



February 24, 2004

Germany
Mobile Telecommunications Services

Wapme Systems AG

Primary Exchange: Frankfurt Symbol: 549550/WPM
Prime Standard ISIN: DE0005495501

12 Month Price Target: €7.00
Rating: Strong Buy

Comprehensive Report

Risk Rating: High

Highlights

- In the first 9 months of 2003, Wapme generated a dramatic increase in revenue to €94.792m (Q1-Q3 2002: €4.252m).
- Wapme achieved a positive EBITDA of €0.238m which represents a substantial improvement over the same period in 2002 (-€3.899m).
- In the 9-month period the Trade subsidiary More Phones, which buys and sells mobile handsets, provided most of the Group's outstanding revenue growth with 81% of the total revenue.
- However Wapme management considers mobile solutions, with a focus on SMS and Premium SMS services, to be their core business and it is this segment that provides most of the Group's earnings.
- This quarter Wapme is due to re-launch its brand, emphasising its development from a technology provider to a service provider. As opposed to offering only the software for SMS services, Wapme is positioning itself as a full service provider with the set up of a new text centre.
- As part of the new strategy for 2004 management intend to focus on the areas of mobile marketing and interactive TV and to increase Wapme's presence in markets like Turkey and the US.
- Wapme management have turned the company around in the course of 2003 but it now remains to be seen whether the team is strong enough to succeed in the rapidly changing market in which the company operates.

Company Profile

The Wapme Group is one of the leading German mobile messaging providers. It develops service applications for SMS, Premium SMS services and mobile marketing.

Wapme consists of three divisions:

- Value Added Services which includes the segments Messaging and Mobile Applications
- Equipment Wholesale– i.e. the trading of mobile handsets– which is carried out by the subsidiary More Phones GmbH.
- Software which is the foundation for Wapme's Value Added Services. Wapme's customers include Carriers/ Telcos, Internet Portals, Marketing/ Advertising companies and Media Companies.

Financial History & Projections

	2001A	2002A	2003E	2004E	2005E
Revenue €m	9.072	20.447	127.784	105.595	111.522
Yr/Yr Growth	154%	125%	525%	-17.4%	5.6%
EBITDA €m	-1.257	-7.080	0.778	3.440	5.049
EBIT €m	-3.379	-14.781	-0.10	2.640	4.269
Net Income €m	-1.731	-15.925	-1.768	1.895	3.262
EPS €	-0.31	-2.94	-0.30	0.31	0.49

Stock Data

Market Capitalisation	€23.538m
Shares Outstanding	6,113,750
Liquid Assets	€2.394m
Total Assets	€19.431m
Working Capital	€5.793m
Total Shareholder's Equity	€10.004m
Book Value per Share	€1.64

Stock Overview



Source: Bloomberg

Current Price: (closing February 23)	€3.85
Average Daily Volume (1 yr)	90,163
52 Week Range:	€4.65/0.62
Free float	31.12%

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Recent Financial History

- In November 2003 Wapme released its Nine Month Report for 2003 which showed a dramatic increase in revenue to €94.792m (Q1-Q3 2002: €4.252m).
- In the first three quarters of 2003, Wapme achieved a positive EBITDA of €0.238m which represents a substantial improvement over the same period in 2002 (-€3.899m).
- Net loss for the period was €1.996m, dramatically better than the total 2002 net loss of €15.925m.
- Wapme has two main business segments– Trade and Value Added Services. In the 9-month period the segment Trade provided most of the Group's outstanding revenue growth with €76.609m, 81% of the total revenue for the year so far.
- The VAS segment also performed impressively in the period, generating revenue of €17.930m as compared to €0.720m in the first 9 months of last year. This high-margin segment provides profitability for the Group, with an EBITDA of €1.285m for the 3 Quarters, amounting to over 50% of the total.
- Software provided €0.253m in revenue and a net loss of €0.156m.
- Wapme's balance sheet remains stable. As of the 30 September 2003 the company had assets totalling €19.431m, of which €2.512 were intangibles. The company also had working capital of €5.793 with cash and cash equivalents totalling €2.394m.
- Management recently announced the issue of 600,000 partial convertible bonds totalling €2.9m which were offered to current shareholders on a 1 bond for each 10 shares basis. Approximately 50% of shareholders took up what we believe is a very attractive offer. The bond gives the holder 5% interest p.a. plus an option to convert their bonds into shares at a price of €4.50 at any time after the end of August 2004. Any shares not taken up by current shareholders were underwritten by two institutions. These funds will be used to further improve Wapme's liquidity.

