The Mobius Investment Club

Investors' Toolkit[1]

Telecom Plus

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Version	Date	Description	Author
1.0	20/01/2008	First report fully completed	Bob Croft

[1] This e-toolkit template is version 1.0 – issued in January 2004 – Mourad Kara

Telecom Plus – cash cow

This month we performed a defensive, high yield search using Company REFS. The candidates also had to have net cash on their balance sheets and their share prices had to be outperforming the wider market. The sieves selected were dividend yield greater than the UK base rate of 5.5% (146 candidates); dividend cover of 1.5 times or above (74 candidates); cash as a percentage of capital and reserves greater than 50% (8 candidates); three month relative strength greater than zero (1 candidate). The only share out of a total of 1,884 to come through these demanding REF sieves was Telecom Plus.

Low cost business model

With the possible exception of Tesco, Telecom Plus is the UK's only true low-cost multi-utility supplier in the residential market. Utilities resold to the end consumer at competitive prices encompass energy (electricity and gas), telephony and broadband and Internet services. The company does not have the high infrastructure and back office costs associated with incumbent suppliers like BT and Centrica. Instead, the company uses the collective buying power of its 204,763 customers (March 2007: 208,444) to negotiate bulk buying deals with major suppliers, passing the benefit back to its customers and members in the form of discounted prices.

In September 2003 Telecom Plus rebranded its offering to reflect the multi-utility nature of it by launching 'The Utility Warehouse Discount Club' brand. In 2005 Telecom Plus additionally launched The Utility Warehouse Discount Club for Business, which today has over 7,800 customers.

High barriers to entry

Telecom Plus provides discounted utilities on one bill under The Utility Warehouse brand through its integrated customer handling and billing system. According to CEO Charles Wigoder this gives Telecom Plus a competitive advantage as a result of its lower administration, postage and processing costs.

Telecom Plus' distribution channel is also unique within the industry keeping the company's customer acquisition costs unusually low. Customers are acquired via 16,600 independent distributors who recommend friends, family and contacts. The company has no high street presence and does no central advertising but instead relies on word of mouth. These unique features, Mr. Wigoder maintains makes it very hard for competitors to replicate the Telecom Plus model and any new entrant would additionally need to apply to the regulator to obtain a licence to supply gas and electricity.

Customer loyalty (sticky customers)

Telecom Plus aims to tie its customers to its service by offering additional bundled discounts and other benefits for taking on multiple services, such as free phone calls in the UK. Distributors, meanwhile, are incentivised to ensure customers stay with Telecom Plus. And, it appears to work.

Although headline customer numbers have fallen slightly the quality of the Telecom Plus customer base is much improved. Between 1999 and 2007 the average revenue per customer increased from £190 in 1999 to £801 notwithstanding considerable price deflation in the fixed telephony over this period. The average number of services taken by Club members continues to increase and was up from 2.95 to 3.03 during the first half to September resulting in the number of services provided increasing by 10,450 to 552,489. And, whilst the churn rate (rate at which customers leave) has been on the increase, it is still favourable compared with the sector. In the year to March 2007 the churn rate for Telecom Plus' energy customers was around 2% per month compared with an industry average of around 5%.

'prospective dividend yield 6%'

Looking forward, Mr. Wigoder says that he is 'cautiously excited' about prospects following the Sales Conference last October where a number of new channel and promotional initiatives were unveiled.

De-risking the business

Whilst margins in telephony have always been highly predictable, by contrast energy margins are extremely volatile. After losing £8 million buying gas on the wholesale market between November and December 2005 Telecom Plus sold its electricity and gas businesses to npower in March 2006 and instead entered into a long term supply agreement. This has significantly de-risked the business and now ensures that Telecom Plus is guaranteed a positive margin and a steady return from selling energy with npower taking the hedging risk. Telecom Plus, however, still benefits from colder winters and fuel price rises.

Results and recent trading

In interims to September, Telecom Plus increased pre-tax profits by 15% to £6.4 million and EPS by 16% to 6.6 pence on sales up 4% to £71.1 million. The gross margin fell from 22.4% to 20.5% due to the changing sales mix. Here, energy and telephone line rental accounted for 64% of turnover up from 59% in 2006. There was also a reduction in high margin telephony revenues following the introduction of 'Free UK Calls' in October 2006 for customers taking multiple bundled services.

