

## Teleunit

Ringing the changes...



**TELEUNIT**

**Roger Tejwani**

020 7847 0380

[roger.tejwani@danielstewart.co.uk](mailto:roger.tejwani@danielstewart.co.uk)

**Daniel Stewart & Company Plc**  
48 Bishopsgate  
London  
EC2N 4AJ

**Tel: 020 7374 6789**

**Fax: 020 7374 6742**

[www.danielstewart.co.uk](http://www.danielstewart.co.uk)

# TELEUNIT



## COMPANY OVERVIEW

### Activity

Teleunit is an Italian telecoms company with operations in fixed line, wireless local loop, premium access numbers and pre-paid calling cards

### Research

#### Roger Tejwani

020 7847 0380

roger.tejwani@danielstewart.co.uk

#### David Johnson

020 7847 0399

david.johnson@danielstewart.co.uk

#### Alex Davies

020 7847 0359

alex.davies@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

Teleunit SpA (formerly Telephonica) was founded in 1997 by entrepreneur, Gianfranco Cimica, at the time of deregulation in the Italian telecoms sector. Based in Perugia, Umbria, it operated originally as a reseller, before acquiring a national telecommunications operator licence in late 2000.

Since then it has expanded from the provision of fixed line telephony services to Italian residential users and SMEs into supplying premium rate numbers to providers of paid voice and data content, and, more recently, pre-paid international calling cards. Amidst an unfavourable economic climate for telecoms operators in general, the company has grown its revenues and profits rapidly without recourse to capital markets, using high quality infrastructure and service levels. The company has maintained a low cost business model by avoiding the excessive acquisition trail and infrastructure and brand building exercises undertaken by many other operators.

Year to December	2001 a €'000	2002 a €'000	2003 a €'000	2004 f €'000	2005 f €'000	2006 f €'000
Total revenue	5,245	37,490	44,271	63,977	94,120	132,281
Revenue growth %		614.8%	18.1%	44.5%	47.1%	40.5%
Gross profit	2,123	7,175	9,778	17,050	27,608	44,621
Gross margin	40.5%	19.1%	22.1%	26.7%	29.3%	33.7%
EBITDA	188	4,187	4,976	8,413	12,549	21,339
EBITDA margin	3.6%	11.2%	11.2%	13.2%	13.3%	16.1%

Source: Teleunit, Daniel Stewart estimates

The acquisition of a twenty-year Wireless Local Loop (WLL) licence for the Umbria region in July 2002 allowed Teleunit to become the only Wireless Local Loop network operator in central Italy. WLL is key to the future strategic development of the business. It is a mature technology that allows cable-speed transmission without the high associated infrastructure backbone costs. It is highly suitable for installing broadband coverage across Italy's provinces, which lack the residential or commercial density to make cable installation financially viable.

Since rolling out its WLL network in September 2003, the company has attracted over 120 customers, to whom it offers high-bandwidth Internet capacity, subscription-free fixed line telephony, and data services. It is important to note that the fixed line telephony, which is priced more attractively than Telecom Italia, can only be offered through Teleunit's national operator licence. The high service specification in its WLL offering, combined with commercial flexibility and an attractive pricing structure have allowed Teleunit to attract larger corporate clients and negotiate a strategic partnership with IBM, who act as both main contractor for WLL installations and a sales distribution channel.

Teleunit now wishes to list on AIM to increase the financial and commercial profile of the business, and to raise up to €20m to take advantage of its first mover status in Wireless Local Loop by expanding its network into the neighbouring Italian regions of Tuscany, Marche, Emilia-Romagna and Lazio. This expanded network will give Teleunit a presence in regions covering approximately 27% of the national population and 30% of national GDP, and the opportunity to break Telecom Italia's "last mile barrier" to corporate and residential customers. We believe that AIM is the appropriate junior market for high growth companies such as Teleunit.

We have valued the business' cash flows using a discounted cash flow methodology and also applied a multiple valuation to earnings. We value Teleunit's equity on this basis between €99m and €106m.

**Daniel Stewart acts as Nominated Adviser and Broker to Teleunit**

**Daniel Stewart & Company Plc**  
**48 Bishopsgate**  
**London**  
**EC2N 4AJ**

**Tel: 020 7374 6789**

**Fax: 020 7374 6742**

[www.danielstewart.co.uk](http://www.danielstewart.co.uk)

## Contents Page

Investment Strengths	3
Investment Concerns	4
Overview of Services	5
Italian Telecoms Market	8
Wireless Local Loop – the last mile	12
Teleunit Wireless Local Loop	14
Fixed Line Telephony	22
Pre-paid International Calling Cards	25
Premium Access Numbers	28
Management	33
Financial Discussion	35
Evaluation	37
Appendix 1: Profit & loss and cash flow summary	41
Appendix 2: Evaluation	43
Appendix 3: Shareholder Structure	45

## INVESTMENT STRENGTHS

### **Focus on low cost model and customer service**

Teleunit has, in contrast to many other telecoms operators, focussed on maintaining a low cost operating model and high levels of customer service to gain recognition, rather than an expensive brand building and marketing campaign. Not only does this mean that it can make comfortable margins in areas where many competitors cannot, but the combination of low cost and focus on customer service is used effectively to generate new business, for example in the premium access numbers business, where prompt payment to Service Centres has been instrumental in the significant increase in revenues

### **Experienced and entrepreneurial management**

Gianfranco Cimica has considerable previous experience in establishing and growing businesses. The successful launch of the premium access numbers and pre-paid international calling card businesses, shows that management has good understanding of the Italian telecoms market and the wherewithal to execute new ideas

### **First mover advantage in Wireless Local Loop is key**

We believe that the low cost and simple installation of WLL, limited alternatives to DSL technology in non-metropolitan areas, and growing requirement from SMEs for higher bandwidth for both existing needs and new services such as IP telephony and video conferencing, will lead to strong growth of this service line. Moreover, Teleunit's WLL allows the company to completely bypass Telecom Italia's last mile infrastructure for fixed line telephony. This gives Teleunit the opportunity to offer its WLL customers subscription-free fixed line telephony, saving an estimated 30-35% off their monthly telephone bill.

Teleunit already has experience in setting up and operating a WLL network in Umbria, and will benefit from first mover advantage in central Italy. Telecom Italia is prohibited by the Italian telecoms regulator from entering this market until 2008 at the earliest, and other operators are too small and financially constrained or too inflexible, having previously pursued a strategy of unbundling local loop, to make significant inroads into WLL in the short term

### **Cross-selling ability**

Teleunit's service lines can be combined in an integrated service package to attract and retain customers. For example, the company can offer its WLL customers subscription-free fixed line telephony through its national telecoms licence. This positions it well against single service operators

### **Strong strategic partnerships**

Teleunit has partnered with IBM for sale of its WLL services, testament to both the credibility of the product and management capability. Other partnerships are currently being negotiated and we believe that achieving public status will enhance the company's commercial profile and encourage further strategic tie-ups

### **Strong growth in revenues and profits**

Teleunit has a track record of revenues and profitability and we expect this to accelerate swiftly as a result of the above effects. As the WLL network is expanded, quality of earnings should improve, as the company becomes less dependent on Telecom Italia for last mile connectivity. Teleunit therefore represents a compelling and well-timed investment opportunity.

## INVESTMENT CONCERNS

### **New entrants to WLL market**

Given the highly attractive opportunity for Wireless Local Loop services, we expect competition to eventually enter this market. However, we believe that many operators are financially constrained, either through balance sheet inflexibility or through having invested heavily in unbundling local loop to target the residential market. Moreover, Teleunit has first mover advantage in central Italy through acquisition of a WLL licence in 2002, and the four-year restriction on Telecom Italia deploying a WLL network gives sufficient time for the company to build critical mass. Teleunit has the added ability to cross-sell subsidised fixed line telephony into its WLL customers to attract and retain business

### **Managing growth will be key**

With the rollout of the WLL network, Teleunit will transform itself from what is essentially a local WLL operator in Umbria to one with a presence in regions covering 27% of the national population and 30% of national GDP. It will be critical for the company to maintain its strong focus on customer service, which has served it well to date, whilst managing such growth. Investors should note that the company has successfully developed its other service lines on a national basis

### **Specific markets are challenging**

Both the premium access numbers and pre-paid international calling card markets are challenging, with the former characterised by recent legislative changes and the latter by strong competition. We believe that Teleunit's planned strategy of bypassing distributors in the pre-paid international calling market will allow it to offer a lower priced product than incumbents, attracting what are essentially price-constrained ethnic customers. In premium access numbers, whilst the recent legislative changes have capped prices, they have brought greater transparency to the market, which should ultimately lead to greater demand from end users

### **Reliance on infrastructure providers**

Outside of Wireless Local loop, where Teleunit can pass the "last mile barrier" of Telecom Italia, it is dependent on the former state monopoly or other infrastructure providers to provide sufficient capacity for its services

### **Wireless loop operations have not always been successful**

Investors may remember the failure of two operators, Atlantic Telecom and Ionica, who attempted unsuccessfully to offer last mile alternatives using unproven technologies and frequencies. We discuss later the key differences between these companies and the Teleunit model. Teleunit's WLL technology is mature, has a successful track record and will be rolled out on a regional rather than national basis, without, in our opinion, attracting undue competitive pressure from Telecom Italia or other operators. Moreover, in contrast to Teleunit, both Atlantic and Ionica used shared and unregulated frequencies.

## OVERVIEW OF SERVICES

### Wireless Local Loop (WLL)

In Italy, as in the UK, the former state monopoly, Telecom Italia, owns the last mile infrastructure to the business or home. The concentration of Italy's business and residential users around major cities has meant that installation of fibre optic cable has been limited in some non-metropolitan areas, with DSL technology being used instead. DSL has insufficient bandwidth to service existing needs of many businesses and, in particular, many newer, but important business applications such as IP telephony and video conferencing. We therefore believe that WLL is the only viable alternative to DSL for last mile connectivity outside of major cities, allowing the traditional copper wire connection between end users, voice and data infrastructure and the telecom operator to be replaced with high-speed wireless access.

Teleunit's broadband WLL network is key to the long-term strategic development of the business. Its key advantages are the low infrastructure costs compared to cable, controllable bandwidth, which can support customers at each stage of their growth or can be flexed for short term capacity requirements e.g. a video conference call, and high level of upload and download capacity. CPEs (see section entitled "Teleunit Wireless Local Loop") come with 8 Mbps capacity, which can be extended to 34 Mbps for special requirements and base stations have a minimum 16 Mbps capacity, which can be increased to 94 Mbps. Beyond this, the compact design of base stations means they can be easily clustered together, offering virtually limitless capacity.

The company has already rolled out WLL infrastructure in Umbria through 13 base stations at a cost of €2.2m. It has attracted over 120 customers to date and is currently the only WLL operator in central Italy. It is intended to use the IPO proceeds to build out similar WLL networks in Tuscany, Marche, Emilia-Romagna and Lazio over the next 12-15 months.

### Fixed line services

Teleunit originally entered the fixed line (FL) market in 1997, building relationships as a reseller, whilst the Italian telecoms market was being deregulated. In July 2000, the Company procured a national operators licence, which allowed it, through agreement with two exchanges in Perugia and Ancona, to expand the client base. Whilst the early focus was on serving SMEs in the Umbria and Marche regions, Teleunit now provides fixed line voice and data (ISP) services to approximately 8,000 business and 1,500 residential customers, only 20% of whom are in these two regions. The remainder are throughout Italy, with Tuscany being the key revenue generator. Fixed line services are sold through a national network of 60 indirect sales agents. A recent partnership agreement for sale of fixed line services has also been signed with online insurance company, Zuritel. Two new multi-level distribution agreements have also been concluded on a national and regional basis, with a further potential agreement with an Italian bank in advanced negotiations.

### Pre-paid international calling cards

Teleunit entered the pre-paid international calling card market in Q4 2003, supplying international calls via pre-paid calling cards primarily to non-EU migrant workers living in Italy. This market is estimated at between €300-€350 million per annum, driven by the rising number (currently estimated at three million) of foreigners who wish to call their countries of origin at low cost.

Teleunit's initial routes to market are through both a branded pre-paid €5 phone card, distributed through tobacconists and kiosks, and secondly through phone shops where end users purchase and use talk time, rather like an Internet café. There are approximately 150,000 tobacconists, newsagents and kiosks and 2,500 phone shops in Italy, all of which could potentially be used as a point of sale. Whilst the company has entered this market cautiously, using a distributor to gauge demand, its planned strategy is to go direct to the point of sale and cut out the distributor who controls supply into the market. In order to help achieve this, the company is currently trialing a system in conjunction with a leading Italian phone card distributor for printing of PIN numbers at the point of sale. If successful, this would not only remove the risk and volatility of relying on a distributor as middleman, but could also be used to supply PIN numbers of third party traffic providers, giving scope to substantially raise revenues and margins. This has not been factored into our forecasts.

### Premium Access Numbers (Value added services)

Teleunit entered the premium access numbers market in 2002, supplying premium (originally “709” but now “899” prefix) Internet access numbers to providers of paid voice and data content. Revenue has grown rapidly from a standing start to €35m in 2003. End users wishing to access premium content over the Internet, must disconnect from their ISP and reconnect to the premium content provider’s website via a premium rate telephone number supplied by Teleunit. This re-routing process is automated, through download of a service centre dialler onto the user’s PC, which contains the premium rate number required for re-connecting to the new site.

Teleunit receives a proportion of the premium rate charge after commission to both the telephony provider and Service Centre. The gross amount for Teleunit in 2003 was approximately €1.96 per minute before commission to both Telecom Italia and the Service Centre. The content provider, or Service Centre, is Teleunit’s client for this service.

The Italian telecoms regulator has recently introduced price capping into this market. Whilst this has undoubtedly caused some short-term pain, as Service Centres review their pricing strategies, we believe that the changes are beneficial for Teleunit over the short to medium term, with greater transparency in the market expected to lead to greater demand for paid content. Teleunit is also planning to provide premium access numbers for mobile voice traffic and enter the premium SMS text market within the next six months.

## FINANCIAL SUMMARY

We believe that the investment case is compelling, with Teleunit offering high growth, strong profitability and cash generation. A detailed financial discussion and full P&L and cash flow forecasts can be found later in the note, but we discuss the key growth and profit drivers here.

### Key growth drivers

- Deregulation of the Italian telecoms market has allowed new operators to successfully take market share from Telecom Italia over the last five years. At the same time, competitive pricing pressures and harsh economic conditions over the last three years, particularly for highly leveraged telecoms companies have caused the number of operators active in Italy to decrease from 151 in 2000 to approximately 20-25 at present. The more benign competitive environment gives Teleunit a good opportunity to expand its market share.
- At the same time, business and residential end users have become more demanding in their requirements. Operators’ pricing levels have generally converged, meaning that competition is now more service-led than price-led. Growth in paid services (e.g. recipes, weather reports, financial information), which can be accessed over the Internet or through SMS messages, should offer strong growth to Teleunit’s premium access numbers business.
- The natural progression from zero Internet access to narrowband and subsequently broadband, witnessed in the US and other European territories is now taking place in Italy. Demand amongst small and medium size enterprises (SMEs) for higher bandwidth for both existing needs and new but important business applications such as video conferencing and IP telephony should drive a fundamental move towards broadband access. Outside of major cities in Italy, Wireless Local Loop (WLL) represents the only credible alternative to the lower capacity ADSL or prohibitively expensive HDSL.

### Profit and loss and cash flow estimates

Figure 1 below provides a summary of revenue and profitability from 2001 to 2006. More detailed forecasts can be found at the back of this note.