History

Wapme was founded in 1996 and at the time of its IPO in July 2000 was focused on developing Wapme, its software for the WAP mobile Internet

platform. WAP (Wireless Application Protocol) technology had been tipped to carry the internet into a new era by allowing wireless service subscribers to access Web-based information from mobile phones and PDAs. However by 2000 consumers had passed a poor usability verdict on WAP technology. Companies, like Wapme, which had invested heavily in developing WAP platforms had to find new business areas.

Wapme started to focus on software for mass SMS sending and Value Added Services (Premium SMS and MMS- Multimedia Messaging Services) and since then it has developed into an end-to-end provider of messaging services in this high growth market. Wapme uses the technology it developed previously as the basis for these services.

As part of their recovery, Wapme also needed a business line which would provide them with the revenues needed to be taken seriously in their market. To this end, the trade subsidiary More Phones GmbH was set up in Q3 2002.

Trade

Although Wapme considers Value Added Services to be its core business, its main revenue generator is the trade subsidiary More Phones. More Phones buys and sells mobile handsets and its addition to the Group in Q3 2002 was the reason for the huge revenue surge in 2003. EBITDA margins for handset trading are only in the region of 1.5%, therefore this subsidiary does not provide a high level of earnings for the Group.

However the very success of More Phones in rapidly increasing its revenues has brought the company to the attention of the German tax authorities. They are currently holding back €4.3m in VAT while they conduct a tax audit. This is standard practice and management are confident that they will receive the money back.

Wapme management have stated that they intend to restrain further strong revenue growth in this segment in the coming quarters for strategic and risk management reasons. Therefore management would prefer More Phones to improve margins rather than increase revenues. This would require a shift of focus to high-margin mobiles rather than mass sales. If this new policy is successfully implemented management expect €60m revenues in 2004 from the Trade segment, which is a considerable reduction over from our estimate of €102.1m for 2003.



If EBITDA margins reach 2-3% in 2004 Wapme management may consider selling More Phones. Based on our initial estimates we believe the company will be able to sell the subsidiary for €10m-€15m.

SMS Products and Services

Wapme's core products are its messaging services:

Wapme smart SMS

Companies can use Wapme's smart SMS services to send marketing or advertising messages and information instantly to their customers.

Premium SMS

Premium SMS provides companies with a simple micro payment system whereby amounts between €0.49 and €2.49 can be charged to the SMS user's phone bill after a message has been sent to a special short code number.

The Premium SMS system can be used to charge for products like ringtones and chat or participation in games and voting. Its advantages for the end user are convenience, lower cost, security and transparency compared to credit card payment or premium rate telephone numbers.

The Adult Market

In 2003 Wapme was viewed as the market leader in erotic chat, which costs the participant in the region of €1.99 per SMS. This is a high margin area and one that was successful for Wapme in 2003. As the mobile technology develops, for example, the increasing level of ownership of multi-media mobile phones, there will be opportunities to diversify in this area. Wapme could develop further relationships with suppliers of adult content so that images could also be sent on request. The market also has the advantage of being less attractive to the big mobile carriers, who may not be willing to get involved in adult entertainment.

However management have expressed their intention of moving away from the erotica area and instead focusing on increasing Wapme's presence in the media and marketing sectors. This is part of their programme for developing a new corporate identity as Wapme tries to expand further into international markets i.e. Turkey, the UK and the US. As an aspect of this drive Wapme is due to re-launch its brand, emphasising its development from a technology provider

to a service provider.

New Direction

In a recent conversation André Borutta, Wapme's CEO, said that he now wants to move the company further into the media sector. He cited as a recent examples of the possibilities in this field Wapme's involvement in the 'Fun Night' on TV station Super RTL and in the interactive version of the TV show 'Who wants to be a Millionaire' in Turkey. Wapme is entering the Turkish market, getting involved in interactive TV shows through their cooperation with the mobile communications company Turkcell. Wapme provides the technical back up necessary for the running of voting, competitions, interactive games etc via Premium SMS.

The Text Centre

Wapme's latest step towards covering all elements of the value chain is the setting up of One2pay GmbH, as a fully owned subsidiary of the Group company Centrium GmbH. One2pay was founded in Q3 2003 and will provide Wapme with an internal text centre based on the creation of 79 'Mini-Jobs' or part time jobs.

