



## The small company specialists

# COMPANY INFORMATION

### KEYCOM PLC

Date: October 2006

Company Eye Ranking

15/50

### EDITOR'S NOTE

Keycom plc is a communications service provider aimed at the UK's University education market. The Company has developed a prepaid model for voice, Internet and mobile communications, allowing the service to be tailored for the student market, delivered to the student bedroom or on the move access.

The Company has invested in a centrally managed infrastructure, allowing a flexible model which can provide

the services at competitive pricing whilst maintaining a good margin. In particular, the majority of the students are connected using a Voice Over IP ("VOIP") structure which can be developed to allow broadband and other complementary services to be delivered.

In our opinion the company is not performing at a profitable level and at this stage this is high risk investment.

### CHART



### FUNDAMENTALS

Company Name	Keycom plc
Current Price	2.75p
Status	PLUS
Market Cap	£0.91 m.
Shares in Issue	33,260,573
Activities	The company delivers in-house developed value-added telecommunication services to further and higher education institutions.
Sector	Information Technology Hardware
Corporate advisor	J M Finn & Co
Registrar	Capita Registrars (Beckenham)

### HISTORY

The company was incorporated in February 2000 and has built its own communications core, giving control over its own infrastructure.

This gives it commercial and technical packaging flexibility and allows it to create and test new products in a self-contained environment. It is an internet service provider

(ISP) and can deliver a wide range of modular and complementary services to customers. It is a fully licensed telecommunications company with direct interconnect to all major UK and global voice carriers. Dealings in the shares commenced on PLUS in December 2001

### THE BUSINESS

Keycom is a communications service provider targeting the UK university education market. The company now is a market leader in its niche and services over 50,000 students in 150 halls of residence at over 50 universities. Keycom invested in a centrally managed infrastructure. This allows a flexible model that can provide competitive services, whilst maintaining a good margin. In particular, the majority of the students are connected using a Voice

over Internet Protocol, which transmits ordinary telephone calls over the internet rather than over the telephone network. This can be developed to allow broadband and other complementary services. Keycom markets its services through direct selling, where Keycom takes the lead, and through partnerships, where an infrastructure provider will often take the lead.

### SERVICES

The company's voice competence is well proven and has a centrally managed, multi-lingual switch, ensuring that customers never miss a call. Keytalk is a pay-as-you-go telephone service provided to students at their hall of residence bedroom. Its key features are: no connection or line rental charges, pay as you go prepaid service,

dedicated inbound 0870 number to room, free handset, free voicemail and competitive tariffs. Enhanced voice customers can have SMS alerts sent to mobiles when a voice mail is received by their direct fixed line. Users have a direct dial number, which can be configured for communal phones, and a PIN number that allows them to



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access the Keycom voice service from any Keycom phone on campus. Keycom's own mobile service is due for launch. Internet access is essential for students, not just for academic research purposes but also to satisfy social and leisure needs. For social use, Keycom provides students with access to the internet at two pence per minute through keysurf.net, which is its student portal. In addition, access to the Joint

Academic Network can be delivered through the same route. Keysurfplus.net access is available on and off campus and, just like the voice service, is paid for and controlled by using the same PIN number. All student rooms have access to keysurf and internet access can be unmetered at some halls of residence. A broadband service will be launched from September 2004 for a number of properties

## BENEFITS

### Benefits to the institution are:

- Technology enabled rooms attract higher rates and can be a marketing tool
- Wholly outsourced solution
- Secure system.

### Benefits to the student are:

- All communications through one route and all pre-paid so no direct debits and no subsequent bills
- Bedroom and remote access to all services
- Affordable cost and real-time credit authorisation.

## DIRECTORS

### Rod Matthews - Chairman/CEO

Rod Matthews has built a high profile in the UK technology sectors in the course of the last 30 years, based on a sustained record of high achievement. His crucial contribution was officially recognised in 1991 by the award of an MBE. He has many years of experience as CEO and COO including Versapoint, Global Crossing, Scottish Telecom, ICL, STC and the CEGB. As founder of Scottish Telecom from 1993 he created a new template for integrated information and communications using both fixed and mobile networks.

### Graham Robertson - Finance Director & Company Secretary

Graham is a Chartered Accountant and has spent considerable time in the telecommunications industry in start up and mature environments.

Most recently Graham was Financial Director for 21accessUK, a significant broadband start up prior to which he was CFO International for Worldcom, before which he was Financial Director and/or Treasurer for a number of cable companies and for Cable & Wireless plc.