- Fixed line revenues are deemed to grow steadily, highlighting the price stability that has returned to the market. However, the other three divisions are expected to be the key revenue drivers, growing collectively between 45-52% over each of the next three years. Key to this growth is the successful rollout of Teleunit’s WLL network

- We also expect gross margin to grow, from 22.1% in 2003 to 33.7% in 2006. The two key drivers for this are a significant reduction from 2004 onwards in commission rates payable by Teleunit to Telecom Italia for Internet and fixed line voice for premium rate numbers, and a shift in the business mix towards the high margin WLL offering
- We expect all operating costs except administrative and marketing expenses to increase as a percentage of revenues over the forecast period. This is largely due to the lead-time between upfront costs for staff employment/training, network/infrastructure related costs and the benefits of the associated revenue flows and a slightly higher percentage of marketing costs in 2004, in advance of network deployment. Depreciation and amortisation increases are due to investment in both the WLL infrastructure and licences. Nevertheless, EBITA margins are expected to increase from 9.0% in 2003 to 11.5% in 2006, although capital expenditure on WLL in 2004 and 2005 means that this margin growth should largely come in 2006.

**Figure 1: Teleunit group profitability 2001-2006**

Year to December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
Total revenue	5,245	37,490	44,271	63,977	94,120	132,281
Revenue growth %		614.8%	18.1%	44.5%	47.1%	40.5%
Gross profit	2,123	7,175	9,778	17,050	27,608	44,621
Gross margin %	40.5%	19.1%	22.1%	26.7%	29.3%	33.7%
EBITA	-33	3,710	4,000	6,327	8,392	15,242
EBITA margin %	-0.6%	9.9%	9.0%	9.9%	8.9%	11.5%

Source: Teleunit, Daniel Stewart estimates

- Whilst we expect an annual €2m working capital outflow over the forecast period, Teleunit should maintain positive gross cash flow, due to the strong increase in profitability. Investment in the WLL infrastructure is, however, expected to largely swallow this cash flow, particularly in 2004 and 2005, when our forecast €10.3 and €15.0m capex requirements lead to a free cash outflow of €5.9 and €6.6m respectively. The benefits from this investment should be rapidly translated into profitability gains, as we forecast operating profit to rise from €6.2m in 2004 to €15.1m in 2006 with €7.7m of free cash in 2006. It is worth, however, noting Teleunit's policy of early settlement in the premium access numbers business and a strong outperformance of that particular business line could increase working capital requirements.
- Whilst external funding from an IPO is required to develop the WLL network, we expect Teleunit to reduce its net debt position to €1m in 2006 without financing. Beyond the forecast period, we expect a move to a net cash position of €14.9m in 2007.

**Figure 2: Teleunit summary cash flow 2001-2006**

Year to December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
Operating profit	-33	3,710	4,000	6,171	8,237	15,087
Depreciation & amortisation	221	477	976	2,242	4,312	6,252
Increase/(decrease) in working cap	-419	-2,558	4,841	-2,000	-2,000	-2,000
Net interest	-190	-470	-224	-500	-800	-400
Tax paid	-93	89	-957	-1,504	-1,369	-2,278
Exceptionals/other	5	97	203	0	0	0
<b>Gross cash flow</b>	<b>-509</b>	<b>1,345</b>	<b>8,839</b>	<b>4,409</b>	<b>8,380</b>	<b>16,662</b>
<b>Total capex</b>	<b>-821</b>	<b>-2,821</b>	<b>-3,182</b>	<b>-10,280</b>	<b>-15,010</b>	<b>-8,972</b>
<b>Free cash flow</b>	<b>-1,330</b>	<b>-1,476</b>	<b>5,657</b>	<b>-5,871</b>	<b>-6,630</b>	<b>7,690</b>
Financing	285	117	1,000	0	0	0
<b>Change in cash</b>	<b>-1,045</b>	<b>-1,359</b>	<b>6,657</b>	<b>-5,871</b>	<b>-6,630</b>	<b>7,690</b>
<b>Opening net cash/(debt)</b>	<b>-439</b>	<b>-1,484</b>	<b>-2,843</b>	<b>3,814</b>	<b>-2,057</b>	<b>-8,687</b>
<b>Closing net cash/(debt)</b>	<b>-1,484</b>	<b>-2,843</b>	<b>3,814</b>	<b>-2,057</b>	<b>-8,687</b>	<b>-997</b>

Source: Teleunit, Daniel Stewart estimates

# THE ITALIAN TELECOMS MARKET

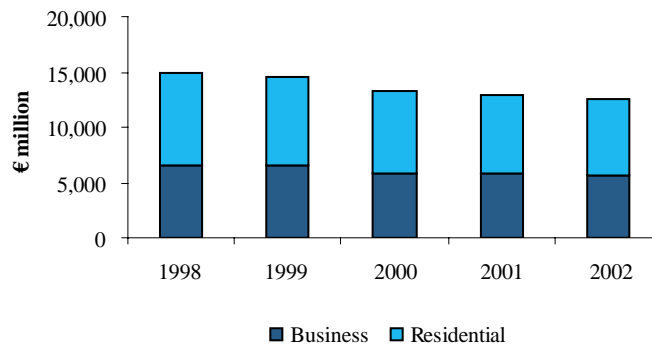
## OVERVIEW

### Fixed telecoms market

Italy is the fourth largest fixed telecoms market in Western Europe, with revenues estimated by Analysys of €21.4bn in 2002. In line with most EU countries, the market was deregulated in 1998, although it was not until 2000 that competition intensified. Many new telecoms operators, encouraged by strong economic conditions and receptive capital markets, invested heavily in infrastructure and brand building, and were highly acquisitive to generate strong growth.

Whilst Telecom Italia remains the dominant national operator, its share of the fixed telecoms market has been rapidly eroded in the five years since deregulation to approximately 80%, meaning that approximately €4.3bn of the market is accredited to other operators. New entrants competed strongly with Telecom Italia on price, most notably in the business market, with the result that the fall in tariffs outstripped the rise in traffic (figure 3). Analysys estimates that whilst fixed line connections increased 4% between 1998 and 2002 to 27.3m, the actual value of the fixed line market has fallen 16% over the same period to €12.5bn. This drop has been negated to some degree by strong growth in Internet penetration from just over 2m users in 1998 to 17.1m users in 2002.

**Figure 3: Fixed line voice spend in Italy, 1998-2002**



Source: Analysys

At the national level, the two largest players are Telecom Italia and Wind, with second tier operators including Albacom, Atlant and FastWeb focussing on the corporate and SME markets and Tele2Italia focussing on the residential market (see figure 6).

Beyond the national market, various regional and city-based suppliers have been successful in taking local market share from Telecom Italia through alternative local access networks based on switched Ethernet technology (FastWeb) and Metropolitan Area Networks, offering broadband services via unbundled local loops (FastWeb and Wind).

The subsequent bear market caused a shake out in telecoms, with many of the smaller operators, unable to support their price discounting strategies, forced to withdraw, and others engaging in mergers and acquisitions to survive. The number of operators in the market fell from 151 in 2000 to approximately 20-25 at present. The largest of these acquisitions in Italy was that of Telecom Italia by Olivetti. Of more significance to Teleunit was the acquisition of EdisonTel (one of the largest providers of pre-paid telephone cards) by Plug-IT (the largest provider of premium rate access numbers) in 2003. The combined entity has been renamed Eutalia.

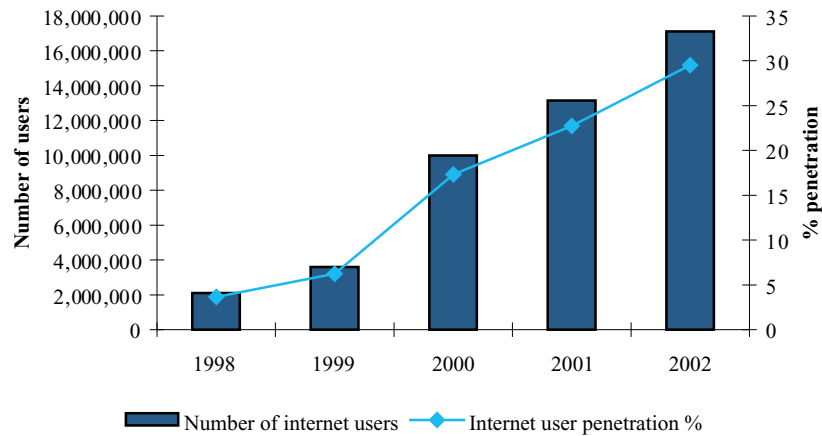
Italy has one of the most advanced mobile telecoms markets in Europe, with a 93% mobile penetration at June 2003. Narrowband and particularly broadband markets have been slow to take off compared with other major European territories, primarily due to lack of cable infrastructure outside major cities and low levels of PC penetration in the home. Despite this, areas where broadband has penetrated (major cities and densely populated residential areas), higher bandwidth services such as Video-on-Demand and VoIP have been made quickly available.

### Internet market

Unlike the fixed telephony market, there is no dominant player in the Italian Internet market. As bundling of voice and Internet access is commonplace, fixed line operators and Internet Service Providers compete head to head, for example in the dial-up market between Telecom Italia Media, Tiscali and Wind. The lack of cable infrastructure in Italy has meant that the broadband market has been dominated by DSL technology.

Growth in the Internet market was initially driven by the introduction of subscription services, with Analysys estimating 17.1m active Internet users and 9m fixed sites by the end of 2002. Despite the strong growth shown in Figure 4 below, Internet penetration of the Italian population reached 29.5% in 2002, low relative to the UK, Scandinavia and Germany. We estimate that 75% of the market is collectively shared by Wind (28%), Telecom Italia Media (22%), Tiscali (16%) and Tele2 (9%). Telecom Italia is omnipresent in the business market, targeting large corporates, SMEs and SOHOs. Wind and Albacom also have a significant presence in the business place and a number of pan-European operators (COLT, Infonet and MCI) have also entered this market.

**Figure 4: Internet users in Italy, 1998-2002**



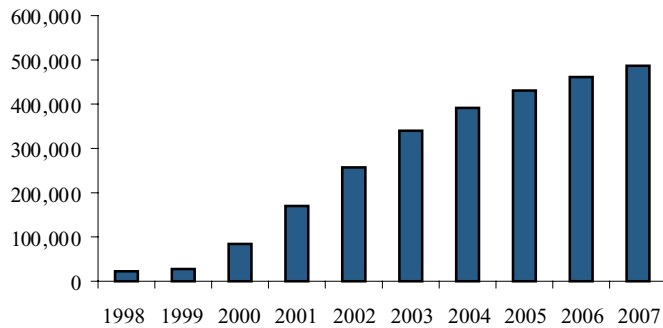
Source: Analysys

### Broadband

Although Italy, with an estimated 1.93m broadband connections or 3.36% penetration of the population, has been slow to take up broadband compared with other EU countries, growth is accelerating with the number of connections growing by 79% in the nine months to September 2003. Three players dominate the market in terms of connections; Telecom Italia (78%) and FastWeb and Wind with 18.6% combined as at September 2003. The lack of fibre cable has encouraged deployment of the majority of broadband via ADSL, although access through Ethernet LANs and switched Ethernet services is becoming increasingly popular. DSL technology currently accounts for 90% of the total number of broadband connections.

Analysys expects that advanced broadband services will stimulate future broadband demand and therefore increase its penetration. As the speed and data capacity of PCs increase, together with the range of data-intensive services only accessible by broadband, demand for speeds in excess of that achieved through ADSL should increase in both the business and residential community. NetConsulting has estimated that broadband access technologies have the potential to account for over 70% of business Internet access over the next 12-24 months. This creates a strategic opportunity for telephony companies to benefit from the demand for broadband access itself or from the services and applications that broadband access can deliver.

**Figure 5: Forecast business broadband connections, 1998-2007**



Source: Analysys

**Infrastructure**

Telecom Italia remains the dominant network operator in Italy. Since deregulation, a number of alternative Italian and overseas operators (e.biscom, EdisonTel, Albacom, COLT and MCI) have been rolling out alternative networks, such as fibre-optic local loop. This has, however, focussed on major cities and whilst this has led to high service levels and downward pressure on prices, it has created a dichotomy of service availability seen in figure 6 below. Outside the major cities, the lack of population density has made the laying of cable non-commercial and there is little competition to Telecom Italia’s last mile copper wire.

**Figure 6: Fixed telecoms infrastructure providers in Italy**

Company	Local access network	MANs	Regional/national network (route km)	International network
Telecom Italia SpA	✓	✓	✓	✓
Wind SpA	Unbundled PTSN & xDSL	30	18,275 km	✗
Tiscali SpA	✗	✗	✓	✓
FastWeb SpA	Ethernet & xDSL	5	4,000 km	✗
Albacom SpA	xDSL	✗	✓	✗
Albacom.Amps	xDSL	1	✓	✗
COLT Telecom SpA	✗	3	✓	✓
Autostrade Telec. SpA	✗	25	3,600 km of fibre along Italian motorway system	✗
ACONET SpA	xDSL	✗	✓	✗
Elitel SpA	✗	✗	✓	✗
Energ.it SpA	xDSL	✗	✓	✗
Estel SpA	✗	3	✗	✗
NOICOM SpA	✗	✗	✓	✗
Atlanet SpA	xDSL	1	✓	✗
Serenissima Infracom SpA	XDSL and WLL	✓	✓	✗
EdisonTel SpA	xDSL	✗	4,900 km	✗
Acantho SpA	Ethernet	1	✗	✗

Source: Analysys Research

MANs = Metropolitan area networks

**Outlook**

As mentioned above the fixed line voice market witnessed a period of intense price competition post deregulation, which has subsequently eased during the consolidation phase of the last three years. With fewer players in the market, and Telecom Italia’s wholesale prices regulated under a RPI-x structure, the outlook for pricing is more stable.

In line with consumer demand, competition has shifted from a price-led strategy to a service-led one, in particular more data intensive services and increased bandwidth in both fixed line and mobile. Strong growth is expected from data traffic (predominantly broadband over dial up), and Analysys expects the number of broadband connections in the business sector alone to grow at 10% compound from 2003 to 2007. Broadband has already achieved respectable penetration in large cities, so the bulk of this growth is likely to come from regionally located businesses.

The business market place comprises 55% of Italian telecommunications by value and is dominated by small and medium size enterprises (SMEs). In their rush to serve large corporates or the mass residential market, the majors have historically overlooked SMEs. Whilst regional operators are better placed to address this market, their price-led strategies have produced low margins and high churn levels. Teleunit's strategy has been to target SMEs throughout Italy. Its focus has been less on building infrastructure and branding and more on high quality services and high levels of customer satisfaction. This has given the company a stable and profitable platform, together with the required operating experience, from which it is now well placed to expand.

## COMPETITION

We highlight the main players in the fixed line market below, who we believe, collectively have 20% of the market not controlled by Telecom Italia. Wind and Albacom are the largest players outside of Telecom Italia. From Teleunit's viewpoint, the most significant competitor is Plug-IT/EdisonTel, which has a market leading position in both premium rate access numbers and pre-paid calling cards.

### Telecom Italia

Telecom Italia is the former state owned monopoly, acquired in 2003 by Olivetti. Whilst it is Italy's second largest ISP after Wind, less than 3% of its revenues come from Internet access, with the majority coming through the fixed line voice market (where Telecom Italia dominates) and the mobile network via its 56% holding in Telecom Italia Mobile. Telecom Italia generated over €30bn of revenues in 2002 with a 46% EBITDA margin.

### Wind

Wind is Italy's second largest telecoms provider and Italy's largest ISP, with 3.2m active accounts at September 2003. It is also a dominant player in the fixed line market, with almost 7.5m fixed line customers and is in the top three providers of Italian mobile telephony. It owns 30 Metropolitan Area Networks and 18,275km of national backbone. Wind is fully owned by the state controlled electricity provider, ENEL, and achieved €3.9bn of revenues in 2002, with an EBITDA margin of 16%. Its IPO is expected in 2004 or 2005.

### Albacom

A consortium comprising British Telecom, Banca Nazionale del Lavoro, ENI and MediaSet owns Albacom. It achieved revenues of €578m in 2002, and is deemed the second largest alternative operator after Wind, with 132,000 fixed line customers. Services provided include voice and xDSL to the corporate market and wholesale services through its regionally focussed network.

### e.Biscom

e.Biscom (FastWeb) is the leading last mile competitor to Telecom Italia and is a listed company. Provision of its fixed line broadband service to both businesses and residential users is through its subsidiary, FastWeb, whose fibre optic network covers Italy's six major cities and runs to 4,000 km. FastWeb is also penetrating other Italian cities through unbundled local loop (xDSL services). It introduced Video-on-Demand and Personal-Video-Recording services for its ADSL customers in 2003. Whilst the business generated revenues in excess of €300m in 2002, it is nevertheless loss making, which is hampering its expansion.