The new internal text centre allows Wapme to offer corporate customers an extended service range including applications like chat, competitions and voting, in addition to SMS distribution and Premium SMS handling. The customer does not have to make any investment in infrastructure.

Strategy

Recently Wapme management have been articulating the company's role as an enabler, allowing its customers to add value through its messaging services and infrastructure. For example, Wapme can work with TV producers who want to generate revenues from their TV programmes by making them more interactive. On one side, there are the viewers who want to participate in the voting, chat and competitions which are increasingly becoming an integral part of interactive TV. On the other side, are the TV producers who need to find a secure and reliable way of generating revenues from this trend. Wapme is positioning itself in the middle with its Premium SMS services.



The next area in which Wapme wants to enable its customers to profit from the interactive element of SMS, and in the future MMS, messages is their use in marketing and advertising. In this area Wapme's customers are mainly advertising agencies.

The company recently undertook a project from the agency Saatchi and Saatchi to promote the hygiene and cosmetic products of Henkel to teenage girls in Turkey. Wapme can utilise the sense of trust built up the text message or chat room environment to place products in a subtle and effective way.

Wapme already has a database of over 2 million mobile phone users who have consented to receive marketing information through SMS. The areas of TV interactivity and marketing can be linked. When someone votes, as part of a TV show for example, their details can be logged and their permission for further communication sought.

Now that Wapme has set up a text centre it can offer customers the full infrastructure necessary to bring their marketing straight into the pockets of consumers. The primary function of SMS, and in the future MMS services, as part of marketing package, is in customer retention and relationship management rather than acquisition of new customers. Wapme management stress the fact that they never put themselves into competition with their customers but sell themselves first of all as an enabler which will allow the producers or marketers to reach an audience ready to participate.

MMS and mobile marketing– Materna

One of the market leaders in mobile communication solutions in Germany is Materna, a private company. Materna is currently making MMS distribution channels available to customers who want to implement multimedia Value Added Services. It is also working on ways of using MMS in direct marketing as the ownership of sophisticated handsets becomes more widespread.

The Multimedia Messaging service is the ability to send messages comprised of a combination of text, sounds, images and video to MMS capable handsets. MMS applications are viewed in the telecommunications industry is one of the key ways to provide 3G services in the coming years and so to allow carriers to recoup the huge expense of acquiring the 3G li-

censes.

The extent of the popularity and rapid spread of SMS was not widely predicted in the industry but it is expected that MMS services, based as they are on the popular features of SMS, will eventually be taken up by users. The capacity to send and receive images, which complements the growing popularity of digital photography and digital imaging, makes possible services like personalised MMS postcards. In market surveys users express an interest in richer content and downloadable services like news, games, travel and sports information and screensavers. However before these services can be widely offered and used MMS handsets have to reach a certain penetration and that is expected to take at least two years.

Wapme management have said that they are prepared to let bigger companies like Materna be the first movers in the MMS services area so that they can follow when the market has been established.

Interactive TV– Minick

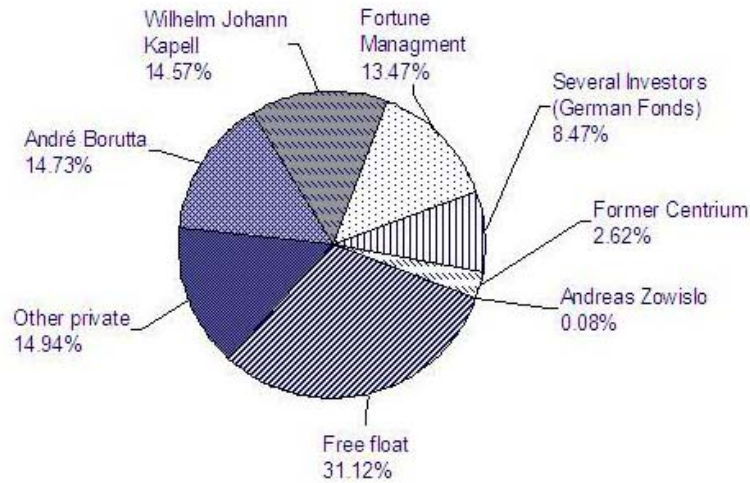
In the interactive TV area, companies already well established in the sector include Minick, which also supplies infrastructure, applications and platform for mobile interactivity. Minick's expected 2003 revenue of \$23m and positive EBITDA of \$2m put it in the same size category as Wapme's VAS segment. The company, which is not listed, was founded in Switzerland and also operates in Germany, Spain, Sweden and the UK and has been involved in a number of high profile projects in these markets.

