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Ihr Zeichen, Ihre Nachricht vom

Unser Zeichen, unsere Nachricht vom
TB-04/1001904-

Sekretariat
Frau Peters

Datum
23.02.2005

- 620 Kls 5/04 -

In der Strafsache

g e g e n

Alexander Falk

beantrage ich die Vernehmung der Zeugen:

1. Paul Sharma
2. Joel Ripley

beide zu laden über J.P.Morgan Securities Ltd.

Beweisthema: Veröffentlichung J.P Morgan am 12.März 2001 unter dem Titel : Energis, a song for Europe und den darin enthaltenen Zahlen.

Die Zeugen werden aussagen, sie hätten unter dem 12. März 2001 den obigen Report mit entsprechenden Unternehmenszahlen der Ison für das Jahr 2000 und insbesondere das 4. Quartal des Jahres 2000 veröffentlicht sowie eine Orientierung über die Ison –Planungen für das Jahr 2001. Der entsprechende Report wird als Anlage überreicht.

Es wird beantragt, den Report zu übersetzen und als Urkunde zu verlesen.
Die Einvernahme der Zeugen wird folgendes Zahlenwerk ergeben:

Anlage zum Beweisantrag vom 24.2.2005.

Die Vernehmung der Zeugen wird ergeben, dass trotz angeblicher Scheinumsätze im 3. Quartal 2000 ISION seine Planzahlen im 4. Quartal des Jahres 2000 übererfüllt hat.

Die Zahlen bieten damit die tatsächliche Grundlage für den Ausgangspunkt der Aussage des Sachverständigen Prof. Dr. Dr. Drukarczyk wonach ISION ein Wachstumsunternehmen war und eine mögliche Umsatzdelle im 3. Quartal 2000 im 4. Quartal bereits wieder kompensiert hatte.

Die Mär von der mangelnden Leistungsfähigkeit durch „legale“ Umsätze ist nicht aufrechtzuerhalten.

Die Umsatzleistung des 4. Quartals 2000 bestätigt weiter, dass die sogenannten Scheinumsätze lediglich eine einmalige Umsatzdelle darstellen, die wegen der Einmaligkeit der Umsätze keinerlei Relevanz hatte für die Bewertung des Unternehmens und für den Businessplan 2001.

Tatsächlich – und dies werden die Zeugen aussagen- hatte Ison die Umsatzlücke nachweislich im 4. Quartal wieder geschlossen und so die Leistungsfähigkeit des Unternehmens unter Beweis gestellt. Eine Korrektur der Planrechnungen des Jahres 2001 und des DCF Kalküls war somit nicht notwendig.

Die Zahlen belegen ferner, dass nach den gängigen Bewertungskriterien das Unternehmen ISION bei Bereinigung um die inkriminierten Umsätze unter Ansehung der Zahlen in Q 4 und des insofern realistischen Financial Plans für 2001 einen deutlich höheren Wert hatte als im unbereinigten Zustand.

Es wird durch Vorlage der Zahlen bewiesen, dass ISION ein leistungsstarkes Wachstumsunternehmen war. Die Bereinigung um die fraglichen Umsätze erhöht die Wachstumsrate erheblich und damit den Unternehmenswert.

Die als Anlage beigefügte Tabelle 8 belegt, dass es nachträgliche Stornierungen von Umsätzen gegeben hat, die Aussage Marten Reidel wird insofern bestätigt.

Die Veröffentlichung J P Morgan belegt die Irrelevanz der Umsätze im Quartal 3 des Jahres 2000 und widerlegt damit die These, es gebe für die Behauptung des Sachverständigen über die Überkompensation der Umsatzdelle im Quartal 3 keine tatsächlichen Anhaltspunkte.

Die Beweisaufnahme wird ergeben, dass Energis im März 2001 die Umsatzerwartung für das Jahr 2001 auf € 158,3 Mio festlegt. Auch diese Zahlen entsprechen dem Financial Plan.

Im Ergebnis wird bewiesen werden, dass die Wachstumserwartungen und die Umsatzerwartungen nach Vorlage des Q 4 Zahlen deutlich erhöht wurden und über den Erwartungen lagen, die Energis zum Zeitpunkt des Erwerbs der ISION hatte.

Die Kammer wird aufgefordert, sofort über den Beweis Antrag zu entscheiden. Die Beweiserhebung berührt in zentralen Punkten die Annahmen aus dem Beschluß vom 9.2.2005 und damit die Haftfrage.

Für die Verteidigung

Anlage zum Beweisantrag von Rechtsanwalt Thomas Bliwier vom 24.2.05

Energis hat im März 2001 im Rahmen einer Analystenkonferenz die Ergebnisse des vierten Quartals 2000 und eine "Orientierung" über die Ison-Planungen des Jahres 2001 bekanntgegeben.

1. Analyse Q4 Ergebnisse

1.1. Q4 Umsatz nach Segmenten

Das Ergebnis des vierten Quartals ist im Company Update "Energis - A song for Europe" von JPMorgan vom 12. März 2001 dargestellt (S. 10, Table 4):

(GBP million - using €1,58:GBP1)

	Nine Months	Full Year
Website Management	18,40	28,80
Access	11,50	14,50
Systems & Services	10,80	17,60
Total	40,70	60,90

Source: Company data.
Tabelle 1

Überträgt man dieses Quartalsergebnis in Euro, so ergibt sich folgendes Bild:

Euro Millionen	Nine Months	Full Year
Website Management	29,13	45,59
Access	18,20	22,95
Systems & Services	17,10	27,86
Total	64,43	96,40

Tabelle 2

Tabelle 2 zeigt, dass Energis einen Gesamtumsatz für das Jahr 2000 von ISON in Höhe von € 96,4 Mio. veröffentlichte, wovon € 45,6 Mio. auf das werbliche Segment Website Management entfallen.

Durch Substraktion der Spalte "Nine Months" von der Spalte "Full Year" ergeben sich die Ergebnisse des 4. Quartals wie folgt:

Euro Millionen	Q4 2000
Website Management	16,46
Access	4,75
Systems & Services	10,76
Total	31,98

Tabelle 3

Ein Vergleich mit den Planzahlen für Q4 aus dem Ison Financial Plan zeigt, dass Ison den Plan im werthaltigen Segment Website Management erfüllte und fürs gesamte Unternehmen um ca. 10% übererfüllte.

	Q4 2000 IST	Q4 2000 Financial Plan
Website Management	16,46	16,83
Access	4,75	6,49
Systems & Services	10,76	6,49
Total	31,98	29,77

Tabelle 4

Ergebnis: Trotz angeblicher Scheinumsatz ein 3. Quartal 2000 hat Ison im 4. Quartal die Planzahlen des Financial Plan erfüllt bzw. übererfüllt. Damit ist die Annahme der Anklage widerlegt, dass eine Umsatzlücke des 3. Quartals 2000 die Leistungsfähigkeit der Ison in Zukunft beeinträchtigt hätte. Desweiteren bestätigt die Umsatzleistung der Ison des 4. Quartals, dass die sogenannten Scheinumsätze lediglich eine einmalige Umsatzzufuhr darstellte, die durch den einmaligen Charakter der Umsätze keine Relevanz für den Businessplan des Jahres 2001 oder die Bewertungen darstellt. Tatsächlich hat Ison nachweisbar die Umsätze bereits in Q4 wieder geschlossen und so die Leistungsfähigkeit des Unternehmens unter Beweis gestellt. Eine Korrektur der Planrechnungen des Jahres 2001 oder der DCF Bewertungen nach unten war somit nicht nötig.

1.2. Vergleich der IST-Wachstumsraten mit den von Energis erwarteten Wachstumsraten

Tabelle 4 zeigt, dass im vierten Quartal ISON gemäss den Veröffentlichungen von Energis ein Umsatz von € 32 Mio. insgesamt und von 16,5 im Website Management erwirtschaftet wurde. Vergleicht man die Quartalsergebnisse mit den Erwartungen, die Energis in der relevanten DCF Bewertung vom 29.11.00 aufgestellt hat, ergibt sich das in Tabelle 5 dargestellte Bild:

Quartalszahlen gemäss DXB DCF Bewertung vom 28./29.11.2000 (ohne Bluetrix € 2,7 Mio.)

	Q 1 (IST)	Q 2 (IST)	Q 4 (PLAN)	Full Year
Website Management	5,38	9,89	16,83	45,31
Access	4,53	8,88	6,49	25,31
Systems & Services	6,51	6,39	6,49	23,32
Total	16,41	25,16	29,77	93,91

Tabelle 5

Quartalszahlen gemäss Energis Veröffentlichung März 2001, bereinigt um alle sogenannten Scheinumsätze (ohne € 5,8 Mio.)

