VoIP Newsletter

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MERCATOR CAPITAL

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AOL joins VoIP gold rush

It is inevitable that some of **AOL's** customers will eventually convert to VoIP, so it might as well be **AOL** who enables the conversion. That seems to be the logic for **America Online**, who after much delay and thought, has finally ventured into the crowded VoIP market in the US with its unimaginatively named "**AOL** Internet Phone Service".

AOL launched its first phase of VoIP services last month across the United States in 40 cities including New York, Chicago, Los Angeles, and San Francisco, which will later be extended to other cities. The company sees integrated voice and data features as a natural extension of its prowess in the ISP market, and particularly to its instant messaging capability.

Level 3 will be providing **AOL** with managed VoIP infrastructure across 40 US markets in addition to enabling the Enhanced 911 platform and Local Number Portability. **Sonus Networks** is providing the VoIP technology that integrates with **AOL's** feature set. **Linksys** and **Netgear** will supply the VoIP adaptors and home routers. **AOL** has also done its own internal development to link the service to its **AOL** Instant Messaging (AIM) platform.

AOL's 22.5 million existing Internet customers – about four million of whom have broadband connections – present an excellent opportunity for **AOL** to convert to VoIP subscribers. The company hopes that it can match **Cablevision**, who has successfully converted 272,000 of its 1.2 million broadband customers to VoIP. If **AOL** is as successful as **Cablevision**, we could see up to one million VoIP subscribers for **AOL** by the end of this year. But this is a daunting task for a company who does not control the pipes to the home; **Vonage** has only been able to acquire about 600,000 subscribers during the past 2 years despite hundreds of millions of dollars of advertising.

The residential VoIP market is overcrowded with startups, cable operators and even traditional phone companies, so **AOL** will have to work hard to sign up customers for the new service. The main competition will come from competitors such as **Vonage**, **AT&T** CallVantage, **Verizon** VoiceWing and **Primus** Lingo. **AOL** is banking on its AIM integration, enhanced features and competitive pricing for existing customers to win over the competition.

AOL is trying to differentiate itself by bundling its online service and also providing Enhanced 911 (E911) that delivers a caller's address to dispatchers in case of an emergency. Just last week the FCC ruled that all VoIP providers must provide E911 capabilities to their customers. **Packet8** currently offers E911, but charges extra. **Vonage** takes a different approach that requires users to register their addresses in advance. **AOL** also claims to make it easier for consumers to manage their service from a web portal where the users

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can change call-forwarding settings, view call logs, and access contact lists that will dial a number simply by clicking on it.

AOL believes that its offering of convenient features – including unified voice, e-mail, instant messaging, enhanced voicemail, call management capabilities, and presence awareness – will help it outpace competition in the long run. These enhanced features will be in addition to the standard calling features presently offered by Voice-over-Broadband companies.

AOL VoIP pricing follows similar patterns as those found in the market, though it is priced marginally higher than the competition for non-**AOL** customers. The company is offering its existing service plus long distance and local calling for $39.99 per month. For existing **AOL** broadband customers that subscribe to local calling only, the charge is $18.99 a month. These price packages include unlimited local and regional calls and $0.04 per minute for long distance calls in the US and Canada. There are additional price promotions for the first few months of the service. By comparison, **Vonage** charges $24.99 a month for unlimited US and Canada dialing, whereas **Packet8** charges $19.95 for its "Freedom Unlimited" plan.

Feature server vendors use mobility to get traction

Mobile operators today are facing strong competition from alternative service providers such as Multi-Service Virtual Network Operators (MVNOs) and fixed line broadband access providers. With penetration in many Western European markets reaching saturation, use of mobile services is increasing, but margins, especially for voice services, are eroding**.**

As part of the fixed-mobile convergence trend that is sweeping through the telecom market, some enterprises are completely replacing their fixed lines with a fully mobile hosted PBX solution. Some of the obvious industry names that are enabling this transition include **Broadsoft** and **Sylantro**. Both vendors have find-me / follow-me and simultaneous ring capabilities that allow a person to be reached from their desk phone, mobile phone, soft phone, or WiFi phone – all with a single number. Another feature server vendor, **Longboard**, is positioning itself along similar lines. **Longboard** features include handoff between the WiFi and the cellular, single identity for the user, and the same set of business features across those networks.

