TELEUNIT – FULL YEAR RESULTS 2004

FY results 2004 | **30 March 2005** | **TLU.L** | **23.75p** | **BUY (retained)**

Key Data

Market Cap €m/£m	64.2/44.3
Enterprise Value €m/£m	61.2*/42.3*
Shares in Issue m	186.7
Est Free Float %	27.2
Gearing %	Cash
Net (Debt)/ Cash €m/£m	3.0*/2.1*
Next Results (Int)	Sep 05

Description

Italian telecoms operator

Research

Roger Tejwani
020 7847 0380
roger.tejwani@danielstewart.co.uk

David Johnson
020 7847 0386
david.johnson@danielstewart.co.uk

James Hollins
020 7847 0386
james.hollins@danielstewart.co.uk

Ian Berry
020 7847 0387
ian.berry@danielstewart.co.uk

Sales

Tom Jenkins
020 7847 0370
tom.jenkins@danielstewart.co.uk

Daniel Willmott
020 7847 0364
daniel.willmott@danielstewart.co.uk

Sebastian Wykeham
020 7847 0362
sebastian.wykeham@danielstewart.co.uk

Alex Davies
020 7847 0359
alex.davies@danielstewart.co.uk

Daniel Stewart & Company Plc
48 Bishopsgate
London
EC2N 4AJ
Tel: 020 7374 6789
Fax: 020 7374 6742
www.danielstewart.co.uk

Management has exceeded our profit expectations for FY2004, despite difficult trading conditions, including price capping in Premium Access Services in 2003 and a delay by the Italian Ministry in auctioning the remaining Wireless Local Loop licences. Revenues increased 37% year-on-year even with lower than planned investment and operating profit increased 65%, with the operating margin rising from 9.0% to 10.9%. Whilst we have reduced our pre-tax profit forecasts for 2005 and 2006 to exclude development of WLL business beyond Umbria and Tuscany, we still expect top line growth of 49% and 33% respectively. Moreover, a lower than expected tax charge in 2005 keeps our post-tax profit expectations unchanged. Our revised forecasts put Teleunit (TLU) on a current year P/e of 12.5x, falling to 6.6x in 2006. This is at a discount to the UK Communications Services sector's 17.5x and 14.7x respectively, whose constituents are not witnessing similar growth in profits as TLU.

Year To: December	Turnover €'000	DS&C PBT* €'000	DS&C EPS** €	EV/EBITDA X	PER X	DPS p	Yield %
2003 A	44,271	3,842	3.38	12.3	10.2	0.0	0.0
2004 A	60,767	5,745	2.89	7.4	11.9	0.0	0.0
2005 E	90,667	6,539	2.76	6.2	12.5	0.0	0.0
2006 E	120,732	12,235	5.19	3.5	6.6	0.0	0.0

* Pre amortisation and exceptionals
** Weighted and fully diluted

- FY2004 revenues came in at €60.8m, up 37% on 2003, compared to our forecast €64.0m, the shortfall being largely due to delays by the Telecoms Ministry in auctioning the Tuscany licence and the loss of Fixed Line customers through Carrier Pre Selection, with some competing operators pricing aggressively. The drag on both these divisions also moved gross profit post depreciation below our forecast €14.8m to €13.6m (2003: €8.6m), although it is worth noting that the pre paid calling cards business performed well, with divisional gross margins of 25% compared to our forecast 12%**.** This helped to maintain group gross margin post depreciation close to forecast (actual 22.3% against forecast 23.1%), even with lower than expected revenues from the high margin WLL business.

- Operating profit came in at €6.6m (2003: €4m), compared to our forecast €6.2m, with the 10.9% margin above our expectations, helped by lower infrastructure costs (€669k) and lower sales commissions (€887k) resulting from the delayed launch of WLL operations in Tuscany. A higher than expected interest charge from a derivatives transaction led to a clean pre-tax profit of €5.7m, below our expected €5.8m. Nevertheless, tax incentives for Italian companies listing on overseas exchanges produced a lower than forecast tax charge - €0.8m versus €1.4m - with the combined effect giving retained profit of €4.8m, higher than our forecast €4.3m. *Net cash was €3.0m, however, this excludes €6.8m of near cash, which was invested in monetary assets.

- We have reduced our pre-tax forecasts for 2005 and 2006 (see figure 8). We now expect 2005 revenues of €90.7m (compared to €94.1m previously) and clean pre-tax profits of €6.5m compared to €7.6m previously. This still represents a 14% upside to 2004 and a 70% increase on 2003. However, we also now expect a lower tax charge to keep our post-tax profit expectations unchanged. Fully diluted 2005 EPS is forecast at 2.76 cents, however this is impacted by the dilutive effect of the placing in 2004. On a like for like basis, EPS is 3.10p, a 7% increase on 2004. Investors should note that these revisions are highly conservative, given that monthly invoicing has increased steadily since the June interims and our forecasts assume no further development of WLL beyond Tuscany. Given the investment in new infrastructure and people during H1 and the time needed to scale up new business lines, we would expect to see a greater weighting of the full year results in H2.

