

Telit Communications ^{1,3,4,5}

Telecommunications

Handsets strong, modules delayed

- Telit reported its results for the six months to 30 June 2005 this morning. These results show that the company's handsets division is scheduled to meet this year's forecasts. This operation represents 87% of the company's valuation as presented in our pre-IPO research. Telit is performing strongly in this area and has seen a rise in gross margin from 13% to 17% by virtue of better sourcing of suppliers. The recent appointment of a local CEO for the company's Trieste-based handset business is likely to help win a mandate with a large Italian mobile operator.
- We expect the handsets business to achieve revenue of €83m in 2005 and PBT of €6.2m. This is equivalent to a PBT of £4.1m. A low tax rate of 20% by virtue of accumulated losses in Italy will result in profit after tax of £3.3m for this business area.
- Meanwhile, the company's modules division is making progress on building infrastructure to support future sales, but has not made the actual sales we had expected. We believe that the modules business will develop, but possibly twelve months behind our initial forecasts. We had expected Telit to sell 700,000 modules this year and 1,500,000 in 2006. We are downgrading this estimate to 200,000 this year and 700,000 in 2006. Accordingly, we expect revenue of €96m in 2005 as opposed to €113m. This reflects modules revenue of €14m compared to €31m. In 2006, we forecast modules to generate €30m of revenue as opposed to our original estimate of €58m.
- The company has sold modules to companies based in the UK, Belgium and Italy. Applications include automated meter reading, fleet management, electronic point-of-sale and electronic tagging. We are convinced about the longer term merits of this market and expect to see the announcement of major contract wins in this area in the near future. Meanwhile, shares in peer group company, Wavecom have risen by 288% in the past twelve months.
- Our consolidated estimates are revised as follows. We cut our 2005 revenue estimate from €113m to €96m. We cut our 2006 revenue estimate from €154m to €124m. The modules business needs scale to be profitable and we were originally forecasting profit in 2006. This now occurs in 2007. Our new PBT estimates are €551,000 for 2005 and €3,698,000 for 2006.
- We believe that a sum-of-the-parts valuation analysis is most appropriate for Telit as its businesses are in completely different stages of development. We believe that Telit needs to sell over one million modules

BUY

103.50p

AIM TCM.L

No of shares (m)	43.2
Market cap (£m)	44.7
Net cash (£m)	15.0
Enterprise value (£m)	29.7
(%)	1m 3m 12m
FTA relative	-7.9 -16.5 na

12 month high/low (p) 145.5/106.5

Next news

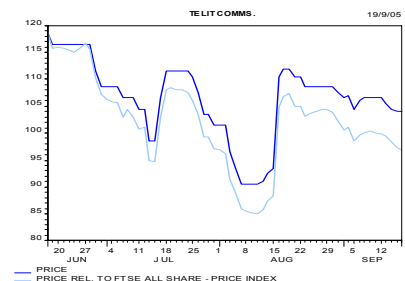
FY results – March 2006

Business

Telecoms equipment

www.telit.com

Price and price relative (-3m)



Source : Datastream

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to make profits in this division. We now expect this to be achieved in 2007. In the meantime, valuing the modules business is difficult using conventional valuation tools. For this reason, we choose to deploy the methodology adopted in our pre-IPO research note. This applied a top-line comparative valuation multiple to the modules unit. We choose Wavecom as our benchmark which trades at a historic EV/Sales ratio of 0.7. Applying this ratio to €11m of Telit modules sales in 2004 gives a valuation of €8m.

- Meanwhile we are comfortable that Telit's handset business can command a market valuation based on these results and imminent contract wins. Applying a market PE multiple of 14 to this unit gives a valuation of £46m.
- Our sum-of-the-parts valuation suggests that Telit is worth £68m. This is based on a valuation for handsets of £46m, a valuation for modules of £5m, a valuation for the group's 30% of Cellcom of £2m and £15m of cash. This is equivalent to 157p per share. Shares in Telit have lagged the market by 16% in the past quarter. We see forthcoming contract wins and a scheduled investor visit on 6 October as catalysts to stir interest in the shares.
- Our valuation analysis is supportive to Telit and we retain our **BUY** recommendation.

Year end December	Sales (€000s)	PTP (€000s)	PAT (€000s)	PAT GBP (£000s)	EPS (p)	P/E (x)
2004A	75,343	9,106	8,780	6,014	13.8	7.5
2005E	96,000	551	-543	-362	na	na
2006E	124,000	3,698	2,837	1,890	4.38	23.6

Source: Seymour Pierce Limited full year forecasts

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