	Q 1 (IST)	Q 2 (IST)	Q 4 (IST)	Full Year
Website Management	5,38	9,89	16,46	41,85
Access	4,53	8,88	4,75	25,30
Systems & Services	6,51	6,39	10,76	27,49
Total	16,41	25,16	31,98	94,64

Tabelle 6

Vergleicht man die Wachstumsraten der beiden Quartalsrechnungen des werthaltigen Segmentes Website Management der Tabellen 5 und 6, ergibt sich das in Tabelle 7 dargestellte Bild:

Wachstumsraten Website Management

	in%	Q1 auf Q2	Q2 auf Q3	Q3 auf Q4
Quartalswachstum DKB DCF Bewertung (bereinigt um 2,7 Mio. Blueink, gemäss DKB vom 28.11.2000)		83,87	33,54	27,39
Quartalswachstum gemäss Energis Veröffentlichung (bereinigt um alle sogenannten Scheinumsätze)		83,87	2,20	62,84

Tabelle 7

Tabelle 7 zeigt, dass Ison, bei Bereinigung um alle potentiellen Scheinumsätze, sich als deutlich wachstumslärker erweist. Nach gängigen betriebswirtschaftlichen Kriterien ist das Wachstum der Ison im bereinigten Zustand (84%, 2,2% und 66,3%) wertvoller als im von DKB dargestellten Zustand (84%, 33% und 27%), da der Wachstumstrend positiv und steigend ist. In der Variante, die zum DCF Wert in Höhe von € 1.034 führt, ist der Wachstumstrend negativ und das Wachstum deutlich geringer.

Ergebnis:

Das Ergebnis des Q4 zeigt, das Ison ein leistungsfähiges Wachstumsunternehmen ist.

Eine Bereinigung der Quartalszahlen um die sogenannten Scheinumsätze erhöht den Wachstumsausweis der Ison deutlich.

Eine Bereinigung der Quartalszahlen um die sogenannten Scheinumsätze ändert den ansonsten negativen Wachstumstrend in einen positiven, der die tatsächliche Leistungsfähigkeit der Ison korrekt darstellt.

Bei objektiver Betrachtung können die sogenannten Scheinumsätze somit weder die Planrechnungen der Jahre 2001-2010 verzerrt haben, noch die Bewertung der Ison künstlich erhöht haben.

Bei objektiver Betrachtung ergibt sich vielmehr, dass eine Bereinigung zu verbesserten Wachstumsraten und somit höheren Unternehmenswerten geführt hätte.

1.3. Umsatzstorno Q3 2000

Die Veröffentlichungen von Energis vom März 2001 belegen die Aussagen von Maarten Reidel, dass es tatsächlich nachträgliche Umsatzstornos bei Ison für das Quartal 3 gegeben hat. Tabelle 8 stellt die Q1-Q3 Umsätze gegenüber, die Ison im November 2000 (unter Leitung der Distefora) veröffentlicht hat und die Q1-Q3 Umsätze, die Energis für Ison im März 2001 veröffentlicht hat.

Euro Millionen	Q1-Q3 laut Ad-hoc Nov 2000	Q1-Q3 laut EGS März 2001
Website Management	30,15	29,13
Access	18,85	18,20
Systems & Services	17,74	17,10
Total	66,74	64,43

Tabelle 8

Tabelle 8 zeigt, dass Energis nachträglich die Q3 Umsätze um € 2,3 Mio. reduziert hat. Dies widerlegt die Annahmen der Anklage, dass eine Umsatzreduktion des Jahres 2000 irgendwelche besonderen Konsequenzen nach sich ziehen könnte. Die Reaktion im Text von JPMorgan zeigt, dass der Umsatz des Jahres 2000 keine Relevanz für die Bewertung der Ison hatte.

Ergebnis:

Die Veröffentlichung von Energis vom März 2001 belegt die Richtigkeit der Aussage von Maarten Reidel, dass es nachträgliche Stornierungen von Umsätzen des dritten Quartals gegeben hat.

Die Reaktion der Investbank JPMorgan belegt die Irrelevanz dieser Umsätze; dies insbesondere vor dem Hintergrund der planmäßigen Q4 Leistung.

Die Stornierung widerlegt zusätzlich die These, dass Energis auf Basis dieser Q3 Umsätze sich im Irrtum über die Leistungsfähigkeit von Ison hätte befinden können.

2. Konsequenzen der Q4 Ergebnisse

Dem JPMorgan Report vom 12.3.2001 kann man auf den Seiten 10-13 entnehmen, dass für das Gesamtjahr (im Gegensatz zum Q4 Ergebnis) der Ison Umsatz um € 1,6 Mio. unterhalb den Markterwartungen lag. Die Ebitda Erwartungen wurden um € 2,4 Mio. verfehlt. Trotzdem hat Energis im März 2001 die Gewinnplanung von Ison deutlich erhöht, nämlich von € -40 Mio. auf € -24 Mio. was einer Verbesserung in Höhe von 31% entspricht. Gleichzeitig bestätigt Energis zum gleichen Zeitpunkt nach Vorlage der Q4 Zahlen einen Planumsatz der Ison in Höhe von € 158,3 Mio. (GBP 100 Mio.) für das Jahr 2001.

Wie man Tabelle 9 entnehmen kann liegt diese Planung deutlich über den Annahmen, auf deren Grundlage Energis Ison gekauft hat.

Euro Millionen		EGS Plan 2001, März 2001		Abweichung in %	
Umsatz	DKB Plan 2001, 29.11.00	142,00	158,30	11,48	
Ebitda		35,00	24,00	31,43	

Tabelle 9

Im Vergleich zu dem Plan, der Energis zum Kauf der Ison bewogen hat, hat Energis nach Vorlage der Q4 Zahlen die Umsatzerwartung für das Jahr 2001 um 11% angehoben und den Ebitda-Gewinn um 31%. Ein täuschungsbedingter Irrtum von Energis über die Leistungsfähigkeit der Ison erscheint bei Berücksichtigung der Q4 Leistungen und der darauf resultierenden Planerhöhungen ausgeschlossen. Eine Hochrechnung der Q4 Zahlen lag Energis ab Mitte Dezember vor. Energis wusste damit zum Zeitpunkt der Kaufvertragsunterzeichnung, dass der Q 4 Plan erfüllt wird. KPMG war seit Beginn Dezember 2000 mit der Prüfung der Bilanz auf den 31.12.00 beschäftigt. Die Hochrechnungen standen somit bereits Mitte Dezember zur Verfügung.

Ergebnis: Die Planung der angeblichen getäuschten Energis über die angeblich wachstumsunfähige Ison wurde nach Vorlage der Q4 Zahlen deutlich erhöht und liegt weit über den Erwartungen, die Energis zum Zeitpunkt des Kaufes hatte. Damit ist genau das Gegenteil von der Unterstellung der Anklage eingetreten: Aus Sicht von Energis war Ison nach Vorlage der Q4 Zahlen besser, d.h. wachstumsstärker, als erwartet.

March 12, 2001
London

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Company Update

Energis

A Song for Europe

BUY

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Over the past year Energis has transformed itself from a predominantly UK-based operator into a leading pan-European web hoster and e-commerce provider, with a presence in the United Kingdom, Netherlands, Germany and Italy. In doing so, it has been one of the few companies in the sector to beat consensus expectations in the past 12 months for both revenues and EBITDA. Its most recent strategic move was to buy Ison, a German web-hosting company, for about £600 million. The deal to buy 75% from Distefora was completed in January and Energis has made an all-share offer to the minorities.

Energis is capable of generating £75 million in revenues from hosting and bandwidth per 50,000 sq ft data centre, in our view, and we believe it has 50% EBITDA margins on the hosting element, although we would expect this to fall as connectivity and hosting are bundled. As the company has 450,000 sq ft available in March, we expect strong revenue and EBITDA growth to continue. We forecast revenues of £840 million and EBITDA of £141 million for this year, with CAGRs of 54% in revenues and 62% in EBITDA from 2000-03. In addition, we believe the company is fully funded (if only just) with a debt facility of £1.35 billion. Our DCF (WACC 8.8%) implies a value for the company of 626p per share, while a peer-group analysis suggests 360-580p per share. **Given the suggested upside on the DCF and Energis' ability to grow EBITDA — a rarity in today's market — we continue to rate the stock a Buy with a price target of 626p.** However, there is a stock overhang due to the Ison transaction from Distefora and if the National Grid cannot find a strategic buyer for its stake, it may choose to sell part of its holding once the new UK tax regime is introduced in autumn.

Overall, we believe Energis' main priority is to integrate the Ison business and consolidate its position in the market, with new data centres in Hamburg and Munich. **Extra value should be generated over the next 12 months as the company extends its access network in the United Kingdom and the Netherlands.** We believe that DSL technology is capable of generating incremental returns in the SME space, which is Energis' core market. Now that capital is less freely available, we expect the previously forecast rush for UK exchange space will become an orderly queue. Energis should be able to leverage its long-distance backbone, which will be connected to 70% of British Telecom's digital local exchanges by autumn.

Summary Financials

(£000, year-end March)

		Revenue	EBITDA	EPS	Net PP&E
Price (08/03/01)	459p 2000	494,000	92,531	(2.8)	757,308
52-Week Range	812-384p 2001E	839,533	140,575	(6.2)	1,151,066
FTSE 100	5917 2002E	1,288,068	211,905	(7.7)	1,411,152
Shares Out.	1,694 million 2003E	1,788,790	395,156	(0.7)	1,648,027
Market Cap.	£8,129 million CAGR 2000-03E	54%	62%		
Free float	66% Multiplies	FV/Revenue (x)	FV/EBITDA (x)	CEPS (x)	
Net debt last rep	£450 million 2000	18.0	95.9	3.8	
	2001E	11.0	65.5	4.1	
	2002E	7.3	44.3	6.9	
	2003E	5.3	23.9	16.5	

Source: J.P. Morgan estimates.

