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ADEPT TELECOM PLC

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We recently visited B2B telco Adept Telecom to see its VOIP demo centre, which shows seven ways of deploying VOIP in a business environment. Despite the share price doubling in recent months, the shares should continue to benefit from Adept's strong cash generation and de-leveraging.

Adept Telecom has recently decided to move into offering VOIP services to its small and medium sized business customer base, and has set up a demo centre showing how VOIP can be deployed in seven different scenarios. According to CEO Ian Fishwick, whilst VOIP has offered strong potential in the business space for some time, the lack of standardised product from financially robust providers has held Adept back. This has all changed, with BT Wholesale now offering a fully tested, end to end VOIP service to resellers.

The Adept demo shows the seven ways in which the BT VOIP product can be deployed: on large sites using SIP and supporting both TDM and IP PBXs/handsets; on smaller sites using a hosted PBX and again supporting both TDM and IP handsets; and for home and mobile workers over broadband, again supporting TDM and IP handsets as well as PCs. PSTN breakout is achieved on BT's VOIP platform, co-hosted at Teleticity and Telehouse data centres for redundancy.

VOIP in consumer environments (eg Skype) is mainly about saving money for many users, but in business environments Adept is pushing its other attractions, including access to non-geographically tied numbers, very quick and easy number moves, advanced messaging/call forwarding capabilities and simultaneous number ringing. The company will, however, offer free calls between Adept customers, to encourage take-up by supply chains. To ensure quality for VOIP delivered over broadband, Adept will encourage customers to upgrade their broadband connectivity.

Ian noted some bullish forecasts for business VOIP, with the market reaching £700m by 2013/14 and 'seats' growing from 500k to 2m by the same date. However, the company is feeling its way with VOIP and trying various commercial approaches, and there is no suggestion that VOIP will have a significant near term impact on Adept's finances. Broadly speaking, the company gains two-thirds of its revenues from 20,000 smaller businesses, competing against the likes of XLN, and one-third from its 200 largest customers spending more than £1k per month.

In contrast to most of its peers, Adept has suffered ongoing revenue declines due to a heavy debt burden curtailing business expansion, but has managed to extract strong EBITDA margins and cash flow, which has enabled a steady repayment of debt. Forecasts for the year just completed (end March) are for revenues down 6.6% to £24m and EBITDA down 9% to £3.3m, and net debt cut from £9.2m to £7.6m; however, as the company managed to grow EBITDA 3% to £1.9m in the first half, it would not be surprising to see Adept beat market expectations and come close to last year's £3.6m EBITDA. Notwithstanding the move to offer VOIP, Ian noted that with 45% of revenues

subject to ongoing regulatory-driven price reductions, the top line will remain under pressure (market forecasts are for flat revenues next year), and the company will continue to focus on margins and cash flow.

Adept's shares have doubled since last year to 42p, which have taken the shares up to 4.6x FY10/11 EBITDA (assuming £3.6m), still below the bottom end of the 5-8x of business focused peers. However, debt is just under half the company's firm value, much higher than for its peers, though is much more manageable now than in previous years, at just over 2x forecast EBITDA. As we have argued before, if one assumes no growth (as forecast) and constant valuation multiples, Adept's share price should be benefiting from the constant repayment of debt; for example, the £2m debt repayment forecast for FY11/12 should increase Adept's equity value by 22%.

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