### Jon Richardson - Chief Technology Officer

Jon joined Keycom in 2002 with an operational and highly technical background with large, pan-European Internet Service Providers. He has been instrumental in designing and implementing innovative products and services as well as creating a robust national IP network of which to layer new products and services (such as Voice over IP, broadband and IP-TV).

### Bill Roberts – Sales Director

### Mike Beatty- Business Development Director

## SHAREHOLDINGS

### Ordinary Shares of 1p each 30 September

	2005	2004
C E Brown	233,266	138,000
R A Matthews	377,928	230,000
G L Robertson	147,928	-
N R W Ross	400,000	200,000

### The Company has granted the following directors options to subscribe for ordinary 1p shares:

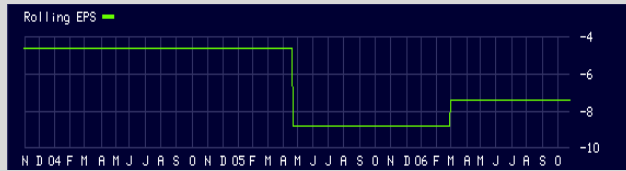
	Exercise price	Number of options		Performance conditions	Period exercisable
		As at 1 Oct 2004	Granted / Lapsed / Waived		
C E Brown	£1.20	50,000	-	No	Until 29 Sept 2013
R A Matthews	20p	434,200	-	Yes	Until 28 April 2014
R A Matthews	20p	500,000	-	Yes	Until 28 April 2014
Granted 5 April 2005					
R A Matthews	12.5p	-	2,000,000	Yes	Until 5 April 2015
G L Robertson	12.5p	-	1,000,000	Yes	Until 5 April 2015



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## ROLLING EPS



## MOMENTUM



## SUBSTANTIAL SHAREHOLDINGS

Electra Kingsway	6,546,250	26.2%
Universities Superannuation Scheme	3,668,640	14.7%
Rathbone Management	2,816,574	11.3%
A Atkinson	2,586,584	10.8%
G Wallace	720,000	2.9%

## CHAIRMAN'S STATEMENT

### FINANCIAL REVIEW

With the cessation of service in less profitable voice-only sites the turnover for the six months was GBP690,000 (2005: GBP853,000), 19% lower than the same period last year. That decline in traditional service revenue is a consequence of the removal of some voice-only contracts and the shift of students from traditional voice services to mobile phone and was to be expected.

The growth of 85% in broadband services revenue over the same period in the prior year to GBP307,000 demonstrates the reasons for the change of emphasis in the Company's products.

The broadband services revenue is the focus of management and it is already providing 44% of the company's revenue, up from 19% in the same period in the prior year.

The gross margin for the period was 58%, from 61% in the previous year; with actual gross profit at GBP398,000 (2005: GBP517,000). Although there is a decline in overall gross profit as a direct result of the decline in traditional service revenue, the broadband gross profit has increased by 77% over the same period in the prior year.

The broadband services now contribute 57% of the Company's gross profit, up from 25% in the prior year.

The gross margin for broadband services has been maintained at a level in excess of 70% while increasing the revenue and subscriber base considerably. The gross margin from traditional services has fallen to 42% for the six months, down from 49% in the prior year as a consequence of the declining traditional service revenue.

Administrative expenses continue to be kept under control; at GBP704,000 (2005: GBP668,000). The Company effected a headcount reduction in the first half of the year with an associated cost that is greater than the comparable costs associated with the headcount acquired through the acquisition of TeleGeneration and therefore the administrative costs for the second half of the year are expected to be lower than the same period last year.

Exceptional costs of GBP191,000 (2005: Nil) were incurred as a consequence of the staff reduction programme and the costs associated with an aborted acquisition. The attempted acquisition would have

improved the turnover of the Company and provided through synergies for a significant reduction in administrative expenses as a percentage of turnover. The directors decided not to proceed with the acquisition when the demands of the target changed.

Interest was GBP132,000 (2005: GBP87,000) for the six months. Depreciation has increased to GBP305,000 (2005: GBP228,000) with the deployment of new broadband and ISP equipment at the beginning of the year.

As a result of the above, the loss for the period was GBP934,000 (2005: GBP466,000) with an EBITDA (before exceptional costs) of GBP(306,000) (2005: GBP(151,000)).

In addition to the organic growth of the broadband turnover and gross profit we are excited about the impact that the acquisition of TeleGeneration Limited will have on that growth. In its full year ended 30 November 2005 the turnover was GBP239,000 (2004: GBP54,000) and gross profit GBP188,000 (2004: GBP24,000), a gross margin of 79% (2004: 44%).