Recommendation and valuation

Although a highly competitive market, utilities are 'must have' so the company should be relatively well insulated from any consumer downturn. Indeed, Telecom Plus looks set to benefit in 2008 from higher energy prices after npower recently announced retail price increases of 13% for electricity and 17% for gas.

Utilities also have the attractive attribute of being highly cash generative. Net cash increased by £11 million during the first half, which supports both the company's progressive dividend policy and its share buy-back programme (circa £5 million over the last six months).

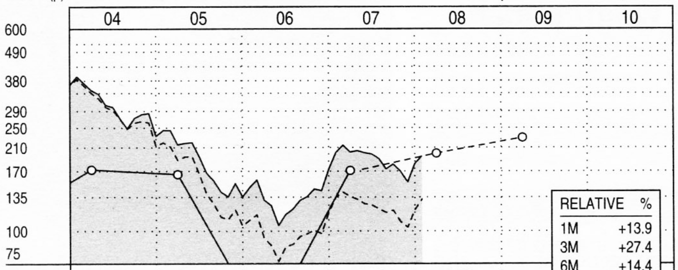
Because of the company's minimal need for capital expenditure most of its earnings can be paid out as dividends and its 6% prospective dividend yield is comparable to BT's. Meanwhile, the company's 20% stake in Oxford Power Holdings, an independent supplier of electricity to the SME market, if sold could realise additional surplus cash of circa £15 million worth around 22 pence per share, which could be returned to shareholders. Telecom Plus' share of profits in the first half more than doubled to £401,000 (2006: £153,000) and so Oxford Power, therefore, represents an increasingly valuable asset. Npower, meanwhile, has an option to acquire the shares of directors representing 29% of the company exercisable in 2009, which house broker KBC believes could be valued at 300 pence per share.

At 200 pence the share is on a reasonable prospective PER of 12.3 against an EPS growth rate of 15.7%.

Not only do directors have the owner's eye with their sizeable stake but at the end of November there was cluster buying of a further 160,000 shares at prices between 167 pence and 176 pence. **Buy on a two to three year view.** □

TELECOM PLUS

PRICE (p) Ord 5P vs FTSE All-Share vs norm eps (Scale 8)



	04	05	06	07	08
HIGH	408	257	200	232	203
LOW	203	117	97	138	184
AVE PER	28.0x	15.3x	379x	130x	15.6x

EPIC: TEP

ACTIVITIES ANALYSIS (07AR)

		T/O	Pr
Customer Management	%	99	100
Customer Acquisition	%	1	–24
United Kingdom	%	100	100

PRICE (NMS 0.5) 15-JAN-08 **200p**

				m	s
market cap			£132m		
position			621st		
index			FTSE SmallCap		
norm eps (pr)			16.3p		
turnover (07AR)			£176m		
pretax (07AR)			£11.6m		
DY (pr)	%		6.02		
PER (pr)	x		12.3		
PEG	f		na		
GR (pr)	%		15.7		
ROCE	%		40.4		
MARGIN	%		5.67		
GEAR	%		–79.8		
PBV	x		4.25		
PTBV	x		4.81		
PCF	x		-		
PSR	x		0.78		
PRR	x		na		
nav ps (07AR)			46.9p		
net cash ps (07AR)			37.4p		

SECTOR: Fixed Line Telecommunications. **ACTIVITIES:** A group engaged in the supply of fixed telephony mobile telephony gas electricity and internet services to residential and small business customers.

DIRS: Rt Hon C F Wigoder (ce), Mr R Hateley (fd), Mr P R Nutting (ch)*, Mr M A Lawson*, Mr R Michell*, Mr M Pavia*, Mr K Stella*. **HEAD & REG OFF:** Dryden House, The Edge Business Centre, Humber Road, London, NW2 6EW. Tel: +44 (0) 871 2227777 **REGISTRAR:** Capita Corporate Registrars Plc

BROKERS: KBC Peel Hunt & Co. **FINANCIAL ADVISERS:** KBC Peel Hunt & Co. **AUDITORS:** PKF.