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INVESTMENT THESIS

Energis is one of the European leaders in the growing complex web-hosting market and is demonstrating strong market traction with significant growth in revenues and EBITDA. We expect revenues to increase from a forecast £840 million this year (financial year to March 31) to £2,347 million by March 2004. However, technical factors, including stock overhang from the Ision transaction and the possibility that National Grid may choose to sell down its stake in autumn once the new UK tax regime is in place, should it not find a strategic buyer for its stake, are likely to weigh on the stock in the short to medium term. Nevertheless, we believe that management will continue to show it can generate value and synergies from its portfolio of assets in order to justify the company's current rating. In addition, in our opinion, Energis is well positioned to benefit as the local loop unbundles around Europe, but we have yet to ascribe any value to this.

Positives

Acquisitions Strengthen Strategic Footprint

Ision was the key acquisition in 2000. Not only did it strengthen Energis' footprint in Germany, following on from the carrier 24 acquisition, but it means Energis now has one of the largest businesses in the fast-growing complex hosting space and could, arguably, become the leader on the European stage. By March 2001 we expect Energis to have generated about £300 million in internet-related revenue (hosting and internet termination), representing 36% of group revenues. We expect this area to grow both in real terms and as a percentage of group revenues — we forecast this revenue at about £1,430 million by March 2004, representing 60% of group revenues.

An Accelerating EBITDA Growth Profile

Energis management has already shown in the United Kingdom that it can achieve market traction and grow EBITDA year on year. We forecast an EBITDA CAGR of 54% from 2000-03 in the United Kingdom and we expect EBITDA margins to grow from 22.3% in the year to March 2000 to 32.2% by March 2004 in the United Kingdom. As there are start-up losses in the new ventures, we forecast international group EBITDA margins to grow from -15% in the year to March 2001 to 17% in the year to March 2004.

Complex Hosting Is High Margin

While many companies have stated their intention to move into the data centre market, we believe there are relatively few players that can offer the suite of services offered by Energis. In our view, Energis' key competitors are Worldcom (with its UUNet subsidiary), T-Systems in Germany, BT Ignite in the UK, Colt with its managed services offering and nationally based companies, such as Versatel in the Netherlands. We expect Energis will have more than 450,000 sq ft in space by the end of March 2001 and we believe the company has 50% EBITDA margins in this business. While we believe margins in this area may decline over time to 40%, the complexity of services offered mean that this area seems unlikely to become commoditised in the short to medium term, in our view. We believe the complex hosting market will present significant barriers to entry, especially as it moves into new areas such as storage.

Company Is Fully Funded

Energis is in the enviable position of being one of the few telcos that does not have any need to go back to the market to raise cash — unless it wants to make acquisitions. We forecast net debt at £743 million at the end of this year, peaking at £1,301 million in financial year 2004. The company has £550 million in bonds and two bank facilities totalling £800 million, resulting in a total funding capability of £1,350 million. Assuming that Energis achieves our EBITDA and capex forecasts, we believe it is fully funded, although there is little headroom for expansion.

Risks

European and Data Centre Execution

While Energis has shown it can execute in the United Kingdom, it has yet to demonstrate that it can do the same in mainland Europe. Established in the United Kingdom in 1993, Energis has become a significant market player in eight years. To speed its entry into Europe, the company has made a string of acquisitions, which are at too early a stage to demonstrate the same performance as the UK business. However, this risk is mitigated, in our view, as Energis has one of the best management teams in the business and has consistently shown it is one step ahead of the market. Nonetheless, we forecast 44% of its long-term EBITDA will come from Europe, making execution there vital.

Freeserve Revenues Are Doubtful Long Term

Wanadoo's recent acquisition of Freeserve may affect Energis' revenue in the long term. Energis currently has the contract to terminate both metered and unmetered internet traffic until September 2003. We expect much of the Freeserve revenue to move to NTL, given France Telecom's position in the company, but Energis should continue to retain some of Freeserve's hosting and termination revenues, given that its network has much more depth in the UK than NTL. (For modelling purposes, we have assumed that Energis loses 66% of termination revenue, that hosting for Freeserve remains constant after the contract expires and that Energis does not find a replacement for Freeserve.)

Technical Factors a Concern

Following the completion of the Ision deal, Distefora is likely to sell its stake of 62 million shares, which is a sizeable stock overhang. In addition, National Grid, which owns 34% of Energis, may choose to sell its stake once the new UK tax laws, which aim not to penalise strategic investors in public companies, are likely to effect in autumn. In essence, the new laws would allow National Grid to sell its stake without paying capital gains tax as it holds more than 30% in another entity. Details of the new capital gain tax regime will be confirmed in the new finance bill in autumn.

Pan-European Presence Not Complete

While Energis is present in the United Kingdom, the island of Ireland, the Netherlands and Germany, it has yet to enter the French or Spanish market. (It is present in Italy with a data centre in Milan.) We do not expect it to enter the French or Spanish markets in the short term, as it would need to raise new funds for any acquisition. Furthermore, the French interconnection regime is such that Energis would need to buy a large network in order to offer bundled services.

INCOME STATEMENT

Since our last note on Energis, following the Ision transaction, the company has given guidance on 2001 and 2002 forecasts. Energis is one of the few companies in the telecoms space to have its revenue and EBITDA forecasts revised up. Our revenue forecast in March 2000 was £785 million for the year to March 2001; we are now forecasting £840 million, of which only an incremental £10 million is due to acquisitions.

We have not made major updates to our forecasts, but the following are our key changes.

- We expect Energis to record Ision revenues of £10 million and an EBITDA loss of £5 million for two months of this year's numbers. As a result, we now forecast revenues at £840 million this year and £1,288 million for 2002 (a full year of Ision); we also project EBITDA at £141 million this year, rising to £212 million in 2002 (again a full year of Ision).
- The Ision transaction should lead to minimal integration costs (initial expectations were £5 million) of £5 million for this year and £10 million for 2002. We anticipate that the 2002 costs will be offset by synergies (savings on SG&A and infrastructure) of £10 million.
- Capital expenditure in Europe will be slightly higher than previously expected, a result of the Ision transaction and additional spend on access networks in Europe. We forecast total capex for the group at £395 million for this year to March, £424 million in 2002 and £435 million in 2003.
- We forecast depreciation and amortisation at £177 million for this year, rising to £254 million next year; the rise would be due in part to a full year of Ision amortisation (an extra £39 million pa).
- The company has made loans of £50 million to joint venture partners in Poland and Northern Ireland to build 50,000 sq ft data centres in each location and, accordingly, we have increased our associate line losses from £2 million to £4 million.

As a result of the above changes, we expect net debt to increase from £591 million in March 2000 to £743 million in March 2001, to £1,078 million in March 2002 and to £1,268 million in 2003. The company has a total debt facility of £1.35 billion — £550 million in bonds and two bank facilities totalling £800 million. In our view, it is fully funded — but there is little room for error in our forecasts. That said, Energis is a highly rated company and we would expect additional bank financing could be arranged.

NTL and Wanadoo

We have also tried to take into account the impact of Wanadoo buying Freeserve in our model and valuation. Energis' current contract for metered and unmetered dial-up, plus Freeserve hosting, terminates in September 2003. We would expect Energis to retain terminating and hosting revenue for some time after the contract ends, as there is large amount of equipment installed to support the service and it is unlikely that NTL would be able to terminate all the Freeserve traffic immediately given its limited hosting capability.

We have made the following conservative assumptions to estimate the impact of the Wanadoo/Freeserve deal.

- After September 2003, only one-third of new contracts will be terminated on the Energis network.

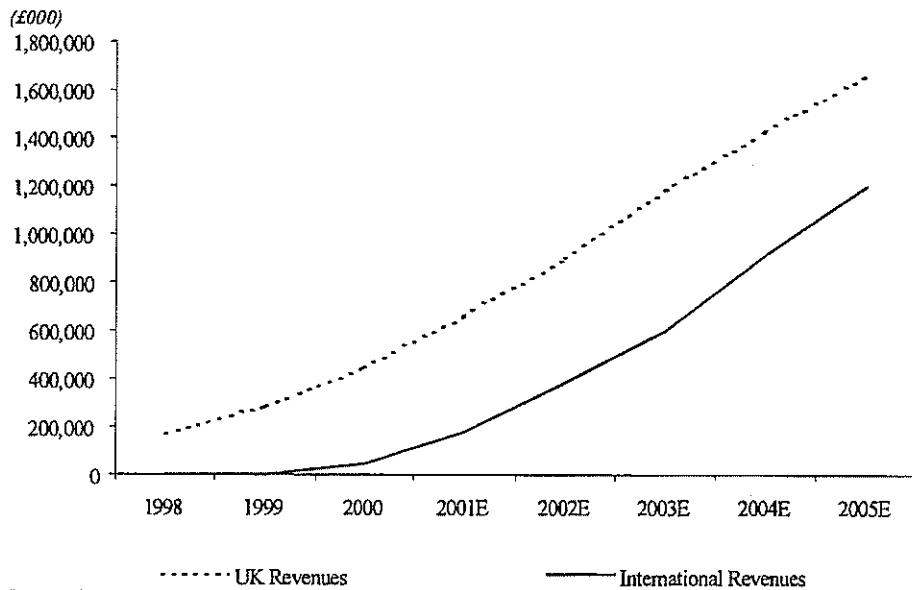
- In addition, only 33% of new Freeserve broadband contracts will be terminated on the Energis network.
- Energis does not have a replacement for the contract by 2003, but this should not be problematic since it still has 2½ years to run.

