



Teleunit – Trading Update

15 December 2004

TLU.L

20.25p

BUY (retained)

Key Data

Market Cap €/£m	54.7/37.8
Enterprise Value €/£m	37.2/25.7
Shares in Issue m	186.7
Est Free Float %	27.2
Gearing %	N/a
Net (Debt)/Cash €/£m	17.5/12.1 est.
Next Results (FY)	April 2005

Teleunit (TLU), the Italian telecoms operator, has today updated the market in a pre-close trading statement. Despite what has been a difficult year, including the effect of price capping in Premium Access services, slowdown in the Fixed Line business and delay by the Italian Ministry in auctioning the Wireless Local Loop licenses, we expect the FY2004 results to be in line with our forecasts at the pre-tax profit level.

Monthly invoicing has steadily increased since the interims in July, with the €4.9m monthly revenue at the mid point increasing to €6.6m in November. This gives €79m annualised (or 84% of our 2005 forecast) assuming no growth in the business over the next 12 months. Whilst a scenario of no growth is highly unlikely, we are leaving our 2005 forecasts unchanged at this stage, but highlight the potential for upgrades during H1 of next year.

Description

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Fixed Line

Growth in the highly competitive Fixed Line market has been slightly slower than expected. However, rather than stand still, management has developed a new service - VoIP through ADSL to SoHo (small office, home office) and SME customers - which should be ready for launch in 2005. This will allow the end user to bypass Telecom Italia's last mile connectivity, through installation of a TLU gateway VoIP, offering greater flexibility and lower costs to the consumer and potentially significant additional revenues to the company.

Whilst TLU's ADSL will be sufficient to support both data and voice, its capacity is considerably below that of WLL and, therefore, is not expected to cannibalise revenues from the latter. Moreover, the service can be sold using existing spare capacity in the Fixed Line sales force, sweating the overhead more effectively.

Pre-paid calling cards

Whilst penetration of tobacconists and newsagents with the new PoS system has been slower than expected, numerous alternative routes to market exist e.g. travel agents, supermarkets. The latter, in particular, is appealing, given large retailers geographical coverage and consumer throughput, and management expects to sign a new deal with a 15-unit supermarket in the new year.

Management has also commenced selling national and international prepaid traffic to the wholesale market. Whilst margins are modest (c.13-14%), potential revenue flows from the large national and international carriers could be considerable. TLU has hired a team of three from another Italian operator, who are tasked with developing this business over the coming months.

Premium Access

The strong growth witnessed at the interim stage has continued in Premium Access services. Revenues for November alone were €4.5m, more than double the prior year, helped by a new divisional manager recruited from FastWeb, and a strong performance from Starline, a Rome-based provider of premium rate telephony voice content, which has agreed to migrate its premium access numbers traffic progressively to TLU until 2007. Approximately 60% of Starline's traffic is currently passing through TLU, with management expecting this to increase to 85% during 2005.

Wireless Local Loop (WLL)

Further bureaucratic delays in the auction for the Tuscany license has led management to consider alternative opportunities for developing WLL in Tuscany. Management expects to make an announcement on this in the new year.

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Mobile content/ 5-digit market

Delay in the rollout of 5-digit services from September to November was outside of TLU's control, and, with partners such as radio stations and football teams slow to advertise the service, revenues for 2004 will be below our expectations at the interims.

Management has now adopted a subscription model (when an end user requests new content he/she must subscribe to ongoing weekly content receipt). Although users can unsubscribe at any point, current cancellation rates are running at 42.4%, which management informs us is below the industry average of 50%. In the first month of operation, TLU has achieved 8,000 subscribers, and expects this to double by the end of December.

Subscription levels are closely linked to advertising levels and the company is planning to advertise its 5-digit service through television in Q1 2005, taking advantage of numerous additional consumers who will have received mobile phones as Christmas presents. Whilst television advertising may be more expensive, it should generate higher business volumes. The type of content requested also impacts revenues, with ringtones (60% of requests to TLU) and wallpaper (30% of requests) achieving a higher price point.

Conclusion

Despite a difficult trading environment during 2004, management has grown the business largely in line with our expectations. Where delays have occurred or trading has been slow, management has been quick to adapt by generating new revenue lines and new services to keep profitable growth at a consistently high level. It is this entrepreneurial nature and adaptability that should stand this dynamic and rapidly changing company in good stead. We maintain that the stock is cheap on a value to growth basis and reiterate our BUY recommendation.

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