

## RECOMMENDATIONS

Rating	<b>BUY ▲</b>
Risk	High
Price Target	<b>\$0.20</b>
Share Price	\$0.16

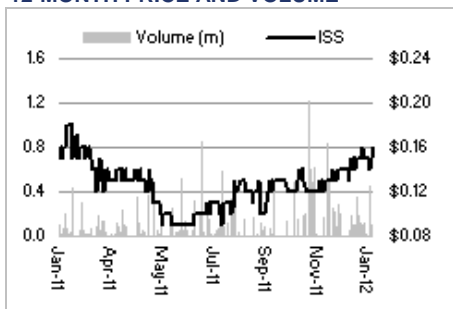
## SNAPSHOT

Monthly Turnover	\$0.4mn
Market Cap	\$22mn
Shares Issued	137.7mn
52-Week High	\$0.19
52-Week Low	\$0.09
Sector	Information Technology

## BUSINESS DESCRIPTION

ISS Group Limited (ISS) delivers operational management software solutions to the global oil and gas, mining, metals, minerals and manufacturing industries. ISS Group was established in 1995 and listed on the ASX in 2004. The company has offices in Australia, US, Europe and Asia and has a blue chip client base including Chevron, BHP Billiton, Woodside, Santos, Rio Tinto, Shell, BG Group, BP, Hess Corporation, Maersk Oil, Petronas and Fortescue Metals.

## 12-MONTH PRICE AND VOLUME



## RESEARCH ANALYST

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## Disclosure

The author owns no shares in ISS. E. L. & C. Baillieu Stockbroking Limited has acted in a short-term strategic and marketing role for ISS Group Limited and earned fees in relation to that activity in the past 12 months.

# ISS Group (ISS)

## COMPANY REPORT – INITIATION OF COVERAGE

### Transition to growth phase

- ISS Group is an information technology company that develops operational management software for the oil and gas, mining, and manufacturing sectors. In FY2011 the business model was restructured with early signs suggesting that the company is now on track for sustainable revenue and profit growth. CEO Mr Richard Pang has identified the need for a greater direct sales focus rather than the previous re-seller model. With the customer base increasing 20 percent over the past 12 months, we are expecting a very strong first-half result.
- The company's product suite is called "BabelFish". The growing selection of software products is a powerful interface through which companies can aggregate their many real-time systems to provide a single view of their complex processes and operations. The software enables detailed analysis and identification of potential efficiency gains and exceptions to normal operating conditions.
- ISS represents a late cycle resources and oil and gas service play as a large percentage of its earnings are exposed to the operating phase of projects. Earnings are derived from selling software licences, contract sales (three to five-year terms, charging a monthly lease fee), implementation services and joint venture agreements. ISS also achieves about 20 percent of revenues as an annuity stream (maintenance and support).
- ISS was established in 1995 and listed on the ASX in 2004. The company operates from a Perth-based head office, and has software development and sales offices in Adelaide, Asia, the UK and the US. ISS now has approximately 130 employees, with approximately 60 percent located in Perth. The company's key customers include Chevron, BHP Billiton, Woodside Petroleum, Rio Tinto, Santos, Shell, BG Group, BP, Hess Corporation, Maersk Oil, Petronas and Mars Snackfood.
- As well as these large customers, ISS also has joint venture agreements with significant industry participants such as Schlumberger and KBC. The distribution agreement enables Schlumberger exclusive rights to market and distribute "BabelFish" Server module to the upstream hydrocarbons market for periodic payments totalling \$17 million over five years.
- We have a \$0.25 discounted cash flow valuation and a \$0.20 price target. Our price target is based on a 20 percent discount to our valuation to reflect the high risk from the low scale of the business, and execution risk of the restructured business model. We have a Buy rating for ISS.

## INVESTMENT SUMMARY

Year End: 30 June		2010 (A)	2011 (A)	2012 (E)	2013 (E)	2014 (E)
Revenue	\$mn	19	17	20	22	23
EBITDA	\$mn	3.7	1.5	3.5	4.7	5.2
EBIT	\$mn	3.2	1.2	3.3	4.4	5.0
Reported Profit	\$mn	3.6	1.1	2.8	3.8	4.3
Adjusted Profit	\$mn	3.6	1.1	2.8	3.8	4.3
EPS (Reported)	¢	2.7	0.8	2.1	2.7	3.1
EPS (Adjusted)	¢	2.7	0.8	2.1	2.7	3.1
EPS Growth	%	N/A	-69.6	151.4	32.9	12.9
PER (Reported)	x	5.9	19.5	7.8	5.8	5.2
PER (Adjusted)	x	5.9	19.5	7.8	5.8	5.2
Dividend	¢	0.5	1.2	1.4	1.6	1.7
Yield	%	3.1	7.2	8.8	10.0	10.6
Franking	%	100	37	50	50	50