Highlights of Our Energis Forecasts

Below are the main highlights of our forecast. See the end of the report for a more complete model.

- Revenues will continue to grow strongly, in our view. We forecast group revenues at £840 million in 2001 rising to £1,288 million in 2002 and £1,788 million in 2003. We forecast international revenues at £175 million for this year, rising to £603 million by 2003.

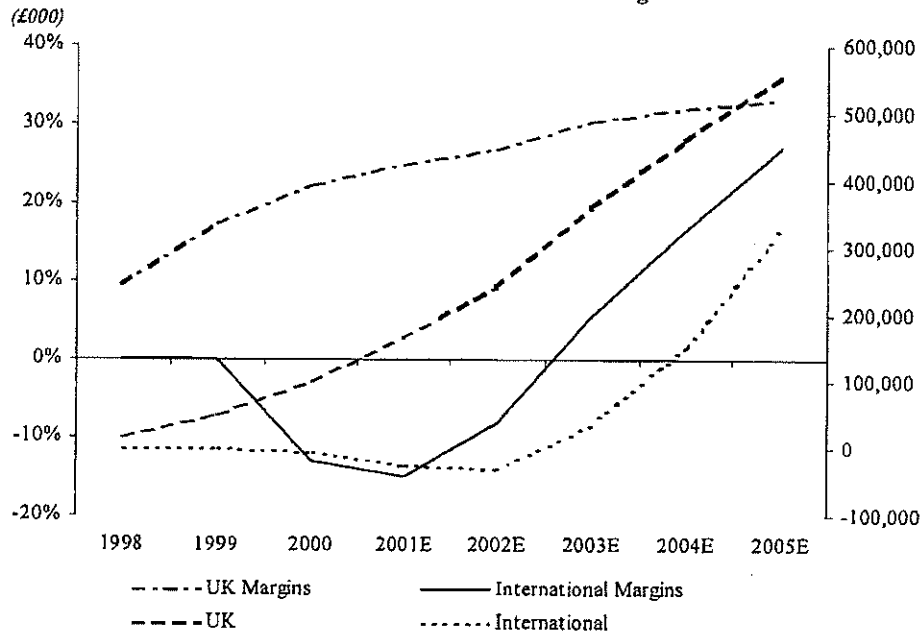
Chart 1: Revenues



Source: Company data, J.P. Morgan estimates.

- Group EBITDA should continue to increase, from £141 million this year to £212 million in 2002 and £395 million in 2003, on our estimates. Importantly, we expect continual growth in UK EBITDA margins from 25.1% this year to 30.5% in 2003, driven by web hosting and network economies from greater loading.

Chart 2: UK and International EBITDA and EBITDA Margins



Source: J.P. Morgan estimates.

- Net debt will increase from £591 million in March 2000 to £743 million in March 2001, on our forecasts. It continues to increase to March 2004, peaking at £1,268 million, after which we expect the company to become free cash flow positive.

Table 1: Profit & Loss Summary

(£ million, year ending March 31)

	1999	2000	2001E	2002E	2003E
Turnover	285.5	494.0	839.5	1288.1	1788.8
EBITDA	49.7	92.5	140.6	211.9	395.2
EBITDA margin %	17.40%	18.73%	16.74%	16.45%	22.09%
Group operating profit	(15.8)	(6.0)	(40.4)	(44.8)	104.2
Pre-tax profit (FRS3)	(31.1)	(41.4)	(106.8)	(131.5)	2.6
EPS (pence) (FRS3)	(3.3)	(2.0)	(4.0)	(3.1)	3.9
EPS (pence) fully diluted	(1.9)	(1.9)	(4.0)	(3.1)	3.8
CEPS (pence)	(0.0)	4.3	3.8	4.4	7.5
Shares in issue (millions)	1460	1550	1694	1694	1694
Capex	(119,145)	(249,600)	(395,487)	(425,476)	(437,108)
Net debt	(230,846)	(591,000)	(749,336)	(1,083,868)	(1,268,737)
FV/Sales	30.5	18.0	11.0	7.3	5.3
FV/EBITDA	175.6	96.0	65.5	44.4	23.9
FV/net fixed assets	13.5	11.7	7.9	6.6	5.7

Source: J.P. Morgan estimates.

VALUATION

Valuation has been a key area of debate in the alternative carrier space in the past year. We have used DCF as our preferred method and, in general, have maintained our price targets, which has resulted in our targets being beaten by a substantial margin on the way up and conversely undershot on the way down.

DCF Indicates 626p per Share

We have adjusted our DCF valuation in two areas.

- We have increased our WACC to 8.8% from 8.2%, reflecting a higher beta of 1.93.
- Energis has stakes in Wanadoo (via Freeserve) and Emblaze, which have fallen dramatically in value during the TMT shakeout.
- As a result, our price target, using DCF, is now 626p, which continues to offer significant upside on the current price.

DCF Sensitivity

In addition to our base case, we have undertaken a sensitivity analysis on our DCF. The base case WACC of 8.8% uses the following method: a risk-free rate of 5.08%, beta of 1.93, a terminal growth rate of 4.5% and pre-tax cost of debt of 9% (Energis is fully funded and this is the average rate of borrowing). If we take the current yield of the bonds, which is around 9.7%, and use this as the pre-tax cost of debt, we have a WACC of 9.0% and an equity value of 591p per share. A WACC of 10% and terminal growth rate of 4.5% generate the current share price.

Table 2: DCF Sensitivity

(p)

Terminal Growth	WACC				
	8.50%	9.0%	9.5%	10.0%	10.5%
2.5%	497	442	395	354	319
3.0%	533	471	419	374	335
3.5%	575	504	445	395	352
4.0%	629	546	478	422	374
4.5%	695	596	517	453	399
5.0%	780	659	565	490	428

Source: J.P. Morgan estimates.

Revenue Multiples Indicate a Price Target of 360-580p

We have also used growth-adjusted revenue multiples, which indicate a price target of 360p-580p, based on 3.5 times and 5.5 times 2002 estimated revenues. We have used multiples based on a peer group which comprises KPNQwest (5.5 times) and Colt (3.6 times). We prefer to use 2002 multiples, given the lack of visibility in the market, the sector average 2002 revenue multiple is 3.6 times, which equates to a price of 369p. Looking ahead to 2003, we note that Energis is the most highly rated alternative carrier, which reflects its outperformance of the sector in the past six months, in our view. Energis does not look cheap versus its peer group but, in our opinion, deserves a premium for its market traction and strong EBITDA growth prospects.

Pan-European Alternative Carriers Versus the CLECs

We believe there is a split in the market between the pan-European alternative carriers — KPNQwest, Colt, C&W and Energis — and the smaller CLECs. In our view, the pan-European stocks have gained market traction and have defined funding situations and, therefore, deserve higher multiples, while the smaller CLECs have yet to prove they can execute in their respective markets. In addition, the smaller CLECs' debt is trading at higher levels than that of the larger pan-European operators, which again reflects the greater risk perceived to be associated with these companies. This is reflected in the cost of capital and, hence, valuations.

Table 3: Peer Group Multiples

	FV/Revenues						FV/EBITDA					
	1998	1999	2000	2001E	2002E	2003E	1998	1999	2000	2001E	2002E	2003E
Cable & Wireless	2.00	2.03	2.81	2.55	2.14	1.88	5.83	7.80	12.20	10.40	8.31	6.91
Colt Telecommunication	38.35	21.44	13.02	6.88	3.56	2.27	NM	NM	NM	110.21	18.75	9.18
Energis	25.33	15.30	9.00	6.44	4.84	3.93	145.62	81.91	50.52	32.76	20.10	14.95
Jazztel	NM	37.88	12.90	6.48	4.11	2.82	NM	NM	NM	NM	NM	15.19
Kingston	2.90	3.53	2.64	1.94	1.38	1.04	13.17	23.22	27.76	11.57	6.97	4.56
KPNQwest	NM	57.49	21.79	11.35	5.50	3.17	NM	NM	NM	NM	42.94	13.99
Viatal	0.77	2.26	2.37	4.45	4.29	3.61	NM	NM	NM	NM	NM	67.06

Source: J.P. Morgan estimates.

Note: Energis, Kingston and Cable & Wireless have a March year-end and figures have been calendarised.