### FUNDING OF THE BUSINESS

The Board reviews the funding of the business on a regular basis, taking into account the trading of the business, investments in the infrastructure and services being made and requirements for liabilities.

In the six month period, the Company raised a total of GBP1.25 million from shareholders.

### HISTORIC LITIGATION

At the Annual General Meeting and in the financial results for the year ended 30 September 2005, we confirmed the successful progress in the settlement of historic litigation and disputes. We retained a provision in those financial statements because there was still some litigation outstanding. I am delighted to report that we have managed, after a lengthy period, to agree settlements with all claimants. That brings to a close all the historic litigation and disputes that have impacted upon management time and resources for the past three years.



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### INVESTMENT IN INFRASTRUCTURE

The management team believes that the future for the Company lies in the provision of broadband services and the TV, Video on Demand, content and associated marketing opportunities that such infrastructures enable.

From the commencement of the last academic year, the Company has been developing broadband services at a number of universities, utilising both cabled and wireless technologies. The Company now provides broadband services

to in excess of 5,000 rooms across six universities and has customer commitments for others which will be implemented between now and the beginning of the 2006 academic year.

Capital investments now deliver excellent payback and contracts secured are long term.

We believe that the work and investment during the year will provide a basis for significant growth in revenues and earnings in the forthcoming year and beyond.

### STRATEGY FOR THE FUTURE

The growth in the number of rooms to which we provide our broadband services has been slower than we would have hoped. This is in large part due to a number of

universities attempting to provide broadband access to students in university accommodation through an extension of the internal academic network infrastructure. Some universities have already experienced the problems and hidden costs of attempting such a solution and have solved those problems by contracting with the Company. I am confident that over time the problems encountered by universities seeking to satisfy the students' broadband services requirements will result in the change in approach and the involvement of Keycom in the solution to those broadband issues. The Company continues to discuss alternative methods of delivery with those universities to whom we currently provide voice services.

The Company is also progressing the provision of IPTV and other services to student rooms whether broadband access is provided by Keycom or the university.

From October 2005, because of the increasing desire for broadband access, some of the sites have contracted with Keycom for the provision of broadband services to all the student rooms as a basic utility included in the room rent.

The students then opt for additional value added services. This provides an attractive annuity revenue and margin stream for the Company.

## FINANCIAL HISTORY

### Profit and loss account for 6 months ending 31<sup>st</sup> March 2006

£000	six months to 31 <sup>st</sup> March 2006	six months to 31 <sup>st</sup> March 2005
TURNOVER	690	853
Cost of sales	(292)	(336)
GROSS PROFIT	398	517
Administrative expenses	(704)	(668)
Exceptional costs - administrative expenses	(191)	-
Depreciation	(305)	(228)
LOSS FOR THE PERIOD BEFORE INTEREST & TAXATION	(802)	(379)
Interest payable	(132)	(87)
Tax on loss on ordinary activities	-	-
LOSS FOR THE PERIOD	(934)	(466)
EBITDA - before exceptional costs	(306)	(151)
Loss per share	(3.61)p	(3.13)p
EBITDA (before exceptional costs) per share	(1.18)p	(1.01)p

### Balance sheet at

£000	Year ended 2005	Year ended 2004
Tangible assets	2,054	1,834
Current Assets	524	571
Profit and Loss Account	(10,697)	(9,229)
Shareholders Funds	(1,606)	(1,458)

## RISK FACTORS

Telecommunications should be an attractive sector, in principle, given the growth in demand and new technology. However, it has not been successful in capturing the value added, which has largely accrued to the consumer, in the form of lower prices, and government, in the form of

taxation and 3G license fees.

The sector was transformed in the two decades since BT was privatised.

Competition was then the order of the day and technology, such as fibre optics, mobile phones and the internet,



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fuelled the TMT mania that ended in 2000. The sector was then buffeted by bust business models, worthless goodwill, huge borrowings and bankruptcies.

Players put on the hair shirt, cut costs and retreated to core businesses.

The price of telecommunications has fallen relentlessly, as traditional telephone carriers face intense competition from ultra low priced internet telephony and video. Indeed, the latter are even free by using messenger services that communicate between computers.

The sector is reaching saturation and new growth opportunities are limited but include increased internet usage and 3G. In short, the profitability of the sector has been hollowed out and it is not a good space to occupy in general. It is still partly regulated and this could threaten the profitability of the gorillas, such as BT and Vodafone.