### Tiscali

Tiscali is the fourth largest ISP in Italy with 1.8m subscribers. Whilst the company has its own national infrastructure, it uses Telecom Italia's last mile connections for narrowband and broadband subscribers. The company is listed in Italy, and has grown rapidly by acquisition into 14 European countries and South Africa. Total subscribers are seven million. Tiscali offers free Internet access.

### Plug-IT (post acquisition of EdisonTel, renamed Eutalia)

Plug-IT and EdisonTel are primarily focussed on the business market, providing fixed line voice and data services. Plug-IT's purchase in 2003 of EdisonTel, market leader in pre-paid international calling cards, for €70m cash plus €67m of debt enhanced the Company's infrastructure backbone, now covering 4,900km of cable. Plug-IT/EdisonTel compete in two of Teleunit's markets, being the largest provider of premium rate access numbers to voice and Internet content providers and one of the largest providers of pre-paid international calling cards respectively.

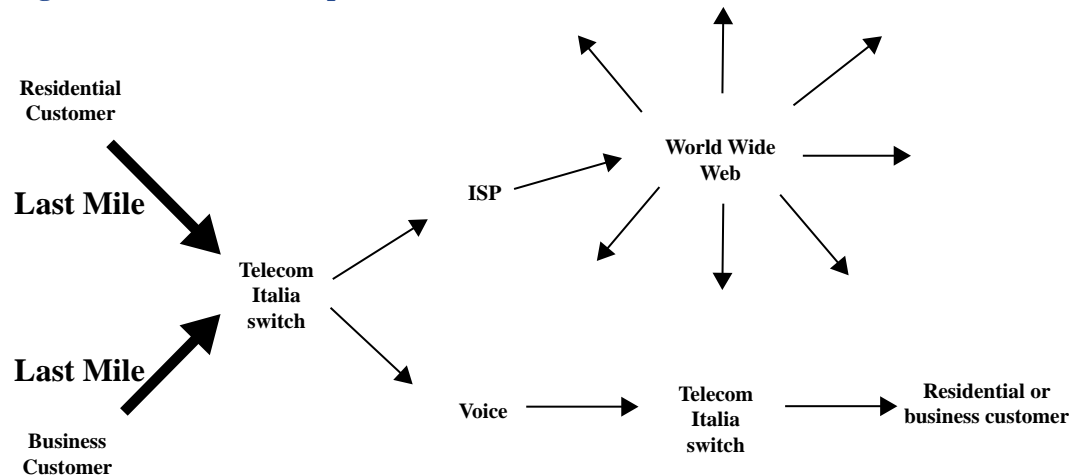
## WIRELESS LOCAL LOOP – THE LAST MILE

In this section we discuss the problem of the last mile and examine why WLL compares favourably to other last mile delivery solutions in Italy.

### What is the last mile?

The last mile represents the last (or first) stage of a connection from the relevant network (fixed line, mobile or Internet) direct to the customer (telephone or PC).

**Figure 7: Last mile example**



Source: Daniel Stewart

### Last mile solutions

During most of the last decade, telecoms operators undertook considerable investment in building a national and international telecoms infrastructure. Given the required investment in laying copper wire from local exchanges to businesses and residential areas across the country, it was the national carrier in the main, which undertook build out of the last mile. Subsequent telecoms deregulation has thus focused on generating competition in this area, predominantly through unbundling of local loop (where the national carrier retain the assets, but offers capacity to telecoms operators under a regulated pricing regime) or through alternative last mile infrastructure such as fibre optic cable and wireless infrastructure. Figure 8 below compares these alternatives.

#### ❑ Unbundled local loop

Network costs for unbundled local loop tend to be high, with time to market dictated by owner of the infrastructure assets (Telecom Italia), rather than the telecoms operator. Moreover, the quality of services in terms of capacity and speed are low, as the infrastructure used is essentially the existing narrow copper wire. Consequently, it has limited application for high bandwidth or data intensive services and tends to be suitable for residential or SOHO (small office, home office) use.

#### ❑ Fibre optic cable

In contrast to unbundled local loop, fibre optic cable has both high capacity and speed and is therefore suitable for residential, SOHO, SMEs and corporate users. There are no constraints through Telecom Italia, as build out of the network requires the laying of new infrastructure. This can however cause problems for the network provider. Firstly, upfront investment costs to replace copper wire with cable deep in the ground are substantial. Build out of the network takes considerable time and cannot be done piecemeal, and end-user demand for high bandwidth services needs to be high to achieve a suitable return on investment. Fibre has thus not been commercially viable outside of major cities.

#### ❑ Wireless Local Loop (WLL)

We discuss Teleunit's WLL technology in detail in the next section. In summary, it offers similar capacity and speed to fibre optic cable at considerably less cost to both the network provider and end user. Installation is quick and simple, and constraints with Telecom Italia are

avoided by circumventing existing last mile infrastructure. Like cable, WLL is suitable for residential, SOHO, SMEs and corporate users, although Teleunit specifically targets SMEs within industrial areas.

**Figure 8: Comparison between last mile solutions**

<b>Comparisons</b>	<b>ULL</b>	<b>WLL</b>	<b>Fibre</b>
Network costs	high	high	very high
Time to Market	dependent on T.I.	short	very long
Quality of Services	low-medium	very high	very high
Customers Size	residential – SOHO– SME	residential – SOHO– SME – corporate	residential – SOHO– SME – corporate
Constraints with Telecom Italia	Very high	none	none

**Source: Teleunit**

## TELEUNIT WIRELESS LOCAL LOOP (WLL)

Teleunit's broadband WLL network is key to the long-term strategic development of the business. WLL technology allows the traditional "last mile" copper wire connection between the end users, voice and data infrastructure and the telecom operator to be replaced with high-speed wireless access. Teleunit has already rolled out WLL infrastructure in Umbria through 13 base stations at a cost of €2.2m. Approximately 120 customers have been activated in a relatively short timeframe. It is intended that similar WLL networks will be built out in Tuscany, Marche, Emilia-Romagna and Lazio over the next 12-15 months.

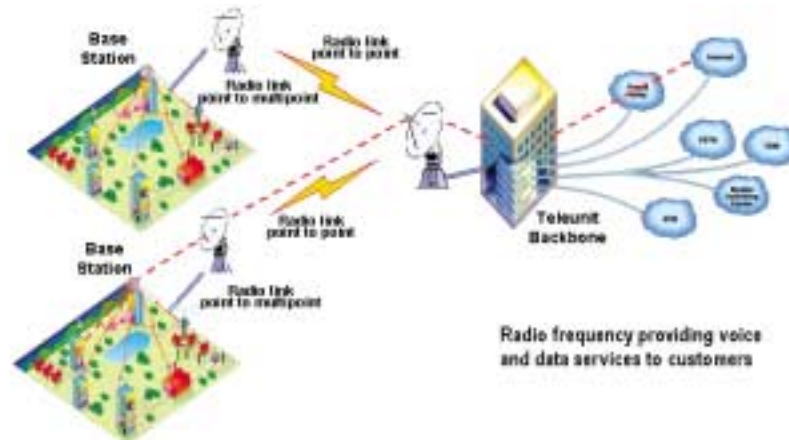
Target customers are likely to be larger SMEs, with requirements for bandwidth applications which require guaranteed upload speeds above 576Kbps, such as video conferencing and VoIP. Statistics show that there are 800,000 SMEs within the five target regions (including Umbria), although not all are likely to be of sufficient size to require WLL. Nevertheless, using our estimated average spend per Internet customer of €4,345 per annum, and assuming that 20% of the total number of SMEs are potential clients, this still provides a potential market size of €695m.

The company plans to use a mixed sales force of independent agents and employed sales executives, although weighted much more towards the latter. Teleunit's fixed line business currently uses a pool of independent agents, which can be used to source the WLL business and employed sales executives can be sourced from numerous other software houses and Local Area Network providers. Teleunit will also use strategic partnerships as a distribution channel. The largest of these to date is IBM, which acts as main contractor for the installation of the WLL network, as well as a distribution channel for the WLL product. This is an important relationship to both parties, allowing Teleunit access to the larger SME customers of IBM's business partners and giving IBM's partners an additional service offering. Partnership with IBM also gives Teleunit additional credibility and endorses its WLL service.

Figure 9 below shows how a WLL network can be achieved. Teleunit supplies its customers with a small dish (like a television satellite dish) and on-site router (known collectively as CPE), which converts voice and data traffic from the customer's network into encrypted radio signals. These signals are then transmitted to a Point-to-Multi-point repeater base station. These base stations are strategically positioned within an industrial area on tall buildings or other high infrastructure, so as to be in line of sight of one another, and can receive and transmit radio signals from CPEs located within a 5 km and 90 degree arc. Base stations have a useful economic life estimated at 12 years.

The next stage is for the base station to transmit the radio signal over wireless Point-to-Point repeaters, which can each be up to 60 km apart, to the backbone/telecom operator, from where the signal is converted back from a radio frequency and is routed onto a fixed line or Internet network. In terms of Teleunit's existing WLL, the Umbrian network is routed back to the company's existing infrastructure in Perugia and Internet traffic is routed to the Milan Network Access Point (NAP). CPE's can now support up to a guaranteed 8 Mbps of capacity as standard, although this can be increased up to 34 Mbps if customers require, and, whilst base stations are purchased with a set level (16 Mbps) of capacity, in reality, this is unlimited.

**Figure 9: WLL routing structure**



Source: Teleunit

**What are the alternatives?**

WLL technology can be used for both fixed line voice traffic and Internet last mile connectivity. Whilst the existing last mile copper wire connection owned by Telecom Italia is suitable for fixed line voice traffic, Teleunit offers subscription-free fixed line telephony through its WLL network, saving end users an average 30-35% off their monthly telephone bill. However, it is in Internet connectivity where the advantages of WLL over alternative solutions such as unbundled local loop (e.g. ADSL) and fibre can be clearly seen.

**ADSL**

ADSL has become commonly known as broadband, and whilst it has a theoretical maximum upload speed of 640 Kbps, it is a shared access channel and achievable speed depends on the number of simultaneous users. In reality, the highest guaranteed minimum access speed is 50 Kbps. Whilst this is an improvement on the historical 56k dial up Internet connectivity, it is not suitable for many existing or new data intensive applications such as video conferencing. We believe that its value is more for the residential market over the business market. Consequently, it comes a poor second to both fibre optic cable and fixed wireless access, despite its marginal cost to the operator (through use of existing infrastructure) and cheap hardware requirements (modem) for the end user.

High bit-rate DSL (HDSL), a variant of DSL technology, can guarantee upload and download speeds of either 1 Mbps as a shared channel, or 2 Mbps and upwards, if a dedicated line is leased from Telecom Italia. Dedicated lines can be prohibitively expensive for many SMEs. WLL on the other hand offers a range of access capacity, allowing the customer to match access requirements, and cost thereof, with growth of the business. Figure 10 below compares HDSL leased line costs from Telecom Italia to Teleunit’s WLL offering.

**Figure 10: Cost for end user – HDSL v WLL**

	Activation cost €	Annual rental €	Annual cost ex transmission €
Telecom Italia 34 Mbps leased line	17,043	49,584	66,627
Teleunit 34 Mbps WLL	150 (hardware cost borne by Teleunit)	7,380 maximum	7,530

Source: Teleunit

**Fibre optic cable**

Despite cable having the capability to access television, telephone and Internet, networks have been restricted to the six major Italian cities. This is largely due to the capital intensity and lengthy process of laying cable underground, and the resultant inability to expand such a network piecemeal, which requires a high level of take-up to be commercially viable. With satellite operators and Internet Service Providers offering competitive pricing for television access and Internet service respectively, cable has not achieved the desired penetration initially

expected. Moreover, revenues from services such as Video-on-Demand need to be generated to recoup the capital outlay, unlikely in sparsely populated residential areas.

## Growth drivers

### □ Licences

Wireless network providers, operating between 24.5Ghz and 26.5Ghz frequency in Italy are required to have a regional licence granted by the Italian regulator, AGCOM. Under the last round of licensing in 2002, up to ten licences were auctioned in each of the Marche, Lazio, Tuscany, Emilia-Romagna and Umbria regions. Teleunit used this opportunity to acquire a 20-year licence for €85,000 to operate a WLL in Umbria at radio frequencies from 24.5Ghz to 26.0Ghz. However, take up in the remaining regions was slow, as most operators were not (and still are not) in the financial position to support the cost of licences and network build out. Thus interest was mainly from operators wishing to manage their mobile traffic (Telecom Italia Mobile, Wind and Vodaphone).

Under the terms of the licence, licensees must achieve service coverage of 30% of the total provinces in a region within two years of grant, failure to do so resulting in the licence returning to the regulator for re-auction. We understand at the time of writing that no licensee other than Teleunit has rolled out a full WLL network in the five regions in question. Teleunit also believes that suppliers of its WLL equipment are not supplying other operators in Italy.

Accordingly, a new auction process is underway for licences to operate in Teleunit's four other target regions. The public consultation process, which started on April 2, is expected to close on May 2, subject to any local authority objections, upon which time the auction will be formally opened. At the time of publication no objections appear to have been lodged and we expect the auction to open on time. Operators will then have 30 days in which to express their interest in a particular licence, such interest being made public. Upon expiry of the 30 days, the auction will close, and, so long as there are fewer bids than licences, each operator will be granted the licence in which it expressed an interest.

Under the reverse scenario i.e. where there are more expressions of interest than licences, a bidding process will ensue. We believe, however, that given the number of licences available in each region, and poor take-up in the last round, Teleunit will secure the required licences at the expected price (see figure 11). Moreover, the auction for licences that are not initially acquired remains open for 12 months, giving Teleunit the flexibility to acquire some of its licences at a later date than planned, tying up less working capital in the short term. For sake of our forecasts, we prudently assume that the full cost of acquiring the licences (shown in figure 12) is incurred in 2004.

**Figure 11: Auction of WLL licences, 2002 and 2004**

	Tuscany	Marche	Emilia-Romagna	Lazio
2002 – licences available	10	10	10	10
Acquired by mobile operators	3	3	3	3
Acquired by others	2	1	0	0
2004 – licences available	5	6	7	7

Source: Teleunit

This represents a considerable growth opportunity for Teleunit to rollout its WLL network over the next 12-15 months. Figure 12 shows the expected deployment dates.

**Figure 12: Expected cost of WLL licences and deployment dates**

Region	Cost of 20 year licence €	Expected deployment date	Average no of companies in region*
Tuscany	800,000	Summer 2004	223,888
Marche	210,000	Early 2005	90,646
Emilia-Romagna	800,000	Early 2005	258,494
Lazio	1,300,000	Summer 2005	223,292

Source: Teleunit and Istat (2001 Census)

\* excludes retail

❑ **Lead time to gain critical mass**

In order to encourage competition in the “last mile” market, AGCOM has determined that Telecom Italia must wait four years between being granted a WLL licence and deploying a WLL network. Telecom Italia did not partake in the last round of licensing, so the earliest it could deploy a WLL network would be May 2008, giving Teleunit considerable lead time to build critical mass within this market. Teleunit is currently the only operator of a WLL network in central Italy and there are no other WLL operators in the five regions in question.

Whilst Telecom Italia could, in theory, reduce the prices of its HDSL offering to protect against loss of market share to WLL, HDSL is expensive, cannot be sold profitably at low prices and is unlikely to be able to compete against Teleunit’s lack of upfront charge for the CPE and low (€190) installation charge. Moreover, Telecom Italia would have to reduce its prices nationwide, which would be commercially and financially undesirable. Outside of Telecom Italia, smaller operators are struggling following the harsh economic climate of the last three years and may not have sufficiently deep pockets to fund development of a WLL infrastructure. Larger operators have invested heavily in ADSL to target the residential market, and may not wish to diversify from this strategy.