- TLU is trading on a current year P/e of 12.5x and EV/Ebitda of 6.2x. Our forecast FY06 weighted and diluted P/e and EV/Ebitda are 6.6x and 3.5x respectively. The UK Communications Services sector is currently trading on a 2005 PER of 17.5x, falling to 14.7x in 2006. *Investors should note that if the €6.8m monetary assets are included as cash, TLU trades on a current and prospective EV/Ebitda of 5.5x and 3.1x respectively.

Daniel Stewart & Co acts as broker and nominated advisor to Teleunit SpA.

Divisional analysis

I Wireless Local Loop
II Premium Access Services
III Fixed Line
IV Pre paid calling cards and wholesale
V Five digit

I. Wireless Local Loop (WLL)

FY2004 divisional revenues of €619k were below our initial expectations of €1.7m, resulting from delay by the Italian Telecommunications Ministry in auctioning the WLL licences. This delay left the company with an under-utilised sales network, idle infrastructure and several customers in Tuscany, who had already signed up and were awaiting the service.

In response to this, management signed an agreement post period-end with Tuscan telecoms operator, Wirlink S.r.l., under which TLU can buy capacity from Wirlink's WLL license in Tuscany. Wirlink acquired this during the previous auction in 2002, but is not planning to expand aggressively into WLL. The agreement is for 18 years and covers over half the total available frequency in Tuscany, sufficient to cover all the areas originally envisaged in the business plan.

The cost of the agreement is €425,000, payable in three tranches during H1 2005, considerably below the expected cost of €800,000 we forecasted if acquisition had been made in the auction.

Our 2005 and 2006 WLL forecasts include contribution solely from Umbria and Tuscany, although at higher margins than originally forecast, reflecting firmer bandwidth pricing to customers than envisaged. Whilst the Telecommunications Ministry has recently announced the tender call for the regional frequencies, indicating that the auction should commence soon, management is taking a wait and see approach. This is driven both by the availability of new alternative last mile technologies – ADSL VoIP, which management is already using, and Wi-Max, which we discuss below, as well as a 12 month auction process, during which TLU can bid for a licence at any point, so long as there are fewer bidders than licences.

Investors should note that Wi-Max, a frequency being used in the wholesale market in the UK, Denmark, Ireland, Norway, Austria and Germany to provide Voice and ADSL, could represent a credible alternative last mile solution to WLL. It operates on a lower 3.5 Ghz (compared to 26.0 Ghz for WLL), but without the line of sight requirement, and with the ability to transmit over a distance of 30km, compared to 5km for WLL. Installation equipment for WIMAX currently costs approximately €400, compared to €2,300 for WLL, and this would likely decrease as the new technology becomes more accessible.

We appreciate that new, cheaper to manufacture technology may enter the market – in Italy the Wi-Max frequency is currently for military use only but this may be commercialised. The Italian Telecommunications Ministry is due to clarify Wi-Max availability for the Italian wholesale market in Summer 2005. If approved, such a solution could be used instead of WLL in Emilio and Marche or complementary to existing WLL infrastructure in Umbria and Tuscany by "piggybacking" on WLL base stations to plug gaps in the existing industrial areas and/or to cover the city residential market.

Figure 1: Wireless Local Loop – historical and forecast

Year end December	2003 a €'000	2004 a €'000	2005 f €'000	2006 f €'000
Revenue	**115.0**	**619.0**	**2,938.5**	**8,421.5**
% change		*438.3%*	*374.7%*	*186.6%*
Cost of sales	**-26.0**	**-216.0**	**-532.3**	**-1,616.2**
Gross profit	**89.0**	**403.0**	**2,406.2**	**6,805.3**
Gross margin	**77.4%**	**65.1%**	**81.9%**	**80.8%**

Teleunit, Daniel Stewart

II. Premium Access Services

The strong growth in Premium Access Services witnessed at the interim stage has continued in H2. Revenues for December alone were €4.6m, more than double the prior year, helped by a new divisional manager from FastWeb, and a strong performance from Starline, a Rome-based provider of premium rate telephony voice content, in which TLU acquired a 30% stake during the period. As part of this acquisition, Starline agreed to progressively migrate its premium access numbers traffic to TLU until the end of 2007 at the earliest. Over 70% of Starline's traffic is currently passing through TLU, with management expecting this to increase to 85% during H1 2005. Starline added €1.2m to revenues and €200k to profits during 2004.

Nevertheless, full year divisional revenues were slightly below our expectations at the interims due largely to one Service Centre losing a key webmaster (companies that advertise numbers and content on the web), which saw it's daily traffic minutes fall from 32,000 to 15,000 during the year. This had an adverse €1.7m impact on TLU's revenues.

