

October 2004

Inside This Issue

1. **ATA revival brings sophistication in product features**
2. **Tekelec acquires Vocaldata**
3. **VoIP opening Pandora's box in Canada**
4. **iBasis closes \$31.5 million in private placement**

For more information contact:

Rod Hackman
Partner
rhackman@mercatorcapital.com

www.mercatorcapital.com

Virginia Office:

One Fountain Square
11911 Freedom Drive
Suite 1080
Reston, Virginia 20190



ATA revival brings sophistication in product features

Back in the late nineties when companies like **Riparius**, **Quicknet**, **Net2phone** and **Innomedia** came out with adaptors to connect ordinary analog phones to the Internet for making voice calls, the industry did not show much excitement. The ATA (analog telephone adaptor) they offered at the time, connected phones over a PSTN dial-up link into the ISP PoP. Therefore, no PC was required to make an Internet telephony call.

These adaptors are still being used in developing countries. However, in the developed countries where the broadband user base has grown dramatically, ATA devices have seen a major revival. Owing mainly to the abundance of bandwidth at the edge that was missing in the PSTN dial-up scenario, the ATA device makers have re-oriented their products to meet a growing demand for consumer voice over broadband services worldwide.

Many technical hitches have been solved including the method for handling voice in multi-protocol environment and in particular the MGCP networks of Cable operators. Security aspects, which are being solved by Session Border Controllers in carrier installations, are addressed by ATA devices by incorporating an in-built router. The in-built routers also prioritize voice to give it a better chance for maintaining quality.

The new generation ATA connects a traditional analog phone to a DSL or cable modem. Vendors that dominate the ATA market include the likes of

Cisco, **Motorola**, and **D-Link**. **Motorola** supports **Vonage** service and also supplies its ATA to some major cable companies. **D-Link** has been supporting **AT&T's** CallVantage offering. **Cisco** also provides its equipment to many service providers worldwide.

As the device becomes more and more sophisticated, many new companies have started to bring their version of ATA into the market. Some of them include **Sipura**, **Arcturus**, **Linksys**, **Grandstream Networks**, **Zoom**, **i2Telecom**, **VOIP Inc**, **eLEC**, **engin**, **Packet8**: the list goes on and on.

Minor differences exist among different ATA models. A common trend is to move from a single port device to a multi-port broadband residential gateway type product. Management of the device through a web interface is another area of development that ATA manufacturers have embarked upon.

Grandstream's product has a built-in router, NAT, DHCP server, FXS and PSTN port. The company started shipping its product in March 2004. Service providers that use **Grandstream** ATAs include the likes of **Primus**, **BroadVoice**, **Deltathree**, **SIPphone.com**, **Pulver.com** (FreeWorldDialup), **SIPGate** (Germany), **Europasstelecom** (UK), **China Railcom** (China), and **China Unicom** (China). The product has been found compatible with many service offerings including those of

October 2004

ATA Cont'd....

Vonage, **Net2Phone** and **Go2Call**. It is also interoperable with a wide range of third party VoIP products from **Cisco**, **Nortel**, **Siemens**, **Broadsoft** and **Sylantro**.

Arcturus develops SIPjack, the smallest SIP based VoIP telephony adapter. SIPjack is available for license to OEMs, ODMs and carriers. **Sipura** develops a two-port device that connects standard telephones and fax machines to IP-based data networks. The device features include extensive programmability, security and sophisticated provisioning capabilities. **Sipura** started shipping the product (list price \$120) in October 2003 to service providers as well as select networking equipment distributors.

The ATA products from **Grandstream**, **Motorola**, **D-Link** have built-in routers. This enables the service provider to offer improved voice quality by prioritizing voice traffic. Built-in routing also can help solve a problem that service providers have encountered in delivering VoIP service - the need to penetrate computer network firewalls and to deliver phone calls to private IP addresses. Some carriers provide this functionality, known as firewall traversal and NAT, by installing Session Border Controllers in their networks. But with ATAs having built in routers, service providers have the option of

addressing that issue in the ATA instead, thereby saving costs.

