



## **ESPRE Solutions (OTC Pink Sheets: EPRT.PK)**

Rating: Speculative Buy maintained

Price Target: \$1.5

Share Statistics	10/29/05	Financial Summary					
Symbol	EPRT	000' \$	FY04	FY05E	FY06E	FY07E	FY08E
Current Price	\$0.37	Revenue	126	150	8,500	25,000	30,000
52 Weeks range	\$0.16 - \$4.75	Net Income app. to common shareholders	(13,923)	(34,402)	4,020	20,160	24,850
Avg. daily volume	68,790	EPS	(\$0.34)	(\$0.26)	\$0.03	\$0.11	\$0.14
Market Cap., Smln	\$48.3	P/S	n/m	n/m	5.7	1.9	1.6
Basic sh. outstg, mln	130.5	P/E	n/m	n/m	14.31	3.30	2.68

### **SUMMARY OF ANALYST RATIONALE**

*Since our initiating report, dated March'05, ESPRE Solutions (EPRT or "the company") made outstanding progress on its business model acceding to a new stage in its development cycle. The company has undergone a transition from focus on product development to marketing and selling-oriented activities. Having invested heavily in product development over the last two years, now comes the time for EPRT to reap the rewards. According to management, during the fourth quarter of 2005, the company will report the first revenue from the sales of its solutions, expecting that in 2006 and 2007 it will generate total sales of about \$35 - \$40 million. Taking into account that the value of the company lies in its software-based compression technology, which compresses 30% to 50% more than the traditional benchmarking MPEG4 technology, and a huge market potential, EPRT's perspectives are indeed favorable. We reaffirm our rating determined in the initiating report and consider the new business model workable and able to generate strong revenue growth in the short-to-middle term. We assign a price target of \$1.5 per share based on DCF analysis and a discount of 40%.*

### **Investment merits**

- **Unique technology ...**

EPRT is currently undergoing a challenging period accompanied by a range of activities in order to continue product development and to enter the marketing and selling phase successfully. The company continues to focus on further development of solutions as its competitive advantage lies in its high performance and promising video compression technology. Investing in this technology, EPRT moved ahead from its competitors by integrating the applications which are optimized by the company's Lightning Strike video compression technology.

It is worth reminding the basic features of EPRT's technology, which indeed should become a benchmark technology for the video compression industry players:

- Faster real-time encoding than that provided by any similar CODEC;
- The users of this technology can deliver higher-quality video without increasing bandwidth costs;
- Higher quality video at lower bit rates;
- Compresses 30% to 50% more than competing products (for instance the MPEG 4), resulting in smaller video file sizes;

- More detailed image quality.

Over the last two years, since the inception of the company and until August'05, EPRT was engaged almost exclusively in the research and development of its product range: eViewChat, eViewMail, eViewLink, eViewPlayer and eViewZoom. Currently, a new eViewStudio solution is in the works. Another focus over the last few years was the development of partnerships with other companies to develop the technology. Among them are Oracle, LINQware and Persony.

Accordingly, until the mentioned date EPRT had a very limited sales and marketing program and did not generate material revenue. However, starting with August'05, EPRT changed its business focus and commenced marketing its services to corporations, advertising agencies, ISPs, ASPs and value added resellers. Currently, 7 out of 23 of the company's staff are involved in sales and marketing activities, underlining the significance of the new business stage.

eViewChat and eViewLink will have their first general availability release in the first quarter of fiscal 2006, with continuing updates throughout the year to provide additional functionality. In the nearest future EPRT expects to undertake the following actions:

- During the fall 2005, EPRT expects to be ready for volume deployment of eViewLink. This became possible after the company contracted a third party to fabricate tooling necessary to allow eViewLink to be built for volume shipment.
- Also, soon EPRT plans to offer the new software-based video conferencing virtual private network (VPN) service, following the released version of eViewChat in July'05.
- eViewMail is currently in production and will have a series of releases to extend its functionality.

- **... on a huge market**

The company's market is considered to be vast, particularly targeting vertical market opportunities via joint venture partners and integration opportunities, including entertainment, collaboration/online communities, wireless and hardwire carriers and video distribution services.

According to management<sup>1</sup>, the market for eView solutions is worth over \$1 billion. Frost & Sullivan estimates just the desktop video conferencing market for 2005 to be over \$1.7 billion and online collaboration solution targeting collaboration solution providers was forecast for 2005 to be around \$600 million.

- **... anticipated by management to generate considerable revenue in the coming period**

Management expects that starting with the fourth quarter of calendar year 2005, EPRT will start generating revenue following the agreements the company has with several customers. However the bulk of the revenue growth is anticipated to be during 2006 with a steep growth in 2007. According to management, in 2006 EPRT should generate revenue of about \$10 million. For 2007, the expectations are in a range of \$25 – \$30 million. Besides that, management anticipates that its joint venture StreamTraX Media Group will also start providing revenue in the coming quarters.