TLU's customers are the Service Centres, thereby offering limited control over end users. However, dependence on some of the larger Service Centres is being diluted through agreements with a number of smaller ones, which should increase visibility.

Figure 2: Premium Access Services – historical and forecast

Year end December	2002 a €'000	2003 a €'000	2004 a €'000	2005 f €'000	2006 f €'000
Total VAS revenue	**30,384.0**	**35,376.0**	**42,534.0**	**53,135.8**	**56,740.5**
% change		16.4%	20.2%	24.9%	6.8%
Voice 899 revenue (€ 000)	0.0	900.0	0.0	0.0	0.0
Internet 899 revenue (€ 000)	30,384.0	34,476.0	0.0	0.0	0.0
Fixed Line	0.0	0.0	35,554.5	44,728.1	47,651.0
Mobile services	0.0	0.0	3,674.2	4,284.8	4,760.5
Satellite & Internationals	0.0	0.0	3,305.3	4,122.9	4,329.0
Cost of sales	**-26,225.0**	**-29,621.0**	**33,431.0**	**44,103.1**	**47,094.8**
Voice cost of sales	0.0	-800.0	0.0	0.0	0.0
Internet cost of sales	-26,225.0	-28,821.0	0.0	0.0	0.0
Fixed Line	0.0	0.0	27,742.7	37,131.2	39,524.3
Mobile services	0.0	0.0	3,097.9	3,480.4	3,904.4
Satellite & Internationals	0.0	0.0	2,590.4	3,491.5	3,666.0
Gross profit	**4,159.0**	**5,755.0**	**9,103.0**	**9,032.6**	**9,645.7**
% change		38.4%	58.2%	-0.8%	6.8%
Voice gross profit	0.0	100.0	0.0	0.0	0.0
Internet gross profit	4,159.0	5,655.0	0.0	0.0	0.0
Fixed Line	0.0	0.0	7,811.8	7,596.8	8,126.7
Mobile services	0.0	0.0	576.3	804.4	856.0
Satellite & Internationals	0.0	0.0	714.9	631.4	663.0
Gross margin %	**13.7%**	**16.3%**	**21.4%**	**17.0%**	**17.0%**
Voice gross margin	-	11.1%	-	-	-
Internet gross margin	13.7%	16.4%	-	-	-
Fixed Line	-	-	22.0%	17.0%	17.1%
Mobile services	-	-	15.7%	18.8%	18.0%
Satellite & Internationals	-	-	21.6%	15.3%	15.3%

Source: Teleunit, Daniel Stewart

The historical divisional split has been changed from 2004 with "voice 899" services consolidated into both "Fixed Line" and "Mobile Services" and "Internet 899" consolidated into "Fixed Line". Our forecasts for "Fixed Line" therefore represent both Internet traffic and voice traffic from fixed line, and our "Mobile" services forecasts relate to voice traffic from mobile telephone users only. "Satellite and Internationals" represent specific numbers, which connect to Satellite or are international.

III. Fixed Line

Whilst TLU's Fixed Line business grew in 2004, this was slower than expected, influenced by Carrier Pre Selection, which allows telephone users to choose between competing carriers.

VOIP opportunity

However, rather than stand still, management has developed a new VoIP service through ADSL. The service is most suited to SoHo (small office, home office) and smaller SME customers and gives TLU greater presence in the SME market through both WLL and ADSL. We expect this service to grow the top line strongly.

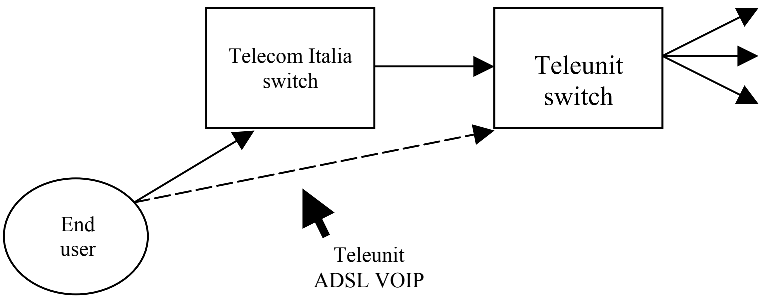
The service was launched in mid January, in line with advances in VoIP technology and greater accessibility to Telecom Italia's switches. This greater accessibility has been made possible through long distance "lining", whereby telecom operators collecting a sufficient level of fixed line voice traffic over long distances can ask Telecom Italia to provide a dedicated long distance line connection for fixed line voice flows. This avoids the need to position a switch next to a Telecom Italia switch, the cost of which had limited TLU to interconnecting with three out of Telecom Italia's 33 switches. Outside of these three TLU was reliant on third party carriers to collect voice traffic, pass it to Telecom Italia, who would then pass it onto TLU.

