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**Research Report**

# Wapme Systems AG

**May 2005**

**Refocused business offers chances  
-Attractive turnaround story--**

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**IMPORTANT INFORMATION:**

**Please pay regard to disclaimer/risk information  
as well as potential conflicts of interest in accordance with §34b WpHG on page 71**

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# Wapme Systems AG

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**Price EUR 2.10**

**Date 27.04.2005  
(5.30 pm)**

**ISIN:DE0005495501**

**Symbol: WPM**

**Sector:  
Mobile Entertainment**

**Number of shares:  
10.683m**

**Market cap:  
EUR 22.43m**

**Market segment:  
Prime Standard**

**Accounting Standards:  
IFRS**

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**Profile:**

Wapme Systems AG has been listed on the Frankfurt Stock Exchange since 2000 and is one of the leading providers of contents and technological infrastructure for „Mobile Entertainment“ in Europe.

„Mobile Entertainment“ basically includes erotic, dating, game-playing, gambling and music via Internet, SMS, GPRS/UMTS and similar technologies. Due to the acquisition of the Swiss Lawa Group in 2004, Wapme mainly focuses on providing erotic contents at the moment. However, this so-called „Adult Entertainment“ presents only one part of the company. Via their subsidiary more phones GmbH, Wapme also sells mobile phones and end devices at wholesale.

After a new business direction and several capital increases as well as the issue of a convertible bond, the company is on its way into the black.



**Fundamentals and estimates**

In Euro m	2004	2005 E	2006 E
Sales	66.32	120.00	140.00
EBITDA	-4.71	4.17	5.27
EBIT	-5.95	3.77	4.87
Net profit	-7.21	2.77	3.57
EPS €	-0.75	0.26	0.33
EBITDA-margin	-7.10%	3.48%	3.76 %
EBIT-margin	-8,97%	3.14 %	3.48 %
EV/Sales	0.31	0.19	0.15
EV/EBITDA	-4.40	5.44	4.02
Price-Earning Ratio (PER)	Neg.	8.10	6.28
Price/Book Ratio (P/B)		2.7	

**TOPICS:**

- Refocussed business - „Mobile Entertainment“
- Expected annual market growth of more than 40%
- Significant profits expected already in 2005
- Attractive valuation on the basis of positive expectations

**Refocussed business activities****Refocussed business**

Until mid-2004, Wapme AG was a service provider for so-called Value Added Services which are nongratuitous services e.g. mobile phone logos, ring tones and also messaging (sms-chats) of mobile providers. Thus Wapme linked providers and customers providing its own technology and software.

As a consequence of too low margins, there was a drastic restructuring of business in 2004 leading to the closing of some parts and the re-arranging of its activities. The company now focuses on providing erotic contents, dating services, games, music downloads and gambling.

According to the management, the most promising area at the moment is „Adult Entertainment“, the providing of erotic contents. In order to achieve more expertise in this field, at the end of 2004 Wapme acquired the Swiss Lawa Group which brought, above all, considerable know how and distribution channels. The acquisition of the Lawa Group extended Wapme's market influence, in addition to Germany, also to Switzerland and Austria.

**The market****Sophisticated mobile phone technology enables the sending of high data volumes**

During recent years, the Western European mobile phone market has become more and more sophisticated. There are mobile networks almost all over in Europe while the market for mobile phones is nearly saturated. The equipping of mobile phones is technologically well developed and makes it possible to send and receive high data volume.

Functions of mobile phones and other mobile devices like PDAs go far beyond their original applications such as phoning and sms. New applications of „Mobile Entertainment“ like downloading of logos, ring tones, music and games are responsible for the soaring data volume. The major part using these applications are private consumers.

**Data volume sales will increase strongly in the following years**

Owing to the almost complete saturation of the Western European market, data sales for telephony services will stagnate in the next 4 years while the volume of data sales for new services will rise from 16.4% in 2004 to 22.9% in 2008.

In 2004 the volume of the complete Western European market for mobile entertainment amounted to US\$ 4.3bn. In 2008 the volume is likely to reach US\$ 18.4bn which corresponds to an annual growth of more than 40%.

Concerning the field of so-called Rich Media, i.e. the transmission of picture and sound, expectations are even higher. Market volume of currently US\$ 151m is to rise to US\$ 657m by 2008. Correspondingly, this means an expected annual growth of more than 44%.

**Tight situation last year was the reason for the poor result**

**Market share of Lawa is likely to soar in Germany**

**High growth rates and margins offer chances**

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### **Fundamental analysis**

Wapme's sales amounted to EUR 66.3m last year whereas the subsidiary more phones GmbH accounted for EUR 50.7m. The difficult cash situation had a negative influence on more phones's activities and was thus the reason for the sales decline of almost 50% in comparison to the previous year.

