

TeleCommunication Systems

(TSYS:NASDAQ)

Outperform 2

TeleCommunication Systems (TCS) provides wireless data and location solutions to communications carriers and government agencies.

TSYS: 1Q08 Results

- ◆ TeleCommunication Systems reported 1Q08 results last night with non-GAAP EPS of \$0.19 (excluding a one-time \$0.02 write-off) above consensus of \$0.15 and our \$0.17 estimate. Revenue was \$40.4 million (+18% y/y) vs. consensus of \$43.1 million and our \$43.5 million estimate due to customer driven delays in the government systems business. Backlog was up over 100% y/y (down 3% sequentially) to \$225 million.
- ◆ As expected, TCS recognized around \$10-11 million in messaging revenue during the quarter from a \$12 million order that the company announced earlier this year. Management also mentioned that it has subsequently received incremental capacity orders and no longer expects a significant dip from this segment in 2Q08. The company guided that it now expects at least another \$7.5 million in messaging revenue over the next couple of quarters rather than in 2H08 as previously expected.
- ◆ Management raised 2008 EBITDA guidance to \$20-23 million from \$17-20 million previously and our previous \$18 million estimate. TCS attributed its higher EBITDA guidance to higher revenue expectations for its high-margin messaging systems business. 2008 revenue guidance remains at \$165-175 million (+16-22% y/y). We are increasing our 2008 EBITDA estimate to \$20.3 million from \$18 million and non-GAAP EPS to \$0.43 from \$0.39. We are raising our 2009 EBITDA estimate to \$22.9 million from \$20.8 million and non-GAAP EPS to \$0.49 from \$0.44.
- ◆ We are maintaining our **Outperform** rating and \$5.00 target price based on an EV/EBITDA ratio of about 9.5x, which is in-line with comps. We believe management has been conservative in its inclusion of large government systems deals and government systems margin expansion in guidance, which could allow for 2H08 revenue and EBITDA upside. Risks to the outlook include timing of large orders, margin pressure on government systems deals, and location systems orders. TCS ended 1Q08 with around \$19.1 million in cash and \$12.8 million in debt.

Non-GAAP							GAAP EPS
EPS	Q1	Q2	Q3	Q4	Full	Full	
FY= Dec	Mar	Jun	Sep	Dec	Year	Year	
2007A	\$0.10	\$0.00	\$0.10	\$0.13	\$0.33	\$(0.03)	
Old 2008E	0.17	0.01	0.10	0.11	0.39	0.11	
New 2008E	0.17A	0.09	0.07	0.10	0.43	0.16	
Old 2009E	UR	UR	UR	UR	0.44	0.16	
New 2009E	UR	UR	UR	UR	0.49	0.20	

Rows may not add due to rounding. UR: Under Review. Non-GAAP EPS is pro forma.

Please read disclosure/risk information on page 4 and Analyst Certification on page 6.

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EQUITY RESEARCH

May 2, 2008

Communications Software
Company Comment

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Current Price
(5/1/2008) \$3.62
Projected 12-Month Target Price:
\$5.00

52-Week Range \$5.77-\$2.71
Dividend/Yield \$0.00/0.0%
Book Value (03/08) \$1.14
Suitability Aggressive Growth

Shares Out. (mil.) 43.8
Market Cap. (mil.) \$159
Avg. Daily Vol. (10 day) 102,020

Proj. 3-Yr EPS Growth Rate 15%
ROE NM
LT Debt (mil.)/% Cap. \$13/10%

P/E Ratios (Non-GAAP)
2008E 8.4x
2009E 7.4x

Revenues (mil.)