❑ **SMEs have been poorly served by the majors**

Teleunit’s WLL technology is particularly suited to the Italian market, with over 3.4m SMEs, the highest number of any European country (see figure 13). The majority of these are located in non-metropolitan areas where the laying of fibre optic cable has not proved commercially viable and demand for HDSL has been limited. Consequently, this sector has not been well served by the majors who have focussed their attention on large cities. This has left many SMEs with the choice of either leasing an HDSL line from Telecom Italia at considerable cost, or simply missing out on applications, which require greater bandwidth than ADSL.

Although ADSL offers a theoretical 640 Kbps maximum upload speed, in practice this is often only a 20 Kbps guaranteed minimum, with the highest guaranteed minimum access speed of 50 Kbps. Understandably, many SMEs require a greater bandwidth than this and not only does WLL avoid the cost and delay associated in laying fibre optic cable, its modular network structure means that cost effective installation is achievable even in remote areas, with easy upgrade or relocation possibilities.

**Figure 13: Italian SME market (000s)**

Employee numbers	Italy	Europe	Italy/Europe %
1-9	3,190	17,800	17.9
10-99	230	1,400	16.4
100-499	20	210	9.5
	<b>3,440</b>	<b>19,410</b>	<b>17.7</b>

Source: Assinform

❑ **Cross-sell potential**

Longer term, as Teleunit’s WLL infrastructure network expands, broadband services such as Video on Demand could be sold to residential customers, an area of potentially significant growth (excluded from our forecasts). Whilst the average cost per CPE of €3,000 (although this will drop to €2,300 in the short term) may not make it suitable for individual households, the signal can be split, allowing one router to serve six abodes within one block of flats. Teleunit is currently testing the feasibility of this.

**Competitive landscape**

As mentioned above, Teleunit is currently the only operator of WLL in central Italy and there are no other WLL operators in the five regions in question. Whilst we believe that other operators may enter the market, this is likely to be over the medium term, given the investments they have undertaken in, and the opportunities arising from, residential ADSL services. This gives Teleunit sufficient lead-time to build critical mass.

**Key strengths**

We believe that WLL compares favourably to other last mile Internet connectivity solutions. From a capacity viewpoint, Teleunit supplies CPEs with an 8 Mbps data capacity in both upload and

download. Capacity can be increased to 34 Mbps if the customer requires. This is a key attraction for businesses, where ADSL's upload capacity is considerably slower than its download capacity, making it unsuitable for video conferencing and other intensive data exchange usage. The scalability of the technology means that base station capacity (currently a minimum of 16 Mbps) is virtually limitless.

An additional key benefit of Teleunit's WLL is that, by bypassing Telecom Italia's last mile infrastructure for fixed line telephony, the company can offer a subscription-free telephony service to its customers, saving them an average 30-35% off their monthly telephone bill.

The only negatives compared to ADSL are the higher cost of deployment and requirement to have line of sight between CPEs, base stations and point-to-point repeaters. On the latter point, Italy's hilly landscape supports installation of WLL infrastructure at high up points to achieve such connectivity.

In terms of costs, WLL does not require payment to Telecom Italia (unlike ADSL which uses the existing local loop) and payback on investment is estimated between six and eight months, even before factoring in short-term reduction in hardware costs. Compared to fibre optic cable, installation cost is low and can be recouped through Internet access charges alone. It is therefore commercially viable to install in non-metropolitan areas and can be expanded incrementally according to growth in the customer base, rather than incurring an upfront network backbone cost. From the customer viewpoint, it costs €190 to switch to the WLL service, with Teleunit picking up the hardware cost.

**Figure 14: Comparison of WLL to alternative Internet connectivity**

	WLL	ADSL	HDSL	Fibre
Guaranteed upload speed	8 Mbps*	50 Kbps	1 Mbps	10 Mbps
Symmetry	symmetric	Download only	symmetric	symmetric
Monthly cost	medium	low	high	high
Constraints with Telecom Italia	no	yes	yes	no

Source: Teleunit, Daniel Stewart

\* can be increased to 34 Mbps

### History does not repeat itself

Investors may remember the high profile failures of both Ionica and Atlantic Telecom. These two companies had attempted to offer last mile alternatives using unproven technologies and frequencies, which ultimately failed. We believe, however, that not only were market conditions less favourable then than at present, but also that there were specific reasons for each failure, in particular, use of different technologies and frequencies to Teleunit. WLL technology of a suitable frequency has already proved successful both by Teleunit in Italy and by others elsewhere.

Ionica's technology was temperamental and easily disrupted by environmental factors such as rain. Ionica attempted to operate through a complex set of partnerships, which were ultimately difficult to manage and more importantly, in planning to take its technology nationwide, (its licence required coverage of 75% of the population), it underestimated the response from British Telecom, which slashed costs and proved tough competition. In contrast, Teleunit is targeting specific industrial regions, rather than going for national domination or focussing on cities where competition is high, and is less likely to incur the wrath of Telecom Italia. Moreover, should Telecom Italia decide to reduce its prices, it would need to introduce this nationally, which would be highly impractical. Even in the highly unlikely event of this happening, we expect Teleunit to maintain high customer retention levels through its focus on customer satisfaction and subscription-free telephony.

Atlantic Telecom, on the other hand, failed for largely different reasons, in particular acquisitions of heavily loss-making companies across Europe. Investors should note that Teleunit is not planning to make acquisitions, nor does it have national or international aspirations. Atlantic also compromised its WLL strategy by rolling out a DSL network in Germany. Teleunit will not build a DSL network. In contrast to the 2.4Ghz band used by Atlantic, which is a shared and largely unregulated band with high risk of interference, the 26.0Ghz band used by Teleunit is much more sophisticated. Its WLL technology is more mature yet cheaper and Teleunit is expanding its WLL network at a time when businesses need increased bandwidth for existing and new business applications.

## Financials

Teleunit receives two revenue streams from its WLL service: Internet and voice traffic. Internet access is charged at a fixed monthly fee, depending upon the level of bandwidth guaranteed. Currently, Teleunit's charges range from €95 per month for a guaranteed 128 Kbps, €615 per month for a guaranteed 1 Mbps, €1,195 for guaranteed 2 Mbps and so on all the way up to 8 Mbps. If circumstances dictate, capacity can be increased to 34 Mbps. Within this charging structure the customer has the flexibility to purchase increased guaranteed bandwidth for specified durations, e.g. for a video conference call. Voice traffic is charged as in the fixed line business on a per minute basis, but with no fixed monthly fee.

Teleunit does not make an upfront charge for the CPE, but locks in the customer under a two-year contract. Payback for the CPE is estimated between six to eight months and the customer incurs a €1,500 penalty in the unlikely event of early termination. Gross margins on voice traffic are higher than those in the fixed line business, due to lack of collection costs payable to Telecom Italia. Whilst it is difficult to accurately calculate a cost of sales for the WLL Internet business alone, as bandwidth is used for a variety of services, we assume approximately 10% of total WLL revenues. This is based upon the cost of transport and bandwidth charges payable to the Milan NAP, which are currently €10,500 per month for the Umbria network. We use a conservative ratio of 5:1 to calculate how many customers will be using the maximum bandwidth at any one time, which equates to 170 customers each using 1 Mbps per 34 Mbps connection (34x5x1).

170 customers are deemed to provide a maximum €104,550 of revenue per month (170 x €615 for 1 Mbps), giving an estimated cost of sales of approximately 10%. We apply this to total WLL revenues, rather than solely to WLL Internet revenues, and have, therefore, been aggressive on costs.

The remaining significant cost drivers are depreciation and staff costs. All WLL infrastructure is depreciated over five years, giving an estimated average annual depreciation charge of €2.4m between 2004 and 2006.

Our estimates assume that Teleunit will employ five direct sales people by the end of 2004 growing to 60 by the end of 2005. These are likely to be recruited from other software houses or companies that sell Local Area Networks. We expect the indirect sales force to grow to 18 by 2004 and 30 by 2005. Direct sales people are offered a fixed €1,800 monthly salary plus volume-based commission, making Teleunit a highly attractive employer.

Teleunit expects its direct sales force to sign up five new customers per month (60 per annum) and agents to sign up 12 per annum. Our forecasts assume that this will be achieved in 2004, with the rate slowing beyond that. We assume that Internet customers alone will each spend €4,345 in 2004, slightly above the annual average range between €95 and €615 per month. We do not include any contribution from the partnership with IBM. We expect revenues from voice traffic to increase from €0.8m in 2004 to €14.1m in 2006, driven by the attractiveness of subscription-free telephony to the customer, and revenues from Internet traffic to increase from €0.9m in 2004 to €17.7m in 2006. Gross margins are estimated at approximately 70% over the forecast period.

We are conservative in our estimates of Teleunit's expected market share. Analysis estimates that 430,667 new business broadband connections will be made in 2005. Given that the five regions targeted by Teleunit equate to 30% of Italian GDP, this gives us an estimated 129,200 potential broadband connections within Teleunit's market (430,667 x 30%). Our forecasts assume that Teleunit signs up 2,076 new customers in 2005, which equates to a 1.6% share of the potential market.

In order to manage this growth successfully, Teleunit will employ four area managers with responsibility for all direct and indirect sales people in the five regions. Area managers will report into a sales manager based in Perugia. Each region will also have a satellite office with overall technical management done from Perugia.

**Figure 15: WLL P&L estimates**

<b>Year end December</b>	<b>2003 a</b>	<b>2004 f</b>	<b>2005 f</b>	<b>2006 f</b>
	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>
<b>Revenue</b>	<b>115</b>	<b>1,678</b>	<b>11,811</b>	<b>31,767</b>
% change		1359.1%	603.9%	169.0%
Internet	57	886	6,242	17,667
Fixed line	58	792	5,569	14,100
<b>Cost of sales</b>	<b>-26</b>	<b>-486</b>	<b>-3,533</b>	<b>-9,501</b>
Internet	-9	-175	-1,228	-3,304
Fixed line	-17	-312	-2,305	-6,197
<b>Gross profit</b>	<b>89</b>	<b>1,192</b>	<b>8,278</b>	<b>22,266</b>
Internet	48	712	5,014	14,363
Fixed line	41	480	3,264	7,903
<b>Gross margin</b>	<b>77.4%</b>	<b>71.0%</b>	<b>70.1%</b>	<b>70.1%</b>
Internet	84.2%	80.3%	80.3%	81.3%
Fixed line	70.7%	60.6%	58.6%	56.0%
<b>INTERNET</b>				
<b>Revenues € 000</b>	<b>57</b>	<b>886</b>	<b>6,242</b>	<b>17,667</b>
<b>Direct sales force</b>				
Direct agents at start of year	0	0	5	60
New direct agents	0	5	55	40
Direct agents at end of year	0	5	60	100
Average number of direct agents	0	2.5	32.5	80
<b>Indirect sales force</b>				
Indirect agents at start of year	0	8	18	30
New indirect agents	8	10	12	20
Indirect agents at end of year	8	18	30	50
Average number of indirect agents	4	13	24	40
Total agents at end of year	8	23	90	150
Total average number of agents	4	15.5	56.5	120
<b>Customers</b>				
Customers at start of year	0	51	357	2,433
New customers	51	306	2,076	2,800
Direct sales agents (customer p.a.)	0	60	55	30
Indirect sales agents (customer p.a.)	0	12	12	10
Customers at end of year	51	357	2,433	5,233
Average number of customers	26	204	1,395	3,833
<b>Average revenues per customer €</b>				
128Kbps-2Mbps per month €	4,260	4,345	4,476	4,610
% change	95	96.9	99.8	102.8
1Mbps-8Mbps per month €	615	627.3	646.1	665.5
% change		2.0%	3.0%	3.0%
<b>Direct costs €</b>	<b>9</b>	<b>175</b>	<b>1,228</b>	<b>3,304</b>

Source: Teleunit, Daniel Stewart estimates

**Figure 15: WLL P&L estimates (cont'd)**

<b>Year end December</b>	<b>2003 a</b>	<b>2004 f</b>	<b>2005 f</b>	<b>2006 f</b>
	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>
<b>FIXED LINE</b>				
<b>Revenues € 000</b>	<b>58</b>	<b>792</b>	<b>5,569</b>	<b>14,100</b>
% change				
Average number of customers	26	204	1,395	3,833
Average monthly minutes per customer		4,900	5,145	4,888
% change			5.0%	-5.0%
Total minutes per period (000)		9,996	71,760	187,323
% change			617.9%	161.0%
Average revenues per minute € cents	8.08	7.92	7.76	7.53
% change		-2.0%	-2.0%	-3.0%
Average minutes per customer		49,000	51,450	48,878
% change			5.0%	-5.0%
Average revenue per customer €		3,880	3,993	3,679
<b>Costs € 000</b>		<b>312</b>	<b>2,305</b>	<b>6,197</b>
Average cost per minute € cents	2.31	3.12	3.21	3.31
% change		35.0%	3.0%	3.0%
Direct costs € 000	17	312	2,305	6,197

Source: Teleunit, Daniel Stewart estimates

## FIXED LINE TELEPHONY

Teleunit originally entered the fixed line (FL) market in 1997, building relationships as a reseller, whilst the Italian telecoms market was being deregulated. In July 2000, the Company procured a national operators licence, which allowed it, through agreement with two exchanges in Perugia and Ancona, to expand the client base. Whilst the early focus was on serving SMEs in the Umbria and Marche regions, Teleunit now provides fixed line voice and data (ISP) services to 9,500 business and residential customers, only 20% of whom are in these two regions, the remainder throughout Italy. Tuscany is currently the key revenue generator.

This diversification has spread risk, with no FL customer comprising more than 1% of turnover. New business is channelled solely through a network of 60 independents agents requiring minimum advertising support and client transfer is undertaken by the Carrier Pre-Selection Service (CPS) of Telecom Italia, facilitating the registration of customer traffic without on-site installation of “diallers” or the need to dial a carrier pre-fix. FL capacity is through four suppliers: Edisontel (71%), Telecom Italia (11%), Omnitel (9%) and Albacom (8%). Whilst investors will note Edisontel’s historical financial difficulties, these have been subsumed within a larger, better-capitalised group, through its acquisition by Plug-IT. In any case, there are several other capacity providers that Teleunit could use in a worse case scenario.

### Growth Drivers

Against a background of a flat fixed line market, Teleunit has grown divisional top line at an impressive 17% compound between 2000 and 2003. Whilst we do not believe the fixed line business will be the standalone engine of future growth, it is vital in driving the overall business forward. The established customer and carriage relationships within it are being used to develop the other divisions, and we expect the fixed line business to be a beneficiary of growth from both WLL expansion and the increasing move within the sector from a price-led to a service-led strategy, driven by market consolidation and growth in demand for new services. Teleunit’s add-on services (e.g. “Personal Fax” numbers, “Web-Agendas” and “Video email”) can be used to retain and increase fixed line customers at higher average revenues. We also expect additional distribution partnership deals to drive fixed line growth.

#### □ Sales agents

Teleunit has grown the number of its agents from 43 in 2001 to 51 in 2003 and 60 presently. Agents will typically be small, private companies employing up to five people, with strong relationships with SMEs. Revenue from a client such as Teleunit is therefore significant. We forecast the average number of agents to increase to 88 by 2006, with each agent expected to service 155 of Teleunit’s customers. This is conservative, given that the existing base handles approximately 168 customers each.

#### □ Distribution partnerships

We believe that the recent distribution partnership with Zuritel, the online division of the Zurigo insurance company, heralds a new route to market. Under the deal, Zurigo will offer consumers who request car insurance quotes (180,000 per annum currently) Teleunit’s fixed line telephony contract at a 5% discounted rate. We believe that listing will raise Teleunit’s profile and attractiveness to other large commercial partners. Management has recently finalised two additional multi-level network distribution agreements, and a new agreement with a Bank in the South of Italy is currently at advanced negotiations. These recent agreements have not been factored into our forecasts.

### Competitive Landscape

The fixed line market has undergone considerable change over the last 18 months, on both the supply and demand sides. Deregulation combined with capital markets’ appetite for telecoms stocks in the late 1990s led to an explosion in the number of independent telecoms providers. Given Telecom Italia’s previously dominant position, heavy price discounting was employed by the new entrants to win market share.