However, "long lining" enables TLU (which has reached a sufficient size to request this) to connect with each of Telecom Italia's 33 switches at low cost, and we expect this to be completed in June of the current year. Once done, management will be able to offer the VOIP ADSL service throughout Italy from H2.

- **Legacy system**

Under the legacy system Telecom Italia had to collect the call and then pass it to TLU. The call was then terminated with Telecom Italia or another operator, depending on which was cheaper. TLU paid Telecom Italia for call collection and again for termination unless with a different operator. This is currently set at €0.007 per minute for collection and termination nationally, with termination overseas or to a mobile higher.

Figure 3: ADSL VOIP for call collection and termination



- **New system**

The new service allows customers subscribing to the Internet through ADSL to receive a VoIP telephone or CPE (known as "Lead IP") depending on how many telephones are required, up to a maximum of eight. Telephone calls can then be made in the normal way, but over ADSL, bypassing Telecom Italia's last mile connectivity.

TLU collects the call through a dedicated ADSL line, thereby avoiding the €0.007 per minute collection cost from Telecom Italia, and terminates it in the normal way through the copper wire. A proportion of the cost savings can be passed back to the customer, who in any case can save Telecom Italia's monthly subscription charges by switching contract to TLU.

The ADSL line offers guaranteed bandwidth up to 256 kbps, depending on how many telephones the customer operates, with each telephone requiring 15 kbps for transmission over the Internet. The price Telecom Italia can charge for call termination is currently set in an official list and cannot be indiscriminately applied. Moreover, Telecom Italia (as the main provider of ADSL in Italy) is obliged to allow competition in the wholesale market.

TLU charges users €130 for installation of the "Lead IP". Monthly subscription for the customer depends on the amount of bandwidth required. Each system costs TLU €600 to manufacture and €100 to install.

We expect this new service to rejuvenate the divisional top line at high margins. The key advantages of this service for customers are:

- The ability to bypass Telecom Italia's last mile connectivity, thereby saving costs;
- Exceptional call quality and reliability - unlike calls made through a PC, customers using TLU's VoIP receive guaranteed bandwidth with traffic being terminated on traditional copper wire;
- Customers do not need to change their existing telephone number to use the service and calls can be made through a normal home telephone in the usual manner;

From TLU's side, the main advantages of this service are:

- Customers sign up for a minimum two-year contract and cancel their contract with Telecom Italia, thereby becoming a captive customer of TLU for voice and Internet services. This will reduce the customer volatility witnessed in the Fixed Line business through Carrier Pre Selection;
- Sales can be made using existing spare capacity in the Fixed Line sales force, sweating the overhead more effectively.
- TLU's ADSL VoIP is not expected to cannibalise revenues from WLL. Whilst it is sufficient to support both data and voice, it has a lower bandwidth than Wireless Local Loop (WLL) and can serve a maximum of eight telephones, compared to 30 under WLL.

Management expects to have signed up 4,600 new VOIP customers by the end of 2005, which would give approximately €5m in incremental revenues. Approximately 270 customers have been signed up in the first month.

The service can also be extended at low cost to residential customers. This would require installation of an IP telephone (cost €50), which could be connected to the ADSL line through an ADSL router (cost €30). We forecast that residential users will comprise €960k of the €5m forecast.

POS systems

TLU is also piloting a new service for credit card transactions in the retail market. The majority of credit card payments today are made via PoS machines, which dial a telephone number for authorisation. This is subject to national call rates e.g. €10-12 cents per minute, which are borne by the retailer. Whilst the individual retailer has no pricing power with Telecom Italia, TLU is a national carrier and can buy capacity at cheaper rates, generating cost savings, which can then be passed back to the retailer.

Currently Telecom Italia provides the telephone number and receives the full revenues of the call, with the bank, which provides both the credit card and the PoS system foregoing any proceeds. An alternative would be for TLU to provide the telephone number, reducing the amount the retailer pays with a portion of the saving being returned to the credit card and PoS system provider.

Management has successfully completed a trial with an Italian bank, which owns 25,000 PoS systems deployed in 25,000 different retailers. This may lead to a formal agreement in future, although we exclude any contribution from this business in our forecasts in figure 4 below. Should such business be developed, investors should note that the bank is part of a much larger group, with an estimated 250,000 PoS systems in the market.