For instance, at the recent MTV Europe Music Awards Minick provided the infrastructure to allow the viewing public to vote live via SMS for the 'Best Song'. Minick have also implemented the SMS based voting for shows like Big Brother in the UK and has established partnerships with media companies like Channel 4, MTV, Universal and RTL.

There is no doubt that Minick has proven technological capacities, with a messaging centre capable of processing up to 18,000 SMS per second and impressive media contacts. Wapme will have to work hard to build up its own range of contacts in the media industry.

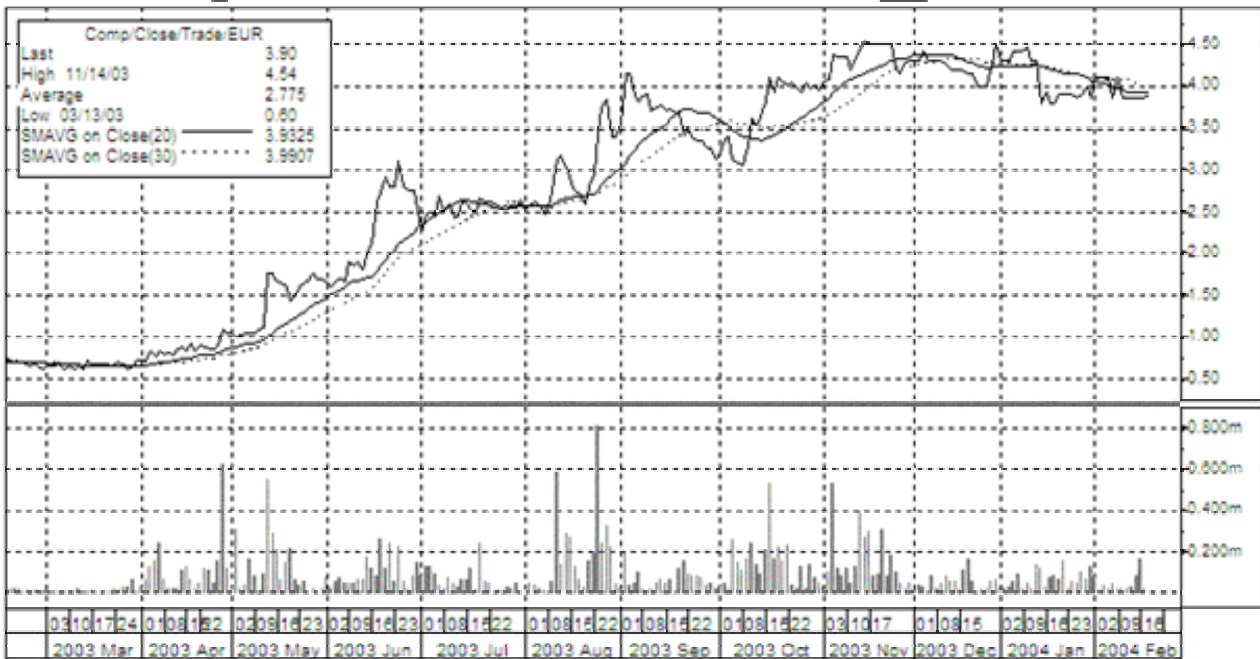


Wapme Shareholder Structure



The founders of the company, Wilhelm Kapell and André Borutta both own just under 15% of Wapme. The other board member Andreas Zowislo owns 0.08% of the share capital whilst the three founders of Centrium, a subsidiary of Wapme own a further 2.62%. Several German funds like DWS, DIT and Julius Bär own just over 8% of the company but most significant is Fortune Management who in Q4 2004 purchased 13.47% of Wapme.

Shareprice Development



Source: Bloomberg

The average daily share volume, over the last year, for Wapme Systems has been 90,163 shares. Over the same period the share price rose dramatically from a low of €0.60 in March to a high of €4.54 in November. The share price has since fallen back to under €4 but we believe this is only a consolidation phase and expect the share to move to higher levels over the coming months.