Certain companies operate in the market as vendors as well as service providers with the ATA device being the main product offering, on top of which they offer voice over broadband service as an ASP. These include **Zoom**, **i2Telecom**, **VOIP Inc.** and **Packet8**.

Linksys, now part of **Cisco**, recently announced a relationship with **Verizon** to promote its new product PAP2. The Phone Adapter with two Phone Ports (PAP2) converts analog telephone calls into digital packets that travel over the Internet. It also enables certain calling and call-management features for **Verizon's** VoB service. **Vonage** and **AT&T** have also announced that they will use a **Linksys** device for their consumer VoB service.

Riding high on the VoB wave, ATA device makers apparently have a huge market opportunity. VoB is being deployed all over the world. Incumbent operators are also introducing their own consumer broadband voice offerings. Recent regulatory developments in the US, South Korea, and Canada have indicated that VoB will largely remain unregulated, thereby helping the service to grow. However, for ATA manufacturers, partnerships with vendors and service providers will be crucial.

Tekelec acquires Vocaldata

Following the acquisitions of **Santera** and **Taqua** in VoIP space, **Tekelec** has embarked upon another deal. This time the money is being spent on acquiring **Vocaldata**, a leading IP Centrex feature server vendor.

Tekelec will pay \$27.5 million for the acquisition, consisting of \$14.5 million of cash and approximately 780,000 shares of **Tekelec** common stock, or \$13.0 million, based on the September 20 closing price.

Vocaldata had revenues of \$2.5 million and \$4.8

million for fiscal years 2002 and 2003 respectively. The vendor is one of the leading players in nextgen IP Centrex market along with competitors **Broadsoft** and **Sylantro**.

Vocaldata has over 50 customers worldwide which account for some 250,000 IP Centrex lines. The company has 20 additional trials in the US, a handful in Latin America, and five trials in China. **Vocaldata** has lately focused its attention toward China where some ISPs and emerging alternative providers are involved in trials of the **Vocaldata** solution. Japan's **NTT-Commware** is by far the largest customer of **Vocaldata**.

VoIP opening Pandora's box in Canada

Is VoIP altogether a new technology that calls for new regulations to govern it, or is it just an extension of a traditional calling system that can be handled under the existing regulatory laws?

This was the topic that generated intense discussion among 33 participants at a public hearing called by the Canadian Radio-Television and Telecommunications Commission (CRTC) from 22nd to 24th September to discuss the issue of regulating (or not regulating) VoIP calls in Canada.

The hearing attended by a plethora of telecom companies ranging from communications giants such as **Bell** and **Rogers**, to high profile start-ups such as **Telus** and **Vonage**, brought to fore the huge differences among various VoIP companies who have extreme opinions on the issue that is going to decide the future of VoIP technology in Canada.

Only about 15,000 Canadians use consumer VoIP service, which is cheaper and more portable than a regular phone line. Questions remain, however, about quality and access to emergency services.

The CRTC, presumably concerned about issues of security, protection against hackers, Local Number Portability as well as 911 emergency services and access for the handicapped is inclined to treat VoIP phone services like any other local phone service.

"The commission is inclined to look at these services, known as Voice over Internet Protocol or VoIP, as just a kind of updated phone service which should be subject to the existing regulatory framework," Charles Dalfen, the commission chairman opined at the opening session of the hearings.

While players like **Bell Canada**, **Telus**, and **Vonage** have asked the commission to allow the market to

largely regulate itself, telecom start-ups such as **Comwave Telecom Inc**, **Primus Telecommunications Canada**, and bodies like Canadian Cable Telecommunications Association, strongly favour the regulation of VoIP industry by the CRTC in Canada.

The Disagreement

While many companies feel that the current legislative and regulatory framework will help to regulate VoIP services in Canada and will provide a level playing field for competition, many others fear that regulatory set up of CRTC would treat the technology as if it were a fixed, facilities-based, wireline telecommunications service and hence could block competition or reduce consumer choices.