## Financial summary

<b>Analyst:</b>	Simon Dumaresq
<b>Date:</b>	01 Feb 2012
<b>Share Price (\$A):</b>	\$0.16

### FINANCIAL PERFORMANCE ( \$mn)

Year End: 30 June	2011 (A)	2012 (E)	2013 (E)	2014 (E)
Sales Revenue	17.4	20.0	22.0	23.1
<b>EBITDA</b>	<b>1.5</b>	<b>3.5</b>	<b>4.7</b>	<b>5.2</b>
Depreciation & Amortisation	0.3	0.3	0.3	0.2
<b>EBIT</b>	<b>1.2</b>	<b>3.3</b>	<b>4.4</b>	<b>5.0</b>
Net Interest	0.2	0.3	0.3	0.3
<b>Pre-Tax Profit</b>	<b>1.4</b>	<b>3.5</b>	<b>4.7</b>	<b>5.3</b>
Tax	0.3	0.7	0.9	1.1
Associates	0.0	0.0	0.0	0.0
Outside Equity Int.	0.0	0.0	0.0	0.0
<b>Reported NPAT</b>	<b>1.1</b>	<b>2.8</b>	<b>3.8</b>	<b>4.3</b>
Significant Items	0.0	0.0	0.0	0.0
<b>Adjusted Profit</b>	<b>1.1</b>	<b>2.8</b>	<b>3.8</b>	<b>4.3</b>

### BALANCE SHEET ( \$ mn)

Year End: 30 June	2011 (A)	2012 (E)	2013 (E)	2014 (E)
Cash	6.3	6.6	7.8	9.6
Receivables	5.2	6.0	6.6	6.9
Inventories	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0
<b>Current Assets</b>	<b>11.5</b>	<b>12.6</b>	<b>14.4</b>	<b>16.5</b>
Investments	0.0	0.0	0.0	0.0
Property, Plant & Equipment	1.3	1.1	1.0	1.0
Intangibles (Net)	0.0	0.0	0.0	0.0
Other	1.7	1.8	1.9	1.9
<b>Non-Current Assets</b>	<b>3.0</b>	<b>2.9</b>	<b>2.9</b>	<b>2.9</b>
<b>Total Assets</b>	<b>14.5</b>	<b>15.6</b>	<b>17.3</b>	<b>19.4</b>
Payables	1.6	1.6	1.7	1.8
Borrowings	0.0	0.0	0.0	0.0
Provisions & Other	0.9	0.9	0.9	0.9
<b>Total Liabilities</b>	<b>2.5</b>	<b>2.6</b>	<b>2.7</b>	<b>2.7</b>
<b>Net Assets</b>	<b>12.0</b>	<b>13.0</b>	<b>14.7</b>	<b>16.7</b>
Share Capital	14.7	14.7	14.7	14.7
Reserves	2.5	2.5	2.5	2.5
Retained Profits	-5.2	-4.3	-2.5	-0.6
Outside Equity Int.	0.0	0.0	0.0	0.0
<b>Total Equity</b>	<b>12.0</b>	<b>13.0</b>	<b>14.7</b>	<b>16.7</b>
<b>Total Funds Employed</b>	<b>12.0</b>	<b>13.0</b>	<b>14.7</b>	<b>16.7</b>
<b>Net Debt / (Net Cash)</b>	<b>-6.3</b>	<b>-6.6</b>	<b>-7.8</b>	<b>-9.5</b>