INTERIM: (29-Nov-07) 1/2 Year to 30 Sep 07. T/O £71.1m (£68.5m). Pre tax profit £6.37m (£5.52m). Int div 4.00p. (2.00p).. **OUTLOOK:** (5-Jun-07) Prelim: ch - "...we therefore remain confident that the current year will see further progress in the development of our business, and in the continuing delivery of satisfactory results". (10-Aug-07) Ann: "...we remain confident of reporting satisfactory results for the full year in due course". (29-Nov-07) Int: ce - "We are confident that our results for the full year will be substantially ahead of the pre-tax profits of £11.6m reported for the year ended 31 March 2007".

BUY BACKS: (20-Jul-07) Ann: 0.75m Ord 5P at 185p to 188p. (31-Aug-07) Ann: 0.67m Ord 5P at 176p. (4-Dec-07) Ann: 0.10m Ord 5P at 178p. (4-Jan-08) Ann: 0.42m Ord 5P at 185p. (7-Jan-08) Ann: 0.44m Ord 5P at 193p.

SHARE CAPITAL, HOLDINGS, DEALINGS

66.0m Ord 5P (Maj 31.7%, Dirs 26.7% [d]).

North Atlantic Value LLP	%	6.50	
Standard Life Investments Ltd	%	5.08	
Herald Inv Mgt Limited^	%	4.30	
Oryx International Gwth Fd Ltd	%	3.32	
Rt Hon C F Wigoder (ce)	%	21.3	3
Mr R Hateley (fd)	k	50.0	3
Mr P R Nutting (ch)*	%	1.56	
Mr M A Lawson*	%	3.11	
Mr R Michell*	k	383	
Mr K Stella*	k	88.2	3

year ended 31 Mar		2003	2004	2005[i]	2006[i]	2007[i]	2008E	2009E
turnover	£m	58.0	81.8	102	136	176		
depreciation	£m	0.50	0.49	0.54	0.58	0.58		
int paid (net)	£m	-0.35	-0.35	-0.52	-0.60	-1.10		
FRS3 pretax	£m	5.59	10.6	10.5	-1.64	11.6		
norm pretax	£m	5.95	11.1	10.4	-0.07	11.5	**13.3**	**14.7**
turnover ps	£	0.99	1.34	1.65	2.03	2.57		
op margin	%	9.65	13.1	9.43	-0.74	5.66		
ROCE	%	86.3	118	75.9	-0.13	40.4		
ROE	%	39.9	60.6	42.9	0.79	26.5		
FRS3 eps	p	6.58	11.9	12.1	-2.06	12.5		
norm eps	p	7.17	12.6	12.0	0.29	12.5	**14.5**	**16.7**
norm eps growth	%	+44.0	+75.3	-4.25	-97.6	+4146	**+16.7**	**+14.9**
tax rate	%	28.8	29.9	26.9	16.0	25.7		
norm per	x					16.0	**13.7**	**11.9**
provisional peg	f					-	**0.82**	**0.80**
cash flow ps	p	6.34	13.7					
capex ps	p	0.62	0.68					
dividend ps	p	5.75	10.0	11.0	1.00	8.00	**10.5**	**12.4**
dps growth	%	+27.8	+73.9	+10.0	-90.9	+700	**+31.2**	**+18.1**
dividend yield	%					4.01	**5.26**	**6.22**
dividend cover	x	1.25	1.26	1.09	0.29	1.56	**1.38**	**1.35**
shrholders funds	£m	10.9	13.0	17.8	25.0	32.3		
net borrowings	£m	-5.71	-9.76	-6.28	-5.89	-25.8		
net curr assets	£m	4.04	6.33	8.29	15.6	24.5		
ntav ps	p	11.1	15.1	22.1	30.8	41.5		

			2008 ESTIMATES			2009 ESTIMATES		
Broker	Date	Rec	Pretax £m	Eps p	Dps p	Pretax £m	Eps p	Dps p
Charles Stanley Securities	27-Sep-07	OWGT	12.5	13.0	9.25 +	13.1	13.8	10.2 +
Fyshe Horton Finney	27-Sep-07	BUY	12.2	13.0	9.50	13.7	15.7	11.2
KBC Peel Hunt	05-Dec-07		13.7 +	15.3 +	11.0 +	15.2 +	17.2 +	13.0 +
	Consensus		**13.3**	**14.5**	**10.5**	**14.7**	**16.7**	**12.4**
	1M Change		+0.80	+1.53	+1.00	+1.01	+0.06	+1.20
	3M Change		+1.11	+1.53	+1.00	+1.01	+0.98	+1.20