Such price-led competition has encouraged prices to converge, which, when combined with bear markets over the last three years, and a shift from a price-led to service-led mentality amongst consumers, has resulted in the failure of many small and medium-sized operators.

The number of telecom operators active in Italy is estimated to have fallen from 151 in 2000 to approximately 20-25 at present. End users, disillusioned with low-price and often low-quality operators are now less willing to change from a supplier who meets their service expectations. Pricing has thus stabilised and we believe that future competition will become increasingly service-led.

Competition varies across regions from different local providers, but the largest single competitor is Telecom Italia. Consolidation in the business market means that Telecom Italia and Albacom are key competitors, whilst Tele2 Italia and Wind (acquired Infostrada) are strong in residential services.

### **Key strengths**

Teleunit has been sensible in refraining from mass advertising or brand building campaigns, preferring to market its brand through independent agents who possess established relationships with SMEs and are remunerated on a results-only basis. This has allowed the Company to avoid the pitfall of expensive, aggressive pricing campaigns, where short to medium term returns on vanilla fixed line services are likely to be low, due to the low revenue potential of each new customer and the fragmented state of the SME market.

At the same time, the Company has taken advantage of the shift from price-led to service-led offerings within the market, and increased competitive barriers by introducing cleverly constructed service additions to its fixed line customers. For example, the “Personal Fax” number mentioned above belongs to Teleunit, and thus cannot be transferred by the customer to another operator.

### **Financials**

The dramatic reduction in the number of market participants over the last three years has led to a more stable pricing environment. This, combined with greater consumer focus on value-added services has helped Teleunit to increase its average revenue per customer from €681 in 2001 to €912 (€76 per month or €7.48 cents revenue per minute) in 2003, despite a corresponding increase in customers from 7,698 to 8,570 respectively.

The adoption of CPS has both lowered the cost of winning new business and removed the traditional sector burden of maintaining inactive customers. Wholesale prices have also continued to fall, as Telecom Italia is subject to an “inflation minus” pricing regime similar to several UK regulated companies. The annual required pre inflation fall in call costs is 8% for local calls and 4.5% for national calls. Average traffic cost per minute has fallen from €4.86 cents in 2001 to €3.92 cents in 2003, leading to an increase in Teleunit’s gross profit per minute from €3.31 to €3.56 over the same period. Agents earn €55 per new customer plus 6% of year one revenues and a further 3-6% of revenues over years two to five. Gross margins are thus high at 40-50% and cash flows are highly visible, with billing undertaken promptly each month by an established third party and 87% of customers paying through direct debit.

We assume a steady increase in agents from the current 60 to 88 by 2006. We expect that each agent will handle 155 customers (conservative, given that non-exclusive agents currently handle 168 customers each) and that ongoing competition in the fixed line sector will reduce revenue per minute by approximately 3% each year to €6.83 cents by 2006. Regulatory pressure on Telecom Italia to reduce its pricing should also further reduce wholesale costs (we assume to €3.47 per minute by 2006). Gross margins should remain above 49%.

**Figure 16: Fixed line business P&L estimates**

Year end December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
<b>Fixed line revenue</b>	5,245	7,106	7,816	10,137	12,386	13,879
% change		35.5%	10.0%	29.7%	22.2%	12.1%
<b>Cost of sales</b>	-3,122	-4,090	-4,097	-5,041	-6,228	-7,051
% change		31.0%	0.2%	23.0%	23.6%	13.2%
<b>Gross profit</b>	2,123	3,016	3,719	5,097	6,158	6,828
% change		42.1%	23.3%	37.0%	20.8%	10.9%
<b>Gross margin %</b>	40.5%	42.4%	47.6%	50.3%	49.7%	49.2%
<b>Agents</b>						
Average number of agents	43	22	51	66	80	88
% change		-48.8%	131.8%	30.0%	20.0%	10.0%
<b>Customers</b>						
Average number of customers	7,698	7,984	8,570	10,277	12,332	13,565
% change		3.7%	7.3%	19.9%	20.0%	10.0%
Average customers per agent	179	363	168	155	155	155
% change		102.7%	-53.7%	-7.8%	0.0%	0.0%
Average revenue per customer €	681	890	912	986	1,004	1,023
% change		30.6%	2.5%	8.2%	1.8%	1.9%
<b>Minutes</b>						
Total minutes per period (000)	64,185	99,663	104,492	139,634	175,939	203,210
% change		55.3%	4.8%	33.6%	26.0%	15.5%
Average minutes per customer	8,338	12,483	12,193	13,588	14,267	14,981
% change		49.7%	-2.3%	11.4%	5.0%	5.0%
Revenue per minute (€ cents)	8.17	7.13	7.48	7.26	7.04	6.83
% change		-12.7%	4.9%	-2.9%	-3.0%	-3.0%
Average traffic costs per minute (€)	4.86	4.10	3.92	3.61	3.54	3.47
% change		-15.6%	-4.5%	-7.9%	-1.9%	-2.0%
Gross profit per minute (€)	3.31	3.03	3.56	3.65	3.50	3.36

Source: Teleunit, Daniel Stewart estimates

## PRE-PAID INTERNATIONAL CALLING CARDS

Teleunit entered the pre-paid international calling card market in Q4 2003, supplying international calls via pre-paid calling cards primarily to non-EU migrant workers living in Italy. This market, estimated at between €300-€350 million per annum, is driven by the rising number (currently estimated at three million) of foreigners (predominantly Moroccans, Albanians, Romanians, Philipinos and Chinese), who wish to call their countries of origin at low cost, yet may have limited proof of creditworthiness, prohibiting them from using credit accounts with utility suppliers.

The market has been historically characterised by low cost and often low quality traffic to specific destinations. Despite margins being low, credit risk is negligible and cash flow is positive. Teleunit's initial routes to market are through both a branded pre-paid €5 phone card, distributed through tobacconists and kiosks, and secondly through phone shops where end users can purchase and use talk time, rather like an Internet café. Teleunit deals directly with these phone shops as business customers.

Access to the service is provided through a free phone number and entry of a PIN code, allowing Teleunit to monitor and manage prepaid telephony accounts.

### Growth Drivers

Key to growing the business is developing reliable distribution channels and keeping costs low. Teleunit is not capacity constrained, having purchased a pre-paid telephony platform from Infotel, with a current licence traffic limit, which we forecast will be sufficient to service demand up to 2007. Beyond this the traffic limit can be increased against payment of higher licence fees.

Whilst Teleunit only entered this market in Q4 2003, it has already generated €1 million in revenues. We expect this to grow strongly in 2004, as the product is distributed through more of the 150,000 tobacconists, newsagents and kiosks and 2,500 phone shops that already sell phone cards or minutes in Italy. Future, potential sales channels include petrol forecourts, mobile phone shops, small general retailers and even community leaders. Teleunit currently sells through 40 phone shops.

Although the company has entered this market cautiously, using a distributor to gauge demand, its planned strategy is to go direct to the point of sale and cut out the distributor who controls supply into the market. In order to help achieve this, the company is currently trialing a system in conjunction with a leading Italian phone card distributor for printing of PIN numbers at the point of sale. If successful, this would not only remove the risk and volatility of relying on a distributor as middleman, but could also be used to supply PIN numbers of third party traffic providers, giving scope to substantially raise revenues and margins. This has not been factored into our forecasts.

### Competitive Landscape

Whilst this is a large and established market, its structure has changed recently. Telecom Italia, Tele2Italia and Edisontel (acquired in mid-2003 by Plug-IT) still dominate the market, although not without difficulty, as the widely publicised financial difficulties of Edisontel demonstrate. End-users are by definition highly price-sensitive, and brand loyalty is negligible, with consumers switching allegiance on price rather than service quality. Low margins have thus caused numerous small, low-quality operators to withdraw, despite the low entry barriers and attractive cash flow profile, leaving a gap in this growing market that Teleunit is aiming to fill.

### Key strengths

Whilst competition in this sector has been intense, phone cards are pre-paid and therefore provide a good source of visible working capital for other more profitable areas of the Company. The prepaid nature of the business, as well as Teleunit's highly scalable infrastructure, should allow rapid development of the business once distribution channels have been established.

With many ethnic groups in Italy, the Company can choose its destinations based on its ability to compete effectively on price, with the existing choice of China, Philippines, Senegal, Brazil, Bangladesh and Columbia, selected on that basis. Switching between destinations should be relatively easy, and the company's prudently cautious expansion into this sector, gives it time to build reliable sales channels and a robust model.

### Financials

This is a high volume, low margin business. Distributors generally take 30% of the sales value of the card, before payment to Teleunit. A further 55-60% goes to the carrier, meaning that a €5 phone card will typically leave Teleunit with just over €50 cents of profit, although there is scope to improve this by cutting out the distributor. However, as mentioned above this is a sizeable market, with low entry costs, and low brand loyalty. The level of migrant workers in Italy has been steadily growing over the past few years, and we see no reason for this to change going forward. Although margins are low, cash flow is highly positive, and potential market volumes are high.

Given the run-rate supporting the impressive €1m revenue in Q4 2003, we estimate €11m of revenues from this division in 2004, growing to €26.2m by 2006. The bulk of the revenues are expected to come from sale of prepaid phone cards, which we forecast to grow from €1m in Q4 2003 to €24.3m by 2006. We forecast average revenues per minute from phone cards to decline from €21.8 cents in 2003 to €21.0 cents in 2006, as prices are reduced to generate the required volume. This has a marginal reduction on gross margins from 11.3% in 2003 to 10.9% in 2006.

Our forecasts do not include potential revenues from sale of PIN numbers at the point of sale.

**Figure 17: Pre-paid international calling cards P&L estimates**

Year end December	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000
<b>Total revenue</b>	<b>964</b>	<b>10,916</b>	<b>19,066</b>	<b>26,210</b>
% change		1032.3%	74.7%	37.5%
Pre-paid phone cards	911	10,215	17,719	24,311
Phone centres	53	701	1,346	1,899
<b>Cost of sales</b>	<b>-855</b>	<b>-9,607</b>	<b>-16,951</b>	<b>-23,350</b>
Pre-paid phone cards	-808	-8,990	-15,754	-21,658
Phone centres	-47	-617	-1,197	-1,692
<b>Gross profit</b>	<b>109</b>	<b>1,309</b>	<b>2,115</b>	<b>2,860</b>
Pre-paid phone cards	103	1,225	1,966	2,653
Phone centres	6	84	149	207
<b>Gross margin %</b>	<b>11.3%</b>	<b>12.0%</b>	<b>11.1%</b>	<b>10.9%</b>
<b>Phone centres</b>				
Number of centres at start of period	0	22	72	122
New centres in period	22	50	50	50
Number of centres at end of period	22	72	122	172
Average number of centres	3.5	47	97	147
Average minutes per phone centre	69,714	68,320	64,904	61,659
% change		-2.0%	-5.0%	-5.0%
Total phone centre minutes (000)	244	3,211	6,296	9,064
% change		1216.0%	96.1%	44.0%
Average revenues per minute (€ cents)	21.82	21.8	21.4	21.0
% change		0.0%	-2.0%	-2.0%
Average costs per minute (€ cents)	19.3	19.2	19.0	18.7
% change		-0.5%	-1.0%	-1.8%
Average gross profit per minute (€ cents)	2.52	2.62	2.37	2.29
Average gross margin per minute %	11.5%	12.0%	11.1%	10.9%
<b>Pre-paid cards</b>				
Number of cards sold (000)	209	2,341	4,143	5,801
% change		1020%	77%	40%
Minutes per card	20	20	20	20
Total minutes (000)	4,180	46,816	82,864	116,010
% change		1020.0%	77.0%	40.0%
Average revenues per minute (€ cents)	21.8	21.8	21.4	21.0
% change		0.1%	-2.0%	-2.0%
Average costs per minute (€ cents)	19.3	19.2	19.0	18.7
% change		-0.7%	-1.0%	-1.8%
Average gross profit per minute (€ cents)	2.5	2.6	2.4	2.3
Average gross margin per minute %	11.3%	12.0%	11.1%	10.9%

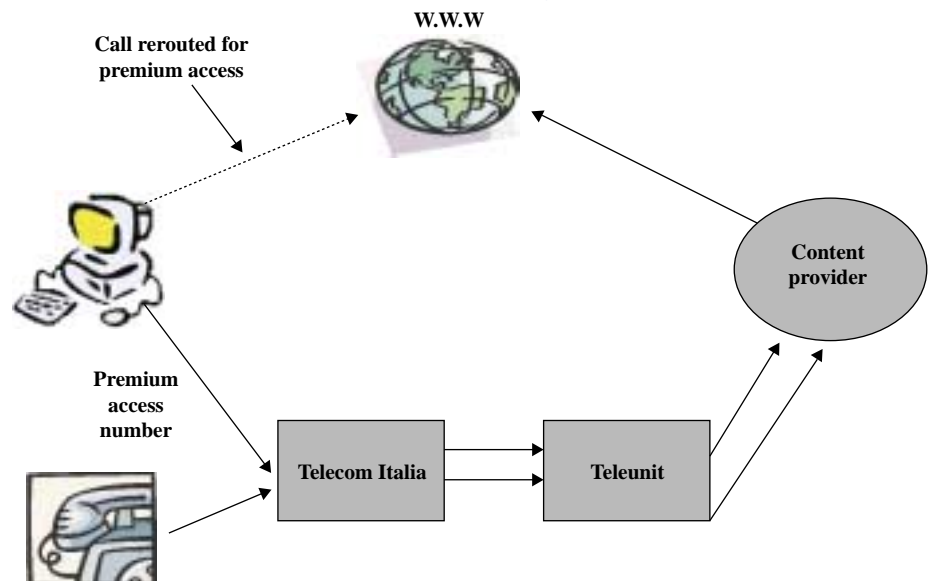
Source: Teleunit, Daniel Stewart estimates

## PREMIUM ACCESS NUMBERS (VALUE ADDED SERVICES)

Teleunit entered the premium access numbers market in 2002, supplying premium (“709” prefix) Internet access numbers to providers of paid data content. Figure 18 below shows the typical routing structure of a call. End users wishing to access premium content over the Internet, must disconnect from their ISP and reconnect to the premium content provider’s website via a premium rate telephone number supplied by Teleunit. This re-routing process is automated, through download of a service centre dialler onto the user’s PC, which contains the premium rate number required for re-connecting to the new site. Teleunit receives a proportion of the premium rate charge after commission to both the telephony provider (Telecom Italia) and the Service Centre. The gross amount for Teleunit in 2003 is approximately €1.96 per minute before commission charges.

Whilst Teleunit’s role appears to be that of facilitator between telephony provider and Service Centre, there is little scope for it to be circumvented. Only licensed telecoms operators can sell premium access numbers. Service Centres cannot buy premium access numbers, but can use Teleunit to provide the infrastructure and technical support, avoiding infrastructure investments and fixed overheads themselves. Teleunit, therefore, views the Service Centre as the client.

**Figure 18: Premium access numbers – call routing structure**



Source: Teleunit, Daniel Stewart

### Growth Drivers

We believe that the recent legislative changes in this market will help drive future growth. The more transparent charging regime put in place should lead to greater acceptance of premium access numbers as an efficient Internet billing mechanism which, combined with increasing consumer appetite for on-line content, is already leading to mainstream content such as mobile phone ring tones, financial news, recipes, weather reports and other low-cost data content being distributed this way. Payment by credit card over the Internet has not been readily accepted in Italy, due to perceived security risk and lower penetration of credit cards compared to other EU territories. Billing for premium access numbers via the standard telephone bill is a suitable alternative.

#### Regulatory changes

Changes imposed by the Italian Telecommunications Minister in 2003 meant that the original Internet premium “709” prefixed numbers, which were generating €20-25 per call on average but uncapped, were brought under the framework of voice premium “899” prefixed numbers and subsequently capped at €10.33 per call. Whilst this is undoubtedly causing some short-term pain within the market, as Service Centres review their pricing strategies, the short to medium term impact for Teleunit should be highly beneficial. We believe that greater pricing

transparency will encourage both consumers and premium content providers into the market place.