Figure 4: Fixed Line - historical and forecast

Year end December	2001 a €'000	2002 a €'000	2003 a €'000	2004 a €'000	2005 f €'000	2006 f €'000
Fixed line revenue	**5,245.0**	**7,106.0**	**7,816.0**	**7,926.0**	**12,555.3**	**16,112.7**
% change		35.5%	10.0%	1.4%	58.4%	28.3%
Traditional Fixed Lines	5,245.0	7,106.0	7,816.0	7,926.0	7,488.3	6,502.2
ADSL VoIP	-	-	-	0	4,106	7,635
Telephone VoIP	-	-	-	0	961	1,976
POS Banks	-	-	-	0	0	0
Cost of sales	**-3,122.0**	**-4,090.0**	**-5,147.0**	**-5,121.0**	**-5,152.4**	**-7,234.5**
% change		31.0%	25.8%	-0.5%	0.6%	40.4%
Gross profit	**2,123.0**	**3,016.0**	**2,669.0**	**2,805.0**	**7,402.9**	**8,878.2**
% change		42.1%	-11.5%	5.1%	163.9%	19.9%
Traditional Fixed Lines	2,123.0	3,016.0	2,669.0	2,805.0	3,803.1	3,302.3
ADSL VoIP	-	-	-	0.0	2,823.2	4,043.7
Telephone VoIP	-	-	-	0.0	776.6	1,532.2
POS Banks	-	-	-	0.0	0.0	0.0
Gross margin %	**40.5%**	**42.4%**	**34.1%**	**35.4%**	**59.0%**	**55.1%**
Traditional Fixed Lines	40.5%	42.4%	34.1%	35.4%	50.8%	50.8%
ADSL VoIP	-	-	-	-	68.8%	53.0%
Telephone VoIP	-	-	-	-	80.8%	77.6%
POS Banks	-	-	-	-	-	-

Source: Teleunit, Daniel Stewart

IV. Pre-paid calling cards and Wholesale

Installation of 300 pre-paid calling card PoS systems with tobacconists and newsagents by the year-end was below management's expectations of 2,000. These revenues were not, however, part of our original forecasts and numerous alternative routes to market such as travel agents and supermarkets could be exploited in future.

Management has also commenced selling national and international prepaid traffic to the wholesale market (Licensed operators, international carriers, resellers, ISPs). We believe that there are numerous opportunities, which the company with its national infrastructure, technical advantage and high service levels can capitalise on. A dedicated team has been hired from another Italian operator, to focus on developing the services highlighted in figure 5.

Figure 5: Teleunit Wholesale market services

Service	Description
White Label Traffic Collection	Collection of fixed and/or mobile network traffic in Italy and/or abroad via a toll free number assigned to the customer
White Label Carrier Selection	Collection of fixed and/or mobile network traffic in Italy using Teleunit's Carrier Selection code
Standard Voice Traffic Termination	Standard voice traffic termination for carriers and switched resellers at an optimised price and quality
High Quality Voice Traffic Termination	Similar to standard voice traffic termination, except via uncompressed routes to give unrestricted 64k bearer capability
Switchless Code Sharing	For customers with Calling Line Identifiers, Teleunit can handle the call until termination
Pre paid Switchless Code Sharing	Similar to switchless code sharing, except traffic is prepaid
PIN service	Provision of PIN numbers sold through resellers enabling customers to dial within Italy and/or from abroad from any access telephone using an access number and PIN

Source: Teleunit

Our forecasts for 2005 show divisional growth below our original expectations, reflecting the recent termination of business with a large customer, who is unwilling to pay in advance.

Figure 6: Pre-paid calling cards and wholesale - historical and forecast

Year end December	2003 a €'000	2004 a €'000	2005 f €'000	2006 f €'000
Total revenue	**964.0**	**9,531.0**	**16,218.2**	**28,294.2**
% change		888.7%	70.2%	74.5%
Pre-paid phone cards	911.0	0.0	0.0	0.0
Phone centres	53.0	0.0	0.0	0.0
POS	0.0	4,149.4	2,684.4	10,503.4
Direct sales	0.0	5,381.6	13,533.9	17,790.8
Cost of sales	**-855.0**	**-7,101.0**	**-13,299.0**	**-23,767.2**
Pre-paid phone cards	-808.0	0.0	0.0	0.0
Phone centres	-47.0	0.0	0.0	0.0
POS	0.0	-3,058.9	-2,339.9	-9,082.0
Direct sales	0.0	-4,042.1	-10,959.1	-14,685.2
Gross profit	**109.0**	**2,430.0**	**2,919.3**	**4,527.0**
% change		2129.4%	20.1%	55.1%
Pre-paid phone cards	103	0.0	0.0	0.0
Phone centres	6	0.0	0.0	0.0
POS	0	1,090.5	344.5	1,421.4
Direct sales	0	1,339.5	2,574.8	3,105.6
Gross margin %	**11.3%**	**25.5%**	**18.0%**	**16.0%**
Pre-paid phone cards	11.3%	-	-	-
Phone centres	11.3%	-	-	-
POS	-	26.3%	12.8%	13.5%
Direct sales	-	24.9%	19.0%	17.5%

Source: Teleunit, Daniel Stewart
Note: Pre paid phone cards have been reclassified under "POS" from 2004 and Phone centres reclassified under "Direct Sales" from 2004

V. Five-digit services

The delay from September to November 2004 in the rollout of five-digit services was outside of TLU's control, with partners such as radio stations and football teams slow to advertise the service. FY2004 revenues, therefore, fell below our expectations at the half-year stage.