### CASH FLOW ( \$mn)

Year End: 30 June	2011 (A)	2012 (E)	2013 (E)	2014 (E)
Receipts from Customers	17.3	19.8	21.8	22.9
Payments to Suppliers	-15.3	-16.5	-17.4	-17.9
Other	-0.2	-1.0	-1.0	-0.8
<b>Operating Cash Flow</b>	<b>1.8</b>	<b>2.3</b>	<b>3.4</b>	<b>4.2</b>
Capital Expenditure	-0.1	-0.2	-0.2	-0.2
Other	0.0	0.0	0.0	0.0
<b>Investing Cash Flow</b>	<b>-0.1</b>	<b>-0.2</b>	<b>-0.2</b>	<b>-0.2</b>
Proceeds from Issues	0.0	0.0	0.0	0.0
Net Borrowings	0.0	0.0	0.0	0.0
Dividends	-1.4	-1.9	-2.1	-2.3
Other	-0.2	0.0	0.0	0.0
<b>Financing Cash Flow</b>	<b>-1.6</b>	<b>-1.9</b>	<b>-2.1</b>	<b>-2.3</b>
<b>Net Change in Cash</b>	<b>0.1</b>	<b>0.3</b>	<b>1.2</b>	<b>1.7</b>
<b>Cash at End of Year</b>	<b>6.3</b>	<b>6.6</b>	<b>7.8</b>	<b>9.6</b>

<b>Rating:</b>	<b>BUY</b>
<b>Valuation:</b>	<b>\$0.25</b>
<b>Price Target:</b>	<b>\$0.20</b>

### EARNINGS

Year End: 30 June	2011 (A)	2012 (E)	2013 (E)	2014 (E)
Basic EPS ( ¢)	0.8	2.1	2.7	3.1
Adjusted EPS ( ¢)	0.8	2.1	2.7	3.1
EPS Growth (%)	-69.6	151.4	32.9	12.9
DPS ( ¢)	1.2	1.4	1.6	1.7
Dividend Payout (%)	140.3	67.9	58.4	55.0

### VALUATION

Year End: 30 June	2011 (A)	2012 (E)	2013 (E)	2014 (E)
P/E (x)	19.5	7.8	5.8	5.2
EV/EBIT (x)	13.4	4.7	3.2	2.5
EV/EBITDA (x)	10.4	4.4	3.1	2.4
Dividend Yield (%)	7.2	8.8	10.0	10.6
Price to Book (x)	1.8	1.7	1.5	1.3

### RETURNS

Year End: 30 June	2011 (A)	2012 (E)	2013 (E)	2014 (E)
EBITDA Margin (%)	8.8	17.9	21.4	22.7
EBIT Margin (%)	6.8	16.5	20.2	21.7
NPAT Margin (%)	6.5	14.3	17.3	18.6
Return on Assets (%)	8.1	21.0	25.4	25.6
Return on Equity (%)	9.4	21.9	25.7	25.6
<i>Asset Turnover (x)</i>	1.2	1.3	1.3	1.2
<i>Equity Multiplier (x)</i>	1.2	1.2	1.2	1.2

### GEARING

Year End: 30 June	2011 (A)	2012 (E)	2013 (E)	2014 (E)
Net Debt to Equity (%)	N/A	N/A	N/A	N/A
Net Debt to ND + Equity (%)	N/A	N/A	N/A	N/A
Net Debt to EBITDA (%)	N/A	N/A	N/A	N/A
Interest Cover (EBITDA/Net Int.)	N/A	N/A	N/A	N/A
Interest Cover (EBIT/Net Int.)	N/A	N/A	N/A	N/A
Franking (%)	37.0	50.0	50.0	50.0

## Strategic plan (Restructured from April 2011)

- Over the past four years ISS Group has not achieved sustained revenue or profit growth, with revenue ranging from \$17.4 million to \$18.6 million. During FY2011 CEO Richard Pang re-focused the business model with early signs that ISS is in the beginning of a high growth phase. Specifically, the company believes 10-20 percent annual revenue growth is achievable with a revenue target of \$30 million in the next three to five years.
- The key changes from the new strategic plan include a greater focus on direct sales and on customer account management, and increased efficiencies through cross-utilisation of staff and standardisation of processes across all regions. This focus on direct sales has doubled the sales team, with the positive result of a 20 percent increase in customers over the past 12 months.
- ISS established that its past re-seller business model was not working, generally due to a lack of incentives for the partners to actively drive growth. As a result, ISS is no longer using these small re-sellers and is not seeking any further relationships. Schlumberger and KBC are exceptions to this rule and are both important parts of the business going forwards, with ISS supporting them in their sales when required.
- The new strategic plan can be summarised as follows:
  1. Sales and Marketing: Growth of the sales organisation and revenues
  2. Employer of Choice: staff development & retention
  3. Knowledge Management: Leveraging accumulated knowledge
  4. Product/Development Management: Product positioning/technology positioning

## Valuation

- Our DCF valuation is \$0.25, assuming a weighted average cost of capital of 14.2 percent and terminal growth rate of 2.5 percent.
- Our 20 cent price target is applying a 20 percent discount to our DCF valuation. The discount reflects the high risk due to the low market capitalisation and scale of ISS's business. The discount also reflects the execution risk of the restructured business model. This may prove to be conservative as early signs would suggest that the changes made over the past 12 months have set the company up for a period of sustained growth.