GEARING, COVER (07AR)

intangibles		Incl	Excl
net gearing	%	-79.8	-90.3
cash	%	79.8	90.3
gross gearing	%	-	-
under 5 yrs	%	-	-
under 1 yr	%	-	-
quick ratio	r		1.73
current ratio	r		1.73
interest cover	x		1925

KEY DATES

next AR year end	31-Mar-08
annual report	6-Jun-06
fin xd (1.00p)	5-Jul-06
int results	13-Dec-06
int xd (2.00p)	10-Jan-07
year end	31-Mar-07
annual report	5-Jun-07
fin xd (6.00p)	11-Jul-07
int results	29-Nov-07
int xd (4.00p)	12-Dec-07

SECTION 2 - HAVE THE COMPANY'S BUSINESS AND PROFITS GROWN?

No of years data (max 5)	5		Sales	Profits for Company	Profits for Shareholders	
1 Most recent year to	2007	£m	176.00	11.50	17.02	p
2 Next most recent year to	2006	£m	136.00	0.00	14.6	p
3 Three years ago to	2005	£m	102.00	10.40	11.7	p
4 Four years ago to	2004	£m	82.00	11.10	9.1	p
5 Five years ago to	2003	£m	58.00	5.95	10.6	p
6 Increase (1-5)		£m	118.00	5.55	6.42	p
7 Percentage increase (6/5x100)			203.4 %	93.28 %	60.6	%
8 Average Annual % Increase			40.7 %	18.66 %	12.1	%

SECTION 3 - ARE THE PEOPLE IN CHARGE DOING A GOOD JOB?

Year	2003	2004	2005	2006	2007	Average of 5 years
Company profits (1)	5.95	11.1	10.4	0	11.5	7.79
Sales (2)	58	82	102	136	176	110.8
Operating margin % (1/2)x100	10.25862	13.53659	10.19608	0	6.534091	8.105075

Year	2003	2004	2005	2006	2007	Average of 5 years
Company profits (3)	5.95	11.1	10.4	0	11.5	7.79
Capital employed (4)						0
Return on capital (ROCE) (3/4)x100	86.3	118	75.9	0	40.4	64.12

SECTION 4 - IS THE SHARE GOOD VALUE FOR MONEY TODAY?

		High Each Year A	Low Each Year B	Earnings Per Share C	PER at High D=A/C	PER at Low E=B/C	Average PER F=(D+E)/2
No of years data (maximum 5)	5						
Most recent year to	2007	210	160	12.5	16.8	12.8	14.8
Next most recent year to	2006	180	105	0.29	620.7	362.1	491.4
Three years ago to	2005	250	135	12	20.8	11.3	16.0
Four years ago to	2004	380	250	12.6	30.2	19.8	25.0
Five years ago to	2003	370	290	7.17	51.6	40.4	46.0
Total		1390	940		740.1	446.4	593.2
Average		278	188		148.0	89.3	118.6