BroadSoft introduced their "Mobile PBX" product to enable more PBX functionality which was missing in their Centrex product, which offers only a subset of PBX features. This lesser functionality could have been the reason that **Broadsoft's** Centrex failed to penetrate the mobile market and had very limited success in the wireline market compared to its hosted PBX solution. **Broadsoft's** Mobile PBX, software-based solution that runs on Sun hardware, works exactly the same way whether configured in a 3G, IMS or non-IMS environment. In a non-IMS implementation, Mobile PBX connects directly to a softswitch that is typically located in the mobile carrier network and communicates with a mobile switching center. **Broadsoft** has one deployment and two trials underway for its Mobile PBX. Among these, one is in Asia, one in Europe and one in the US. All three are incumbent carriers, according to **Broadsoft.**

Sylantro customers are experimenting with WiFi technology and various dual mode phones, including those from **Spectralink. Sylantro** has also developed strategic partnerships with wireless vendors like **Bridgeport Networks**. As an example, **Bridgeport Networks** is working with **Sylantro** to allow mobile endpoints on a cellular/WiFi network to essentially roam onto a hosted service provider network.

Push-To-Talk: A unique opportunity to apply VoIP

If you think about how most people use a cellphone, it is typically used in a variety of ways. Increasingly, phones are being used for things such as games, email or some other application that is non-conversational. The majority of times, however, phones are still used for voice conversations – both with people with which we have frequent contact, and to a lesser extent with people with whom we have infrequent contact. A significant number of these conversations only require short interactions, such as getting quick status updates. These types of conversations usually last no more than 20 or 30 seconds and are typically with people that we know very well. In this application, there is a unique opportunity to apply VoIP technology.

VoIP is ideally suited for these walkie-talkie or intercom style conversations, pioneered years ago by **Nextel** as "Push-To-Talk". This application can streamline communications by allowing people to access each other in one second as opposed to the 8-10 seconds required to set up a traditional circuit-switched voice call. Push-To-Talk is essentially analogous to SMS messaging in the text world, and works well in a VoIP environment, since the voice transmission can be sent as short bursts of data instead of tying up a full voice channel for an extended period of time. Wireless carriers like the application for many reasons, including the ability to better utilize their network infrastructure. As a result, many equipment vendors are looking to provide these features and package them as VoIP-based or Packet-based Push-To-Talk (PTT).

Having twice the ARPU of their competitors and half the average industry churn, **Nextel** has shown conclusively that PTT has potential of being a compelling complementary voice technology to traditional phone calls. PTT was introduced almost 20 years ago as part of the specialized mobile radio (SMR) technology. Three or four years ago **Nextel** had about 6 million subscribers. They have since doubled the customer base. While doubling the PTT base they have simultaneously doubled the ARPU, and halved the churn rate. The company has made PTT simple for customers to communicate with each other. Even non-industrial segments such as law firms are now using **Nextel** technology for fact checking and coordination between the courthouse and office where they need quick instantaneous contact and answers to very simple and direct questions.

Microsoft's product development uses **Nextel** as a way to stay in contact through voice messaging inside their campuses. **Boeing** is another of **Nextel's** Fortune 100 customers. **Nextel** has done a great job of expanding its market from traditional blue collar, to grey collar, to white collar, and now into teens.

VoIP PTT can also be implemented with features like presence and dynamic group creation. A typical VoIP-based PTT system costs a carrier anywhere from $1 million to $10 million to support the same number of subscribers that could cost them $500 million if they were exclusively using a dedicated circuit switched solution. In general, a VoIP-based solution is cheaper to get started with, and it is much more efficient. A carrier receives the dual benefit of low cost of ownership, and a high margin service that utilizes the data channel. Since packet technologies do not dedicate bandwidth for the entire duration of a session, using PTT over IP is spectrally efficient.

Vendors that have made their mark in the VoIP PTT market include **Nokia, Motorola, Siemens, Ubiquity** and **Sonim Technologies,** among others. All of these vendors have committed to PTT standards. What differentiates **Sonim** and **Ubiquity** from the other three is that they are independent and do not have handset divisions. These startups provide their technologies to independent distribution channels like **Nortel, Alcatel** and **Ericsson**.

The startups point out that **Nextel** has been effective in a closed loop circuit, but that their solution does not scale since it is a proprietary implementation. Like SMS, true interoperability happens when you have a standardized approach. For the PTT application to become a successful mass market service, there has

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to be standardization of the solution that provides full interoperability between terminals and operators.

Sonim and **Ubiquity** solutions are standards-based, having built their applications on the IMS architecture and ensuring interoperability with compatible handsets. **Sonim** is unique in the industry, since it only focuses on the PTT application. This sharp focus gives the company a sense of expertise and as they strive toward the "best in breed" VoIP PTT solution.