## **Other investment merits**

- **A promising joint venture aimed at developing marketing and media distribution solutions for the entertainment motion picture industries**

In May 2005, Espre entered into a joint venture agreement with StreamTraX Visual Communications Technologies, Inc. Pursuant to the agreement, the parties created a joint venture partnership called StreamTraX Media Group, LLC. The new entity will create and develop enhanced, secure internet video communications and content delivering products and services. The venture will develop marketing and media distribution solutions for the entertainment motion picture industries. EPRT's proprietary video CODEC compression technology and StreamTraX's proprietary Digital Rights Management (DRM) Solutions will be used. We expect this venture to diversify the application area of EPRT's technology and, together with

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<sup>1</sup> Conference call of ESPRE Solutions' President, <http://www.tradersnation.com/eprt.shtml>

StreamTraX' DRM Solutions, to make it a powerful tool on the entertainment market. In addition, StreamTraX will provide financing for EPRT of \$15 million in exchange for 30% of EPRT's common stock.

- **A new business unit to deliver turnkey video solutions set up by EPRT should accelerate the connection with the media and entertainment market**

Recently, EPRT established a new company ESPRE Media Group, aimed at focusing on the fast-growing segment of custom video streaming services. The new services will include totally customized video email marketing campaigns and video banner ads with unique tracking and delivery requirements. Andrew Wilson, previously ESPRE Solutions' VP of Product Management was appointed to lead the ESPRE Media Group.

## Valuation

We used DCF method to perform the valuation of the company's stock, taking into account that EPRT entered a new phase in its business cycle with anticipated significant revenues and respectively cash generated internally from its operations. We derive our revenue estimations based on the management outlook, according to which EPRT will start generating revenue during Q4 of calendar 2005. For CY06 the revenues are estimated to be around \$10 million. Provided that EPRT's financial year starts on October 1<sup>st</sup> and the bulk of the revenue will be generated during the calendar 2006, we assume FY06 revenue to be around \$8.5 million. Based on the same reason, we assume FY07 revenues to be \$25 million, although management anticipates revenue ranging \$25 - \$30 million and additional revenue from its joint venture StreamTraX Media Group. With these assumptions we come up with a target price of \$2.1 per share. Applying a discount of 40% for risks related to investment in EPRT shares (mentioned in this report), we assign a price target of \$1.5 per share.

\$000 except per share data

### MAJOR ASSUMPTIONS

WACC Calculation

Stock Price	\$0.37
Shares Outstanding, thousands	130,471
Mkt Cap, thousands	48,274
Book Value of Long Term Debt	0
Risk Premium	5.0%
Risk Free Rate	6.0%
Cost of Equity	11.0%
Long-term Equity Weight	100%
Weighted Cost of Equity	11%
Cost of Debt	0.0%
Long-term Tax rate	35%
Tax Effect Cost of Debt	0.0%
Long-term Debt Weight	0%
Weighted cost of Debt	0.0%
WACC	11.0%
Terminal growth	5%

Source: Analyst assumptions.

<b>000s \$</b>	<b>FY05E</b>	<b>FY06E</b>	<b>FY07E</b>	<b>FY08E</b>	<b>FY09E</b>	<b>FY10E</b>	<b>FY11E</b>	<b>FY12E</b>	<b>Terminal Value</b>
EBIT	(31,620)	4,185	20,330	25,025	29,720	34,772	39,988	45,187	
EBIT (1-T)	0	2,720	13,215	16,266	19,318	22,602	25,992	29,371	
Dep & Amort	60	65	70	75	80	85	90	95	
(-) Cap Ex	(37)	(38)	(46)	(59)	(77)	(100)	(120)	(132)	
(-) Changes in Non Cash Working Capital	(634)	(650)	(845)	(972)	(1,069)	(1,176)	(1,293)	(1,423)	
<b>Free Cash Flow</b>	<b>(610)</b>	<b>2,097</b>	<b>12,394</b>	<b>15,310</b>	<b>18,252</b>	<b>21,411</b>	<b>24,669</b>	<b>27,911</b>	<b>488,449</b>

Source: Analyst assumptions.

### Discounted Cash Flow

DCF stream	66,572
DC terminal value	211,951
Total DC Enterprise Value	278,523
(Less) Net Debt	0
Equity Value	278,523
Equity Value Per Share	\$2.1

Source: Analyst assumptions.

