, will support larger, more complex projects, with further integration modules as required for specific tender projects. Adding greater functionality to SATEON extends the potential customer base. Now that SATEON has been installed at a critical mass of sites in the UK, management is confident that the software is sufficiently robust to be installed without intensive on-site support, so it is being promoted more actively in other territories such as mainland Europe, the Middle East and the US.

Access control market

The key driver for the installation of access control is the desire of an organisation to maintain control over building security in an efficient manner. While this is a high priority for most organisations irrespective of revenue, demand is still linked to the economic cycle, with fewer installations linked to new buildings or major refurbishments or installation upgrades taking place when the economic environment is weak.

The access control market is fairly competitive. Direct competitors include majors such as Tyco Fire & Security, Lenel and Honeywell. As JANUS only supports English, adoption has been restricted to the UK and a few geographies such as the Middle East, where installers are familiar with English. SATEON's multi-lingual capabilities will enable Grosvenor to sell it anywhere in the world. Certification by Underwriters Laboratories, which carry out safety checks on products and equipment, enables Grosvenor to target the US market. Certification was granted in FY13.

Time and attendance products

Grosvenor offers T&A terminals and associated embedded software, which enables OEM partners to easily interface their own software with Grosvenor's T&A terminals to build complete workforce management systems. The typical development cycle for an OEM partner to integrate with Grosvenor's terminals is eight to 12 months. This cycle may be longer for larger or more complex projects. It therefore takes a significant time from beginning to promote the product in a new geography to selling material product volumes. New partners in Eastern Europe are still at the integration stage, following initial discussions in late calendar 2011. Our estimates assume that these projects will begin to generate material sales during FY14, with higher volumes shipping once integrations based on the new lower-end IT11 terminal, which is scheduled for release in Q3 of calendar 2013, have successfully completed.

Grosvenor has an established customer base in the UK and Western Europe, which has been selling workforce terminals as part of its T&A solutions for many years. During FY13, several large projects were undertaken, including one for a major retailer and another for a supermarket chain, both of which will continue into FY14. Grosvenor has made sales to the US for many years, strengthening its presence in the region by establishing an office in Florida in H112. New partners in Eastern Europe are at various stages of integrating their software with the Grosvenor terminals.

Time and attendance market

Monitoring employee attendance in an efficient manner is also a high priority for organisations, a task that has become more difficult as more employers offer flexible working hours. Here also, while this is a high priority for most organisations, demand is linked to the economic cycle.

The T&A hardware market is smaller than the access control market. Management estimates that the UK market is approximately £6m pa, with Grosvenor having a one-third share. The key strength of Grosvenor's offer is the embedded software provided with the terminals, which makes it easy to integrate the terminals into a system; the terminals are designed with "plug and play" components to give customers flexibility without the cost of customised components; the terminals may be installed by personnel without specialist training, and once installed, can be monitored and maintained remotely over the internet. According to management, the only serious competitors are Far Eastern and US imports. The Asian products are aimed mainly at the lower-priced segment of the market and some of the US competitors can be slow to adopt new technology. Neither competitor therefore appears to be a serious threat. In our opinion, customers are highly unlikely to switch supplier once they have invested time and money integrating Grosvenor's OEM terminals into their complete solutions.

Asset Protection division (64% revenues FY13, 54% FY12)

Safetell's security screens protect staff and assets from violence and aggression. Key elements of the offer are:

- **Eclipse rising screens:** This is Safetell's core product, first introduced in 1986. Eclipse is supplied primarily to retail banks, building societies, post offices and petrol retailers, where staff who handle large amounts of money come into contact with members of the public. The screen provides protection for counter staff against armed robbery. It is concealed in the counterwork, enabling transactions to be handled across an open desk and eliminating the need for inhibiting grills or glazing. Staff activate the screen when they suspect or perceive a threat. In less than a second, powerful pneumatics raise a bullet-resistant steel barrier from the counter to the ceiling. All screens in the premises are triggered at the same time to create a secure zone separate from the public area. As well as installing Eclipse rising screens, Safetell offers a full installation package, including bullet-proof wall panels and doors, counterwork, queue barriers and CCTV.
- **CounterShield:** This provides protection against violence for staff in non-cash environments such as interview and reception areas for housing associations, local government housing offices, benefits offices and hospital accident and emergency areas. The use of fixed glazing to separate staff from the public has become less acceptable in these environments, because the existence of this barrier and the communication problems it creates can provoke aggression. Staff activate CounterShield when they feel under threat, causing the safety screen to move into position in less than a second.
- **Eye2Eye:** This is a ticket counter that provides ballistic protection for staff and enables ticket authorities to comply with the Disability Discrimination Act's requirements for public services to be offered on an equal basis for all. The counter height can be changed by the ticket clerk or by the customer, for example so that it is easy for a customer in a wheelchair to sign documents on the counter top. Other features to assist various disabilities include sculpted counter edges and a cash scoop to assist those with dexterity problems, an induction loop and speech transfer to aid those with hearing difficulties and contrasting colour schemes to help the

partially sighted. Eye2Eye is featured in the Department for Transport's Code of Practice for the design of accessible stations.

- **FlexiGlaze:** This is a generic product name for Safetell's range of fixed-glass protection screens. These are available in full bullet-resistant format and in anti-physical attack formats, which withstand violent attack from a variety of weapons. The screens ensure staff protection, while retaining light and visible transaction spaces for both retail and administrative functions.
- **Cash handling:** Safetell supplies a range of cash-handling safes. These devices improve branch security and cashier efficiency by minimising the amount of cash held in tills and enabling cashiers to remain at their position at the counter if they need to top up or reduce the amount of cash held in their till. Safetell sources these products from third parties in mainland Europe, although it has begun to develop some products itself. It has an exclusive contract to distribute the products in the UK.
- **Service and maintenance:** Many Safetell customers also sign up to service and maintenance contracts, which are typically of three- to five-year duration. Additionally, Safetell has won significant tranches of work to service locks, access control, CCTV cameras and voice and queue management systems. For example, in March 2011, Safetell signed an agreement with a major UK bank to support, repair and maintain its security equipment, which is worth c £2m over three years. In a typical year such as FY12, service sales account for around half Safetell's revenues.

Asset protection market

The customer base is predominantly in the UK. There are no plans to penetrate new geographic markets, because of the high cost of transporting product and cultural differences precluding adoption elsewhere in Europe. End-user clients include Santander, the Derbyshire, Nationwide, Skipton and Yorkshire building societies, BP, Morrisons, Network Rail, several police forces and numerous local councils. More than 2,000 Eclipse rising screens have been installed. The route to market is fairly complex, involving both end-users and contractors.

There are two key events driving the purchase of Safetell's products. First, a health and safety or security assessment may decide that security screens are needed in a particular location to protect personnel and assets. Secondly, a branch, for example of a building society, may need remodelling, either through participation in a refurbishment programme, a corporate rebranding or relocation. Demand for product is therefore vulnerable to a general economic slowdown, which causes businesses to postpone refurbishments, and to cut-backs in local government expenditure. Consolidation among banks and building societies may depress demand, given that it typically reduces the total number of branches, but may also present an opportunity if some of the remaining branches need to be remodelled in line with the new owner's preferred configuration.

Management estimates that Safetell has almost 100% of the rising screen market, as its former competitor, Ritzenthaler, has exited the market. Avon Armour offers a similar product to CounterShield, although this product is currently a small proportion of divisional sales as a result of local government cuts. Safetell is the only supplier of an Eye2Eye-type product. While there are some competitors for the cash-handling products, the Post Office, which is the main customer, has decided to standardise on product from Safetell. There is one competitor servicing rising screens, although it is much smaller that Safetell and unable to offer a nationwide service. There are numerous other businesses in the UK that offer fixed security glazing. These include Avon Armour, Bastion and C3S Securiglass.