❑ **Mobile voice and text premium services**

The recent regulatory changes that transferred Internet premium services under the regulatory framework for premium voice services have aligned these two sectors more closely. This has facilitated the provision by Teleunit of premium access numbers for mobile voice traffic in addition to the fixed line voice and Internet traffic already serviced. Interconnectivity agreements have been signed with mobile operators, who are currently setting their switches and routing, which will allow end users to access paid content through mobile handsets. Mobile voice calls are not subject to price capping, making this a strong revenue opportunity for Teleunit. We also expect the increasing use of premium five digit text codes to access paid content to generate further growth for Teleunit, although this and revenues from mobile premium services have not been factored into our forecasts.

**Competitive Landscape**

The premium access numbers market is currently estimated at €400m. Plug-IT SpA was the first Italian operator to address this market, and its first mover advantage has allowed it to build up an estimated 60-70% market share. We believe that recent changes in this market, combined with Plug-It's difficulties in integrating EdinsonTel (acquired in 2003), and greater pricing transparency encouraging consumer use, present Teleunit with a strong opportunity to win market share over the next 12 months.

**Key strengths**

Service Centres have considerable capacity to increase the levels of paid content. By focussing on these centres as the primary customer, Teleunit has been able to maximise revenues by offering greater attractions than its competitors: 24-hour technical support, an interruption-free service and prompt payment of invoices (rolling ten-day account as opposed to competitors' practice of settling invoices two weeks post month end). Whilst this may seem simple to achieve, changing payment patterns would be a considerable administrative headache for larger players. In addition, Teleunit's low cost business model and recently negotiated reduced commission rates payable to Telecom Italia allow it to pay higher rates than the norm to the Service Centres.

**Financials**

This is a high growth market, in which Teleunit generated over €30m of revenues in its first year alone, with a gross margin approaching 14%. Whilst regulatory changes in 2003 obviously exerted some downward pressure on the market, Teleunit was still able to achieve a 16% growth in revenue and a 16.6% gross margin, largely due to the strengths mentioned above. The introduction of price capping in 2003 should lead to greater transparency and encourage more users into the market. Consumer demand for mainstream paid content, such as horoscopes, recipes and financial information is also increasing. We therefore believe that the supply of premium access numbers represents a strong growth opportunity for Teleunit over the medium term, particularly given the new opportunities in mobile voice traffic and premium five digit text codes. Revenue received varies depending on whether the connection to the Service Centre is made over a fixed line or wireless (mobile) network.

❑ **Internet and fixed line voice**

Teleunit receives revenue for fixed line Internet and voice premium rate access numbers gross, based on the number of minutes used during the online access. Out of this revenue, Teleunit pays commission to both the telephony provider (e.g. Telecom Italia) and the Service Centre. Thus one revenue minute (approximately €1.96 of revenue to Teleunit) generates approximately €0.47 of gross profit (or a 24% margin).

❑ **Mobile voice**

Revenue received per minute are lower for wireless access premium services. Teleunit receives its revenue net of commission to the mobile operator (typically 30%). A further payment must be made to the Service Centre (which makes a higher charge for the wireless access). Revenue received per minute is thus approximately €1.15, with gross profit of €0.27 (or a gross margin of 23%).

**Figure 19: Revenue and margin characteristics – premium access numbers**

	Fixed line network	Mobile network
Revenue per minute	€1.96	€1.63
Revenue to Teleunit	€1.96	€1.15
Total commission charges	(€1.49)	(€1.36)
Gross profit to Teleunit	€0.47	€0.27
Gross margin %	24	23

Source: Teleunit, Daniel Stewart estimates

Teleunit has grown its average Internet Service Centre customers rapidly to 44 in 2003. We take a conservative view that this rate will slow as a result of changes in the market place. Growth in 2003 was fuelled by the addition of a number of smaller Service Centres, which in turn generated a smaller average number of minutes. Our forecasts show a modest increase in the number of minutes per Service Centre, reflecting both the introduction of new online content, but also penetration by Teleunit of the smaller Service Centres.

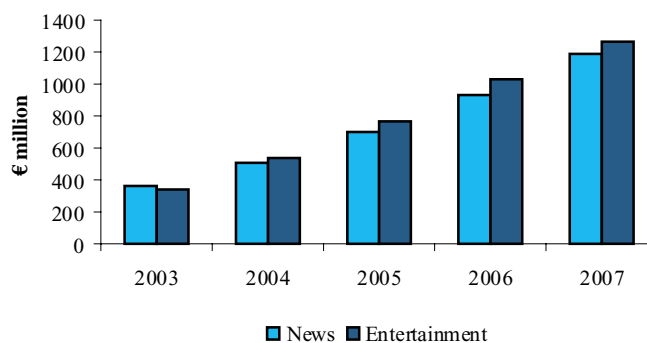
Our model reflects the revised 2004 commission rates with Telecom Italia. We do not expect these underlying rates to change going forward, although as voice minutes grow more rapidly than Internet minutes, Telecom Italia will benefit from higher combined commission rates. We forecast commissions to Service Centres at 65-70%.

We forecast 2004 revenues to grow at a similar rate to 2003, recognising the price-cap that has been introduced into the market. However, as the greater price transparency encourages more content providers and end users into the market, we expect growth to accelerate to 23% in 2005. Additional strong growth should come from mobile voice traffic and premium five digit text codes. Whilst we have not factored these into our forecasts, we recognise that this gives scope for a significant upgrade in revenues and profits over the next two years.

Whilst 2004 revenue growth will match the prior year, this will nevertheless be at higher (22.9%) gross margins, largely due to lower commission rates agreed with Telecom Italia. We forecast gross margins to remain steady at just under 22% in 2005.

Our forecasts do not include contribution from either mobile voice traffic or premium five-digit text codes, which could prove to be significant revenue generators in 2004 and 2005 respectively. Research consultancy, Ovum, recently highlighted the potential growth from the SMS market (see figure 20 below).

**Figure 20: Italian premium SMS text market 2003-2007**



Source: Ovum

**Figure 21: Premium Access Numbers/Value added services P&L estimates**

Year end December	2002 a €'000	2003 a €'000	2004 f €'000	2005 f €'000	2006 f €'000
<b>Total VAS revenue</b>	<b>30,384</b>	<b>35,376</b>	<b>41,246</b>	<b>50,857</b>	<b>60,424</b>
% change		16.4%	16.6%	23.3%	18.8%
Voice 899 revenue (€ 000)	0	900	4,961	12,743	20,389
Internet 899 revenue (€ 000)	30,384	34,476	36,285	38,114	40,035
<b>Cost of sales</b>	<b>-26,225</b>	<b>-29,515</b>	<b>-31,793</b>	<b>-39,800</b>	<b>-47,757</b>
Voice cost of sales	0	-800	-4,217	-10,832	-17,331
Internet cost of sales	-26,225	-28,715	-27,577	-28,968	-30,427
<b>Gross profit</b>	<b>4,159</b>	<b>5,861</b>	<b>9,453</b>	<b>11,058</b>	<b>12,667</b>
Voice gross profit	0	100	744	1,911	3,058
Internet gross profit	4,159	5,761	8,709	9,146	9,609
<b>Gross margin %</b>	<b>13.7%</b>	<b>16.6%</b>	<b>22.9%</b>	<b>21.7%</b>	<b>21.0%</b>
Voice gross margin		11.1%	15.0%	15.0%	15.0%
Internet gross margin	13.7%	16.7%	24.0%	24.0%	24.0%
<b>Internet services – Revenues</b>					
Average Internet service centres	23	44	46	48	49
% change		91.3%	4.0%	4.0%	4.0%
Total minutes from Internet service centres (000)	18,664	17,550	18,471	19,402	20,380
% change		-6.0%	5.2%	5.0%	5.0%
Minutes per Internet service centres	811,478	398,864	403,650	407,687	411,763
% change		-50.8%	1.2%	1.0%	1.0%
Average revenue per minute €	1.63	1.96	1.96	1.96	1.96
% change		20.7%	0.0%	0.0%	0.0%
<b>Internet services – Costs</b>					
Internet commission to Telecom Italia (€ 000)	-4,482	-5,101	-2,177	-2,288	-2,402
Internet commission to Telecom Italia per minute €	0.24	0.29	0.12	0.12	0.12
Internet commission to Service Centre (€ 000)	-21,743	-23,614	-25,400	-26,680	-28,025
Internet commission as % of revenue	71.6%	68.5%	70.0%	70.0%	70.0%
Internet commission to Service Centre per minute €	1.16	1.35	1.38	1.38	1.38
<b>Internet services – Gross profit</b>					
Gross profit per Internet minute €	0.22	0.33	0.47	0.47	0.47
Gross margin per Internet minute %	13.7%	16.7%	24.0%	24.0%	24.0%
<b>Voice services – Revenues</b>					
Average voice service centres	0	7	14	27	43
% change			100.0%	90.0%	60.0%
Total minutes from voice service centres (000)	0	500	2,600	6,422	10,275
% change			420.0%	147.0%	60.0%
Minutes per voice service centres	0	71,429	185,714	241,429	241,429
% change			160.0%	30.0%	0.0%
Average revenue per minute €	0.00	1.80	1.91	1.98	1.98
% change			6.0%	4.0%	0.0%
<b>Voice services – Costs</b>					
Voice commission to Telecom Italia (€ 000)	0	-230	-992	-2,549	-4,078
Voice commission as % of revenue	0.0%	25.6%	20.0%	20.0%	20.0%
Voice commission to Telecom Italia per minute €	0.0	0.46	0.38	0.40	0.40
Voice commission to Service Centre (€ 000)	0	-570	-3,225	-8,283	-13,253
Voice commission as % of revenue	0.0%	63.3%	65.0%	65.0%	65.0%
Voice commission to Service Centre per minute €	0.0	1.14	1.24	1.29	1.29
<b>Voice services – Gross profit</b>					
Gross profit per Voice minute €	0.00	0.20	0.29	0.30	0.30
Gross margin per Voice minute %		11.1%	15.0%	15.0%	15.0%

Source: Teleunit, Daniel Stewart estimates

**Figure 21: Premium Access Numbers/Value added services P&L estimates (cont'd)**

<b>Year end December</b>	<b>2002 a</b>	<b>2003 a</b>	<b>2004 f</b>	<b>2005 f</b>	<b>2006 f</b>
	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>	<b>€'000</b>
<b>Analysis</b>					
Total average number of service centres	23	51	59.8	74.2	92.1
Average revenue per service centre € 000	1,321	694	690	685	656
Total minutes per year (000)	18,664	18,050	21,071	25,824	30,655
Total commission to Telecom Italia (€ 000)	(4,482)	(5,331)	(3,169)	(4,837)	(6,480)
Total Service Centre commission (€ 000)	(21,743)	(24,184)	(28,624)	(34,963)	(41,278)
Total Internet Services commission (€ 000)	(26,225)	(28,715)	(27,577)	(28,968)	(30,427)
Total Voice Services commission (€ 000)	0	(800)	(4,217)	(10,832)	(17,331)
Total commission (€ 000)	(26,225)	(29,515)	(31,793)	(39,800)	(47,757)
Total commission per minute €	(1.41)	(3.24)	(3.11)	(3.18)	(3.18)
Total Voice Service commission per minute €	0.00	(1.60)	(1.62)	(1.69)	(1.69)
Total Internet Services commission per minute €	(1.41)	(1.64)	(1.49)	(1.49)	(1.49)
Total gross profit per minute €	0.22	0.32	0.45	0.43	0.41

**Source: Teleunit, Daniel Stewart estimates**

## MANAGEMENT

Teleunit's main board is supported by three operational managers with distinct experience in finance, sales and technical. The board has appointed two further highly experienced non-executive directors, one based in Italy and a further UK appointment with extensive telecoms experience.

### Main Board

#### **David Lee – Non-Executive Chairman, aged 61**

David has joined Teleunit as Non-Executive Chairman. He has considerable PLC experience through previous roles at Knowledge Support Systems Group PLC, Interx PLC, ARM Holdings PLC and Acorn Group PLC. Current roles include Non-Executive Chairman of Pharmagene PLC (drug discovery and research company), Executive Chairman of Tadpole Technology PLC (development and marketing of secure web infrastructure software) and Senior Non-Executive Director and Audit Committee Chairman of Superscape Group PLC (development and marketing of interactive 3D software for mobile phones and other wireless devices). David is a Chartered Accountant and has attended several General Management courses, including INSEAD, France and the Olivetti Management Programme in Italy and the UK.

#### **Gianfranco Cimica – Chief Executive Officer, aged 60**

Gianfranco Cimica founded Teleunit in 1997 and is currently responsible for the strategic direction, key decision-making and overall management of the business. He has successfully grown the business to date, whilst building the middle management of the company, to allow him to devote more time to strategic development.

Gianfranco has established a track record of success over the last 25 years, both as a manager in larger organisations and as a founder manager. Notable successes include launching a leading brand of children's shoes, whilst at IGI SpA and founding a business, which sold fashion sports bags under the "Le SportSac" brand, and was subsequently sold in 1997 to a US trade buyer.

#### **Francesco Cimica – Chief Operating Officer, aged 29**

Francesco Cimica is Gianfranco's son, and joined the business in 1998. He has significant experience of all areas of the company, through exposure as Sales Manager and Commercial Manager. He now has responsibility for the day-to-day operations of the company. He is also instrumental in the recruitment and management of the company's sales agency network.

#### **Todd Dockum – Chief Financial Officer, aged 41**

Todd Dockum recently joined the company. He has considerable experience of the Italian business market, having been the CFO at Ford Motor Company in Italy, an entity generating €2bn of revenues. Prior to that he was CFO of Ford in Russia. More recently, Todd founded European Internet Services, Inc. and European Internet S.r.l., a US company with an Italian based subsidiary, active in the design and implementation of several proprietary web applications using the latest multi-media web technologies (video chat, SMS/MMS and instant messaging). Todd has an MBA from the Miami University of Ohio.

### Operational management

#### **Andrea Grassini – Sales Manager, aged 47**

Andrea Grassini joined Teleunit in 1999 initially as a salesman. In January 2004 he became Sales Director with responsibility for developing the sales network, recruiting new direct and indirect sales people and also structuring commercial and strategic partnerships such as Zuritel and IBM. Before joining Teleunit, he was responsible for the financial planning agencies of Capitalia's group bank in Tuscany.

#### **Luca Cecchi – WLL Technical Manager, aged 32**

Luca Cecchi joined Teleunit in 2001 as Technical Operations Manager, with responsibility for planning and implementing the company's technical infrastructure. He is currently responsible for planning the technical improvement and expansion of Teleunit's network and services, and management of the company's technical staff. Previous roles include International Sales Manager for a leading television and radio transmitter producer, Itelco, and planning and implementation of

Wi-Fi networks at Mediarama, which gave Luca considerable experience in wired and wireless LAN technologies.

**Simone Barbarella – IT and Internet Services Technical Manager, aged 24**

Simone Barbarella's experience with Internet Service Providers began in 1999 with his role as technical manager for Edi&Sons S.p.A., one of the major Italian Internet dial-up connectivity players. He attended a Cisco Systems technical course in 2001, gaining certification direct from the company and commenced employment with Teleunit in the same year. He has overall responsibility for all Internet and IT services.

**Mattia Bastianini – Fixed line, VAS and pre-paid cards Technical Manager, aged 32**

Mattia Bastianini graduated in 2000 in Electronic Engineering specialising in Telecommunication Systems from the University of Perugia. He subsequently commenced employment with Elettromeccanica Industriale (an electronic component company) developing controls software for PLCs and PCs. Mattia joined Teleunit in January 2001, initially with responsibility for legal, operative and technical phases in the interconnection with Telecom Italia and the Ministry for the Fixed Line Licence. Since 2002 he has focussed on technology aspects of the premium access numbers and pre-paid international calling card businesses.

**Corrado Cherti – Finance Manager, aged 26**

Corrado's career began at Romacard S.r.l. in 1998, a company involved in the sale of prepaid mobile phone cards and international phone cards. He joined the investment banking division of Unicredit Banca Mobiliare in 2001, where he advised on the acquisition of Telecom Italia by Olimpia. Subsequent investment banking experience at Efibanca included the structuring of syndicated loans, bonds and acquisition finance. Corrado founded Corporate Capital S.r.l. in February 2003, a financial advisory firm servicing small and medium sized enterprises in Italy.