## Recommendation

- We are initiating coverage with a Buy recommendation. ISS provides exposure to the very strong level of project activity in oil and gas as well as mining, without taking on commodity pricing risk, and also provides reduced earnings risk through the large exposure to the operating (production) phase of projects.
- While the macro environment is positive, ISS needs to deliver on its new strategic plan and achieve sustainable EPS growth to achieve a re-rating and to remove the large discount to our valuation. ISS is in an industry where consolidation is increasing due to a lack of skilled resources.
- The company is also trading on a very attractive FY2012 dividend yield of 9 percent, with continued strong dividends expected due to the low capital requirements of the business and net cash position.

## BabelFish software product suite

- The BabelFish™ product suite comprises a number of integrated modules that enable operations to capture, validate, analyse and report against business critical data and workflows. BabelFish™ provides an efficient and integral decision-making and problem-solving environment for personal in operations, engineering and business management.

### Description

- ISS Group delivers operational management software solutions to the global oil and gas, mining and manufacturing industries.
- The need for operations to continuously drive for efficiency gains and an in-depth understanding of their complex operational environment requires robust and flexible operational management solutions.
- Companies recognise the return on investment that operational management solutions provide, thus increasing the demand for ISS Group's software solutions. The ability to manage critical business workflows, while providing seamless web-based access to the required operational data from many disparate data repositories, is a key factor in efficient operations.
- The BabelFish product suite is an integrated modular operational management solution that together with ISS Group's world-class delivery capability provides data integration, data modelling, real time visualisation, surveillance and diagnostics, alarm/event reporting, loss and availability, data capture, validation and approval, advanced calculations and workflow-based KPIs, all of which are prerequisites for remote operations environments.
- As such companies are able to implement the specific modules they require and leverage the financial outlay in their existing operational, maintenance and enterprise solutions. This reduces cost and adds value to past investments while providing an end-to-end integrated operations environment
- The BabelFish product suite provides a number of web-based solutions that transgress ISS Group's core focus industries. Production surveillance and optimisation, production data management and asset management are the major areas of utilisation.

### The BabelFish product suite includes the following solutions:

- Data integration, data management and real time visualisation
- Production reporting
- Data validation, data approval and publication
- Operations shift log data capture
- Production loss, deferment and utilisation accounting
- Operational envelope event detection, processing, notification and reporting
- Production plan management
- Asset integrity and asset health monitoring

### The BabelFish product suite also provides a number of oil and gas-specific solutions:

- Well testing, well integrity and reservoir management
- Hydrocarbon allocations
- Cargo off take planning
- Gas nominations and balancing
- Shipping data capture and offtake documentation

## Key customers/contracts

- As discussed, ISS key customers include Chevron, BHP Billiton, Woodside, Santos, Rio Tinto, Shell, BG Group, BP, Hess Corporation, Maersk Oil, Petronas and Fortescue Metals.
- The recent contract win of Gorgon (Chevron) is significant, and is likely to open up further growth opportunities for the company.
- The contract for the Victorian Desalination Project is a clear example of the versatility of ISS's software solutions. Although currently the company is more focused on oil and gas, and mining opportunities, there is the potential for ISS to expand further into process manufacturing.