Since the beginning of 2004 the share has traded in a tight band between €3.80 and €4.40 with daily volumes averaging 56,080 and the highest 10 day historical price volatility being 76%. This is a much healthier situation than in 2003 when the share price volatility was very high. For example, on the 22 May 2003 the 10 day historical price volatility hit 262%. This reduction in volatility largely reflects the improving situation of the business and the purchase by various financial institutions and funds of the Wapme stock. As a result we are reducing our risk rating from Speculative to High.

Wapme's Designated Sponsors are: Seydler AG, HSBC Trinkaus & Burkhardt.



Management and Corporate Governance

- One of the problems that Wapme has encountered in the past is a reputation on the market for poor corporate governance. In our previous report (July 15 2003) we expressed some concern about the relatively young Management Board and, in particular, the fact that they 'personally' owned 27% of the subsidiary More Phones. However this unsatisfactory situation was resolved in Q2 2003 with Julian Riedlbauer's move from the Management Board of Wapme to More Phones in order to focus on the its development. Mr Riedlbauer bought their shares from the other Board members at cost price and he owns the 27% of the subsidiary. (The Wapme Group holds 53.48%, with the remainder belonging to More Phones management). We are pleased that management are working to improve Wapme's market transparency.
- Wapme management emphasise the fact that the company has gone through a learning curve in the last year or two, following their losses in 2002 and the subsequent need to find new business areas. They are now moving from survival mode to the strengthening of their position and re-branding Wapme as a full-service mobile messaging provider. In the coming year they intend to move to the next level i.e. from what has been their base of logos, ringtones, news, erotica etc to TV interactivity involving voting and quizzes and mobile marketing. It remains to be seen whether the present Wapme management is capable of leading the company successfully in this new stage.
- The CEO and public face of the Wapme is André Borutta, who is also in charge of sales, marketing, public relations and investor relations. He has certainly done a good job in the last year in turning Wapme around. However the rapidly expanding and changing market in which the company operates demands a skilful management team and we would like to see Wapme strengthening that team in the coming year.

Outlook

For 2003 we estimate revenues of €127.78m, EBITDA of €0.778m and net income of -€1.768m. In terms of revenue these figures are 17.4% ahead of our estimates in our last report (July 15, 2003) which largely reflects the outstanding performance of More Phones in third quarter. However our previous earnings targets for EBITDA of €2.983m and net income of €0.977m are not going to be met. This mainly reflects the company's change of strategy towards becoming a full service provider and the resulting investment that this change required.

We are expecting 2003 revenues for the VAS sector to be €25.3m, Trade to be €102.1 and software to be €0.338m.

Looking to 2004, we estimate total revenues of €105.595m, down 17% y/y. This decrease in our revenue projection is largely due to management's decision to focus on becoming more profitable by cutting back More Phone's distribution of low margin products. Due to this measure and the continuing development of the higher margin VAS business in 2004 we expect earnings to increase significantly. We are projecting EBITDA of €3.440m and net income of €1.895m which converts into an EPS of €0.31.

For the VAS sector in 2004 we are expecting revenues of €39.800m which represents a 57% increase over our estimates for 2003 (€22.3m). Trade revenues should fall from €105.4m to €65.8m.

For 2005 we are projecting revenues of €111.522m, EBITDA of €5.049m, net income of €3.262 and EPS of €0.49.



Risks and Concerns

- As a messaging services provider Wapme is still very much focused on SMS applications and management have stated that they are not attempting to be first movers in the MMS area. Given the company's experience in the WAP technology hype of the late 90's and the subsequent lack of user take-up, it is understandable that they do not want to invest heavily in MMS technology before it has been widely accepted. Our concern is whether they will get the timing of the company's entry to the MMS market right.
- We are somewhat concerned about how the More Phones situation is going to develop in the coming year. In our 2004 projections we have factored in management's stated intention of reducing the subsidiary's revenue to the €60m level, while improving margins. However actually achieving this smoothly will not be straightforward and will require the full cooperation and change of strategy of the management and shareholders at the subsidiary.

Recommendation

We are issuing a Strong Buy rating on Wapme and are setting a 12 month price target of €7.00. Wapme is currently trading at around 4.7 times our EBITDA for 2005 of €5.049m and 8 times our 2005 EPS projection of €0.49. We believe that the risk/reward relationship for Wapme shares at current levels is compelling and justifies buying the stock. Our valuation of €7.00 is based on our discounted cash flow model and translates into a P/E ratio of 15 times our 2005 earnings.