"There are clear distinctions between VoIP and traditional telecommunications, and because telecommunications regulations were not designed with Internet telephony in mind, we express a real concern that the wholesale application of common carrier regulations to VoIP would have a chilling effect on competition, innovation and investment," said Brook Schulz of **Vonage**, one of the pioneers in the consumer Voice over Broadband field.

Vonage, while urging the commission to leave the companies and the marketplace alone, also said that regulation of Internet communications applications such as VoIP is appropriate only when it is crafted to achieve a significant public policy goal that would not otherwise be addressed by market forces.

Vonage and **Primus Canada** are among eight or so companies today already offering broadband telephone service to Canadian consumers who, using their regular phone, can place calls through their high-speed Internet connections.

Vonage's view is seconded by phone giants **Bell** and **Telus**. Even though VoIP is a direct threat to their existing local services, they are being compelled to enter broadband voice market and would rather be allowed to offer the service as a distinct category in order to escape

October 2004

Canada Cont'd...

legacy telephone regulation. Neither of these companies wants to sell a VoIP service for less than \$20 per month, for the fear of eating into existing revenues.

Bell and **Telus** argue that putting shackles on telcos, while forcing them to allow competing services on their own high-speed lines, does not give them a way to protect their investment or motivate them to keep investing in infrastructure and innovation.

"Our fundamental belief is that the economic regulatory framework for VoIP must be built on principles that allow open, dynamic competition to continue to flourish," said Lawson Hunter, executive vice-president of **BCE**, the parent company of **Bell**. He added that VoIP without regulation would encourage experimentation and innovation that will produce the best and cheapest services.

"This is not telecom as usual. Sure we are big, but forcing the telcos to file for price changes and preventing them from bundling is not necessary in the case of VoIP," added Hunter.

But the consumer groups, many VoIP start-ups and Associations like Canadian Cable Telecommunications Association, see the problem elsewhere. For now they support VoIP regulation because they fear that Canada's two largest telephone companies would use their market dominance to wipe out potential competitors in the fledgling Internet telephony market if the telecommunications regulator does not maintain firm control.

"CRTC must not buy the telcos' argument that VoIP is just another Internet application and therefore doesn't need to be regulated," said a spokesperson from Canadian Cable Telecommunications Association, which represents industry heavyweights, adding that the cable industry wants the CRTC to regulate prices and conditions in the

short term, at least until the cable players and telecom start-ups have a chance to establish a foothold in the VoIP market.

"Competition needs to take hold first and once it has, then we can begin to deregulate," said Michael Hennessy, president of the cable association.

The Public Interest Advocacy Centre, speaking on behalf of a number of consumer groups, argued for tight control. Internet voice is "simply an incremental technological change," the centre said adding the commission does not normally abandon regulatory requirements due to simple, technological improvements in the name of fostering innovation.

Missing Mandatory Services

One of the issues that concern CRTC is whether VoIP companies provide the necessary 911 services to their subscribers. The availability of other mandatory services like legal Intercept and Local Number portability services is also an issue. The 911 angles are tricky, for instance, because a subscriber may tap into the Internet from anywhere. If they call for help, how do you locate them? While most companies said they are working on these problems, a full-fledged custom based solution has not been provided by any of the companies necessitating the CRTC intervention. **Vonage** has the necessary 911 services in place in virtually all of Canada. It uses a solution that correlates the nearest Public Safety Answering Point location to the IP address where the user logs in. Nevertheless, even **Vonage** is unable to provide the service to all its customers in Canada.

Final Decision

After the hearings, participants will have until October 13th to file comments with the commission. A decision is not expected before early next year. CRTC's final decision will be controversial no matter what position it takes. Listening to the hearing last week, most wanted to have the rules extended, twisted or eliminated to serve their own profit motive.

iBasis closes \$31.5 million in private placement

iBasis has announced the closing of a \$31.5 million private placement in return for 15 million shares of common stock. The carrier intends to use the proceeds for working capital requirements.

The purchasers included several existing shareholders of the company and certain new investors who previously purchased an amount of \$29 million of the company's 8% Secured

Convertible Notes due 2007.