PTT vendors such as **Sonim** and **Ubiquity** have three categories of partners. These include network partners like **Nortel**, handset partners like **Ericsson**, and application partners like **IP Unity**. Conferencing application vendors, for instance, are enhancing their conference calling using a PTT "buddy list". This enables users to get a list of frequently-called people with whom we can simply connect to at the push of a button. This enables users to switch over (in real-time) from a PTT conversation to a traditional cellphone call.

VoIP-enabled PTT is emerging as a voice version of SMS, and it is only in its infancy. Over coming years, we should begin to see various flavors of PTT-based applications. In India and China people speak with different dialects that are very difficult to use text message-based applications such as SMS, so PTT may naturally evolve as a killer app.

Cisco makes third ATA acquisition; Thomson acquires Cirpack

During the month of April, two major VoIP acquisitions were announced. European communication and entertainment giant **Thomson** acquired softswitch vendor **Cirpack**, while **Cisco** made a third acquisition in the analog telephone adapter area by grabbing **Sipura**. In March, **Thomson** acquired **Inventel**, which develops VoIP CPE devices similar to **Sipura**.

The **Cirpack** and **Inventel** acquisitions support **Thomson's** plans to grow its telecom business, and focus on VoIP. **Cirpack's** softswitch is key to helping the company expand its voice infrastructure strategy, whereas **Inventel** gives **Thomson** entry into the CPE sector. These acquisitions represent a huge investment for **Thomson**; the **Inventel** acquisition was rumored to be in the range of $100 million, whereas the **Cirpack** acquisition was rumored to be around $50 million.

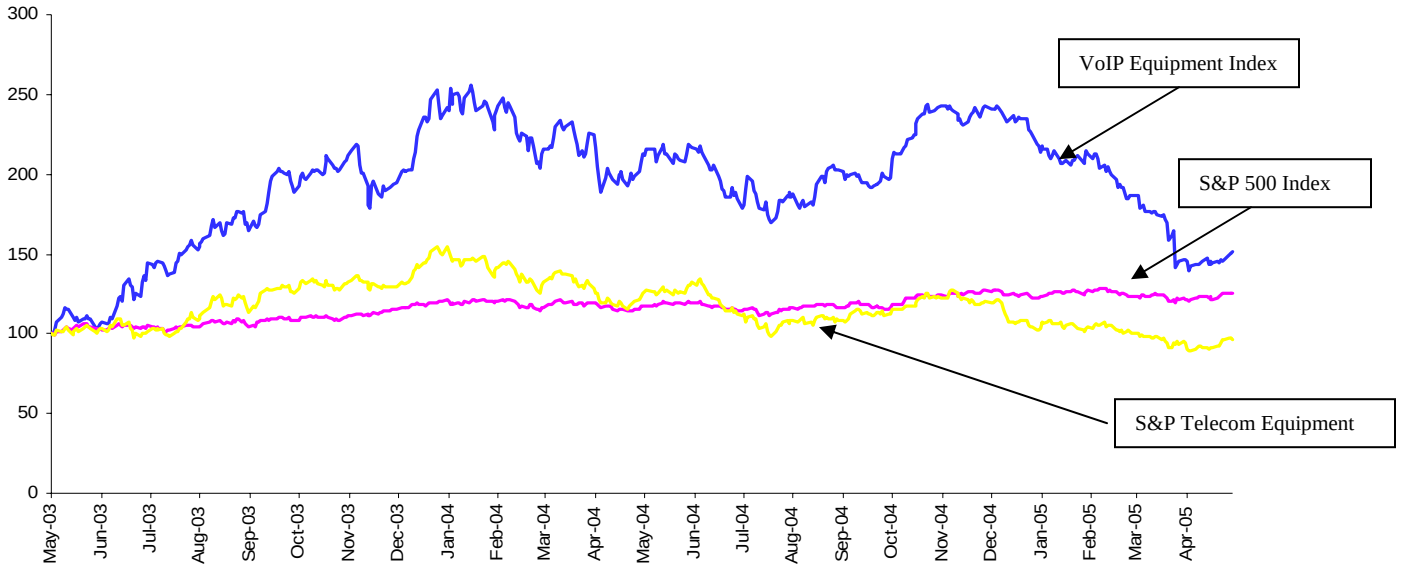
Sipura, which cost **Cisco** $68 million, represents **Cisco's** first acquisition for its **Linksys** division. Overall, **Cisco** has made three acquisitions for ATAs thus far: **Komodo**, **Linksys**, and now **Sipura**. **Sipura** previously had an OEM agreement with **Linksys**, which was using the company's technology in certain VoIP products, including ATAs and wired/wireless routers with integrated phone ports.