Expansion into the cash-in-transit market

In May 2010, Newmark acquired 60% of ATM Protection (UK) (ATMPUK) for £264,000. ATMPUK had prototyped a novel technology for protecting cash-in-transit, ie cash being transferred between customer premises and armoured vehicles. Cash is currently transferred in secure containers, which release a coloured dye after a specified time has elapsed, or when an unauthorised person attempts to open a stolen container. This leaves the stolen banknotes coated in dye. The technology is not foolproof, as criminals have worked out ways to wash off the dye and most machines accepting bank notes cannot recognise it. This is of concern to companies providing cash-in-transit services, not just because of the financial losses incurred, but also because of the increasingly violent attacks on their staff.

Working with Loomis, a major UK cash-in-transit provider, ATMPUK has prototyped an alternative technology based on adhesive bonding. The release of adhesive is triggered in the same way as dye, but with a more detrimental impact on the banknote. The banknotes stick together and tear if any attempt is made to prise them apart. This makes them unusable, although the identity numbers are preserved so the legal owner can secure a refund from the Bank of England. Damaging cash so it cannot be used is a highly effective deterrent against theft.

Following the acquisition, Newmark has undertaken considerable additional development to move from a prototype to a reliable product that can be manufactured in volume and activated at the point of attack, remotely using SMS, and automatically if the tamper-proof circuits are broken. Newmark has also added additional features that were not originally planned, mainly related to the audit trail of events involving the cash box. Internal field trials with Loomis, which concluded in March 2012, proved the concept. However, following recommendations from the field trials, it was decided to develop a lighter version based on aluminium rather than plastic reinforced with steel. The new design also eliminates expensive tooling and moulds, supports more complex customer cash-handling procedures, and offers greater flexibility to accommodate different customer requirements. Internal tests on the second-generation product have completed successfully. Field trials, which are ongoing, resumed with Loomis in May 2013 and are expected to conclude before the end of CY13. While frustrating for investors and management, which had hoped the product would be commercialised more quickly, this iterative process is normal for a product that needs to support customer work flows, which are themselves evolving.

If this field trial is successful, Loomis may place substantial orders to equip all its UK depots. Loomis operates throughout Europe and the US, and it may be rolled out across Europe if the technology is proven to be successful in the UK. Newmark has also had initial talks with other cash-in-transit and related businesses, which management notes as “encouraging”.

Management

Since 1997, the group has been led by its chairman, Maurice Dwek, a successful entrepreneur, who co-founded Dwek Group, which was listed in 1973, and went on to be chairman of Arlen and Owen & Robinson. In April this year, Maurice stepped back from an executive to non-executive role when his daughter, Marie-Claire Dwek, became CEO. Marie-Claire already has several years’ experience of the electronic security sector, having worked in it as a marketing director. She is supported in this role by executive directors Brian Beecraft, who has been group finance director since 1998, and Derek Blethyn, who was a founder of Grosvenor Technology and became managing director of the group’s Electronic division when Grosvenor was acquired in 2002.

Sensitivities

- Economic slowdown and government cutbacks adversely affect refurbishment programmes for banks and building societies, local government offices, academic institutions and businesses generally. The company’s financial performance in future could be hampered by a slower-than-expected economic recovery and protracted curbs on government spending.

- The two large contracts awarded by the Post Office in FY13 to supply and install cash-handling equipment do not specify timescales for installation. The length of time taken to install all the equipment ordered so far will affect when follow-on orders will be received. We note that the two large contracts received in FY13 do not include sufficient equipment to complete installation across the entire Post Office branch network.
- Grosvenor intends to promote SATEON more actively in international markets from FY14 onward. While SATEON has been received favourably in the UK, this is no guarantee of acceptance elsewhere.
- As the field trials with Loomis of the cash-in-transit product have yet to be completed, there is no clarity as to whether there will be any significant sales in future. We treat any sales as upside to our estimates.
- The majority of the cash-handling equipment supplied to the Post Office is purchased from third parties in mainland Europe. The group would not be able to substitute equivalent product if there were a problem. Given the volumes of equipment involved, it would not be rational for the suppliers to voluntarily terminate supply.
- 29.9% of shares are held by the Dwek family. 29.2% of shares are held on behalf of the estates of Mr A Reid and Mrs GAB Reid. We understand that Mr Reid was an independent investor who built up a stake in the group as part of his portfolio of corporate investments and was a non-executive director of the group until his death in 2009. A representative of the Reid estates is one of the current non-executive directors.