	Old	New
2007A	\$144	\$144
2008E	\$170	\$170
2009E	\$191	\$191

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Additional Highlights from the Quarter

- Commercial revenue was \$26.2 million (up 28% y/y), comprised of services at \$15.5 million (+14% y/y) and systems of \$10.7 million (+57% y/y). Government revenue was \$14.2 million (up 4% y/y) composed of services of \$7.3 million (+1% y/y) and systems of \$6.9 million (+8% y/y). Total systems revenue was \$17.6 million (+33% y/y) and total services revenue was \$22.8 million in 1Q08 (+9% y/y).
- Commercial revenue included \$10-11 million in messaging revenue during the quarter from a \$12 million order that the company announced earlier this year. TCS is benefiting directly from the growth in wireless messaging and data services and mentioned that it handles ~25% of the text messages text messages sent across the U.S. and expects to capture around half of the U.S. CDMA messaging market by the end of the year. In mid-2007, the company signed a six-quarter capacity deal with a tier 1 carrier (Verizon Wireless [VZ/\$39.32/Market Perform], we believe). The company mentioned that it expects at least another \$7.5 million in revenue from this arrangement over the next couple of quarters. Subsequent large messaging orders during 2008 could lead to further upside.
- Gross margins for the company improved to 48.4% vs. 40.4% last quarter due to the high proportion of revenue from the company's commercial systems messaging business which carries gross margins that are almost double the corporate average and thus represents a significant driver for profitability. Higher gross profit led to sequentially higher operating margins as well which were up nicely to 13.7% vs. 7.3% last quarter. For the remainder of 2008, the company expects operating expenses to trend downwards.
- Management mentioned that it continues to win orders in its government systems segment and has strong visibility into this business. TCS recently announced that it has secured around \$15.8 million in government contracts to provide its communications solutions for various government agencies. The company remains a prime contractor on a multi-billion dollar procurement vehicle which continues to contribute significantly to this business. TCS is also the prime vendor for Satcom-II with a \$90 million ordering ceiling to support communications transport and equipment for federal agencies.
- Management remained bullish on its location-based services business which is expected to contribute significantly to the company's growth in 2009 and beyond. The company mentioned that it continues to expect to sign at least eight to 10 location-based services deal during 2008. The launch of 3G devices in the market is likely to further drive this business going forward.
- TCS ended 1Q08 with \$124.8 million in funded contract backlog and around \$225 million in total backlog. The company expects to recognize around \$85 million of the funded backlog in 2008.
- Management mentioned that the company currently owns around 59 patents and has over 159 that are pending approval. TCS recently entered into a patent lawsuit standstill agreement with Research in Motion (RIMM/\$128.00) whereby the two parties have suspended legal proceedings until at least June 12, 2008 to negotiate an amicable resolution.