Today's share price is 198 p

LOWER

How does it compare with the average share price five years ago? HIGHER / LOWER

By what percentage has it increased/decreased over the five year period? -15 %

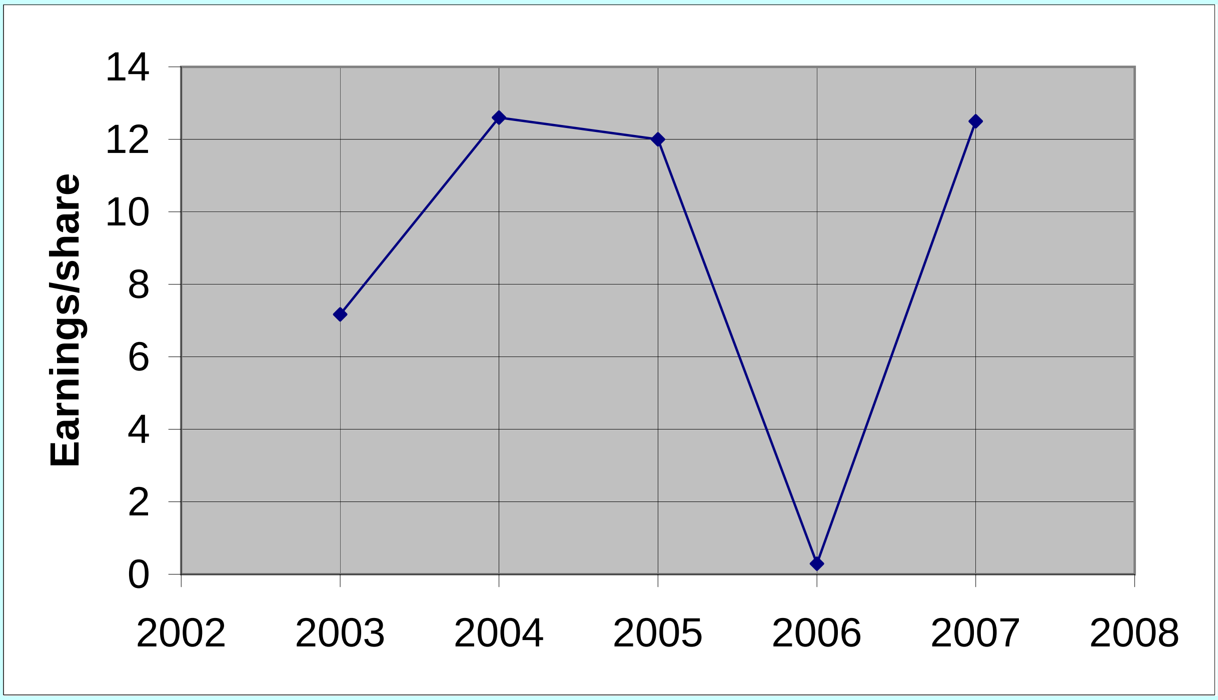
In how many years has the share price been as high as the current price? 4 years

Today's PER is 15.84 (Latest Share Price/Latest Earnings per Share)

LOWER

In relation to past PER's this is HIGHER / SAME / LOWER

SECTION 5 - EARNINGS PER SHARE GRAPH



SECTION 6 - REASONS FOR PAST GROWTH

Reason	Details	Still expected to be effective over next 5 years - YES/NO
Introduction of new products & services	Rebranding Sep 2003 to reflect multi utility nature of business:	YES
Development of existing products	Competitive advantage due to lower admin costs.	YES
Achieving a larger market share	Independent distributors acquire customers by word of mouth.	YES
Technological changes in production		
Management skills	Sold electricity & gas business to nPower in Mar 2006 & took a long term supply agreement (lower risk)	YES
Enhanced marketing and promotion	The Utility Warehouse Discount Club Brand & The Utility Warehouse Discount Club for Business (2005)	YES
Fashion trends		
Acquisition of new companies		
Recovery of cyclical business		
Other reasons	Bundled discounts & benefits to customers. Average revenue per customer increased (x4) & churn rate low for sector (2% compared to 5%).	YES

SECTION 7 - IT'S MAKE-YOUR-MIND-UP TIME…

Put an affirmative tick or a negative cross after each of the following statements:

i)	I understand this company and what it does.	Y
ii)	I am completely confident that this company has a sound five-year financial record.	Y
iii)	I believe the management of this company has developed the product & profits in a cost-effective manner.	Y
iv)	The information I have discovered leads me to believe that this company will continue to produce increasing dividends for it's shareholders	Y
v)	My knowledge and common sense tells me that the share price today indicates that the company is undervalued in the marketplace.	Y
vi)	I like this company so much I would like to own the whole business.	Y

If you have 6 Yes's then this company is worthy of serious further consideration.

If you have a single cross then forget this company. There are plenty of others out there.

Be completely honest with yourself.

In share dealing it is always better to be safe than sorry.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140
135
Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan
2008
Telecom plus PLC
20 day EMA
50 day EMA
200 day EMA
8
6
4
2
0
Telecom plus PLC Volume (millions)
rising price
falling price
100
50
0
14 day RSI
100
50
0
14 day Money Flow Index
Feb Mar Apr May Jun Jul Aug Sep Oct Nov Dec Jan
2008


280
270
260
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110
100
2006
2007
2008
Telecom plus PLC
20 week EMA
50 week EMA
200 week EMA
10
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0
Telecom plus PLC Volume (millions)
rising price
falling price
100
50
0
14 week RSI
100
50
0
14 week Money Flow Index
2006
2007
2008