## Key customers

FIG.1: OIL AND GAS, MINING AND MANUFACTURING CUSTOMERS

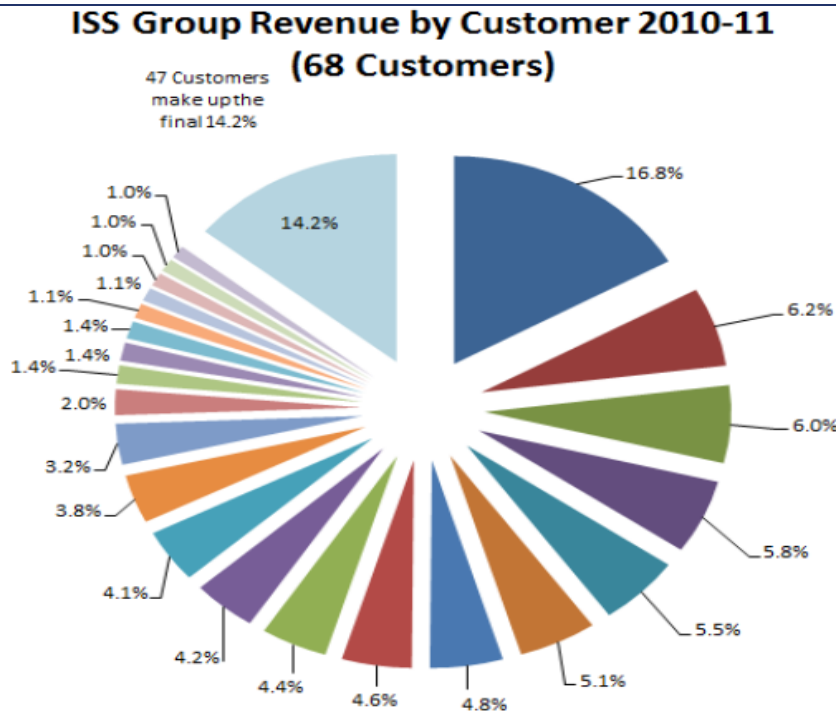


Source: Company presentation

## Customer spread

- The Schlumberger distribution agreement involves periodic payments of \$17 million over five years from May 2008. This means Schlumberger is effectively ISS's largest customer, representing 16.8 percent of FY2011 revenues.
- The second-largest customer is at 6.2 percent of FY2011 revenues, and 47 customers make up the final 14.2 percent.

**FIG.2: 2011 REVENUE BY CUSTOMER 2010-11**



Source: Company presentation

## Market opportunities

- ISS continues to provide operational management solutions to the process industries through software (ISS and third-party products), consulting services (design, implementation and commissioning) and support services.
- Previously as ISS has successfully met the requirements of existing customers, further opportunities have come from word of mouth/reputation. While this is still occurring, the company is now more focused on business development (sales and marketing) with new potential customers to identify opportunities. The more proactive approach has achieved instant results, and is likely to be reflected in strong earnings growth over the next two to three years.
- The Gorgon (Chevron) contract award announced on 19 January 2012 is significant in both its revenue contribution (\$2.4 million in the next 12 months) and the demonstration of ISS's high quality product offering. The contract win is also likely to increase awareness amongst other large LNG project owners, especially considering Chevron's excellent reputation within the industry.
- Management is focused on continuing to increase maintenance and support annuity streams, building on existing relationships and pursuing new customer relationships.
- ISS has an excellent record of customer retention, with many operational relationships now more than 10 years old. This demonstrates the high quality of ISS software products and service, as well as the ability to create value for ISS clients. The renewed sales focus and the large industry growth (mining, oil & gas) has given ISS a very long list of opportunities to pursue.

## Key earnings assumptions

- With ISS's new focus on sales growth the first step has been to increase the number of sales staff, with an ongoing target of 8-10 percent of group employees to be sales-focused.
- As ISS has gained traction and increased its customer base by 20 percent the next step has been to increase the technical staff. Current staff numbers are at approximately 130, with the fixed cost base set-up to handle approximately 160 employees.
- Cost base:** We are assuming the percentage revenue mix between project, licence and annuity (maintenance and support) will stay relatively in line with 2011 (see the table below). Based on this revenue mix, and current utilisation levels we are forecasting a \$350k cost increase (labour) for each \$1 million of additional revenue.

**FIG.3: ISS'S FY11 REVENUE MIX**

Divisional Revenue	FY11	% of Revenue
Project revenue	9,205mn	52.2%
License revenue	4,294mn	24.4%
Maintenance & Support	3,584mn	20.3%
other income	548mn	3.1%
<b>Total Revenue</b>	<b>17,631mn</b>	

- Management is targeting 10-20 percent annual revenue growth, with a three to five-year revenue target of \$30 million. Our base case doesn't assume this level of growth, hence the scenarios below display the valuation impact if management's growth targets are achieved. In all three scenarios it is only the revenue growth that we are changing, and the margin assumptions are as explained in the "cost base" above. Our DCF valuations are assuming a 14.2 percent cost of capital.
- Low Scenario (DCF valuation of \$0.12):** Considering ISS's excellent track record in retaining customers and the fact that a majority of revenues are exposed to the operating phase of projects, the low scenario would only occur in a very serious macro downturn (more severe than the GFC).
- Base Case (DCF valuation of \$0.25):** We are confident that the 20 percent increase in customers over the past year will result in a strong FY2012 result, and our FY2013/FY2014 forecasts are conservative. However, given that ISS has not achieved revenue growth for the past four years, we are waiting for more signs that the strategic plan is being successfully implemented before increasing our forecasts.
- High Case (DCF valuation of \$0.41):** The 20 percent revenue growth would result in ISS achieving its \$30 million revenue target in FY2014.