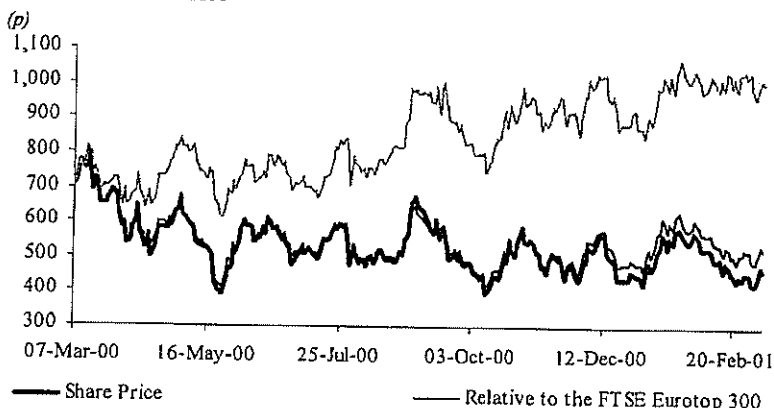
No Real EBITDA Comparisons Possible

In an ideal world, we would like to use EBITDA multiples as comparisons. However, there are only two companies in the sector which have meaningful EBITDA margins, C&W and Energis. Looking round the sector, we forecast that Colt will become EBITDA positive throughout the year for the first time this year, while Equant should become EBITDA negative after the Global One transaction.

Recent Price Performance

For the past eight months Energis has held a fairly consistent pattern, trading between 430p and 590p, with occasional moves below and above the trading line. We note that it has outperformed the overall telecoms market and continue to expect this to be the case, given its financial performance and leading position in the high-margin hosting market. But, in common with other stocks in the sector, has underperformed the wider market. On the positive side, our technical analysts note that there has not been any major chart breakdown, unlike most of the alternative carrier sector.

Chart 3: Share Price



Source: Datastream, J.P. Morgan estimates.

THE ISION TRANSACTION

Energis announced that it bought 75% of Ison from Distefora in December and the transaction was completed in January 2001. We summarise the transaction below.

- Energis paid 62 million shares in Energis plus €210 million (£128 million) in cash. These shares are subject to a nine-month lock-in, although this could be brought forward with Energis' agreement. There was also an earn-out provision of 5.4 million shares if full-year figures reflected more than €97.4 million in revenue and an EBIT loss greater than €37 million, which did not occur. Management and institutional investors were paid in Energis shares only.
- There is also a series of earn-out provisions. Energis will not issue more shares if the price is £5.50 and above; it will issue 5.5 million new shares if the price is £5.00 a share; and it will issue an additional 12.2 million shares if the price of Energis is lower than £4.50.
- Energis has made an all-share offer to the outstanding minority shareholders of Ison at the rate of 6.75 Energis shares for each Ison share (equivalent to €47.13 per share). The exchange offer period is expected to start on Monday March 12, 2001 and close on Monday April 9, 2001. This is equivalent to 33 million new Energis shares.

Overall, we estimate Energis will pay about £128 million in cash and 93 million in shares (worth £465 million at 500p) — a total of £593 million (ex-buffer) for 100% control of the company.

What Did Energis Buy?

Ison is Germany's leading hosting company. It hosts about 800 complex sites and has 35% of key German-language content sites. Customers include Bertelsmann Direct, Motorola, BAE Systems and Mitsubishi Electric. It reported revenues of £40.7 million, or £54 million annualised, for the first nine months of 2000, of which 71% was from hosting and systems & services. The company has 900 staff, 450 of whom are engineers while 130 are in sales. We believe the shortage of skilled staff, which should enable prices to hold up in the complex hosting area for at least the medium term, was the key reason for the acquisition. In terms of assets, Ison has 27,000 sq ft of hosting, of which 6,000 sq ft is in Hamburg and 21,000 sq ft in the rest of Germany and other European countries, mainly the Netherlands.

We have used consensus figures as the basis to model Ison, given that Energis has yet to reveal details of how it expects its German business to develop. However, we have tempered the consensus figures by moving EBITDA in line with company expectations of positive EBITDA in 2003.

Was It Worth It?

The Ison transaction was the largest acquisition that Energis has made to date and, unlike previous deals, it was done in a TMT bear market. On the day of the announcement, Energis' share price fell by 50p, although it recovered during the following week.

Table 4: Ison Sales for First Nine Months and Full-Year 2000

(£ million — using €1.58:£1)

	Nine Months	Full Year
Website Management	18.4	28.8
Access	11.5	14.5
Systems & Services	10.8	17.6
Total	40.7	60.9

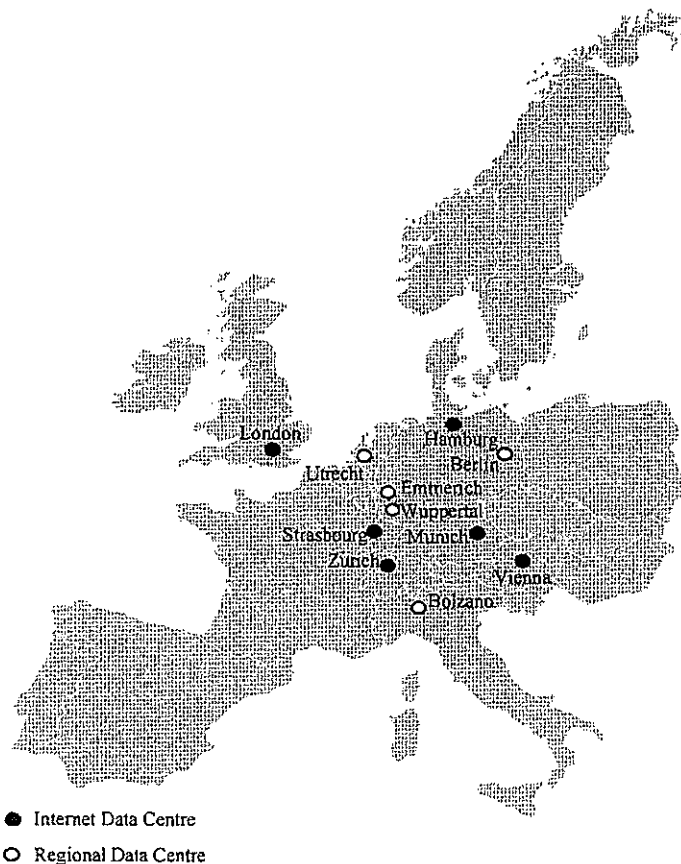
Source: Company data.

As we noted at the time of the acquisition (December 19), Ision's multiples (9.8 times estimated 2001 revenues and 5.1 times estimated 2002 revenues) were high compared with European comparables, such as Integra or Telecity, but cheaper than Exodus, the leading US data centre provider. (Admittedly, Telecity is not an apples with apples comparison as it is mostly co-location and managed services, not web hosting.) One view was that the price for the leading web hoster in Europe's biggest market should lie between that of a US market leader and a regional European player — between 1.5 and 3.9 times 2002 revenues. Taking this view, at 3.6 times projected 2002 revenues, the transaction appeared fairly priced. Since the transaction, however, prices have fallen across the sector, with Exodus falling 40% and Telecity by 37%.

The Ision Deal Is a Major Piece in the Jigsaw

However, we feel that this view does not fully account for Ision's value to Energis. Our strategic view on the space was outlined in our note 'Three Kings', published in July 2000. The basic thesis was that a winner needs a three-part strategy for success in the alternative carrier space: data centres (which are valuable in their own right but also drive traffic onto the network), a backbone network (which lowers costs) and an access network.

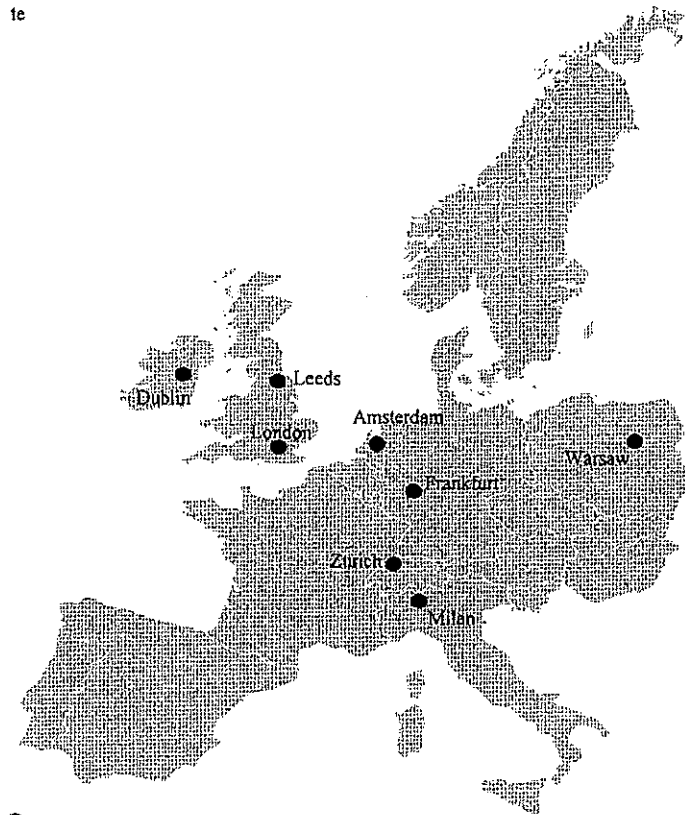
Chart 4: Ision Internet Data Centres



Source: Company data.

Chart 5: Energis Internet Data Centres

1e



● Internet Data Centre

Source: Company data.

Looking first at Germany, Energis had already purchased a backbone network — carrier 24 — which can be used for transport into the data centres. It also had a nascent data centre business with centres in Frankfurt and Amsterdam covering a total of 100,000 sq ft. Furthermore, it has a German ISP, Business Online, which can act as a salesforce for Ision, in addition to its 130 salespeople in Germany.