Also the total sales of the VAS-segment (Value Added Services) have decreased significantly by EUR 8.1m to EUR 15.7m.

Weak business was also reflected by earning figures with an EBITDA of EUR -4.7m and a net income of EUR -7.2m.

Business was then refocussed by the management due to the tight situation. Three capital increases and the issue of a convertible bond constituted a solid ground for new business activities. A further issue of a convertible bond with a volume up to EUR 5.2m (subscription period: April 26, 2005 to May 9, 2005) should complete financial restructuring.

After the acquisition of the Lawa Group, from our point of view, Wapme is well-positioned now. Lawa generated revenues totalling EUR 6.5m in FY 2004. The company, having a market share of 50% in Switzerland, should make the breakthrough in Germany quickly. There are only a few competitors in the German market, most of them are small players without much market influence. Lawa plans to have a market share of 25% in Germany by the end of 2005.

While Lawa currently is mainly present in Switzerland, the large distribution of mobile phones as well as the use of mobile services in Germany offers a large potential to the company. As a consequence, activities in the German market are to be increased already this year.

### **SWOT- analysis**

- |               |  |
|---------------|--|
| Strengths     | <ul style="list-style-type: none"> <li>· Well-positioned in a strong growth market</li> <li>· Good technology and infrastructure</li> <li>· Generation of strong distribution channels with Lawa</li> </ul>  |
| Weaknesses    | <ul style="list-style-type: none"> <li>· Cash situation continues to be tight</li> <li>· Services are still not known enough</li> <li>· Possible dilution of share holders through outstanding convertible bonds</li> </ul>  |
| Opportunities | <ul style="list-style-type: none"> <li>· „Mobile Entertainment“ is a new market</li> <li>· high margins and strong growth rates</li> </ul>   |
| Threats       | <ul style="list-style-type: none"> <li>· If new service offers will not be accepted by customers, this could lead to a tight cash situation again</li> <li>· Necessity of high growth rates of the market to be successful</li> <li>· Successful agreements are decisive for future prospects</li> </ul> |

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### Valuation and DCF - model

The new positioning in the field of „Adult Entertainment“ offers Wapme high chances in a soaring market with a countable number of competitors. This should enable Wapme to enter into the black again and thus to reach nice margins.

**2005 revenues estimated at around EUR 120m; noticeably positive EBIT**

We think the company should be able to increase their revenues noticeably in FY 2005. Rising sales of more phones GmbH and Lawa Group's contribution should lead to total sales amounting to EUR 120m. Structure adjustments regarding margins and costs should result in an EBIT of EUR 3.8m.

According to our estimates, also the net income would be positive in 2005 coming up to EUR 2.8m because of low taxes due to losses carried forward.

Taking this result into account, the valuation of Wapme Systems AG is quite interesting. The P/E ratio of 8 in 2005 seems relatively high at first, but considering the fact that the market, in which Wapme is operating is expected to grow on average by 40% p.a. the P/E is very attractive if Wapme meets expectations.

**High price/earnings ratio is justified by high return on equity (ROE)**

The valuation of the Wapme share is attractive. An expected ROE of 28.3% in 2005 and of almost 29.7% in 2006, justifies the high price-book ratio (P/B ratio) of 2.7.

Due to several capital increases, the equity ratio is 40% and thus in line with the market average. As to the balance sheet, assets are not exceedingly high risky.

Liabilities, mainly consisting of the issued convertible bond, are also not exceptionally high and thus do not constitute a burden for the company.

**2005EV/EBITDA of 5.44 is attractive**

Multiples on basis of the entity value show an attractive valuation as well. Thus the estimated entity value (EV)/EBITDA ratio is 5.44 in FY 2005 and 4.02 in FY 2006. The EV/S ratio of 0.19 based on the 2005 estimate is also moderate.

The valuation on basis of our Discounted-Cash-Flow model emphasizes the above mentioned results and indicates an undervaluation. In our 3-step DCF-model we made explicit assumptions over a seven-year period regarding business development. In Step 1 we estimate the profit and loss statement and the balance sheet in detail, over a period of 2 years. The second step comprises plausible projections over 5 years. Finally, we presume a continuing trend in step 3 leading to the present value of the so-called continuing value or the terminal value.

Thus we expect sales totalling EUR 120 and an EBITDA-margin of 3.5% in 2005. For 2006 we calculated a 16.7% sales increase to EUR 140m and a 3.8% EBITDA- margin.

**Positive forecast in spite of cautious estimates**

**Fair value per share at EUR 3.42 in 2005**

**The share of Wapme Systems AG is an interesting investment with high potential**

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In the scenario for the following years we assumed a 8% sales growth and constant EBITDA- margins of 4.3%. We also anticipate a sales growth of 2% for the perpetuity period. Due to the positive business outlook in the next years, this scenario seems reachable. We decided for cautious assumptions in order to avoid risk. Possible acquisitions have not been considered yet.