TeleCommunications Systems

Income Statement

(Dollars in 000s, except per shr. data)
December Fiscal Year end

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	FY06	1Q07	2Q07	3Q07	4Q07	FY07	1Q08	2Q08E	3Q08E	4Q08E	FY08E	FY09E
Services	88,379	20,885	22,618	22,049	22,510	88,062	22,766	23,000	24,500	25,000	95,266	101,000
Systems	36,556	13,234	12,718	15,586	14,568	56,106	17,647	18,000	18,000	21,000	74,647	90,000
Total Revenue	124,935	34,119	35,336	37,635	37,078	144,168	40,413	41,000	42,500	46,000	169,913	191,000
Rev Discontinued Ops												
Gross profit												
Services	36,164	7,937	8,968	9,160	9,836	35,901	9,108	9,170	9,640	9,900	37,818	42,080
Systems	18,712	6,358	1,713	4,978	5,151	18,200	10,456	6,120	5,340	6,720	28,636	31,760
Total gross profit	54,876	14,295	10,681	14,138	14,987	54,101	19,564	15,290	14,980	16,620	66,454	73,840
Other operating expenses												
Research and development	12,491	3,105	3,266	3,329	3,372	13,072	4,088	4,100	4,165	4,232	16,585	17,954
Sales and marketing expen	11,645	3,163	3,157	2,729	2,868	11,917	3,099	3,157	3,230	3,450	12,936	16,235
General and administrative ex	16,676	4,652	5,499	4,656	4,526	19,333	5,318	5,453	5,568	5,934	22,273	23,684
Total operating expenses	40,812	10,920	11,922	10,714	10,766	44,322	12,505	12,710	12,963	13,616	51,794	57,873
EBITDA	17,644	4,707	264	4,820	5,842	15,633	8,443	3,974	3,428	4,432	20,277	22,885
Noncash operating expenses												
D&A	7,956	1,668	1,556	1,497	1,479	6,200	1,490	1,505	1,520	1,535	6,050	6,109
Amtz of cap software	1,272	344	372	396	409	1,521	409	419	435	453	1,716	2,118
Amtz of other intangibles	148	37	37	37	37	148	37	37	37	37	148	148
Impairment/ writedowns	0					0					0	0
Non-cash financing cost												
Non-cash debt conversion expense												
Amtz noncash stk comp. ex	3,117	988	1,133	1,000	1,212	4,333	975	975	975	975	3,900	4,800
Total non-cash	12,494	3,037	3,098	2,930	3,137	12,202	2,911	2,936	2,967	3,000	11,814	13,175
Operating profit (EBIT)	5,150	1,670	(2,834)	1,890	2,705	3,431	5,532	1,038	461	1,432	8,463	9,710
Interest, net	(1,874)	(492)	(444)	(151)	(165)	(1,252)	(742)	(165)	(165)	(165)	(1,237)	(660)
Noncash amtz equity PIPE fin.	(1,447)	(411)	(257)			(668)	(124)					
Write-off debt			(2,458)	(23)	(42)							
Debt conversion expense												
Income tax benefit & other							(48)					
Net income (loss)	1,973	767	(5,993)	1,716	2,498	(1,012)	4,618	873	296	1,267	7,054	9,050
Cash EPS Continuing Ops	0.40	0.10	(0.00)	0.10	0.13	0.33	0.17	0.09	0.07	0.10	0.43	0.49
GAAP EPS Continuing Ops	0.05	0.02	(0.15)	0.04	0.06	(0.03)	0.11	0.02	0.01	0.03	0.16	0.20
Diluted shares out	39,469	42,471	41,166	44,792	44,305	43,184	43,778	43,978	44,178	44,378	44,078	44,878
Margins												
Gross Margin	43.9%	41.9%	30.2%	37.6%	40.4%	37.5%	48.4%	37.3%	35.2%	36.1%	39.1%	38.7%
R&D	10.0%	9.1%	9.2%	8.8%	9.1%	9.1%	10.1%	10.0%	9.8%	9.2%	9.8%	9.4%
S&M	9.3%	9.3%	8.9%	7.3%	7.7%	8.3%	7.7%	7.7%	7.6%	7.5%	7.6%	8.5%
G&A	13.3%	13.6%	15.6%	12.4%	12.2%	13.4%	13.2%	13.3%	13.1%	12.9%	13.1%	12.4%
Operating Margin	4.1%	4.9%	-8.0%	5.0%	7.3%	2.4%	13.7%	2.5%	1.1%	3.1%	5.0%	5.1%
Tax Rate	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Important Investor Disclosures

The common stock of TeleCommunication Systems currently has an **Outperform** rating within our four-tiered rating system. Definitions of our ratings follow:

- Strong Buy (SB1)** Expected to appreciate and produce a total return of at least 15% and outperform the S&P 500 over the next six months. For higher yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next 12 months.
- Outperform (MO2)** Expected to appreciate and outperform the S&P 500 over the next 12 months. For higher yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next 12 months.
- Market Perform (MP3)** Expected to perform generally in line with the S&P 500 over the next 12 months and is potentially a source of funds for more highly rated securities.
- Underperform (MU4)** Expected to underperform the S&P 500 or its sector over the next six to 12 months and should be sold.

Out of approximately 674 rated stocks in the Raymond James coverage universe, 55% have Strong Buy or Outperform ratings (Buy), 38% are rated Market Perform (Hold) and 7% are rated Underperform (Sell). Within those rating categories, 30% of the Strong Buy- or Outperform (Buy) rated companies either currently are or have been Raymond James Investment Banking clients within the past three years; 17% of the Market Perform (Hold) rated companies are or have been clients and 9% of the Underperform (Sell) rated companies are or have been clients.