We believe the Ision transaction has the following benefits.

- The primary advantage is that Ision brings personnel, and new products and services. It has 900 staff, of which 130 are in sales.
- The Ision network is based on lines leased from Deutsche Telekom. Moving this traffic onto carrier 24 is expected to lower Energis' costs. Management believes that the main advantage of the carrier 24 network is that it ensures quality of service to the data centre, a key requirement for corporate customers.
- Energis' data centres in Frankfurt and Amsterdam each have 50,000 sq ft in space, which can be sold by Ision's salesforce in Germany and the Netherlands. It should be noted that Energis brings a large amount of additional capacity to Ision and, assuming that it can be sold at the same rate as Energis Squared in the United Kingdom, (see below for discussion on revenue per data centre), Ision's revenues could increase by £75 million.

- Ision's traffic can be carried over the Energis network, which has Tier 1 peering status for exchanging internet traffic. This should lower costs for both Energis and Ision.
- John Beaumont, managing director of Energis Squared, will take over as interim CEO. While Ision will have its own CEO (in time), we believe that the transfer of skills from Energis Squared, especially its experience of scaling up an asset base, will prove useful to Ision.

Table 5: Energis Germany and Ision Sales Personnel

Energis Germany	Sales Personnel	Ision	Sales Personnel	
Hamburg		13	Hamburg	85
Other Germany		53	Other Germany	45
Total		66	Total	130

Source: Company data.

Ision's Full-Year Results

Ision reported its full-year results on March 6. Overall, they were in line with consensus for revenues but slightly below expectations for EBITDA. Importantly, we note that Energis reiterated guidance for revenues and increased forecasts for synergies, which, in our view, is positive. The key points of the results are listed below.

- Q4 revenues were €29 million, which missed the earn-out target of €32 million. The company reported an EBITDA loss of €39.4 million and an EBIT loss of €62.8 million.
- Overall, Ision's performance was slightly below consensus expectations, with full-year revenues of €96.4 million (versus consensus estimates of €98 million) and an EBITDA loss of €17.4 million (versus consensus estimates of -€15 million).
- Having missed the Q4 revenue earn-out target of €32 million, we believe Ision used the opportunity to tidy up its books before the Energis acquisition. This included a series of one-off costs, which took into account restructuring costs, stock options, SG&A and some consultancy charges. These amounted to €22 million and, therefore, the underlying EBITDA loss for the year was €17.4 million.
- We note that these one-off costs are for the year ending December 31, 2000, and that only the February and March 2001 costs are consolidated by Energis — the acquisition having been completed in late January.
- Energis gave new guidance for Ision for 2000-01 and 2001-02. In December, the company expected Ision to report £15 million in revenues, a £5 million EBITDA loss and £5 million in integration costs for 2000-01. Energis now expects the integration costs to be minimal, given expected synergies and the one-off costs already paid by Ision.
- In December, Energis expected Ision to report revenues of £100 million, an EBITDA loss of £15 million and £10 million in exceptionals for 2001-02. The company now expects synergies of £10 million will balance the exceptionals and, therefore, net net, losses will be only £15 million in EBITDA. The company continues to forecast that Ision will become EBITDA positive in Q2 2001-02 (i.e. around September 2002).

Moving Outside Germany

Energis has a European expansion plan, which aims to export its data centre business. It has the ECS carrier's carrier network and it is likely that it will use this to link its in-country fibre and data centres into a mesh network. This would enable the company to build a pan-European network of data centres, which could all be linked together by Energis fibre. This would allow Energis to move information from one data centre to another, for example to create back-up and storage networks as well as pan-European streaming media networks.

Table 6: Energis' Data Centre Build

Current Centres	Space (sq ft)	Ision Centres	Space (sq ft)
Leeds 1 and 2	87,000	Hamburg	6,000
London	60,000	12 local centres inc	
Frankfurt	50,000	Munich, Zurich and Vienna	21,000
Amsterdam	50,000		
Zurich	50,000		
Milan	50,000		
Dublin (with nevada tel.com)	50,000		
Warsaw (with NGKT)	50,000		
Total	447,000		27,000

Source: J.P. Morgan estimates.

A critical consideration for the company is whether Energis would have enough market presence in countries other than the United Kingdom, Germany and the Netherlands. Given the current funding situation, Energis will choose to grow organically outside these three countries, in our view. This is because there is little spare cash for acquisitions and the market is unlikely to fund a further deal until its sees the positive results of the Ision transaction.

THE ENERGIS DATA CENTRE OPPORTUNITY

We believe that data centres represent one of the key value-enhancing mechanisms in the fixed-network market. Not all data centres are created equal, however. In our analysis we segment the market into three basic areas.

- **Collocation.** This is the most basic segment of the market in which a company installs its own switches or computers into a data centre and both manages and owns the equipment. There is a minimum of maintenance by the data centre and the main value added is power and security. Revenues per square foot are about £150-300 pa, which is currently increasing.
- **Managed services.** The middle tier of the data centre opportunity is where the data centre provider puts together a range of services, such as basic maintenance, outsourcing of storage, firewalls and load balancing. This area can be characterised as moving from fairly basic engineering to almost a full outsource of a server. Therefore, revenues per square foot range from £400 to £1,000 — for example, Colt and KPNQwest generate £20,000 per rack and a rack takes up 18-20 sq ft.
- **Hosting.** The most lucrative area (and most difficult to provide) is akin to a fully outsourced solution, where the hosting company owns and manages the hardware and services. Hosting can range from a shared solution (many sites on one server) to a full load balancing, back up, security and guaranteed levels of service for one company and, importantly, the integration of hosting with existing back-office systems, especially for e-commerce systems. Energis Squared and Ision specialise in this area, and they also offer shared hosting, which is many customers sharing the same server.

The UK Experience

The Energis hosting division is now called Energis Squared and is based on the Planet Online acquisition in November 1998. The division has established itself as the UK leader in complex web-hosting applications, with clients such as Boots, GMTV and MTV. These clients require both technical and consultancy services as they migrate towards a 'clicks and mortar' strategy. They also require Energis Squared to develop a long-term online technical platform as they effectively outsource their online presence to the company. In addition to these high-end customers, it also hosts SME customers. The number of corporate websites rose from 10,000 in March 2000 to 16,500 by September 2000.

Energis can earn about £1,000 per sq ft in pure hosting revenue with an additional £1,000 in bandwidth, in our view, and we believe the company has 50% EBITDA margins for hosting. We expect these margins to be maintained in the short to medium term as this area requires a high level of skills, which are in short supply.

In addition to pure hosting revenue, data centres are important for telcos as a means of driving traffic onto the network. Estimates for hosting:bandwidth generation ratios vary across the industry, with KPNQwest seeing 1:5, Equant 1:4 and Level 3, 1:8. This partly reflects their customer bases, but also their varying levels of hosting prices in the first place.

Hostest With the Mostest

We know that Energis had £125 million in internet-related revenues for H1 2001, of which we expect 70% or £87.5 million was in data centres (hosting and bandwidth), or £175 million annualised. The company currently has 120,000 sq ft in space, of which we estimate 100,000 is net lettable. We believe that Energis has sold around 80% of space — 80,000 sq ft — and it has 35 racks per 1,000 sq ft, or 2,800 racks sold. This would equate to £62,000 revenue per rack, £2,200 per sq ft, (each rack takes up 28 sq ft) or £75 million per gross 50,000 sq ft centre.

In our view, this is less than the revenue Ision is generating per rack, which indicates the potential upside. Ision says it has revenues of €3,000 per month per server. Assuming that there are three servers per rack, this would equate to £72,000 pa per rack, compared with Energis' £62,000 pa per rack.

Energis includes bandwidth sales for the data centre in addition to hosting sales. We believe the company has a 1:1 bandwidth to hosting ratio (this is lower than that of other companies, as we believe it has the premium revenue per rack), and we therefore expect hosting revenue to be around £31,000 per rack and £31,000 of bandwidth. This seems reasonable, given that Colt receives £20,000 per rack for hosting and has a 1:2 hosting to bandwidth ratio. Energis is currently expected to have 450,000 sq ft available by the end of March 2001, and, therefore, at current prices it has the potential to generate £675 million from these data centres, should they be fully utilised.

Table 8: Data Centre Economics

Hosting Revenues	
Internet and hosting for year (£ million)	175
Data centre space available (sq ft)	100,000
Data centre space used (sq ft)	80,000
At 35 racks per 1,000 sq ft	2,800 racks
Revenue per rack per year (£)	62,000
Of which 50% is hosting (£)	31,000
Of which 50% is bandwidth (£)	31,000
Each rack is 28 sq ft so per sq ft per year (£)	2,200

Source: J.P. Morgan estimates.

Overall, we feel the key metric going forward will be the total revenue — hosting plus bandwidth — that a hosting centre can generate for an integrated carrier. Having a high company:bandwidth revenue ratio may not be a good thing, since it may just be that the company has a poor hosting business. In addition, we would expect margins for a well-run data centre to exceed those of a network operator, given we believe Energis has 50% EBITDA margins on its hosting business.