### Financial analysis

EPRT's financial statements presented features of a development stage company, therefore after a new stage starts, they will respectively take a different shape. For this reason, insignificant revenue reported by the company during 9moFY05 are not considered material by management, as EPRT did not engage in any sales and marketing programs intended to produce material revenues on a short-term basis. Therefore, a thorough analysis of revenue will be accomplished when EPRT effectively starts to sell its products on the market. Also it is worth mentioning that the financial analysis provided below considers only the financial statistics of ESPRE Solutions, without the acquired Wireless Peripherals, completed in 2004. However the financials of Wireless Peripherals were rather marginal, not having an overall impact and therefore neglected.

- **Change in priorities in the cost structure indicates the entry into a new market pre-launch phase**

Over the last nine months of FY05 there was shift from R&D expenses to sales and marketing expenses and to general and administrative expenses. During this period, R&D expenses declined as much as 2 times as compared to 9moFY04 period. In contrast, other expenses increased. Selling, general and other expenses were up as much as 14 times versus the similar period of FY04. However, the bulk of the operating expenses were impacted by a charge for stock-based compensation of \$27,810 thousand.

We anticipate that with the marketing and selling phase SG&A expenses will continue to experience an increasing trend.

### Income statement

000'\$, except per share data	9moFY04	9moFY05	YoY%
Period ends June 30			
<b>Revenues</b>	115.6	85.7	-26%
R&D	2,340.7	1,280.4	-45%
Selling, general and administrative	156.1	2,226.0	1326%
Stock based compensation	0	27,810.0	n/m
Total operating expenses	2,497.1	31,368.7	1156%
Loss from operations	(2,381.6)	(31,283.0)	n/m
<b>Net loss</b>	(2,382.4)	(31,558.0)	n/m
Net loss applicable to common shareholders	(2,382.4)	(34,057.0)	n/m
EPS, basic and diluted	\$0.08	\$0.31	n/m

Source: SEC Filings, Analyst's estimates

- **Private sale of common stock is the main source of funding the working capital deficit**

Similar to the previous financial year, EPRT experienced a deficit of liquidity during the 9moFY05 period. Total working capital deficit rose to more than \$2 million as of June 30'05, company reporting a critical current ratio of 0.3. Although the current ratio improved slightly due to increased cash and cash equivalents, compared to similar period of FY05, the ratio was rather dismal. As of June 30'05, cash and cash equivalents made up 69% of total assets versus 8% a year ago.

## Balance sheet

000'S	30-Jun-04	30-Jun-05
Cash and cash equivalents	20.7	737.1
Total current assets	40.2	807.0
Total assets	252.3	1,068.1
Total stockholders' deficit	(1,939.2)	(1,766.5)
Working capital	(2,151.3)	(2,027.6)
Current ratio	0.02	0.28

Source: SEC Filings, Analyst's estimates

- **EPRT expects to secure its operations financially for the next few quarters, provided that its partner, StreamTraX, fulfills its promised contractual obligations**

Management anticipates that it will continue to finance its operations with proceeds from the private sale of its equity securities during the rest of FY05 and partially during calendar year 2006. EPRT also expects proceeds generated internally from provided services and sales of the company's products.

However, currently management relies primarily on financing pursuant to Share Acquisition Agreement signed with StreamTraX. According to the contract, EPRT anticipates to receive \$15 million from the sale of a 30% equity interest in the company over a 13 month period, with a \$2 million deposit. As of October 18'05, the company had not yet received the deposit from StreamTraX. So far, StreamTraX has advanced the company \$0.57 million.

In addition to the above mentioned sources of financing, EPRT has an agreement with GPM Asset Management, pursuant to which it receives financing of \$200 thousand per month through May'06.

## Cash flow statement

000'S	Period ends June 30	9moFY04	9moFY05
Operating cash flow		(445.1)	(1,956.9)
Investing cash flow		(12.5)	(33.2)
Financing cash flow		478.3	2,646.8
Net increase in cash, end of period		20.7	656.6

Source: SEC Filings

## Recent events

- *On October 19'05, EPRT announced that it filed a registration statement on Form 10 with the U.S. Securities and Exchange Commission. When effective, the registration statement will register the company's common stock as a class under Section 12(g) of the Securities and Exchange Act of 1934 and EPRT will become a reporting company. Following this action, the company will be able to apply for quotation of its securities on the NASD OTC Bulletin Board and other quotation systems.*

- *On October 11'05, EPRT announced that Technology Marketing Corporation's TMC Labs division named EPRT's eViewLink wireless video collaboration solution the 2005 Innovation Award winner from Customer Interaction Solutions magazine. We consider that the award clearly proves the unique features provided by EPRT's solutions.*

- *On September 27'05, EPRT announced that it would be working in alliance with Digital Recorders to demonstrate new application of EPRT's technology. Digital Recorders' new transit security-related technology and concept, Digital Recorders VacTell Video Actionable Intelligence and Digital Recorders*

Remote ShutDown was supposed to be demonstrated during the American Public Transportation Association's triennial International Public Transportation Expo, APTA Expo 2005.