Our 2003 revenue projection is €127.784m, which because of the performance of the Trade subsidiary More Phones is well ahead of our previous target. However both EBITDA at €0.788m and net income at -€1.768m are considerably below the targets we set last July. This mainly reflects the company's change of strategy towards becoming a full service provider and the resulting investment that this change required.

For 2004 we are projecting revenues of €105.595m, EBITDA of €3.440m and net income of €1.895m. The expected decline in revenue is due to the management's intention of restraining revenue growth at More Phones in favour of higher margins.

For 2005 we estimate revenues of €111.522m, EBITDA of €5.049m, net income of €3.262 and EPS of €0.49.

We are reducing our risk rating on Wapme from Speculative to High due to the stock's lower volatility levels over the last few months and the stabilisation of their business model.

The primary risks to our target price are management's ability to execute their strategy, the handling of the move into the MMS market and the development of More Phones.


Detailed Financial History & Projections IAS

in t €	2002E	2003A					2004E				2005 E	
	Total A	Q1A	Q2A	Q3A	Q4E	TotalE	Q1E	Q2E	Q3E	Q4E	TotalE	TotalE
Total revenues	20.447	23.424	29.374	41.994	32.992	127.784	24.829	25.322	30.122	25.322	105.595	111.522
Other operating income	434	73	206	72	79	430	76	123	122	122	443	600
Changes in inventories of finished goods and work in progress	0	120	404	-213	122	433	120	120	100	87	427	499
Production for own fixed assets capitalised	831	93	150	136	123	503	111	123	134	143	511	400
Total performance	21.711	23.711	30.134	41.989	33.316	129.150	25.136	25.688	30.478	25.674	106.976	113.021
Cost of purchased materials and services	-19.001	-22.461	-28.578	-40.145	-31.233	-122.418	-22.843	-23.043	-28.315	-23.043	-97.243	-98.231
Personnel expenses	-4.501	-916	-837	-884	-920	-3.557	-940	-945	-965	-940	-3.790	-3.890
Other operating expenses	-5.289	-491	-583	-701	-623	-2.397	-623	-600	-650	-630	-2.503	-2.603
EBITDA	-7.080	-158	137	259	540	778	730	1.100	548	1.061	3.440	5.049
Depreciation and amortization	-7.701	-181	-263	-234	-200	-878	-220	-210	-190	-180	-800	-780
EBIT	-14.781	-339	-126	25	340	-100	510	890	358	881	2.640	4.269
Amortization of financial assets	-754	0	0	-436	0	-437	0	0	0	0	0	0
Interest income and expenditure	298	-3	10	363	13	382	-36	-36	-36	-37	-145	-145
Other income and expenses	0	0	0	0	0	0	0	0	0	0	0	0
Income before income taxes (and minority interest)	-15.237	-342	-116	-48	353	-154	474	854	322	844	2.495	4.124
Other expenses relating to previous periods				-1.020								
Income taxes	-646	243	-150	-114	-50	-72	-20	-25	-30	-35	-110	-352
Income from ordinary activities	-15.883	-100	192	-1.714	303	-1.319	454	829	292	809	2.385	3.772
Minority interest	-42	-206	55	-223	-75	-449	-118	-119	-134	-119	-490	-510
Net income	-15.925	-306	247	-1.938	228	-1.768	336	710	158	690	1.895	3.262
Net income per share (basic)	-2,94	-0,06	0,05	-0,32	0,04	-0,30	0,06	0,12	0,03	0,11	0,31	0,49

Assumptions

- 1) More Phones reduces in size but is not sold in either 2004 or 2005.
- 2) That all convertible bondholders convert their bonds to shares in 2005.

Investors should assume that First Berlin has sought or is seeking a professional relationship with this company.

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The Analyst(s) own(s) no shares in this company.

First Berlin owns no shares in this company.

Risk Rating

Risk ratings which are a reflection of expected price volatility and other fundamental risk factors are: Low, Medium, High and Speculative.

Rating system

STRONG BUY (outperform the market by 15% or more)

BUY (outperform the market by 15% or less)

HOLD (perform at market level)

REDUCE (underperform the market by up to 15%)

SELL (underperform the market by 15% or greater)

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