## FINANCIAL DISCUSSION

We have included a detailed breakdown of our estimates and assumptions throughout the earlier sections of this note. However, we bring the four divisions together in this section and show our estimates for revenue, profits and cash flows for the group as a whole.

### Profit and loss

Figure 22 shows the rapid growth in revenues expected over the forecast period. Fixed line revenues are deemed to grow steadily, highlighting the price stability that has returned to the market. However, the other three divisions are expected to be the key revenue drivers, growing collectively between 45-52% over each of the next three years. Key to this growth is the successful rollout of Teleunit's WLL network.

**Figure 22: Teleunit divisional revenue growth**

Year end December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
<b>Revenue</b>						
Wireless Local Loop	0	0	115	1,678	11,811	31,767
Value added services	0	30,384	35,376	41,246	50,857	60,424
Fixed Line	5,245	7,106	7,816	10,137	12,386	13,879
Pre-paid cards	0	0	964	10,916	19,066	26,210
<b>Total revenue</b>	<b>5,245</b>	<b>37,490</b>	<b>44,271</b>	<b>63,977</b>	<b>94,120</b>	<b>132,281</b>
Revenue growth				44.5%	47.1%	40.5%

Source: Teleunit, Daniel Stewart estimates

We also expect gross margin to grow, from 22.1% in 2003 to 33.7% in 2006. The two key drivers for this are a significant reduction from 2004 onwards in commission rates payable by Teleunit to Telecom Italia for Internet and fixed line voice for premium rate numbers, and a shift in the business mix towards the high margin WLL offering.

**Figure 23: Teleunit divisional gross profit and margin growth**

Year end December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
<b>Gross profit</b>						
Wireless Local Loop	0	0	89	1,192	8,278	22,266
Value added services	0	4,159	5,861	9,453	11,058	12,667
Fixed Line	2,123	3,016	3,719	5,097	6,158	6,828
Pre-paid cards	0	0	109	1,309	2,115	2,860
<b>Total gross profit</b>	<b>2,123</b>	<b>7,175</b>	<b>9,778</b>	<b>17,050</b>	<b>27,608</b>	<b>44,621</b>
<b>Gross margin</b>						
Wireless Local Loop	0.0%	0.0%	77.4%	71.0%	70.1%	70.1%
Value added services	0.0%	13.7%	16.6%	22.9%	21.7%	21.0%
Fixed Line	40.5%	42.4%	47.6%	50.3%	49.7%	49.2%
Pre-paid cards	0.0%	0.0%	11.3%	12.0%	11.1%	10.9%
<b>Total gross margin</b>	<b>40.5%</b>	<b>19.1%</b>	<b>22.1%</b>	<b>26.7%</b>	<b>29.3%</b>	<b>33.7%</b>

Source: Teleunit, Daniel Stewart estimates

It is not possible to split out operating costs across service lines, because many of the services are inter-related e.g. growth in fixed line telephony and growth in WLL, as Teleunit offers the former services to its WLL customers. However, we expect all operating costs except administrative expenses and marketing expenses to increase as a percentage of revenues over the forecast period. This is largely due to the lead-time between upfront costs for staff employment/training, network/infrastructure related costs and the benefits of the associated revenue flows, and a slightly higher percentage of marketing costs in 2004, in advance of network deployment. Depreciation and amortisation increases are due to investment in both the WLL infrastructure and licences. Nevertheless, EBITA margins are expected to increase from 9.0% in 2003 to 11.5% in 2006, although capital expenditure on WLL in 2004 and 2005 means that this margin growth should largely come in 2006.

**Figure 24: Teleunit operating costs**

Year end December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
<b>Operating costs</b>						
Infrastructure costs	-145.0	-557.0	-785.0	-1,407.5	-3,576.6	-5,555.8
<i>% revenue</i>	2.8%	1.5%	1.8%	2.2%	3.8%	4.2%
Administrative costs	-576.0	-558.0	-1,059.0	-1,599.4	-2,353.0	-3,307.0
<i>% revenue</i>	11.0%	1.5%	2.4%	2.5%	2.5%	2.5%
Depreciation	-221.0	-477.0	-976.0	-2,086.2	-4,156.8	-6,097.0
<i>% revenue</i>	4.2%	1.3%	2.2%	3.3%	4.4%	4.6%
Amortisation	0.0	0.0	0.0	-155.5	-155.5	-155.5
<i>% revenue</i>	0.0%	0.0%	0.0%	0.2%	0.2%	0.1%
Staff costs	-393.0	-696.0	-997.0	-1,919.3	-3,482.4	-5,555.8
<i>% revenue</i>	7.5%	1.9%	2.3%	3.0%	3.7%	4.2%
Sales commissions	-371.0	-467.0	-649.0	-1,343.5	-2,353.0	-4,233.0
<i>% revenue</i>	7.1%	1.2%	1.5%	2.1%	2.5%	3.2%
Marketing costs	-528.0	-710.0	-1039.0	-2367.2	-3294.2	-4629.8
<i>% revenue</i>	10.1%	1.9%	2.3%	3.7%	3.5%	3.5%
Other expenses	0.0	0.0	-273.1	0.0	0.0	0.0
<i>% revenue</i>	0.0%	0.0%	0.6%	0.0%	0.0%	0.0%
<b>Total operating costs</b>	<b>-2,234.0</b>	<b>-3,465.0</b>	<b>-5,778.1</b>	<b>-10,878.7</b>	<b>-19,371.5</b>	<b>-29,534.0</b>

Source: Teleunit, Daniel Stewart estimates

### Cash flow

Whilst we expect an annual €2m working capital outflow over the forecast period, Teleunit should maintain positive gross cash flow, due to the strong increase in profitability. Investment in the WLL infrastructure is, however, expected to largely swallow this cash flow, particularly in 2004 and 2005, when our forecast €10.3 and €15.0m capex requirements lead to a free cash outflow of €5.9 and €6.6m respectively. The benefits from this investment should be rapidly translated into profitability gains, as we forecast operating profit to rise from €6.2m in 2004 to €15.1m in 2006 with €7.7m of free cash in 2006. It is worth, however, noting Telephnica's policy of early settlement in the premium access numbers business and a strong outperformance of that particular business line could increase working capital requirements.

Whilst external funding from an IPO is required to develop the WLL network, we expect Teleunit to reduce its net debt position to €1m in 2006 without financing. Beyond the forecast period, we expect a move to a net cash position of €14.9m in 2007.

Full profit and loss and cash flow forecasts are found on the following pages.

## EVALUATION

We have valued Teleunit using both a discounted cash flow (DCF) and earnings multiple. We value the equity on this basis between €99m and €106m.

For our discounted cash flow, we use a cost of capital of 15% to discount the free cash flows, which we estimate will reach €25m by 2008. Our terminal growth rate of 2% is highly conservative, given the company's strong growth opportunities. The present value of the terminal cash flows equates to 80% of the overall valuation. Whilst this may seem high, it recognises the high capital expenditure between 2004 and 2005, which will be required to build out the WLL network. We would also stress that the high capex requirements in 2008 are deemed to continue into perpetuity under the DCF methodology. In reality it is unlikely that the company would need to sustain such a level of capex to support on-going growth of the business. There is thus a case to be made for an equity valuation above the €106m generated by our DCF.

We also value Teleunit on an Enterprise value (EV) to sales and EBITDA basis. We prefer the EV/EBITDA basis, as it takes account of the cost structure in a business, important for a fast growing company such as Teleunit. We use a blended multiple from a selection of UK and European alternative carriers, broadband access providers and other telecoms operators. This gives us a 2005 estimated EV/EBITDA multiple of 7.6x, which, when applied to Teleunit's 2005 forecast EBITDA of €12.55m, values the equity at €99m. It is worth noting that the majority of the peer group are loss making. Accordingly, there is an argument for Teleunit to trade at a premium to the average EV/EBITDA multiple.

We provide brief descriptions of the comparables used below. Our full DCF and multiple valuation can be found at the end of this note.

### Comparables

**Vanco plc** (LSE: VAN) is a global virtual network operator. The Group offers end-to-end data network solutions, e-business, e-security and consulting services to businesses throughout the world. Vanco's packaged network solutions business provides the operation, design, security and day-to-day management of a network.

- Gross margin of 35-37%. 4 year average of 37%
- Demonstrated revenue growth of 30-43% over past three years. 39.1% four-year average.
- Pretax margin of 7.3%, Operating margin of 8.2% over four years.
- Net Debt of £7.5m
- Most recent historic revenues of £53.1m
- Return on assets four-year average 1.8%
- Profitable

**3U Telecom AG** (DAX: UUU) is a German-listed provider of telephone services. Its customers can access the company's network by dialing "01078" before making a call. 3U Telecom AG offers local, long-distance and international telephone services. The Company also provides mobile telephone and other wireless services.

- Average revenue growth of 35.9% for four years
- Cash of £30m
- Return on Assets 2.0% – 5 year average
- Return on Equity 2.46% – 5 year average
- Most recent historic FY revenues of €65m
- Gross margin FY03 of 21.7%. Five-year average of 20.1%
- Profitable

**Fibernet Group plc** (LSE: FIB) designs and manages communications networks. The Company installs individually designed optical networks for large corporations, other telecommunications companies, and Internet service providers in the United Kingdom and Frankfurt. Fibernet's networks facilitate communication between employees and systems. The Company also offers wholesale DSL Internet access.

- Most recent historic revenues of £36m
- Five-year sales growth rate of 43.3%
- 35% five year average gross margin – 27% FY03 gross margin
- Loss making

**Easynet Group PLC** (LSE: ESY) and subsidiaries provide Internet access, computer networking hardware, software, peripherals and consultancy services to customers in the UK and Europe. The Group's ISP services are marketed under the UK Online brand, to customers in the UK, France, Germany and Belgium. Easynet also supplies branded Internet services for a number of businesses and organizations.

- Most recent historic revenues of £91.5m
- Average five-year revenue growth of 67.4%
- Average gross margin over 5 years of 54.3%
- Net debt of £33m
- Loss making

**e.Biscom** (IM: EBI) is an Italian-listed provider of fixed broadband telecommunication services in Italy through its wholly-owned subsidiary FastWeb. The company provides voice, Internet connectivity, data transmission and video services over a single connection by using Fiber-to-the-Home/Office and DSL access technologies on a fully integrated IP architecture. e.Biscom offers its services to both the corporate and residential market.

- Most recent historic FY revenues of €529m
- Rapid growth in revenues – average growth of 158.2% over five years
- Net debt of €538m
- Loss making

**Versatel Telecom International NV** (NA: VRSA) is a Dutch-listed provider of telecommunications services. The company offers basic telephone, fast Internet access, data transmission, business telephone, and remote access services to residential and business customers in Belgium, the Netherlands, Luxembourg, and Germany.

- Most recent historic FY revenues of €462m – 109.8% average growth over five years
- Five year average gross margin of 38.4%
- Cash of €126m
- Loss making

**COLT Telecom Group plc** (LSE: CTM) offers business communications services across Europe. Through its fiber optic network, the company offers voice, bandwidth, e-business, and managed network services to finance, industry and service sector customers, and governments.

- Most recent historic revenues of £1.2bn
- Average revenue growth of 43.3% over past five years
- Gross margin of 21% in most recent results – 15.8% over five year average
- Loss making

**Kingston Communications (Hull) PLC** (LSE: KCOM) provides, manages and operates end-to-end network and telecommunication services and solutions to business and residential customers throughout the UK. The Group's portfolio of services includes voice telephony, data communications, mobile and Internet. Kingston's media and inter-active divisions offer DSL television services and satellite communications.

- Most recent historic revenues of £329.8m
- 5 year average revenue growth of 21.3%
- £110m of net debt
- Loss making

**Redstone plc** (LSE: RED), the holding company for RNSL, supplies communications services throughout England and Scotland. The Group has a network of six switching centres, which provide local, long-distance, international and mobile phone services. Redstone also offers DSL Internet access to various ISPs in the UK. Their Callsure feature allows calls to be diverted from location to location.

- Most recent historic revenues of £68m
- Average turnover growth over four years of 31%
- Gross margin in 2000 of 7.5% rising to 27.4% in 2003
- Cash of £12m
- Loss making

**Pipex Communications Plc** (LSE: PXC), a telecommunications network operator, providing a variety of business communications solutions. The Company offers integrated voice and data connectivity and Internet access services.

- Most recent historic revenues of £8m
- Four-year average gross margin of 22.7%
- Loss making

**Thus Group plc** (LSE: THUS) operates as a supplier of Internet, data and telecom services in the United Kingdom and the Netherlands. The group offers dial up Internet services to the public, and a variety of business Internet access services, including web hosting, web design, leased lines and e-commerce. Thus' data and telecom services include switched direct, indirect and number transition.

- Most recent historic revenues of £291m
- Average four year turnover growth of 15%
- Average gross margin over past five years of 31%
- Net debt of £35m
- Loss making

**Telewest Communications plc** (LSE: TWT) is a provider of digital and cable television, telephone and Internet services to residential and business customers in the United Kingdom. The group's services include Active Digital, a digital TV and telephone service package, FrontRow, a pay-per-view movie service, Blueyonder, a high-speed Internet service, and Endeavour, an Internet portal for travel agents.

- Most recent historic revenues of £1,267m
- Demonstrated minimal revenue growth in FY02. Five year average of 38.0%
- Undergone considerable debt restructuring
- Loss making

**Telecom Plus PLC** (LSE: TEP) is a supplier of fixed wire and mobile telecommunications services, gas, and electricity to residential and small business customers in the United Kingdom.

- Revenue growth of 16.2-77.9% over the past three years. Five-year average of 87.1%.
- Gross margin of 24-37% over the past five years. 30.9% five-year average.
- Most recent historic pretax margin of 9.6%
- Four-year average return on assets of 12.0%
- Profitable

**Invox plc** (LSE: INX) is an AIM-listed interactive voice services company. The group specialises in the conception, promotion, collection and distribution of card-based competitions. Invox derives its revenues from claims to premium rate return phone calls and SMS messaging as home gamers respond to competitions.

- Most recent historic revenues of £18.2m
- Two-year average gross margin of 36.8%
- Operating margin of 27.2%
- Net cash of £4.5m

**Tiscali S.p.A.** (IM: TIS) is an Italian-listed provider of telecommunications and information technology services. The Company offers fixed-line telephone services in Italy, France, and the United Kingdom, Internet access services in Europe, virtual private networks, leased lines, website hosting and streaming services, and operates Internet portals.