**FIG.4: THREE REVENUE GROWTH SCENARIOS AND IMPACT ON VALUATION**

Scenario (Revenue Growth)	FY12	FY13	FY14	FY15 (Onwards)	DCF Valuation
Low	10%	-5%	-5%	2.5%	\$0.12
<b>Base</b>	<b>15%</b>	<b>10%</b>	<b>5%</b>	<b>2.5%</b>	<b>\$0.25</b>
High	20%	20%	20%	2.5%	\$0.41

## Competitors

- ISS's main external competitors are large multinational information technology, software and consultancy companies including Honeywell, Aspen Technology, Halliburton and Mincom.
- An advantage ISS has over its larger competitors is the flexibility to provide unique solutions that meet individual clients' needs. ISS also has an exceptional track record of successfully implementing software solutions in the oil and gas space. The track record clearly demonstrates tangible value creation for customers via more efficient operations and other savings from an enhanced ability to track data and complete detailed analysis.

- While Schlumberger is a customer for the BabelFish Server product (distribution agreement), it is a competitor in regard to some of the other ISS software solutions.
- ISS can on occasions compete with internal IT departments of the large oil, gas and mineral processing companies. However, with the legacy of the global financial crisis and the threat of new taxes (levies), major companies are seeking to lower costs and conserve internal resources through outsourcing to proven specialists.

## Key risks

- **Macro:** A change in the current strong outlook for oil and gas and mining capital expenditure is a risk for ISS. This risk is partially insulated by ISS's high exposure to the operating phase of projects rather than the construction phase.
- **Customer shift:** Currently, large resource companies are trending towards outsourcing their IT systems. However, any shift in this trend would clearly hamper ISS's growth potential.
- **Competitors:** Development of new and upgraded IT products would provide stronger competition for ISS and result in it having to spend capital to upgrade its own systems.
- **Currency:** With overseas expansion, earnings obviously become exposed to the fluctuations in key currency exposures.
- **Labour:** The ability to attract and retain the skilled labour required to achieve expansion plans is another risk.

## Financial performance

- Over the past four years ISS revenue has been flat at around \$18 million (FY2011 of \$17.4 million including a negative \$1 million currency impact). The first-half 2012 result is likely to be the beginning of a sustained growth phase due to the execution of the new strategic plan.
- During the peak of the GFC in FY2009, ISS incurred a minor fall in revenue to \$18.0 million and a net loss after tax of \$3.0 million (included in the loss was an increase in the bad debt provision of \$0.3 million). In FY2009, ISS also took the conservative step of fully writing down the value of the company's only intangible asset (goodwill) by \$8.1 million, which was a non-recurring non-cash item. The write-down of goodwill was taken due to the inherent uncertainty regarding future economic conditions at the time.
- In FY2010 ISS rebounded solidly from the impact of the GFC and downturn in global economic conditions. While conditions remained difficult, ISS increased sales revenue by 3.3 percent to \$18.6 million that fiscal year and strongly returned to profitability with NPAT of \$3.6 million. The highlight of the year was ISS's solid operating performance in Australia.

**FIG.5: ISS'S RESULTS SINCE FY06**

	FY06	FY07	FY08	FY09	FY10	FY11
Operating Revenue	\$7.7mn	\$9.2mn	\$18.1mn	\$18.0mn	\$18.6mn	\$17.4mn
Growth	60.40%	19.50%	96.70%	-0.60%	3.30%	-6.5%
EBITDA	\$1.3mn	\$1.1mn	\$4.4mn	(\$2.1mn)	\$3.6mn	\$1.5mn
Margin	16.90%	12.00%	24.30%	N/A	19.40%	8.8%
NPAT	\$1.5mn	\$0.9mn	\$3.8mn	(\$3.0mn)	\$3.6mn	\$1.1mn
Margin	19.50%	9.80%	21.00%	N/A	19.40%	6.3%

- **FY2011:** ISS experienced a slow Q1 in FY2011, however recovered for the remaining three quarters. The recovery was achieved despite the strengthening Australian dollar and its impact on group revenues. The group's focus on a clear sales model, long-term customer engagement philosophy and global operational efficiencies resulted in a net profit of A\$1.1 million.