Suitability ratings are not assigned to stocks rated Underperform (Sell). Projected 12-month price targets are assigned only to stocks rated Strong Buy or Outperform.

Suitability Categories (SR)

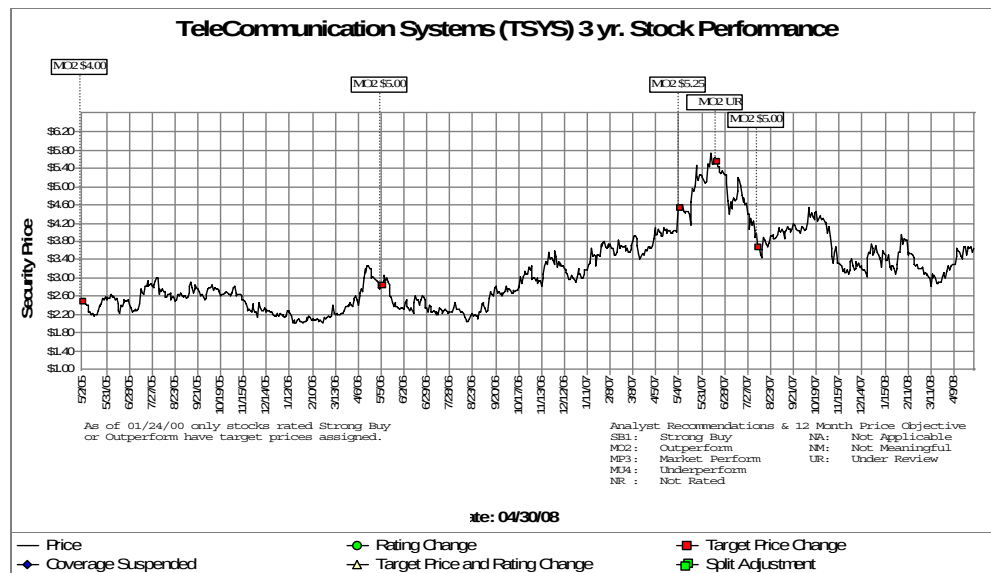
- Total Return (TR)** Lower risk equities possessing dividend yields above that of the S&P 500 and greater stability of principal.
- Growth (G)** Low to average risk equities with sound financials, more consistent earnings growth, possibly a small dividend, and the potential for long-term price appreciation.
- Aggressive Growth (AG)** Medium or higher risk equities of companies in fast growing and competitive industries, with less predictable earnings and acceptable, but possibly more leveraged balance sheets.
- High Risk (HR)** Companies with less predictable earnings (or losses), rapidly changing market dynamics, financial and competitive issues, higher price volatility (beta), and risk of principal.
- Venture Risk (VR)** Companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, and a substantial risk of principal.

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Company Name	Disclosure
TeleCommunication Systems	Raymond James & Associates acted as an agent in the private placement of equity for TeleCommunication Systems in March 2006. Raymond James & Associates makes a NASDAQ market in shares of TSYS.