- On September 1'05, EPRT and ZCorum, an ISP services company based in Georgia, signed an agreement to distribute EPRT's solutions to regional ISP market. Pursuant to the agreement, EPRT will design and host ZCorum-branded video messaging and video conferencing solutions for hundreds of independent operating companies ZCorum serves.

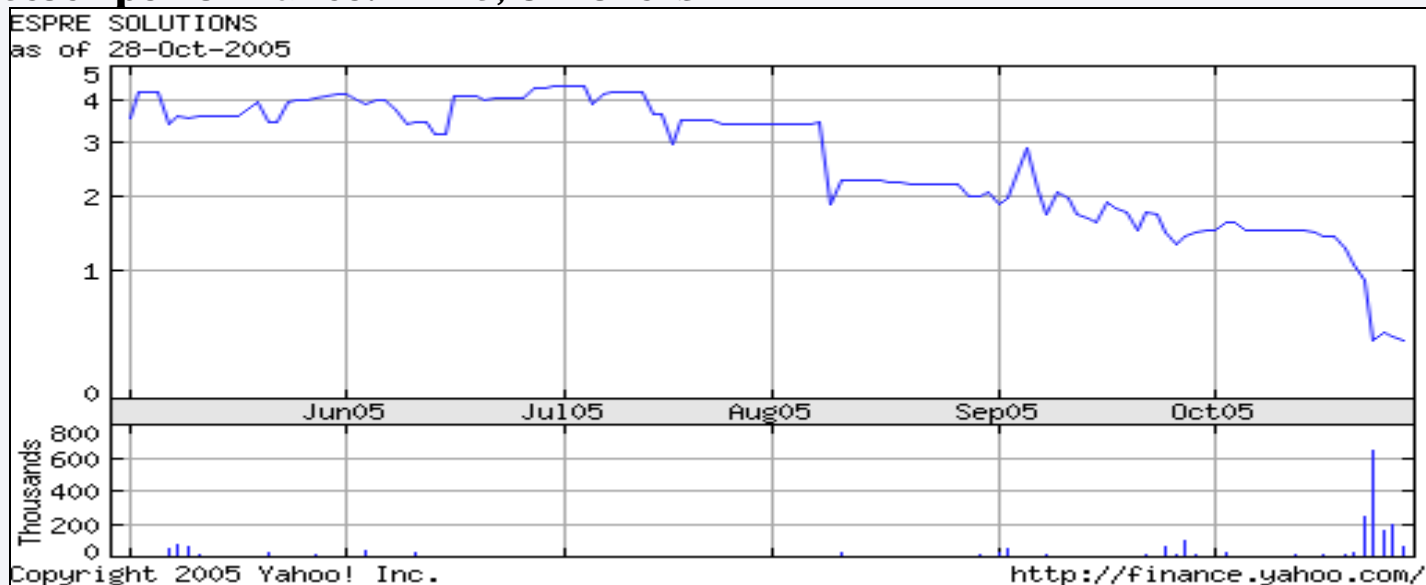
## Risk

Perhaps, the highest risk associated with EPRT's stock is the ability of the company to continue as a going concern. If the cash flow generated by the company is not enough to fund ongoing operations and other liabilities as they come due, and if management fails to raise additional capital and financing, then there is a high risk that EPRT will not be able to continue as a going concern. So far, the management succeeded to finance operations issuing new shares. If it closes soon the announced promising deal with StreamTraX, then EPRT will secure its operations until the beginning of FY07, as \$15 million should be enough to cover its operating needs.

As a development stage company, EPRT is also subject to a set of other risks, among which are:

- short operating history, marked by net losses;
- share dilution, due to constant growth of number of shares to finance operations.
- penny stock and limited trading market Pink Sheets;
- concentration of 49% of outstanding common stock to officers, directors and principal stockholders.

## Stock performance: EPRS, 6 months



Source: <http://finance.yahoo.com/q/bc?s=EPRT.PK&t=6m>

**Alexandru Voizian** is a Senior Analyst with Spelman Research. He joined the company in 2003 and has been covering the Technology, Healthcare and Services sectors. Prior to joining the Company, Mr. Voizian held economist positions at two commercial banks. Mr. Voizian earned his bachelor's degree in finance from the Academy of Economic Studies of Moldova in 2000. Mr. Voizian passed Level 1 exam of the CFA program and is currently registered for the Level 2 (June 2006).

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