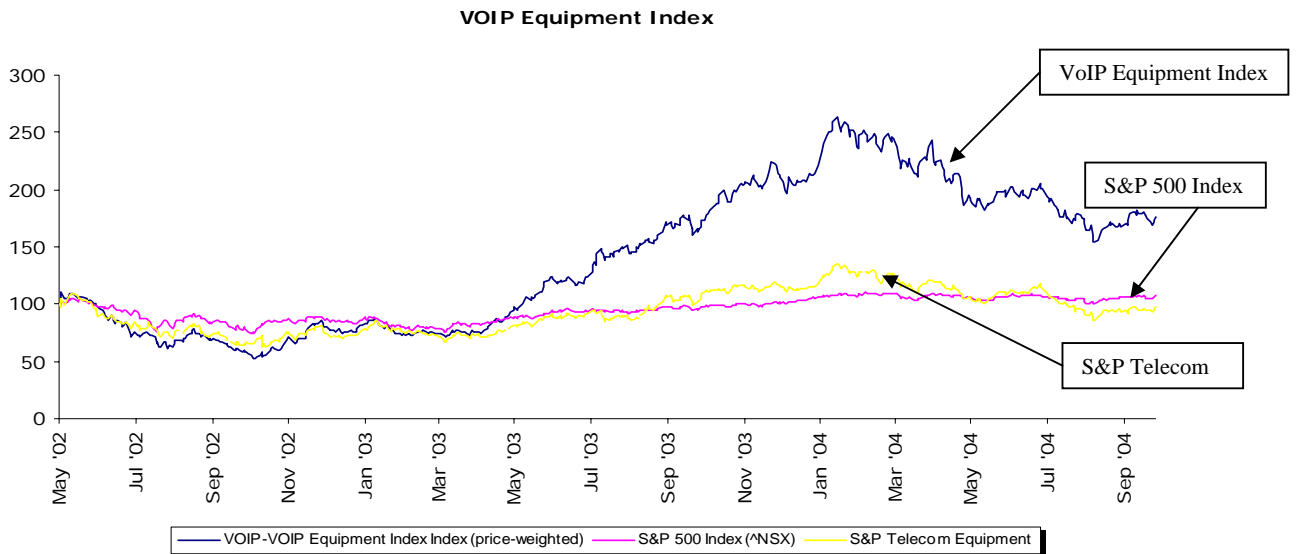
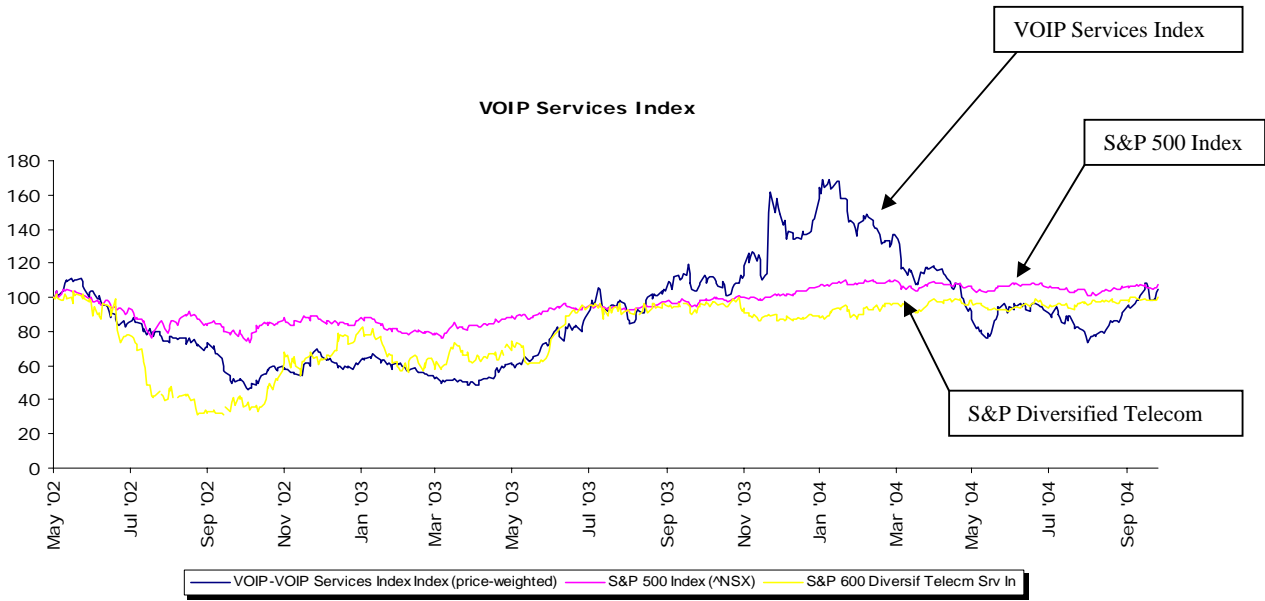
iBasis handles an estimated 400 million minutes of international long distance VoIP traffic per month. **Teleglobe** acquired its rival **ITXC**, which handles a slightly higher volume.