These acquisitions are very positive sign to ATA vendors because they validate the market. Both transactions increase the value of ATA vendors, especially for those whose product design has a flexible architecture and feature set.

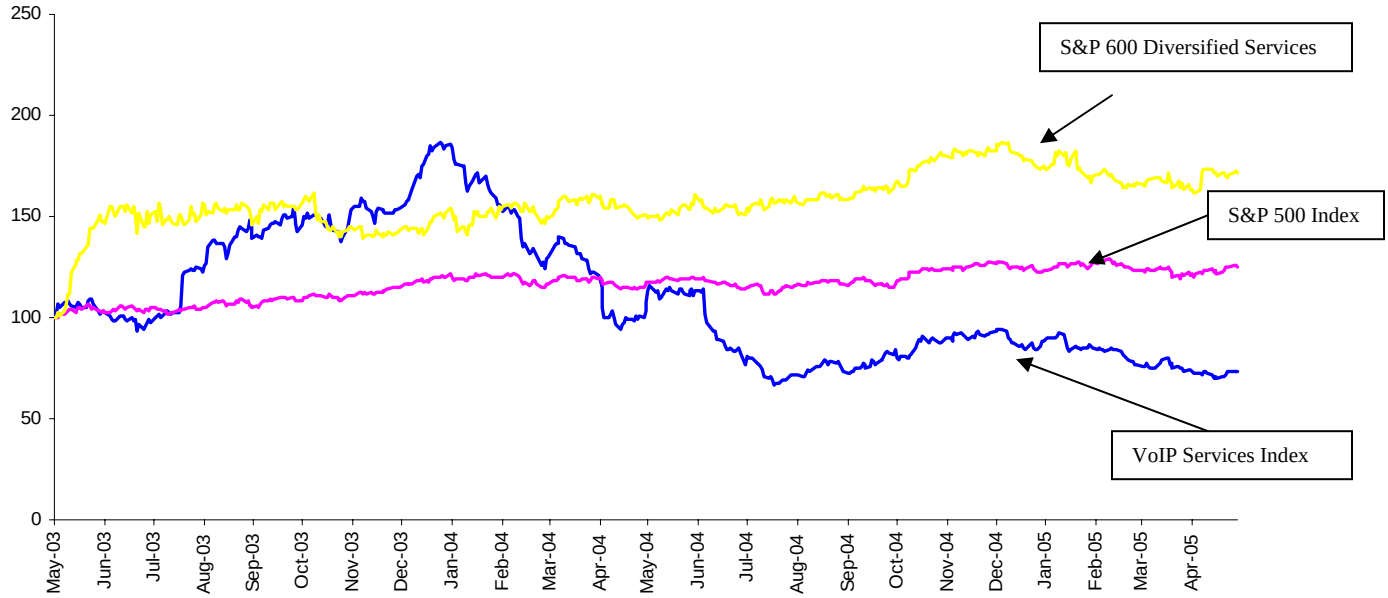
Financial developments May 2005

Company	Products/Services	Development	Details
Sipura	ATA	Acquisition	Acquired by Cisco Systems for $68 million in cash
Cirpack	VoIP Gateways, SoftSwitches	Acquisition	Acquired by Thomson for more than $50 million dollars
SIPquest	SIP software	Funding	Raised $6 Million in funding
AccessLine	Hosted and managed VoIP services	Funding	Raised $9 million in funding
AudioCodes	VoIP products	Quarter results	Revenues $26.9 million, up 76%.
Radcom	VoIP QoS management systems	Quarter results	Revenues $5,017,000, up 43%
deltathree	VoIP Products & Services	Quarter results	Revenues $6.6 Million, up 43%
VocalTec	VoIP equipment	Quarter results	Net loss $2.2 million, compared to a loss of $3.4 million in 4th quarter of 2004..
iBasis	VoIP wholesale carrier	Quarter results	Revenue $88.7 million, Net income $0.2 million.

VoIP Equipment Index



VoIP Services Index



Average Returns					
	VOIP Services Index	VOIP Equipment Index	S&P 500	S&P 600 Diversified	S&P Telecom Index
Annualized LTM	(23.39%)	(21.55%)	9.28%	15.22%	(18.49%)
30-Day Return	(4.90%)	(10.82%)	1.50%	2.36%	1.63%

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