Valuation

Comparison against peers

Exhibit 1: Comparison against listed peers

Company	Market cap	Historic EV/Sales	Historic EV/EBITDA	Current EV/ EBITDA	Next EV/ EBITDA	Historic P/E	Current P/E	Next P/E	EBIT Margin last year	EBIT Margin current year
ADT Corp/The	£5,373m	3.3x	6.6x	6.2x	5.9x	23.2x	21.5x	19.7x	22.7%	22.7%
Assa Abloy AB	£10,415m	2.6x	14.2x	13.6x	12.4x	22.x	20.5x	18.4x	16.0%	16.2%
Axis Communications AB	£1,245m	3.0x	19.0x	17.2x	14.1x	29.9x	25.2x	20.3x	13.6%	14.2%
Kaba Holding AG	£1,051m	1.6x	9.8x	10.3x	9.7x	17.1x	18.9x	17.4x	12.5%	12.1%
Tyco International Ltd	£10,044m	1.6x	12.5x	10.4x	9.2x	33.0x	18.2x	15.7x	8.4%	11.0%
Mean (large market cap)		2.4x	10.8x	10.1x	9.3x	20.8x	20.9x	18.3x		
Alarmforce Industries Inc	£73m	2.4x	17.1x	8.7x	7.0x	97.6x	22.2x	17.1x	9.9%	-
NAPCO Security	£61m	1.6x	18.3x	-	-	40.8x	-	-	3.7%	-
Securidev SA	£64m	0.3x	3.0x	-	-	10.9x	-	-	7.7%	-
Synectics PLC	£87m	1.1x	12.0x	9.7x	8.5x	22.6x	15.1x	13.9x	8.1%	8.2%
View Systems Inc	£5m	9.5x	loss	-	-	loss	-	-	loss	-
Viscount Systems Inc	£5m	2.1x	loss	-	-	loss	-	-	loss	-
Mean (small market cap)		**2.8x**	**7.5x**	**9.2x**	**7.7x**	**16.7x**	**18.6x**	**15.5x**		
Newmark Security	**£7m**	**0.3x**	**1.8x**	**2.7x**	**1.8x**	**2.8x**	**5.9x**	**4.5x**	**13.5%**	**7.1%**

Source: Bloomberg 9 Sept 2013 Note: Grey shading indicates exclusion from mean

While Newmark Security's shares are trading at a significant discount to those of its peers on all metrics, our valuation focuses on current EV/EBITDA multiples. This avoids the unusual uplift in Newmark Security's FY13 performance arising from the major Post Office contracts and any issues comparing EPS data, on which different tax normalisation rules have been applied. We take as our sample set internationally listed companies in the electronic security sector, splitting these into two groups according to market capitalisation. This gives 9.2x current EV/EBITDA as a base-line multiple, which is similar to the mean for our sample set of UK technology hardware companies, excluding semiconductors. We then apply a discount of 25% to reflect the lack of liquidity implied by Newmark's very small market capitalisation, which is exacerbated by the Dwek family and Reid estate holdings. This gives fair value of 3.6p/share, which is double the current level. This implies a current P/E of 13.9x, reducing to 10.7x in FY15. Both these values are below the mean for our sample of security systems companies.

We note that Newmark Security shares are trading at a 37% discount to net assets. In our opinion, value investors should not be deterred by the high proportion of intangible assets, composed of £5.1m goodwill and £4.0m development costs, as these reflect the level of expenditure required by a potential market entrant to develop the product portfolio and establish a dominant position in the UK security screen market.