iBasis has recently launched a retail prepaid calling card service. The carrier has tried several value added applications throughout the last six years of operation. It is one of a very few carriers offering SIP termination.

Financial developments September 2004

Company	Products/Services	Development	Details
Vocaldata	IP Centrex	Acquisition	Acquired by Tekelec for \$27.5 million
Dynamicsoft	SIP Application Server	Acquisition	Acquired by Cisco for \$55 million
Artisoft	IP PBX	Funding, Acquisition	Raised \$27.5 million to fund the acquisition of Vertical Networks
AccessLine	VoIP service	Funding	Raised \$6 million in funding
iBasis	VoIP Wholesale	Private Placement	Raised \$31.5 million in private placement
Viola Networks	VoIP Test and Monitoring	Funding	Raised \$11.1 million in funding
8x8	VoIP hardware and VoB service	Sale of stock	Raised \$12 million in proceeds

October 2004



Mercator Capital is a privately held investment bank committed to helping our clients achieve superior results. Our success stems from our focus on providing clients with quality advice and developing creative solutions. With decades of Wall Street leadership and extensive industry knowledge, we pride ourselves on a culture of excellence that promotes intellectual insight and rigorous analysis. We focus on building long-term relationships with our clients rather than pursuing individual transactions. For our clients, our approach means a much greater understanding of their business and markets, a more thoughtful and committed effort and an unmatched degree of senior-level service.

Our clients rely on our deep understanding of technological vision and financial expertise to assure the successful execution of their strategic initiatives.

Virginia Office:

One Fountain Square
11911 Freedom Drive Suite 1080
Reston, Virginia 20190

Rod Hackman	rhackman@mercatorcapital.com
David Ballarini	dballarini@mercatorcapital.com
Lior Samuelson	lsamuelson@mercatorcapital.com

Israel Office:

Zvi Tower Building D, 10th Floor
24 Raoul Wallenberg Street
Tel Aviv 69719, Israel

(703) 995-5524
(703) 995-5521
(703) 995-5525

Mercator Capital, Inc. Disclaimer:

The information and opinions in this report were prepared by Mercator Capital, LLC. ("Mercator Capital"). The information herein is believed by Mercator Capital to be reliable and has been obtained from and based upon public sources believed to be reliable, but Mercator Capital makes no representation as to the accuracy or completeness of such information. Mercator Capital may provide, may have provided or may seek to provide M&A and other advisory services to one or more companies mentioned herein. In addition, employees of Mercator Capital may have purchased or may purchase securities in one or more companies mentioned in this report. Opinions, estimates and analyses in this report constitute the current judgment of the author as of the date of this report. They do not necessarily reflect the opinions of Mercator Capital and are subject to change without notice. Mercator Capital has no obligation to update, modify or amend this report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, estimate, forecast or analysis set forth herein, changes or subsequently becomes inaccurate. This report is provided for informational purposes only. It is not to be construed as an offer to buy or sell or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy in any jurisdiction.