Advertising

Levels of advertising drive subscription levels and management has started to advertise its five-digit service through a variety of mediums, each of which has an identifiable channel so that management can analyse its effectiveness and target particular mediums effectively on an ongoing basis.

- **Television**
  Following a recent successful trial on MTV, management is now starting to advertise in earnest on MTV and Italia 1 – an Italian channel with a peak viewing audience of 3.5m. The adverts will be broadcast until the middle of May and will cost TLU €700k. Responses from Telecom Italia's fixed line customers have been encouraging so far. Whilst television advertising is expensive, we expect it to generate just over €5m of revenues for 2005.

- **Magazines**
  Management is also advertising its five-digit service in television guides and magazines targeting teenagers. Consumers send an SMS message to receive the required content.

- **Mobile operators**
  Mobile operators such as T.I.M., Vodafone and WIND frequently send free text messages to their customers offering subscription-based content. TLU is able to advertise these services by buying these text messages from the mobile operator. If the end customer then subscribes to TLU's service, TLU will pay the mobile operator approximately 70% of revenues received. Nevertheless, this is still low cost advertising, and the subscription model discussed below gives TLU the opportunity to lock customers into repeat content.

Under the recently adopted subscription model, a subscriber is offered ongoing weekly content receipt until subscription is cancelled. Although end users can unsubscribe immediately, current cancellation rates are running at below the industry average of 50%. Management reports that 45% of customers unsubscribe from the service straight away with 5% per week thereafter. This gives an average service length per customer of 11 weeks (based on a sample 100 customers, 55 remain for the first week, with an additional five leaving per week). After two months of operation, TLU achieved 20,000 subscribers at the end of December 2004.

Code sharing
An alternative, low risk route to market is through code sharing, where advertising partners take TLU's five digit number and advertise it through their advertising channels e.g. local TV. Whilst TLU will pass a portion of any revenues back to the code share partner, it does not pay for advertising.

An example of this is the agreement with Distech Sicme SA, announced post period end. Distech is a company specialising in premium rate access services, which has recently launched a new software package ("Play Desk") for distribution to Italian regional television stations. Its functionality will allow viewers to split screens and, thereby, simultaneously watch television and view a window displaying mobile content, which can be downloaded by sending a message to a premium rate five-digit telephone number. TLU will provide both the content (initially logos, ringtones, games and wallpaper, with future content likely to include televoting services and SMS chat) and the five-digit number for "Play Desk".

Jingle Cards
Management is also starting to distribute Jingle cards through newsagents and tobacconists. Jingle cards are pre-paid scratch cards, which contain a PIN code and content code. Agreements with mobile operators are not required leading to greater revenues for TLU at lower cost.

Figure 7: Five-digit – historical and forecast

Year end December	2003 a €'000	2004 a €'000	2005 f €'000	2006 f €'000
Total revenue	**0**	**158**	**5,818.8**	**11,163.6**
% change			3582.8%	91.9%
Advertising			5,157.1	3,581.1
Code sharing			365.9	664.7
Jingle cards			295.8	6,917.8
Cost of sales	**0**	**89**	**5,622.3**	**7,792.5**
Advertising			5,137.8	2,324.0
Code sharing			317.1	576.0
Jingle cards			167.4	4,892.5
Gross profit	**0**	**69**	**196.5**	**3,371.1**
% change			184.8%	1615.6%
Advertising			19.3	1,257.1
Code sharing			48.8	88.6
Jingle cards			128.4	2,025.4
Gross margin %	**n/a**	**44%**	**3.4%**	**30.2%**
Advertising			0.4%	35.1%
Code sharing			13.3%	13.3%
Jingle cards			43.4%	29.3%

Source: Teleunit, Daniel Stewart

Change in forecasts

Figure 8 below compares our original and revised forecasts for 2005 and 2006.

Revenue forecasts
The reduction in 2005 turnover assumes no further development in WLL operations beyond Umbria and Tuscany. This is more a timing than operational issue as we still expect management to develop wireless operations either through WLL or alternative technology such as WIMAX (see discussion earlier), but we take a highly prudent approach as to timings of these revenues. We also reduce our revenue forecast for pre paid calling cards, although we expect a higher proportion of direct sales to raise divisional gross margins from our original forecast of 11% to 18%.

One other change in forecast revenue worthy of mention is the inclusion of revenues from five-digit business. This business line produced only a minimal contribution for 2004, but the change to a subscription model and more television advertising in 2005 should generate strong top line growth in the current year.