Financials

Exhibit 2: Segmental analysis

£'000s	FY10	FY11	FY12	FY13	FY14e	FY15e
Electronic division revenues	6,325	6,142	6,039	6,615	7,293	7,570
Asset Protection division revenues	7,467	6,510	7,055	11,701	9,900	10,900
Electronic division operating profit	1,402	903	688	238	469	578
Asset Protection division operating profit	919	531	456	2,967	1,612	2,026

Source: Edison Investment Research

FY13 results

Revenues

FY13 group sales rose by 39.9% to £18.3m. Revenues from the Electronic division rose by 9.5% to £6.6m, 36% of the group total. Sales of T&A terminals benefited from several large projects in the UK and substantially higher uptake in the US related to the timing of individual projects. Sales of access control systems were flat as customers waited for SATEON version 2.6 to become available. Revenues from the Asset Protection division rose by 65.9% to £11.7m, boosted by a significant part of two large orders received from the Post Office totalling £7.3m, and by the supply of rising screens to a number of financial institutions undertaking refurbishment programmes.

Profits

Gross margin, after adjusting for exceptionals, rose by 2.3pp to 43.0%, as the group benefited from changes in product mix and management's decision to develop some cash-handling products in house. Adjusted gross profit rose by £2.4m to £7.9m. Underlying administrative expenses rose by 10.2% as the sales teams were expanded to support SATEON. Finance charges remained at FY12 levels. As a result, pre-exceptional pre-tax profit grew by £1.9m (443%) to £2.3m. The group benefits from high levels of research and development allowances, resulting in a net tax credit of £0.1m. Given the level of profitability, the board decided to reintroduce the payment of a dividend of 0.0333p/share. The dividend payment was suspended in FY12 when the board decided to repay £105,000 of unutilised loan notes (this repayment took place in FY13).

Exceptional items

The FY13 P&L included two exceptional items:

1. An impairment provision against development costs of £0.5m was added to the cost of sales as required by IAS36. This treated the newer, lighter version of the cash-in-transit product as separate from the original plastic and steel version, thus incurring a write-off charge against all the earlier development, which in our view is over-conservative.
2. The reviews carried out in April each year indicated that an impairment provision was necessary against the goodwill in the Electronic division of £1.8m. This arose from the

development of SATEON to replace the JANUS system which was the only access control system offered at the time when Grosvenor Technology was acquired in 2002. Investors should note that JANUS will continue to be sold and supported for many years and that much of the IP in SATEON is derived from work developing the JANUS system.

Cash flow and balance sheet

Net operating cash flow rose by £0.9m to £3.0m, reflecting the significant increase in underlying profitability. Counter intuitively, given the higher sales levels, year-end inventories fell by £0.2m because the Post Office equipment being stored at Safetell's premises prior to installation is Post Office inventory. Payables dropped by £0.4m because the invoiced discounting facility was not used. At £1.2m, investment in product development was £0.1m higher than in FY12. Free cash flow increased by £0.7m to £1.4m, equivalent to 0.3p/share. After paying £50k to acquire a further 26.7% of ATM Protection (UK), bringing the total holding to 86.7%, repaying the £0.1m loan notes drawn down in FY12, cash and cash equivalents (net of overdraft) increased by £0.9m to £1.1m. The group moved from a net debt position totalling £0.5m to positive net cash of £0.7m.

FY14 estimates

Group revenues are expected to dip by £1.1m to £17.2m and adjusted profit before tax by £1.2m to £1.2m. Our estimates assume that a substantial proportion of the Post Office business awarded in FY13 will be installed in FY14, and that this will be supplemented by several smaller follow-on orders, but the total value of Post Office-related work will be less than FY13. With regard to the Electronic division, we expect growth to be driven by integrators in Eastern Europe starting to order higher volumes of T&A terminals and SATEON gaining share internationally. Management had postponed international roll-out of SATEON until the new software was sufficiently robust to be installed without any technical support in attendance, so we assume that most of the cost base to support geographic expansion is already in place. We model a progressive dividend. We exclude any contribution from cash-in-transit products from our estimates.

We assume the board will continue to invest significantly in product development. At the lower levels of profitability expected for FY14, this means we forecast free cash flow at only £0.3m, which is sufficient to cover the dividend.

