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INTERIMS: ADEPT TELECOM

BUY*

VoIP contracts point to growth

34p[#]

Year-end March	2010A	2011A	2012E	2013E
Revenue (£m)	25.7	23.7	22.0	22.6
EBITDA (£m)	3.6	3.6	3.3	3.3
Adj. Pre-tax Profit (£m)	2.1	2.4	2.4	2.4
Adj. EPS (p)	9.3	10.2	10.2	10.2
DPS (p)	0.0	0.0	0.5	0.65
Net Cash/(Debt) (£m)	-9.2	-7.4	-5.8	-4.5
P/E (x)	3.7	3.3	3.3	3.3
Dividend yield (%)	0.0%	0.0%	1.5%	1.9%
EV/EBITDA (x)	4.6	4.0	3.9	3.5

Key Data	
Rating (12 month)	BUY
Price Target	60p
Risk	Medium
Sentiment	N/A
Ticker	ADT.L
Shares in issue	21.1m
Market cap	£7.2m
12-mth price range	19.5p-43.5p
Net debt	£6.5m
Next event	Prelims (July)

SOURCE: Northland Capital Partners Limited estimates #Priced at market close, 21st November 2011
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Interim results in line with forecast with underlying EBITDA flat at £1.95m in spite of an 8.2% decline in revenue – a function of a further drop in traditional outbound calls and lines. EBITDA margins of 17.5% (+150bps) are comfortably at the top end of the sector. VoIP for Business service is gaining traction with two substantial contracts secured and these will deliver revenue over the next three years. Net debt reduced a further £0.9m to £6.5m. Management's confidence on AdEPT's cash generative qualities is reflected in the maiden 0.5p dividend. No change to forecasts, BUY rating and 60p price target.

- SCALE EFFICIENCIES & CROSS-SELLING:** Ongoing focus on selling more products into larger customers is bringing scale efficiencies and cross-selling opportunities. Revenue from customers taking three or more products increased to 32.3% (H1 FY11: 27.2%). Historic reliance on traditional outbound calls and lines continues to fall (83.9% from 88.1%) while data and mobile revenues grew 25.4% to £1.30m.
- ENTERPRISE VOIP SUCCESS:** In H1, AdEPT secured two of the largest VoIP contracts ever awarded in the UK (£200k with an IT provider and £2.5m with the UK's largest electrical wholesaler). This represents a key area for growth and the seven configuration offering plus conventional calls and lines means AdEPT can help organisations transition to next generation communications.
- MAIDEN DIVIDEND REFLECTS CONFIDENCE:** The 0.5p dividend, although low in cash terms (c. £100k), signals management's confidence in AdEPT's cash generation profile. Rating of 3.3x FY12 remains anomalous among its peers particularly as the debt level becomes less of an issue. Our 60p price target implies a 5.9x PER or 5.6x EV/EBITDA FY12 and would still represent a discount to the peer group.

COMPANY DESCRIPTION

AdEPT Telecom is a communications integrator (fixed, mobile and data connectivity) to the SME segment. It operates a highly efficient service platform and AdEPT has some of the highest operating margins in the sector. It has built a particular strength in multi-site and 21st Century Network-based call handling systems and has recently launched a VoIP business offering based around BT Wholesale.

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INVESTMENT APPRAISAL

AdEPT can offer its customers lower cost traditional calls and lines as well as a robust and highly flexible VoIP (voice over internet protocol) offering (from BT Wholesale). As such, it is well placed to help corporates with the migration to next generation communications. AdEPT is a 'fast follower' of technology and spent several years waiting for a credible offering from a credible provider and believes the BT service has the necessary attributes. AdEPT has built a National VoIP Demonstration Centre at its Tunbridge Wells headquarters where it can showcase seven different ways of deploying VoIP for businesses depending on their requirements and existing networks.

Helping customers transition to next generation comms

H1 saw AdEPT's first two substantial VoIP contracts secured – a £200k contract with a leading IT provider for 300 SIP (session internet protocol) trunks to replace ISDN channels in its main contact centre; and a £2.5m contract with the UK's largest electrical wholesaler for a full scale VoIP deployment. Both contracts will run for three years, increasing AdEPT's revenue visibility. It has also recently completed the implementation of a cloud-based contact centre for a leading UK airline. Functionality remains the key driver for VoIP's uptake. We believe these contracts are generating interest amongst potential customers and resellers but migration to VoIP will remain gradual.

First substantial VoIP contracts

Whilst VoIP remains a medium term growth opportunity, AdEPT continues to push margins in its business in the interim. Adj. EBITDA margin increased 150 basis points to 17.5%. This is a function of focusing on larger customers that offer scale and cross-selling opportunities as well as a gradual shift in product mix. Traditional outbound calls and lines revenue represented 83.9% in H1 (H1 FY11: 88.1%) whereas data and mobile products accounted for 11.7% (H1 FY11: 8.6%). Ongoing regulatory changes to mobile interconnect rates will continue to reduce wholesale costs and support margins despite falling retail prices.

Sector leading margins

Net debt that was built up through previous acquisitions was reduced a further £0.9m to £6.5m. Cash conversion (free cashflow/EBITA) was lower than last year at 64% (H1 FY11: 79%), a function of payments to suppliers. We expect a further reduction in H2 net debt to £5.8m, in spite of the initial dividend payment (c. £100k).

Continues to pay down debt

Traditional voice revenue will continue to fall as a result of the significant month on month changes to wholesale mobile termination rates plus a continuing depressed economic environment – we trim revenue FY12 forecasts by £0.5m to £22.0m and by £0.4m in FY13 to £22.6m.

AdEPT is successfully diversifying its business away from traditional calls and lines with the addition of mobile, data and VoIP. It has pushed up margins through a focus on larger customers, has substantially reduced debt and is now paying a dividend. As such, it is undeserving of its PER rating of 3.3x FY12 earnings. We maintain our BUY rating and 60p price target.

Maintain BUY rating and 60p price target



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