**FIG.6: ISS'S RESULTS OVER THE PAST YEAR**

	1Q11(A)	2Q11 (A)	1H11(A)	FY11(A)	1Q12(A)
Operating Revenue	\$2.8mn	\$7.1mn	\$9.9mn	\$17.4mn	\$2.8mn
EBITDA	(\$1.5mn)	\$2.8mn	\$1.5mn	\$1.5mn	(\$0.95mn)
Margin	N/A	39.40%	15.20%	8.80%	N/A
PBT	(\$1.5mn)	\$2.8mn	\$1.3m	\$1.4mn	(\$0.96mn)
Margin	N/A	39.40%	13.10%	8.00%	N/A

- **1Q12:** Sales in 1Q12 increased 1 percent versus 1Q11. However, cost of sales (labour) was up 17 percent as a result of hiring more employees ahead of new project commencements and in line with the company strategy of focusing on medium-term revenue growth. Selling, general and administration costs remained comparable. Working capital remained strong at \$7.1 million. As usual the first quarter is the weakest sales period, when many customers are formulating IT budgets for the next 12 months. Management is expecting a strong second quarter and remainder to the FY2012 year.
- **Outlook:** ISS is operating in an attractive macro environment where there is record demand for IT products and services from the oil and gas, and mining sectors. The resources capex outlook in Australia remains strong with ISS also positioned to leverage from growth in India, China and south-east Asia.

### Regional revenues

- **Australia/Asia:** There are very strong growth opportunities and staff numbers have recently been increasing in both locations.
- **Europe:** Current macro weakness in Europe is affecting demand for ISS services, but the region remains in the company's long-term growth plans.
- **USA:** The few staff in the USA are primarily focused on servicing ISS's Schlumberger partnership.

**FIG.7: ISS'S REVENUE BY REGION**

Region	FY11 Revenue
Australia	62%
Asia	24.3%
Europe	11.9%
USA	1.9%

### Working partnerships

- As previously discussed the smaller re-seller partner model was not successful. However, both the Schlumberger and KBC agreements are important partnerships for ISS.
- In May 2008, Schlumberger Limited (NYSE: SLB) formed a partnership alliance with ISS. Under the US\$15.5 million distribution contract, Schlumberger was granted exclusive rights to market BabelFish in the upstream oil and gas industry. ISS itself receives guaranteed payments relating to the contract on an annual basis (the first half of each financial year).
- Schlumberger is the world's leading oilfield services company, supplying technology, information solutions and integrated project management to the oil and gas sector. It has annual revenue of approximately US\$22 billion and annually spends more than US\$800 million on information technology research and development. Schlumberger signed the contract with ISS on the basis that the BabelFish product complements the existing Schlumberger Information Solutions production operations offerings.
- ISS is continuing to work closely with Schlumberger in the development of upstream oil and gas opportunities. Recently, ISS contributed extensively to the successful completion of several key projects. ISS noted in early 2H11 that it is "anticipating further licence sales via Schlumberger which we believe will further cement our relationship with a key partner and provide additional maintenance revenues". During 1H11, Schlumberger achieved sales of its Avocet Surveillance software in amalgamation with BabelFish to both Maersk Oil and Cairn Energy India. BabelFish together with the Avocet production data management, surveillance, analysis and modelling solutions provides a web-based framework for oil and

gas production engineers to monitor operational systems. The Schlumberger-ISS distribution contract concludes in 1H13 (with approximately US\$6.0 million to be received by ISS during the remaining term of the contract).

- We anticipate significant discussions between the two companies in late FY2012. ISS is planning ahead to be able to achieve growth with or without the Schlumberger partnership. Nevertheless, with Schlumberger comprising approximately 16 percent of ISS's earnings, it is effectively ISS's largest customer and thus re-signing the contract would provide earnings security. If the agreement is not re-negotiated we believe ISS is well placed to market itself to the key upstream hydrocarbons customers. A final possibility is that Schlumberger may look to permanently acquire the "BabelFish" Server Module (data integration and visualisation) for the upstream hydrocarbons market.
- It is important to note that Schlumberger exclusive rights to the up-stream oil & gas market is only for the "BabelFish" Server Module, and ISS is free to market other "BabelFish" software products to the up-stream industry.
- In November 2009, KBC Advanced Technologies plc (a UK-based IT and consultancy company) and ISS signed a non-exclusive, multi-year global agreement to jointly provide performance management solutions to the refining and petrochemical industry. The aim of the agreement is to combine KBC's refinery and petrochemical process consulting with ISS's production and integration software for the mutual benefit of both companies.