Profit forecasts

The exclusion of WLL operations beyond Tuscany should also lower depreciation, infrastructure costs and commissions payable, and we, therefore, forecast future WLL business at higher margins than before. In Premium Access Services, we forecast that TLU will raise the rates they pay to Service Centres to support higher levels of revenue growth, hence the decline in the forecast gross margin from 21.7% to 17.0%. In the Fixed Line and Pre-paid cards divisions, introduction of VOIP services and direct sale of pre-paid traffic to the wholesale market should raise forecast divisional margins from our original expectations.

Other forecasts

Tax - Under decree law no. 269 of 30/09/2003, Italian companies, which listed on a regulated European exchange during 2004, are entitled to claim double deductibility of flotation expenses for taxation purposes and a 20% tax rate for three years. Recent press comment has indicated that the European Commission may rule this tax benefit illegal, although no official comment appears to have been made. We assume in our forecasts a 20% tax rate for 2005 and 2006, believing that even if the Commission rules this illegal, TLU could invoke non-retroactive application of legislation. However, in the worse case scenario, the 2004 numbers could be negatively impacted by €172k if the 20% tax rate were to be raised to 33% or €736k if both the tax rate were to be raised and the double deductibility benefit were to be removed.

Investors should also note that the Commission has declared the Italian Regional Tax on Productive Activities illegal. Although the European Court of Justice must confirm this, TLU has already applied for a refund of €991k overpayment of taxes between 2000 and 2004. We prudently exclude this from our forecasts.

Net debt - The €3m of net funds in the 2004 report and accounts masks further near cash of €6.8m, which has been invested in monetary assets. If we include this as cash, net cash at 2004 would be €9,884k as opposed to €3,055k. For 2005, our forecast net debt of €1,470k would change to a net cash position of €5,359k, with 2006 moving from net cash of €5,007k to €11,836k.

Figure 8: Revised divisional forecasts

Year end December	2004 original €'000	2004 actual €'000	2005 original €'000	2005 revised €'000	2006 original €'000	2006 revised €'000
Revenue						
Wireless Local Loop	1,678	619	11,811	2,939	31,767	8,422
Premium Access Services	41,246	42,534	50,857	53,136	60,424	56,741
Fixed Line	10,137	7,926	12,386	12,555	13,879	16,113
Pre paid cards/wholesale	10,916	9,531	19,066	16,218	26,210	28,294
5 digit	0	158	0	5,819	0	11,164
Total revenue	**63,977**	**60,767**	**94,120**	**90,667**	**132,281**	**120,733**
Divisional Gross profit						
Wireless Local Loop	1,192	403	8,278	2,406	22,266	6,805
Premium Access Services	9,453	9,103	11,058	9,033	12,667	9,646
Fixed Line	5,097	2,805	6,158	7,403	6,828	8,878
Pre paid cards/wholesale	1,309	2,430	2,115	2,919	2,860	4,527
5 digit	0	69	0	197	0	3,371
Divisional gross profit	**17,051**	**14,810**	**27,608**	**21,958**	**44,621**	**33,227**
Adjusted Gross margin						
Wireless Local Loop	71.0%	65.1%	70.1%	81.9%	70.1%	80.8%
Premium Access Services	22.9%	21.4%	21.7%	17.0%	21.0%	17.0%
Fixed Line	50.3%	35.4%	49.7%	59.0%	49.2%	55.1%
Pre paid cards/wholesale	12.0%	25.5%	11.1%	18.0%	10.9%	16.0%
5 digit	0.0%	43.7%	0.0%	3.4%	0.0%	30.2%
Total gross margin	**26.7%**	**24.4%**	**29.3%**	**24.2%**	**33.7%**	**27.5%**

Source: Teleunit, Daniel Stewart

MANAGEMENT STRUCTURE

TLU has made a significant hire post period end. Giampietro Catena will be joining the group as Chief Operating Officer from April. He brings with him considerable experience of the Italian telecoms wholesale market through positions at Eutalia (Commercial Director), Edisontel (Operational and Wholesale manager), Albacom (CFO and Director of Wholesale Interconnect) and BT Italia (Finance Manager), which will be invaluable in building TLU's recently commenced wholesale business. Upon Mr Catena's arrival, Francesco Cimica will move to Chief Executive Officer and Gianfranco Cimica will move to Executive Vice-Chairman.

CONCLUSION

Despite some difficult trading conditions wholly outside of management's control, the business has reported strong revenue and profit growth for 2004. Where delays have occurred, management has reacted swiftly, showing a good level of adaptability and commerciality, in what is a rapidly evolving business. Investment is being made for the medium term, with the introduction of new sustainable business lines such as five-digit and VOIP and strategically important hires and the balance sheet remains strong.