- Most recent historic FY revenues of €739m
- Demonstrated rapid revenue growth from €33m in 1999 to €739m in 2002
- Net debt of €250m
- Loss making

## Appendix 1: PROFIT AND LOSS AND CASH FLOW SUMMARY

**Figure 25: Teleunit Profit & Loss estimates**

Year end December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
<b>Revenue</b>						
Wireless Local Loop	0.0	0.0	115.0	1,677.9	11,810.9	31,767.4
Value added services	0.0	30,384.0	35,376.0	41,246.1	50,857.4	60,424.3
Fixed Line	5,245.0	7,106.0	7,816.0	10,137.4	12,386.1	13,879.3
Pre-paid cards	0.0	0.0	964.1	10,915.9	19,065.6	26,210.4
<b>Total revenue</b>	<b>5,245.0</b>	<b>37,490.0</b>	<b>44,271.1</b>	<b>63,977.4</b>	<b>94,120.0</b>	<b>132,281.3</b>
Revenue growth				44.5%	47.1%	40.5%
<b>Cost of sales</b>						
Wireless Local Loop	0.0	0.0	-26.0	-486.2	-3,533.3	-9,501.2
Value added services	0.0	-26,225.0	-29,515.0	-31,793.4	-39,799.7	-47,757.4
Fixed Line	-3,122.0	-4,090.0	-4,097.0	-5,040.8	-6,228.2	-7,051.4
Pre-paid cards	0.0	0.0	-855.1	-9,606.9	-16,950.6	-23,350.4
<b>Total cost of sales</b>	<b>-3,122.0</b>	<b>-30,315.0</b>	<b>-34,493.1</b>	<b>-46,927.3</b>	<b>-66,511.8</b>	<b>-87,660.4</b>
<b>Gross profit</b>						
Wireless Local Loop	0.0	0.0	89.0	1,191.7	8,277.6	22,266.1
Value added services	0.0	4,159.0	5,861.0	9,452.7	11,057.7	12,666.9
Fixed Line	2,123.0	3,016.0	3,719.0	5,096.6	6,157.9	6,827.9
Pre-paid cards	0.0	0.0	109.0	1,309.0	2,115.0	2,860.0
<b>Total gross profit</b>	<b>2,123.0</b>	<b>7,175.0</b>	<b>9,778.0</b>	<b>17,050.0</b>	<b>27,608.2</b>	<b>44,620.9</b>
<b>Gross margin</b>						
Wireless Local Loop	0.0%	0.0%	77.4%	71.0%	70.1%	70.1%
Value added services	0.0%	13.7%	16.6%	22.9%	21.7%	21.0%
Fixed Line	40.5%	42.4%	47.6%	50.3%	49.7%	49.2%
Pre-paid cards	0.0%	0.0%	11.3%	12.0%	11.1%	10.9%
<b>Total gross margin</b>	<b>40.5%</b>	<b>19.1%</b>	<b>22.1%</b>	<b>26.7%</b>	<b>29.3%</b>	<b>33.7%</b>
<b>Operating costs</b>						
Infrastructure costs	-145.0	-557.0	-785.0	-1,407.5	-3,576.6	-5,555.8
<i>% revenue</i>	<i>2.8%</i>	<i>1.5%</i>	<i>1.8%</i>	<i>2.2%</i>	<i>3.8%</i>	<i>4.2%</i>
Administrative costs	-576.0	-558.0	-1,059.0	-1,599.4	-2,353.0	-3,307.0
<i>% revenue</i>	<i>11.0%</i>	<i>1.5%</i>	<i>2.4%</i>	<i>2.5%</i>	<i>2.5%</i>	<i>2.5%</i>
Depreciation	-221.0	-477.0	-976.0	-2,086.2	-4,156.8	-6,097.0
<i>% revenue</i>	<i>4.2%</i>	<i>1.3%</i>	<i>2.2%</i>	<i>3.3%</i>	<i>4.4%</i>	<i>4.6%</i>
Amortisation	0.0	0.0	0.0	-155.5	-155.5	-155.5
<i>% revenue</i>	<i>0.0%</i>	<i>0.0%</i>	<i>0.0%</i>	<i>0.2%</i>	<i>0.2%</i>	<i>0.1%</i>
Staff costs	-393.0	-696.0	-997.0	-1,919.3	-3,482.4	-5,555.8
<i>% revenue</i>	<i>7.5%</i>	<i>1.9%</i>	<i>2.3%</i>	<i>3.0%</i>	<i>3.7%</i>	<i>4.2%</i>
Sales commissions	-371.0	-467.0	-649.0	-1,343.5	-2,353.0	-4,233.0
<i>% revenue</i>	<i>7.1%</i>	<i>1.2%</i>	<i>1.5%</i>	<i>2.1%</i>	<i>2.5%</i>	<i>3.2%</i>
Marketing costs	-528.0	-710.0	-1,039.0	-2,367.2	-3,294.2	-4,629.8
<i>% revenue</i>	<i>10.1%</i>	<i>1.9%</i>	<i>2.3%</i>	<i>3.7%</i>	<i>3.5%</i>	<i>3.5%</i>
Other expenses	0.0	0.0	-273.1	0.0	0.0	0.0
<i>% revenue</i>	<i>0.0%</i>	<i>0.0%</i>	<i>0.6%</i>	<i>0.0%</i>	<i>0.0%</i>	<i>0.0%</i>
<b>Total operating costs</b>	<b>-2,234.0</b>	<b>-3,465.0</b>	<b>-5,778.1</b>	<b>-10,878.7</b>	<b>-19,371.5</b>	<b>-29,534.0</b>
Other income	78.0	0.0	0.0	0.0	0.0	0.0
<b>Operating profit</b>						
Operating margin	-0.6%	9.9%	9.0%	9.6%	8.8%	11.4%
Depreciation – underlying	-221.0	-477.0	-706.0	-1,212.2	-1,754.8	-2,203.6
Depreciation – WLL	0.0	0.0	-270.0	-874.0	-2,402.0	-3,893.4
Total depreciation	-221.0	-477.0	-976.0	-2,086.2	-4,156.8	-6,097.0
Amortisation (licences)	0	0	0	-155.5	-155.5	-155.5

Source: Teleunit, Daniel Stewart estimates

**Figure 25: Teleunit Profit & Loss estimates (cont'd)**

Year end December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
<b>EBITDA</b>	<b>188.0</b>	<b>4,187.0</b>	<b>4,975.9</b>	<b>8,413.1</b>	<b>12,549.0</b>	<b>21,339.4</b>
EBITDA margin	3.6%	11.2%	11.2%	13.2%	13.3%	16.1%
<b>EBITA</b>	<b>-33.0</b>	<b>3,710.0</b>	<b>3,999.9</b>	<b>6,326.8</b>	<b>8,392.2</b>	<b>15,242.5</b>
EBITA margin	-0.6%	9.9%	9.0%	9.9%	8.9%	11.5%
Exceptional items	-5	-97	-203	0	0	0
Interest	-190	-470	-224	-500	-800	-400
FRS3 PBT	-223.0	3,240.0	3,775.9	5,671.3	7,436.7	14,687.0
DS&C PBT	-218.0	3,337.0	3,978.9	5,826.8	7,592.2	14,842.5
Taxation	89	-957	-1,504.0	-1,369.3	-2,277.7	-4,452.7
Tax rate	n/a	29.5%	39.8%	23.5%	30.0%	30.0%
Profit after tax	-134.0	2,283.0	2,271.9	4,302.0	5,159.0	10,234.2

Source: Teleunit, Daniel Stewart estimates

**Figure 26: Teleunit Cash flow summary**

Year to December	2001 a	2002 a	2003 a	2004 f	2005 f	2006 f
	€'000	€'000	€'000	€'000	€'000	€'000
Operating profit	-33	3,710	4,000	6,171	8,237	15,087
Depreciation & amortisation	221	477	976	2,242	4,312	6,252
Increase/(decrease) in working cap	-419	-2,558	4,841	-2,000	-2,000	-2,000
Net interest	-190	-470	-224	-500	-800	-400
Tax paid	-93	89	-957	-1,504	-1,369	-2,278
Exceptionals/other	5	97	203	0	0	0
<b>Gross cash flow</b>	<b>-509</b>	<b>1,345</b>	<b>8,839</b>	<b>4,409</b>	<b>8,380</b>	<b>16,662</b>
Net capex						
Maintenance capex	-821	-2,821	-492	-1,280	-1,882	-2,381
WLL infrastructure capex	0	0	-2,500	-2,952	-6,693	-151
WLL CPE capex	0	0	-190	-949	-6,434	-6,440
Licenses and property	0	0	0	-5,100	0	0
<b>Total capex</b>	<b>-821</b>	<b>-2,821</b>	<b>-3,182</b>	<b>-10,280</b>	<b>-15,010</b>	<b>-8,972</b>
Use of provisions	0	0	0	0	0	0
<b>Free cash flow</b>	<b>-1,330</b>	<b>-1,476</b>	<b>5,657</b>	<b>-5,871</b>	<b>-6,630</b>	<b>7,690</b>
Dividends	0	0	0	0	0	0
Acquisitions & investments	0	0	0	0	0	0
Disposals	0	0	0	0	0	0
Financing	285	117	1,000	0	0	0
Other, FX						
<b>Change in cash</b>	<b>-1,045</b>	<b>-1,359</b>	<b>6,657</b>	<b>-5,871</b>	<b>-6,630</b>	<b>7,690</b>
<b>Opening net cash/(debt)</b>	<b>-439</b>	<b>-1,484</b>	<b>-2,843</b>	<b>3,814</b>	<b>-2,057</b>	<b>-8,687</b>
<b>Closing net cash/(debt)</b>	<b>-1,484</b>	<b>-2,843</b>	<b>3,814</b>	<b>-2,057</b>	<b>-8,687</b>	<b>-997</b>

Source: Teleunit, Daniel Stewart estimates

## Appendix 2: EVALUATION

### Discounted cash flow

Figure 27: Discounted cash flow

Year end December	2003 a €'000	2004 f €'000	2005 f €'000	2006 f €'000	2007 f €'000	2008 f €'000
Operating cashflow	4,976	8,413	12,549	21,339	33,466	46,964
Cash tax	-957	-1,504	-1,369	-2,278	-4,453	-8,027
<b>Gross cashflow</b>	<b>4,019</b>	<b>6,909</b>	<b>11,180</b>	<b>19,062</b>	<b>29,013</b>	<b>38,937</b>
Working capital	4,841	-2,000	-2,000	-2,000	-2,000	-2,000
Capex	-3,182	-10,280	-15,010	-8,972	-11,260	-11,945
<b>Free cashflow</b>	<b>5,678</b>	<b>-5,371</b>	<b>-5,830</b>	<b>8,090</b>	<b>15,753</b>	<b>24,992</b>
<b>Cost of capital</b>	<b>15.00%</b>	<b>15.00%</b>	<b>15.00%</b>	<b>15.00%</b>	<b>15.00%</b>	<b>15.00%</b>
Year	0	1	2	3	4	5
Discount factor		0.8696	0.7561	0.6575	0.5718	0.4972
<b>Present value</b>	<b>-</b>	<b>-4,670</b>	<b>-4,408</b>	<b>5,319</b>	<b>9,007</b>	<b>12,425</b>
<b>Fair value</b>						
NPV of cashflows over forecast period to 2008						17,673
2009 free cash flow (TV year)						25,492
Terminal growth rate						2.0%
Terminal value						196,091
Discount factor						0.4323
PV of terminal value						84,775
<b>Cumulative NPV</b>						<b>102,448</b>
Net (debt)/cash						3,814
<b>Estimated equity value</b>						<b>106,262</b>

Figure 28: Sensitivity analysis

#### Sensitivity analysis

	Terminal Growth Rate				
	1.0%	1.5%	2.0%	2.5%	3.0%
<b>106,262</b>					
10%	179,802	189,945	201,355	214,287	229,066
11%	156,440	164,246	172,920	182,613	193,519
12%	137,744	143,883	150,636	158,100	166,393
13%	122,521	127,436	132,797	138,670	145,129
14%	109,947	<b>113,941</b>	<b>118,268</b>	<b>122,971</b>	128,101
15%	99,435	<b>102,722</b>	<b>106,262</b>	<b>110,085</b>	114,227
16%	90,556	<b>93,291</b>	<b>96,222</b>	<b>99,370</b>	102,760
17%	82,988	85,286	87,738	90,358	93,166
18%	76,489	78,436	80,505	82,708	85,057
19%	70,869	72,531	74,291	76,158	78,141
20%	65,979	67,407	68,915	70,510	72,198
Wacc					

**Figure 29: Multiple Valuation**

Company	EV/Sales 2003	EV/Sales 2004	EV/Sales 2005	EV/Ebitda 2003	EV/Ebitda 2004	EV/Ebitda 2005
<b>Alternative Carriers</b>						
Vanco	2.31	1.67	1.40	19.39	11.80	9.41
3U Telecom	1.48	0.94	0.92	16.88	4.15	3.96
<b>Average</b>	<b>1.89</b>	<b>1.31</b>	<b>1.16</b>	<b>18.13</b>	<b>7.98</b>	<b>6.69</b>
<b>Broadband Access providers</b>						
Fibernet Group Plc	2.34	1.95	1.62	9.97	6.08	4.24
EasyNet Group Plc	1.19	0.94	0.81	n/a	14.06	6.95
E-biscom SpA	6.62	5.02	3.86	45.49	15.53	9.59
Versatel	1.66	1.32	1.12	9.49	5.64	4.46
Colt Telecom	2.22	2.04	1.86	15.83	12.66	9.71
<b>Average</b>	<b>1.85</b>	<b>1.56</b>	<b>1.35</b>	<b>11.76</b>	<b>10.79</b>	<b>6.99</b>
<b>Other</b>						
Kingston	1.03	0.99	0.94	6.88	5.53	4.69
Redstone	0.24	0.23	0.21	n/a	13.64	7.59
Pipex	5.62	2.32	2.07	n/a	13.57	11.25
Thus	1.43	1.28	1.15	11.29	8.27	6.66
Telewest	3.86	4.01	3.85	n/a	11.29	10.66
Telecom Plus	2.83	2.17	1.68	21.69	15.50	11.66
Invox	3.43	3.25	2.94	9.63	9.02	8.09
Tiscali	2.72	1.74	1.47	15.94	13.03	8.09
<b>Average</b>	<b>2.47</b>	<b>1.71</b>	<b>1.49</b>	<b>14.64</b>	<b>12.05</b>	<b>9.14</b>
<b>Blended average</b>	<b>2.07</b>	<b>1.53</b>	<b>1.34</b>	<b>14.84</b>	<b>10.27</b>	<b>7.61</b>

N.B. Averages excludes obvious outliers

TELEUNIT €'000	2005 f Sales	2005 f EBITDA
Teleunit	94,120	12,549
2005 multiple EV	1.34	7.61
Net (debt)/cash	125,704	95,456
<b>Equity Value</b>	<b>3,814</b>	<b>3,814</b>
	<b>129,518</b>	<b>99,270</b>

Source: Daniel Stewart estimates

Although reasonable care has been taken by Daniel Stewart & Co plc to ensure the facts stated and opinions given and projections made in this document are fair and accurate, Daniel Stewart & Co plc has not independently verified all the information given in this document. Readers of this document are advised that Daniel Stewart & Co plc is acting as nominated adviser and broker to Teleunit and accordingly this document may not be considered as objective or impartial.

## Appendix 3: SHAREHOLDER STRUCTURE

Figure 30: Shareholder structure

Shareholder	Shareholding Percentage
Gianfranco Cimica	26.62%
Francesco Cimica	50.51%
Franca Bernardi*	21.65%
Elena Pianigiani	1.22%
	100.00%

\* Wife of Gianfranco Cimica

Any comments contained in this document are intended only for those private investors and business customers of Daniel Stewart & Company Plc to whom it has been distributed. **This document is not intended for the use of private customer as defined by FSA. In the event that any such person should come into possession of this document, it is recommended that they should seek independent advice from a suitably qualified professional advisor before taking any decisions in relation to the investments detailed herein.** The investments mentioned in this document may not be suitable for all recipients or be appropriate for their personal circumstances. The information in this document is believed to be correct but cannot be guaranteed. Opinions constitute our judgement as of this date and are subject to change without warning. This document is not intended as an offer or solicitation to buy or sell securities. Daniel Stewart & Company, its officers and employees may have positions in the securities mentioned herein. Past performance is not necessarily indicative of future performance and the value of investments may fall as well as rise and the income from them may fluctuate and is not guaranteed. Clients may not recover the amount invested. Some securities carry a higher degree of risk than others. The levels and basis of taxation can change. When we comment on AIM or OFEX shares you should be aware that because the rules for these markets are less demanding than those of the Official List of the London Stock Exchange the risks are higher. There is a higher risk of losing the money you have invested. Furthermore, the marketability of these shares is often restricted, you may have difficulty in selling your shares and there is often a big difference between the buying and selling price so that if you have to sell them immediately after purchase you may get back much less than you paid for them. If you are in any doubt, you should consult your investment advisor.

The contents of this document have been prepared by, are the sole responsibility of and have been issued by Daniel Stewart & Company Plc for the purpose of section 21 of the Financial Services and Markets Act 2000.

Regulated by the Financial Services Authority.

April 2004









**Daniel Stewart & Company Plc**  
**48 Bishopsgate**  
**London**  
**EC2N 4AJ**

**Tel: 020 7374 6789**  
**Fax: 020 7374 6742**  
[www.danielstewart.co.uk](http://www.danielstewart.co.uk)