FY15 estimates

Our estimates show group revenues returning to FY13 levels and adjusted profit before tax rising by £0.5m to £1.7m in FY15. With this greater profitability, forecast free cash flow rises to £1.4m (0.3p/share) and net cash rises to £1.8m (26% of current market capitalisation).

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Exhibit 3: Financial summary

	£'000	2010	2011	2012	2013	2014e	2015e
Year end 30 April							
PROFIT & LOSS							
Revenue		13,792	12,652	13,094	18,316	17,193	18,470
Cost of Sales		(7,812)	(7,340)	(7,632)	(10,438)	(10,562)	(11,157)
Gross Profit		5,980	5,312	5,462	7,878	6,631	7,313
EBITDA		2,271	1,464	1,278	3,387	2,246	2,843
Operating Profit (pre amort. of acq intangibles & SBP)		1,745	848	559	2,476	1,227	1,724
Amortisation of acquired intangibles		0	0	0	0	0	0
Share-based payments		(8)	0	0	0	0	0
Exceptionals		(70)	(40)	(370)	(2,274)	0	0
Operating Profit		1,667	808	189	202	1,227	1,724
Net Interest		(89)	(102)	(127)	(131)	(60)	(40)
Profit Before Tax (norm)		1,656	746	432	2,345	1,167	1,684
Profit Before Tax (FRS 3)		1,578	706	62	71	1,167	1,684
Tax		(154)	151	115	69	0	(168)
Profit After Tax (norm)		1,502	897	547	2,414	1,167	1,516
Profit After Tax (FRS 3)		1,424	857	177	140	1,167	1,516
Average Number of Shares Outstanding (m)		450.4	450.4	450.4	450.4	450.4	450.4
EPS - normalised (p)		0.33	0.20	0.12	0.54	0.26	0.34
EPS - normalised fully diluted (p)		0.32	0.19	0.12	0.54	0.26	0.34
EPS - FRS 3 (p)		0.31	0.19	0.04	0.03	0.26	0.34
Dividend per share (p)		0.0250	0.0275	0.0000	0.0333	0.0367	0.0403
Gross Margin (%)		43.4	42.0	41.7	43.0	38.6	39.6
EBITDA Margin (%)		16.5	11.6	9.8	18.5	13.1	15.4
Operating Margin (before GW and except.) (%)		12.7	6.7	4.3	13.5	7.1	9.3
BALANCE SHEET							
Fixed Assets		10,043	10,930	11,408	9,901	10,462	10,923
Intangible Assets		9,313	10,142	10,699	9,092	9,592	9,992
Tangible Assets		730	788	709	809	870	931
Current Assets		4,116	4,354	5,993	5,060	5,118	6,334
Stocks		1,503	1,469	1,520	1,344	1,413	1,518
Debtors		2,402	2,885	2,373	2,588	2,685	2,783
Cash		211	0	2,100	1,128	1,020	2,033
Current Liabilities		(3,553)	(3,510)	(5,767)	(3,544)	(3,198)	(3,356)
Creditors including tax, social security and provisions		(3,241)	(3,053)	(3,620)	(3,250)	(3,005)	(3,215)
Short term borrowings		(312)	(457)	(2,147)	(294)	(193)	(141)
Long Term Liabilities		(580)	(1,024)	(832)	(468)	(416)	(416)
Long term borrowings		(68)	(486)	(424)	(184)	(132)	(132)
Other long term liabilities		(512)	(538)	(408)	(284)	(284)	(284)
Net Assets		10,026	10,750	10,802	10,949	11,966	13,485
CASH FLOW							
Operating Cash Flow		1,839	1,192	2,022	2,969	1,835	2,850
Net Interest		(89)	(102)	(127)	(131)	(60)	(40)
Tax		(143)	(78)	92	(9)	0	0
Capital expenditure		(226)	(197)	(135)	(228)	(228)	(228)
Capitalised product development		(1,004)	(1,108)	(1,131)	(1,239)	(1,200)	(1,200)
Acquisitions/disposals		(20)	(156)	0	(50)	0	0
Financing		(639)	114	(124)	(406)	(305)	(204)
Dividends		(113)	(125)	(125)	0	(150)	(165)
Net Cash Flow		(395)	(460)	472	906	(108)	1,013
Opening net debt/(cash)		-	169	943	471	(650)	(695)
HP finance leases initiated		-	0	0	0	0	0
Other		-	314	0	(215)	(153)	(52)
Closing net debt/(cash)		169	943	471	(650)	(695)	(1,760)