Although we have reduced our revenue and pre-tax forecasts for 2005, our post tax profit forecast remains unchanged. Moreover, our revised numbers are highly conservative and we would anticipate upgrading them in line with increasing visibility in the new business lines. Revenues from these new opportunities are expected to impact the P&L in H2 of the current year, which, when combined with the upfront investment in infrastructure and people, is expected to lead to a greater weighting of the full year result in the second half. Even at our conservative levels, we still forecast revenue to increase 49% for 2005, EBITDA +20% and clean pre-tax profit +14%, which we do not believe is reflected in the discount to the UK Communications Services sector. BUY.

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Sector

Telecoms

Italian telecoms operator focused on SMEs

Profit & Loss Forecast

Year To:	**2003 A**	**2004 A**	**2005 E**	**2006 E**
December	**€'000**	**€'000**	**€'000**	**€'000**
Turnover	**44,271**	**60,767**	**90,667**	**120,732**
Gross Profit	8,610	13,569	21,958	33,227
Gross Margin %	***19.4***	***22.3***	***24.2***	***27.5***
Operating Profit	4,000	6,594	6,665	12,507
Operating Margin %	***9.0***	***10.9***	***7.4***	***10.4***
Goodwill Amort.	(66)	(111)	(75)	(78)
Depreciation	(910)	(1,517)	(3,114)	(5,042)
EBITDA	**4,976**	**8,222**	**9,854**	**17,627**
Exceptionals	0	0	0	0
Net Interest	(224)	(960)	(200)	(350)
FRS 3 PBT	3,776	5,634	6,465	12,157
DS&C PBT	**3,842**	**5,745**	**6,539**	**12,235**
Tax	(1,504)	(830)	(1,308)	(2,447)
Earnings	2,272	4,804	5,157	9,710
Ave No of Shares (weighted)	67,178	165,890	186,744	186,744
Ave No of Shares (diluted)	67,178	166,246	187,100	187,100
FRS 3 EPS c	3.38	2.57	2.76	5.20
DS&C EPS (weighted) c	**3.38**	**2.90**	**2.76**	**5.20**
DS&C EPS (diluted) c	3.38	2.89	2.76	5.19
Dividends	0	0	0	0

Cash Flow Forecast

Year To:	**2003 A**	**2004 A**	**2005 E**	**2006 E**
December	**€'000**	**€'000**	**€'000**	**€'000**
Operating Profit	4,000	6,594	6,665	12,507
Depn & Amort	976	1,628	3,189	5,120
Working Capital	4,841	(6,338)	(1,765)	(2,512)
Net Interest	(224)	(960)	(200)	(350)
Tax Paid	(1,084)	(2,068)	(830)	(1,308)
Other	(1,912)	(443)	0	0
Gross Cash Flow	**6,597**	**(1,587)**	**7,059**	**13,457**
Net Capex	(3,017)	(4,158)	(11,584)	(6,980)
Use of Prv's	0	0	0	0
Free Cash Flow	**3,580**	**(5,745)**	**(4,525)**	**6,477**
Div's	0	0	0	0
Acq. & Invest	(165)	(8,607)	0	0
Disposals	0	125	0	0
Financing	2,121	13,586	0	0
Other, FX	0	0	0	0
Change in Cash	5,536	(641)	(4,525)	6,477
Op. Net Cash (Debt)	**(1,840)**	**3,696**	**3,055**	**(1,470)**
Cl. Net Cash (Debt) (note1)	**3,696**	**3,055**	**(1,470)**	**5,007**
Cl. Net Cash (Debt) (note2)	**3,696**	**9,884**	**5,359**	**11,836**
Gearing %	***Cash***	***Cash***	***4***	***Cash***
Interest Cover	18	7	33	36

Note 1: Net funds position excluding monetary assets
Note 2: Net funds position, including monetary assets

Key Events

Mar 05 – Appointment of Giampietro Catena as Chief Operating Officer
Feb 05 – Agreement with Wirlink for Tuscany licence
Jan 05 – Agreement with Distech Sicme
Sep 04 – Interim 2004 results
Aug 04 – Acquisition of Starline
May 04 – Flotation on AIM

Major Shareholders

	% of Ord. Share Capital
Family – Gianfranco Cimica	32.7
Family – Francesco Cimica	36.8
Total family	**69.5**

Investors > 2%
Framlington Inv Mngt
Fidelity Inv Int'l
Julius Baer AM Ltd
Eden Group

Business Analysis

	Sales € '000		**Gross profit €'000**	
	2005	**2006**	**2005**	**2006**
Fixed Line	12,555	16,112	7,403	8,878
Premium Access	53,136	56,741	9,033	9,646
Pre-paid cards/wholesale	16,218	28,294	2,919	4,527
Wireless Local Loop	2,939	8,422	2,406	6,805
5 Digit	5,819	11,164	197	3,371
Total	**90,667**	**120,733**	**21,958**	**33,227**