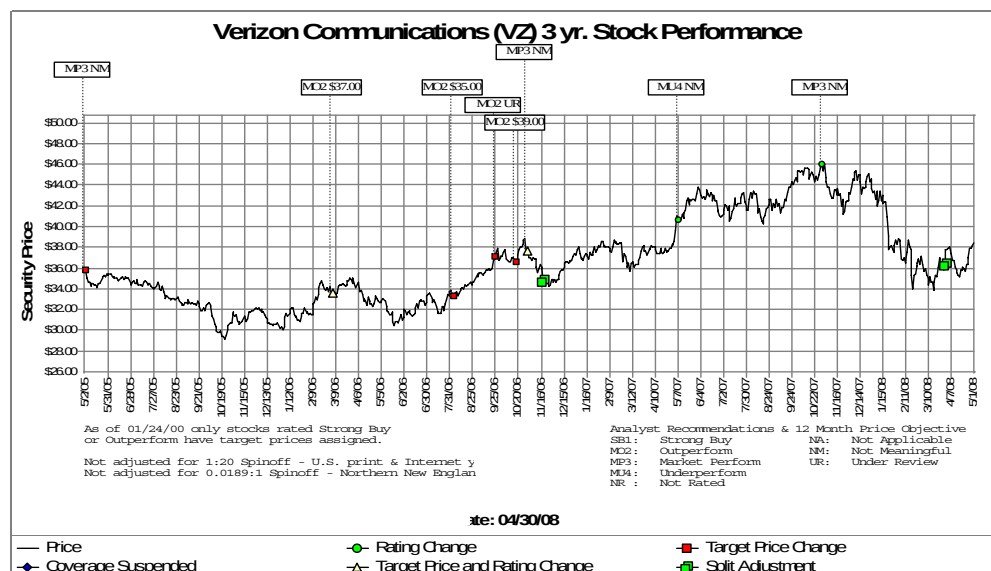
Target Prices: The information below indicates our target price and rating changes for TSYS stock over the past three years.



Update Date	Closing Price	Target Price	Rating
8/9/07	3.68	5.00	2
6/19/07	5.56	UR	2
5/4/07	4.53	5.25	2
5/5/06	2.86	5.00	2
5/2/05	2.48	4.00	2

Valuation Methodology: The Raymond James methodology for assigning ratings and target prices includes a number of qualitative and quantitative factors including an assessment of industry size, structure, business trends and overall attractiveness; management effectiveness; competition; visibility; financial condition, and expected total return, among other factors. These factors are subject to change depending on overall economic conditions or industry- or company-specific occurrences. Our valuation methodology for TeleCommunication Systems is based on relative EV/EBITDA multiple analysis.

The information below indicates target price and rating changes for other subject companies included in this research.



Update Date	Closing Price	Target Price	Rating
10/30/07	45.99	NM	3
5/7/07	40.66	NM	4
10/31/06	37.65	NM	3
10/19/06	36.59	39.00	2
9/25/06	37.10	UR	2
8/2/06	33.27	35.00	2
3/6/06	33.58	37.00	2
5/2/05	35.80	NM	3

General Risk Factors: Following are some general risk factors that pertain to the projected 12-month target prices included on our research for stocks rated Strong Buy or Outperform: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation; or (4) External factors that affect the U.S. economy, interest rates, the U.S. dollar or major segments of the economy could alter investor confidence and investment prospects.

Specific Investment Risks Related to the Industry or Issuer

Communications Software Industry Risk Factors

The Communications Software group is impacted by enterprise and carrier IT spending patterns, as well as timing and magnitude of new technology and service deployments.

TeleCommunication Systems Risk Factors

Balance Sheet

TeleCommunication Systems has a slight net cash position. While much of the company's revenue is recurring in nature, a significant decline in business for the company could require additional financing. This could lead to dilution or increased interest expense.

Competition

Through its software segment, TeleCommunication Systems provides wireless enhanced services technology, such as messaging and location services software. We believe the company can maintain its competitive position in this market. However, large, well-funded competitors exist in this space.

Verizon Risk Factors

Verizon faces a significant amount of competition from both facilities-based CLECs (competitive local exchange carriers) and UNE-P (unbundled network element - platform) providers, which could significantly impact the company's revenue and earnings. In turn, competition could negatively impact pricing, both for traditional telephony services and for xDSL, wireless, and other services. These growing services are offsetting currently declining traditional telephony services, a mix-shift that could negatively impact overall company margins. Other risks include, but are not limited to, increasing pension expenses, a highly unionized workforce, a large debt load, Vodafone's (VOD/\$32.17) ability to put its interest in Verizon Wireless, and a continued weak business spending environment.

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