ASPs — Jam Tomorrow

In our data centre revenue model, we have not included potential revenues for application service provision (ASP). First, we note that some commentators have reclassified e-commerce solutions, such as Intershop, as ASP services because they are hosted away from the company server. In our view, these services were always going to be hosted at data centres. 'Classic' ASP applications, where existing applications are hosted at the corporate LAN, will take some time to move into data centres. We do believe this move will occur, but only when data speeds and confidence in ASP houses improves.

Second, we are sceptical that the ASP model will take off in the SME market in the short term, due to the considerable leap of faith that distant hosting involves for a business already struggling with IT failures. In short, we believe that SMEs will remain with the devil they know.

SO WHAT'S NEW?

Over the past year, our basic Buy thesis on Energis has been based on the following two themes. However, we expect that others, such as access network developments, and the introduction of Friaco (fixed rate internet access call origination) will drive the price over the next 12 months.

- **Financials.** The company has strong EBITDA growth in the United Kingdom, demonstrating market traction, plus it is fully funded. It continues to show strong growth in this area (see discussion above).
- **Products and services.** It has a strong suite of products, which it has developed at Energis Squared (previously known as Planet Online), which we believed it was looking to export to mainland Europe. Energis has expanded its data centres into six European locations as well as making the Ision acquisition, as discussed above.

In our view, the market has now appreciated the first two elements of the story — hence the relative outperformance of the stock — and we expect the last part of the story to become more evident over the year. We expect the following themes over the next 12 months.

- **Access network.** We had expected Energis to move into the access network, using DSL and wireless local loop (WLL) technology. One worry, however, was that Energis would overpay for the WLL licences. Nonetheless, with auction fatigue post-3G, the company bought six licences for £14 million, which is considerably cheaper than the other European licences in Germany and Switzerland. We anticipate that a targeted rollout of DSL and WLL will cut Energis' costs and will prove value enhancing. However, it is too early to put a value on the rollout given that the company has not disclosed its plans. Overall, we expect Energis to adopt a mix-and-match access strategy using fibre, DSL and WLL.
- **Friaco should be neutral/positive.** There are concerns in the market that the move from pay-as-you-go to 'all you can eat' would be negative. We discuss this in more detail below, but expect the effect to be broadly neutral.

We also look at the impact of the Wanadoo acquisition of Freeserve, other acquisitions and recent management changes.

UK DSL and WLL

In our view, Energis will be in a good position to expand its access networks using DSL over unbundled local loop (ULL) and recent WLL licence wins. Energis has been expanding its long-distance network to reach around 70% of BT's DLEs (digital local exchanges). The UK ULL process has been cumbersome (at best), with a phased rollout using a process known as 'Bow-wave'. Bow-wave 1 issued space for new operators in 160 BT exchanges, while Bow-wave 2 is expected to issue space in 380 exchanges in early April.

A key criticism of the Bow-waves process was that the exchanges were scattered over the United Kingdom, making it difficult for operators to achieve any economies of scale. In addition, BT has restricted each operator to three racks per exchange with a total power supply of 5kW (which in practice would be nearer 4kW). As a result, current DSLAM technology allows a maximum of 500 lines to be supported by each operator in a central office, or CO (each DSLAM line card supports eight lines and there are 8-20 line cards per DSLAM, and three DSLAMs per CO). Our research (see *DSL: The Alchemist*, published January 2001), suggests it would require around 100 SME customers per exchange to break even on SDSL, while it would take more than 1,000 residential customers on ADSL. Given that the current technology supports 500 lines of three racks, we can see clear technical reasons why Kingston pulled back from a residential rollout. (We expect that the technology enabling more than 24 lines per card will be available by summer 2002, which makes a residential rollout possible.)

Nevertheless, while the Bow-waves process does not enable a DSL rollout to achieve critical mass in the short term, we expect the lack of capital in the market to reduce the number of players after space in BT exchanges. Given that the Bow-wave process has been abandoned, and if we assume there are eight to 10 serious DSL players, we anticipate that the process will enable all companies to have the space they require (assuming the three racks per exchange rule still applies).

DSL Works for SMEs

Working on the assumption that Energis can have access to BT exchanges by summer 2001, we would expect it to start rolling out a DSL service in the autumn. Importantly, the UK regulator has stipulated that BT should reach agreement with Energis on how it should pay for interconnect to a BT DSLAM. We believe the 'sweet spot' for DSL is customers that currently have 12-20 lines. This is because they generate, on average, £25,000 pa in traffic driven by 16 voice and one or two data lines, all of which can be supported on one 2-Mbit/s SDSL line. This is Energis' core market and we would therefore expect it to start to replace BT tails with SDSL lines for existing customers, which would reduce operational expenditure per customer. In addition, we would expect Energis to be able to extend its target market, as DSL is cheaper to deploy than fibre and less expensive than using BT tails.

WLL Useful as a Fill-In

In addition to using DSL as an access mechanism, Energis has won five WLL licences in the United Kingdom in key metropolitan areas such as London, Manchester and Birmingham. While we believe that WLL is a useful technology, the weather conditions in the United Kingdom and much of northern Europe (i.e. it rains a lot), mean that the distance from base station to the customer antenna needs to be nearer to the customer than in better climates. That said, WLL is useful in greenfield sites and flat areas where it is easy to have line-of-sight, in our view. Overall, we expect WLL will be of incremental value to Energis, but DSL is a more important technology.

Friaco: Positive or Negative?

Friaco has been introduced in the United Kingdom and is a move towards flat-rate pricing for internet access. Essentially, there are two packages for Freeserve: 'as much as you can eat all day' for £12.99 per month, or evenings and weekends for £8.99. The economics of Friaco work as follows: Energis needs to rent a 2-Mbit/s port from BT for £15,300 pa for a tandem port, or £10,500 for a DLE port. These ports can support 30 dial-up lines and, if we assume a contention ratio of 10 users per port, this equates to a cost of between £2.91 to £4.25 per user per month.

Then the call needs to be backhauled to the backbone and then to the data centre, which is Energis' revenue stream. We understand that the cost of backhaul will be around £35.50 per port, or £3.55 per user per month (10:1 contention ratio).

Under this regime, Energis receives £42.60 pa per dial-up user, whereas under the 'pay-as-you-go' system (the NTS regime) it received an estimated £34.90 pa. We believe the margins for Friaco may be the same as that for NTS. On one hand, the network needs more capacity, but the traffic is carried as IP rather than switched traffic, which is more efficient. Therefore, overall, Friaco should be neutral to slightly positive for the company.

Freerserve

In December 2000, Wanadoo, which is majority-owned by France Telecom, made an offer for Freerserve at an exchange rate of 0.225 Wanadoo shares per Freerserve share. Energis holds 2.25% of Freerserve and has options to buy a further 0.75% in three 0.25% tranches in October 2001, 2002 and 2003.

Energis shareholders' main concern was that Freerserve would move its traffic from Energis to NTL, in which France Telecom also has a stake. Currently, the Energis/Freerserve contract runs until September 2003, and Energis has the exclusive right to terminate metered and unmetered narrowband traffic. The contract for ADSL has yet to be decided. In our view, Energis and Freerserve will have three basic options as of September 2003.

1. **To continue the partnership as is.** We believe this is unlikely as we expect NTL will take some of the Freerserve traffic.
2. **To move some of the Freerserve traffic to NTL.** We believe this is the most likely solution. By 2003, Energis should be adjacent to 90% of BT's DLEs whereas NTL will not have the ubiquity of network. Therefore, Energis is likely to continue to collect Freerserve traffic. In our model we assume that NTL will terminate two-thirds of new Freerserve traffic from September 2003 onwards. In addition, we would expect Energis to terminate traffic for other companies but, given that the contract has 2½ years to run, we do not expect any announcements in the near term.
3. **Move all the traffic onto NTL.** We believe this is unlikely as Energis' network will be much closer to BT's DLEs than NTL's. In addition, it is unlikely that NTL will have enough internet terminating equipment ready to transfer all the traffic over immediately the contract expires.

Stentor and Other Acquisitions

Apart from Ision, Energis has made other acquisitions in the past year, which we believe consolidate its market position.

Table 7: Recent Company Acquisitions

	Company	Stake	Price paid (£mm)
January 2000	Energis Polska	23.75%	joint venture
January 2000	Eneriel	100%	338
March 2000	carrier 24	100%	20
May 2000	Eurocall	45%	20
May 2000	Stentor	100%	36
August 2000	Energis Interactive	55%	joint venture
February 2001	Ision	75%	420*

Source: Company data.

*cash and shares — remaining 25% to be completed shortly.

The following stand out.

- Purchase of Stentor in Ireland in summer 2000. The purchase was made by Nevada tele.com, with which Energis has a 50/50 joint venture. Stentor has call centres and a leased network. The combination of this and the current Nevada tele.com network means that Energis now has a presence in the whole of the island of Ireland.
- We believe the joint venture with Graham Technology – Energis Interactive – may be one of the potentially value-enhancing acquisitions, which provides interactive TV to businesses via satellite. Energis has just launched a consumer portal called BrightBlue, which will be a direct competitor to Open.

Management Changes

Although Energis has had a stable management team for some years, there have been some management moves recently. Chris Hibbert, resigned as CFO in the autumn, but remains on the board and is responsible for European development. He was replaced by Bill Trent who was appointed in December 2000 and has recently joined the board. Mr. Trent was a partner and co-leader of Global Corporate Finance and Strategy at McKinsey. Given this background, we would expect the company to continue to move into the e-commerce and value-added space where it is shown it is a leader and can command high margins.