## Balance sheet

- ISS has a very strong balance sheet with \$7.1 million in working capital as of Q1 FY2012, no debt and no intangible assets. The strong balance sheet enables capacity to continue paying dividends, focus on expansion and manage through any periods of weakness.
- Annual capital expenditure requirements are low (less than \$0.2 million) and are related to IT hardware.
- During FY2011, ISS completed an on market buyback where it was initially stated that up to 13.5 million shares would be acquired. In June 2011, ISS announced that it was closing the buyback due to an assessment that its cash reserves were better utilised to fund initiatives aimed at expanding the group's capabilities. From December 2010 to April 2011 1.557 million shares were acquired at an average price of 12 cents per share.

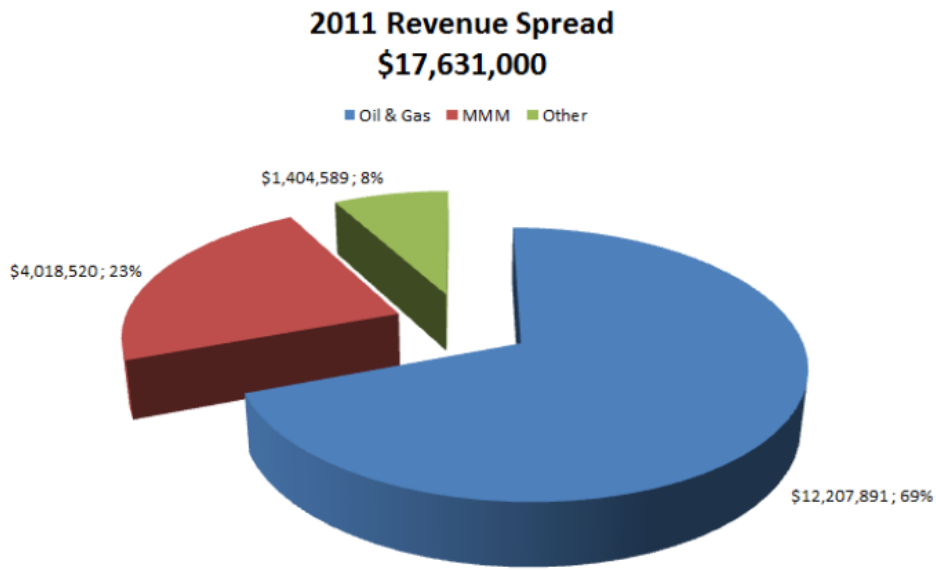
## Management

- Richard Pang was appointed as ISS's CEO in August 2010, and then manager director as well on 1 July 2011. His appointment reflects the importance of Asia and the Middle East to ISS's future growth.
- Mr Pang commenced with ISS in 2002, starting as a product developer in Australia and progressing to project management, then business development manager of Asia/Middle East and then regional manager for Asia and the Middle East.
- In a five-year period Mr Pang developed the Singapore branch from start-up – it is now the group's most profitable branch.
- Shane Attwell was the founding MD of ISS in 1995 and remains as a non-executive director. Mr Attwell has 20 years' experience with process plant information systems and optimisation.

## Revenue spread

- As can be seen in the chart below oil and gas comprises approximately 70 percent of ISS revenues, with mining at 23 percent.
- ISS software can be applied to a number of other manufacturing process companies. However, the current oil and gas and mining focus is a reflection of the high industry margins currently being achieved and the large opportunities for efficiency gains.

**FIG.8: ISS'S 2011 REVENUE SPREAD**



Source: Company presentation

## Appendix 1

**FIG.9: MANAGEMENT AND BOARD**

- 
- CEO : Richard Pang
  - Regional Branch Managers:
    - Australia : Clifford Lang
    - Asia / M.East : Jeremy Smith
    - Europe : John Purnell
    - Americas : Lee Timmins
  - Board:
    - Evan Cross (Non Executive Chairman)
    - Richard Pang (Managing Director)
    - Shane Attwell (Non Executive Director – Founder)
    - Ian Spence (Non Executive Director)
- 

*Source: Company presentation*

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