The sector does have a good tailwind in an increasing digital world but only 5% of the capacity is being used. This will continue to depress prices and be a Damocles sword for the foreseeable future.

Success depends on being a niche player that has the competitive advantage of low cost and/a differentiated product, such as Telecomplus.

In the case of Keycom, it has tried to differentiate itself by focussing on the needs of students who might find it

difficult to access telecommunications, given their status and temporary accommodation. The development and staff costs have been significant, however, and charging a premium price is a problem.

This is due to falling prices in the sector in general and the threat of substitutes, such as mobile phones that are more convenient than landlines. Students also have internet access elsewhere, such as at the university. They are strapped for cash, run up high loans so are keen to minimise costs. Thus, Keycom is likely to face keen price resistance. Its losses to date are £8.6 million and it needed to raise £0.6 million subsequent to the 2003 year end to keep the going. Negative shareholders' equity was £0.6 million at June 2004 and thus the possibility of bankruptcy is a real issue. On a brighter note, the interim loss narrowed to £0.67 million but the company clearly has not yet turned the corner.

The chairman is also the CEO, which is poor corporate governance and conflicts with the recommended code of conduct, which states that these roles should be split.

The low price of the share has relegated it to 'penny share' status, which typically has a wider spread between bid and offer price. In addition, such shares tend to be more volatile than higher-priced shares and consequently tend to attract investors with a higher appetite for risk.

## CONTACT

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Stafford  
Staffordshire  
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## RANKING

	Ranking out of 50 (50 being highest)
<b>Business model - competitive advantage</b>	
Competition	15
Customers	15
Low cost	15
Management	
- corporate governance	10
- quality	25
- shareholding	35
Product	20
Sector	15
<b>Financial evaluation</b>	
Early and profitable exit potential	
Financial strength	
- cash flow	5
- conservative accounting	25
- need for funding	5
Growth at a reasonable price	5
Risk	5
<b>Overall average rating</b>	<b>15</b>



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### FURTHER INFORMATION ABOUT THE RANKING

#### Competitive advantage

Companies are assessed according to their business model and how this translates into strong and sustainable competitive advantage. This can only be achieved with low cost activities and doing something different from the competition. This 'differentiation' must add value to the customer who is then prepared to pay a premium price. The differentiation is most obvious in the product but it can exist anywhere in the company's value chain of activities, such as

easy payment terms, convenient locations, superior management, and quality of suppliers. Companies that do not achieve competitive advantage because they have the same costs and/or do the same as the competition are marooned in a profitless zone. They helplessly try to compete with the one weapon left open to them, which is the disaster of cutting prices and typically leads to similar retaliation by competitors, with disastrous results.

### THE FOLLOWING ELABORATES ON THE RANKING CRITERIA

#### Competition

How intense is the competition and are there barriers to entry?

#### Customers

Is the company controlling its customers and therefore its revenue streams? Are customers glued to the company and providing valuable and reliable recurring revenue or are they one-off, or 'transactional', providing shaky revenue? The company should ideally have weak and numerous customers.

#### Low costs

Has the company achieved low cost activities thus allowing more of the top line revenue to trickle down to the profit line?

#### Management

Is there good corporate governance? What is the quality of management, as this is crucial to any business? Are the directors' shareholdings significant but not so large that they control the company?

#### Product

Is the product different from the competition and adds value to the customer? Are there threatening substitutes? Does it have a powerful brand?

#### Sector

Is the company in an attractive sector that is profitable and adds value?

Services tend to be more protected than products from international competition. Does the sector ride the tailwind of multi-year mega trends? Is the business well positioned in the current stage of the economic cycle? What is its resistance to a recession?

#### Profitable exit potential

What is the potential for selling the share profitably? This is more applicable to pre-flotation investments.

#### Financial strength

Does the company have strong cash flow, the lifeblood of any business? Is the accounting conservative or is there 'accounting for growth'? Does it need more funding? Is the profit margin healthy and at least equal to its sector? What has been the track record in the growth rate of profits?

#### Growth at a reasonable price

Does the share offer growth at a reasonable price? This is commonly measured using the PEG. This is the price earnings ratio (PE) divided by the forecast growth rate in earnings per share (EPS). The lower the PEG the better and under 1.0 is considered good for a blue chip company and under 0.6 for a small growth company.

#### Risk

What is the risk rating of the share due to factors such as new markets, its business model and strategies?

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