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Table 8: Profit and Loss
 (£ 000, year-end March 31)

	1998	1999	2000	2001E	2002E	2003E	2004E	2005E
Revenues								
UK basic services	73,600	98,400	138,300	176,180	204,006	234,116	262,330	289,978
% change YoY		34%	11%	24%	13%	13%	11%	10%
UK advanced services	68,000	109,700	147,700	208,257	274,899	343,624	422,658	498,736
% change YoY		61%	35%	41%	32%	25%	23%	18%
Freeserve revenues			37,742	88,983	134,977	192,043	226,944	245,221
Other internet			120,958	191,114	286,670	415,672	519,590	628,704
% change YoY				40%	33%	27%	25%	21%
UK internet & related services	26,300	77,400	158,700	280,096	421,647	607,715	746,534	873,925
% change YoY		194%	105%	76%	51%	44%	23%	17%
Total International (includes Ision)	-	-	49,300	175,000	387,516	603,335	915,547	1,198,303
% change YoY	0%	0%	0%	255%	121%	56%	52%	31%
Total turnover	167,900	285,500	494,000	839,533	1,288,068	1,788,790	2,347,069	2,860,942
% change YoY		70%	73%	70%	53%	39%	31%	22%
UK EBITDA	16,143	49,670	99,031	166,762	243,054	360,710	460,222	554,583
% of sales	10%	17%	22%	25%	27%	30%	32%	33%
International EBITDA	-	-	(6,500)	(26,187)	(31,149)	34,447	152,572	323,987
% of sales	0%	0%	-13%	-15%	-8%	6%	17%	27%
Total EBITDA	16,143	49,670	92,531	140,575	211,905	395,156	612,794	878,570
% change YoY		208%	86%	52%	51%	86%	55%	43%
Group EBITDA margin	9.6%	17.4%	18.7%	16.7%	16.5%	22.1%	26.1%	30.7%
Depreciation								
Total depreciation	(50,065)	(62,505)	(86,670)	(137,623)	(175,413)	(209,693)	(242,001)	(291,449)
Total goodwill amortised	0	(2,950)	(11,925)	(39,861)	(78,861)	(78,861)	(78,861)	(78,861)
Group depreciation and amortisation	(50,065)	(65,455)	(98,595)	(177,484)	(254,274)	(288,554)	(320,862)	(370,310)
Integration costs (Ision)				(1,000)	0			
Group operating profit (pre-goodwill)	(33,922)	(12,835)	5,906	1,953	36,492	185,464	370,792	587,121
Operating margin %		-4%	1%	0%	3%	10%	16%	21%
Group operating profit	(33,922)	(15,785)	(6,019)	(37,908)	(42,369)	106,603	291,931	508,260
Associates			(1,068)	(4,001)	(235)	6,638	14,077	21,676
Operating profit (inc associates)	(33,922)	(15,785)	(7,087)	(41,909)	(42,604)	113,241	306,008	529,936
Group net interest	(28,090)	(15,339)	(34,320)	(62,425)	(85,960)	(107,918)	(118,790)	(115,125)
Associates' interest			130	(150)	(425)	(800)	(1,100)	(1,300)
Profit/(loss) before tax (norm)	(62,012)	(28,174)	(29,482)	(64,473)	(49,703)	84,184	266,079	493,672
Profit before tax (FRS3)	(62,012)	(31,124)	(41,407)	(104,334)	(128,564)	5,323	187,218	414,811
Tax rate %	0%	0%	0%	0%	0%	20%	30%	30%
Taxation	11,798	870	0	0	0	(16,837)	(79,824)	(148,101)
Profit/(loss) for the financial period	(50,214)	(30,254)	(41,407)	(104,334)	(128,564)	(11,514)	107,394	266,709
Ordinary shares in issue (million)	899.5	826	1,490	1,677	1,677	1,677	1,677	1,677
Fully diluted shares in issue (million)	1,460	1,460	1,550	1,694	1,694	1,694	1,694	1,694
EPS (pence)	(28.0)	(3.7)	(2.8)	(6.2)	(7.7)	(0.7)	6.4	15.9
EPS (normalised)	(5.6)	(3.3)	(2.0)	(3.8)	(3.0)	4.0	11.1	20.6
Fully diluted EPS (normalised)	(3.4)	(1.9)	(1.9)	(3.8)	(2.9)	4.0	11.0	20.4

Source: Company data, J.P. Morgan estimates.

Table 9: Cash Flow
(£ 000, year-ending March 31)

	1998	1999	2000	2001E	2002E	2003E	2004E	2005E
EBITDA	16,143	49,670	92,531	140,575	211,905	395,156	612,794	878,570
Net change in working capital	19,242	(4,066)	(13,080)	(35,000)	(35,000)	(35,000)	(35,000)	(35,000)
Operating cash flow	35,385	45,604	79,451	105,575	176,905	360,156	577,794	843,570
Net interest	(27,996)	(14,363)	(36,270)	(62,425)	(85,960)	(107,918)	(118,790)	(115,125)
Facility arrangement fees	(3,105)	(2,454)						
Taxation	16,700	11,878	(85)				(16,284)	(79,088)
Acquisitions		(79,740)	(430,233)					
Total capital expenditure	(140,856)	(119,145)	(249,600)	(395,487)	(425,476)	(437,108)	(474,372)	(527,268)
Cash flow before financing	(119,872)	(158,220)	(636,737)	(558,336)	(334,531)	(184,869)	(31,652)	122,089
Financing								
Equity			303,244	400,000				
Debt			528,891					
Opening net debt	(382,460)	(47,898)	(230,846)	(591,000)	(749,336)	(1,083,868)	(1,268,737)	(1,300,389)
Closing net debt	(47,898)	(230,846)	(591,000)	(749,336)	(1,083,868)	(1,268,737)	(1,300,389)	(1,178,300)

Source: Company data, J.P. Morgan estimates.

Table 10: Balance Sheet
(£ 000, as at March 31)

	1998	1999	2000	2001E	2002E	2003E	2004E	2005E
Net book value (fixed assets)	435,951	644,540	757,308	1,151,066	1,411,152	1,648,027	1,889,429	2,133,963
Goodwill & Investments	0	0	749,877	485,288	406,427	327,566	248,705	169,844
Total current assets	84,402	95,069	310,375	738,205	534,011	473,344	524,026	522,380
Total assets	520,353	739,609	1,817,560	2,374,559	2,351,590	2,448,937	2,662,160	2,826,187
Share Capital & Reserves								
Called up ordinary share capital	74,887	147,061	155,409	155,409	155,409	155,409	155,409	155,409
Called up preference shares	71,055	0	0	0	0	0	0	0
Other reserves	263,800	263,800	459,851	459,851	459,851	459,851	459,851	263,800
Share premium	213,898	246,917	550,491	558,917	558,917	558,917	558,917	558,917
Profit & loss account	(266,605)	(328,789)	(375,331)	(479,665)	(608,229)	(619,742)	(512,348)	(245,639)
Total reserves	211,093	181,928	635,011	539,103	410,539	399,026	506,420	577,078
Equity shareholders' funds	357,035	328,989	790,420	694,512	565,948	554,435	661,829	732,487
Current Liabilities								
Trade creditors	67,316	122,034	181,448	308,364	418,196	526,576	636,138	728,990
Amounts owed to former parent	5,543	13,461	13,865	14,281	14,709	15,150	15,605	16,073
Total short-term creditors	72,859	135,495	284,627	322,645	432,905	541,726	651,743	745,063
Long-Term Creditors								
Facility agreement + debt	16,895	180,211	758,891	1,300,000	1,300,000	1,300,000	1,300,000	1,300,000
Finance leases	780	305	336	369	406	447	491	540
Deferred contribution from former parent	17,727	26,279	10,000	10,000	10,000	10,000	10,000	10,000
Loans and other creditors	35,402	206,795	769,227	1,310,369	1,310,406	1,310,447	1,310,491	1,310,540
Finance lease to former parent	55,057	52,259	47,033	47,033	42,330	42,330	38,097	38,097
Other creditors	0	16,071	0	0	0	0	0	0
Long-term creditors	90,459	275,125	743,078	1,357,402	1,352,736	1,352,776	1,348,588	1,348,637
Total liabilities, capital and reserves	520,353	739,609	1,817,560	2,374,559	2,351,590	2,448,937	2,662,160	2,826,187

Source: Company data, J.P. Morgan estimates.

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Table 11: Companies Under Coverage Mentioned in This Report

Company	Recommendation	Share Price as at March 8, 2001
BAE Systems	Long-Term Buy	319p
Boots	Long-Term Buy	609p
British Telecom	Buy	588p
Cable & Wireless	Buy	752.5p
Colt	Long-Term Buy	1,308p
Deutsche Telekom	Market Performer	€27.55
Jazztel	Buy	€12.65
Kingston Communications	Long-Term Buy	145p
KPNQwest	Long-Term Buy	€24.00
Level 3	Buy	\$100.0
Mitsubishi Electric	Market Performer	¥688
Motorola	Market Performer	\$16.25
National Grid	Buy	585p
Worldcom	Long-Term Buy	\$16.44



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