For reserved reasons, further useable losses carried forward have not been paid attention to, from which more potential taxes with an estimated amount of EUR 11.0m could be saved, if the business develops well. More than that, a recently unsecure outstanding purchase tax of EUR 5.3m against the tax authorities have not been considered in our valuation. This could lead to an extra Cash-Flow for Wapme and so would increase the enterprise value.

The calculation of all free cash flows which are discounted with the weighted average cost of capital (WACC) of 12.8% is based on this model.

Consequently, the expected fair value of equity amounts to EUR 36.7m on the balance sheet day in 2005. With a number of shares of 10.683m, the price target is at EUR 3.42 per share.

#### **Conclusion:**

**Wapme refocussed its operating business to the field of „Mobile Entertainment“ with special focus on „Adult Entertainment“. The company is now operating in a market with high growth potential for the next years. Its excellent position, mainly owing to the acquisition of the Lawa Group, offers Wapme the chance to benefit from this positive trend.**

**A very favorable valuation of the share is the result of the positive growth scenario. Our calculated price target for 2005 is EUR 3.42 enabling a 60% potential for the share price. Therefore, our rating for the share of Wapme Systems AG is BUY.**

## DCF - scenario , Wapme Systems AG

in EUR m	2005E	2006E	2007E	2008E	2009E	2010 E	2011 E	Continued
Sales	120.00	140.00	151.20	163.30	176.36	190.47	205.71	209.82
change in %	80.9%	16.7%	8.0%	8.0%	8.0%	8.0%	8.0%	2.0%
EBITDA-margin	3.5%	3.8%	4.3%	4.3%	4.3%	4.3%	4.3%	4.3%
EBIT	3.77	4.87	6.07	6.56	7.08	7.65	8.26	8.42
Ebit-margin	3.1%	3.5%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Taxrate	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%	33.5%
Working capital	5.43	5.78	6.25	6.75	7.29	7.87	8.50	8.67
% of sales	4.5%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%	4.1%
Operating fixed assets (ofa)	5.81	6.42	6.94	7.49	8.09	8.74	9.44	9.63
Sales to ofa	20.6	21.8	21.8	21.8	21.8	21.8	21.8	21.8
Depreciation	-0.4	-0.4	-0.43	-0.47	-0.50	-0.54	-0.59	-0.60
% of ofa	6.9%	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%	6.2%
<b>Free cashflows</b>								
EBITDA	4.17	5.27	6.50	7.02	7.58	8.19	8.85	9.02
Taxes on EBIT	-1.26	-1.63	-2.03	-2.20	-2.37	-2.56	-2.77	-2.82
Investments in ofa	-0.60	-1.01	-0.95	-1.02	-1.10	-1.19	-1.29	-0.79
Change of working capital	-0.90	-0.35	-0.46	-0.50	-0.54	-0.58	-0.63	-0.17
Investment in goodwill	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
<b>Gross free cashflow</b>	<b>1.41</b>	<b>2.28</b>	<b>3.06</b>	<b>3.30</b>	<b>3.57</b>	<b>3.85</b>	<b>4.16</b>	<b>5.24</b>

VALUATION IN EUR m	2004	2005E	2006E	2007E
Present value FCFs	12.8	13.1	12.5	11.0
Continuing Value	20.9	23.6	26.6	30.0
Value of Operations	33.8	36.7	39.1	41.0
Net debt*	0.87	-0.48	-4.64	-8.07
Present value options	0.00	0.00	0.00	0.00
Value of Equity	32.9	37.1	43.7	49.1
Minority interests	-0.6	-0.6	-0.6	-0.6
Value of shareholders equity	32.3	36.5	43.1	48.5
Outstanding shares in m	9.555	10.683	11.639	11.795
<b>Fair Value per share €</b>	<b>3.38</b>	<b>3.42</b>	<b>3.70</b>	<b>4.11</b>

COST OF CAPITAL	2004
Cost of equity	13%
Target weight	97%
Cost of debt	8.0%
Target weight	3%
Tax shield in %	25%
<b>WACC</b>	<b>12.8%</b>

\*For reserved reasons, further useable losses carried forward have not been paid attention to, from which more potential taxes with an estimated amount of EUR 11.0m could be saved, if the business develops well. More than that, a recently unsecured outstanding purchase tax of EUR 5.3m against the tax authorities have not been considered in our valuation. This could lead to an extra Cash-Flow for Wapme and so would increase the enterprise value.

## Sensitivity analysis Wapme Systems AG

		WACC		
		11.80%	12.80%	13.80%
Continuing sales growth	1%	3.63	3.28	2.98
	<b>2%</b>	3.81	<b>3.42</b>	3.09
	3%	4.04	3.59	3.22
	4%	4.32	3.79	3.37
	5%	4.68	4.05	3.56



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The Research Report

on

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