

# Flash Note

SEB MERCHANT BANKING

2006-06-13

## ecotel communication

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**Buy**

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Reuters: E4CG  
Bloomberg: E4C

Price: 15.00 EUR  
Target price: 23.00 EUR

In EUR	2005	2006e	2007e	2008e
Revenue (m)	34.7	70.0	110.0	130.0
Operating result (m)	2.2	4.6	7.7	9.1
Operating margin (%)	6.3	6.5	7.0	7.0
Net income (m)	1.0	1.7	3.6	4.3
Earnings per share	0.29	0.49	1.03	1.23
PE (x)	51.7	30.6	14.6	12.2
EV/Revenue (x)	1.30	0.65	0.41	0.35
EV/EBIT (x)	20.6	9.8	5.9	5.0
Market cap. (m)	52.5	Daily volume (shares)		< 1,000
Book value per share	5.12	Shares outstanding (m)		1.026
Shareholders:	Peter Zils (CEO) 34.6%, Tim Schulte Havermann 18.0%, Asgard International Ltd. 10.9%, GVA AG 7.1%, Free Float 29.3%			

### Q1 06 figures slightly better than expected, forecasts for the whole year raised

After the IPO and the first listing on March 29<sup>th</sup> ecotel communication reported Q1 figures for the first time on May 15<sup>th</sup>. The Company offers tailor-made telecommunication solutions to business clients and is active in the carrier services/wholesale market where it offers services to other telecommunication companies and trades free capacities. In the first quarter of 2006 earnings were impacted by IPO and acquisition costs which amounted to EUR 1.6 million. The effect will also be seen in total year earnings.

The dynamic growth ecotel showed in the last years continued in the first quarter this year. Sales grew 56% to more than 12 million EUR compared to last year. Taking the fourth quarter of 2005 as a basis sales were up 18%. The high growth resulted to a big part from establishing and building up the wholesale business as a new segment. These activities were started in August last year.



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The high sales growth is disproportionally reflected in earnings figures for several reasons. For the whole Company the gross earnings were up 15% to EUR 3.3 million compared to last year. EBITDA and EBIT were down by 19% (to EUR 742 thousand) and 32% (to EUR 596 thousand), respectively. Firstly, the new established wholesale business is a low margin business. While in the clients' business the gross margins are between 35 and 40%, which is above market average, the wholesale business usually has gross margins around 5% or below. Secondly, ecotel has invested in staff which is necessary to address future growth opportunities. The number of employees risen from 78 to above 100 and personnel costs increased by 20.1% to nearly EUR 1.1 million. Thirdly, ecotel invested in technical equipment in 2005 to enhance its part in the value chain. These investments involved a higher depreciation.

All in all the quarterly one year comparison is misleading because the figures for the first quarter 2005 didn't comprise of any burden. A better feeling for the business development can be seen by looking at the whole year's figures. These are impacted by the mentioned investments. With respect to this, Q1 figures of 2006 are clearly better. The management has therefore raised its forecasts: sales should reach more than EUR 70 million and the EBIT EUR 4.4 million. These targets include acquisitions to be closed this year (see below).

## **Business clients' segment with good growth prospects**

In this business segment ecotel offers tailor-made telecommunication solutions to its clients. This means telephone and data connections as well as services focusing on voice and data transfer and added values. The targeted customer group are small and mid caps. Currently ecotel has more than 27,000 clients which generate, in average, an annual amount of about 1,100 EUR in sales per user. To enhance this amount through cross selling is one of the growth drivers in the future. Another one are new technologies like "Voice over IP (Internet Protocol)" which offer higher capacities at lower prices and therefore will push clients' demand. Volume growth will overcompensate price deterioration. This process has already lasted for a longer time and will continue in the next future. Price deterioration is the main reason for the difficulties of the fixed line telecom suppliers. The main success factor for future telecommunication business will not be the availability of networks and connections but to sell contents.

The last but not least growth driver is the acquisition of new clients. In this field ecotel pursues a multi channel approach. One to be highlighted is the long lasting successful cooperation with more than 450 marketing partners. They get commissions for every client they acquire. Another one is the close cooperation with more than 70 subgroups of the German Cooperative System. Both deliver more or less a continuous flow of new client contacts which hopefully will broaden



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the clients' base in the end. The growth rate in the business clients segment we assume at above 15% p.a. in the coming three to four years.

In May 2006 ecotel announced the take over of DSLCOMP Communications Group. The purchase price was EUR 7.775 million (paid by the proceeds from the IPO) and the main objective of this take over is to improve the market position. Because DSLCOMP Communications has a complementary business model ecotel will be able to realize some synergies resulting from the procurement and optimizing the structure of the larger group. DSLCOMP Communications will contribute more than EUR 12 million in sales and EUR 1.2 million in pretax profit in the current year. Moreover DSLCOMP Communications has more than 7,500 own clients which will increase the client number of the joined group to more than 35,000.

### **Carrier services/wholesale segment with even higher growth**

Based on their own technical equipment and systems this business segment has been built up since 2004. Here ecotel provides special solutions to other telecom companies and to third parties outside the telecommunication sector. Since August 2005 ecotel has entered the wholesale market.

In this market telecom companies trade their overcapacities (call minutes). It is a growing market strongly pushed by an extending market penetration of Voice over IP (VoIP). Regarding only the fixed lines market studies expect the share of VoIP services growing from 5% today to more than 20% in 2008. Compared to switched traffic VoIP traffic is growing three times faster. In this fast growing area ecotel has gained a good start position. It will be built up in the near future. The more important reason for ecotel to enter the wholesale market was to improve the margins because the Company's procurement reaches a lower price level. To take part in the wholesale business needs to utilize their own appropriate technical equipment (i.e. servers) as a main condition (background of ecotel's investment).

### **Rising sales, declining gross margins**

A comprehensive overview over the development in both business segments, as we estimate them, is given by the following table.

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Million EUR	2005	2006e	2007e	2008e
Sales				
Business clients	32.0	47.5	54.6	65.5
Carrier services/ Wholesale	2.7	22.5	55.4	64.5
Total sales	34.7	70.0	110.0	130.0
Gross earnings				
Business clients	11.4	18.8	21.6	25.9
Carrier services/ Wholesale	0.2	1.1	2.8	3.2
Total gross earnings	11.6	19.9	24.4	29.1
Gross margin (%)	33.1	28.4	22.2	22.4

The table shows that in absolute terms sales and gross earnings will rise in the future. Because the carrier services/wholesale segment has the lower margin, particularly caused by wholesale activities, the gross margin as a whole will come down. This is a result of the growing share of the carrier services/wholesale segment of total sales.

The described effect will be offset by declining rates in operating costs. Economies of scale will have a positive earnings effect. As a result we expect rising operating and net margins.

## Recommendation

Ecotel communication is operating in a highly competitive environment. Since its founding in 1998 the Company reached an impressive double-digit growth per year, in sales as well as in new customers. Obviously the Company's business model is proven and will be the basis for a sustainable development in the future. The management is well experienced and can refer to a very good performance.

Since the IPO when the ecotel shares were issued at 17 EUR per share the price fell to EUR 15 (-12%). This decline was caused by unfavourable market movements. The fundamental situation of the Company is still very good: the growth rates of sales and earnings will remain high in the next years and a sufficient cash flow will be generated. Our price target we see at 23 EUR reflecting the growth potential. We recommend ecotel communication shares to "Buy".