Source: Company accounts, Edison Investment Research

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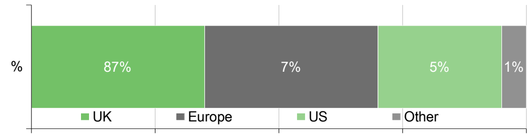
Contact details	Revenue by geography
58 Grosvenor Street London W1K 3JB UK +44 (0)20 7355 0070 www.newmarksecurity.com	

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 11-15e	14.0%	ROCE 14e	7.7%	Gearing 14e	Net cash	Litigation/regulatory	◖
EPS 13-15e	-20.8%	Avg ROCE 11-15e	8.1%	Interest cover 14e	20.5x	Pensions	○
EBITDA 11-15e	18.0%	ROE 14e	9.8%	CA/CL 14e	1.6	Currency	○
EBITDA 13-15e	-8.4%	Gross margin 14e	38.6%	Stock days 14e	30	Stock overhang	●
Sales 11-15e	9.9%	Operating margin 14e	7.1%	Debtor days 14e	57	Interest rates	○
Sales 13-15e	0.4%	Gr mgn / Op mgn 14e	5.4x	Creditor days 14e	60	Oil/commodity prices	○

Management team

Maurice Dwek: Chairman

Maurice Dwek was chairman and co-founder of Dwek Group in 1963, which was listed on the London Stock Exchange in 1973. In 1988, Dwek Group had a turnover of £38m, generating profits before tax of £4.1m, and was sold to a management buy-out team. In 1989, Maurice became chairman of Arlen (electronics) and Owen & Robinson (sports footwear, retailing and jewellery shops). He resigned as chairman of both companies in 1992, but was re-appointed as chairman of Owen & Robinson in1996, when he rescued the business from administration by arranging a placing and open offer and re-listing the company on the Official List of the London Stock Exchange. He retired from the board of Owen and Robinson in 1996 to concentrate on Newmark, where he was appointed chairman in 1997.

Brian Gordon Beecraft: Group Finance Director

Brian Beecraft qualified as a chartered accountant in 1973. In 1985, he joined United Transport International, the transport division of BET, where he became group financial controller in 1990, responsible for all aspects of financial control and accounting for the group. In 1994, he left United Transport following the acquisition of BET by Rentokil and worked as a freelance financial consultant for four years, before joining the board in 1998 as finance director.

Marie-Claire Dwek: Chief Executive Officer

In her early career, Marie-Claire worked in the electronic security sector as marketing director, before changing to property investment and management for Motcomb Estates from 2001 onwards. She was appointed as CEO in April 2013.

Derek Blethyn: Executive Director

Derek Blethyn qualified in the design and manufacture of industrial process control systems. He was the owner and manager of Grosvenor Contract Management, which he started in 1986, as a provider of high-quality industrial process solutions, as well as providing office fitting and data cabling installations. In 1989, Derek was a founding member of Grosvenor Technology. This was sold in 2002 to Newmark Security, where Derek remains as MD of the Electronic Security division.

Principal shareholders	(%)
Investec on behalf of the estate of the late Mr A Reid and Mrs GAB Reid	29.2
E Dwek (beneficial interest)	16.8
M Dwek (Chairman)	13.1
M Rapoport (Non-executive director)	3.4
N Medlam (former non-executive director)	0.4

Companies named in this report

ADT Corp (ADT:US), Alarmforce Industries (AF:CN), Assa Abloy (ASSAB:SS), Axis Communications (AXIS:SS), Kaba Holding (KABN:SW), NAPCO Security Technologies (NSSC:US), Securidev (SCDV:FP), Synectics (SNX:LN), Tyco International (YC:US), View Systems (VSYM:US), Viscount Systems (VSYS:US).