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Directories & Private Equity

Print-form directories have historically been a key cornerstone part of telecommunication businesses worldwide. This is changing, and what is occurring is a perfect example of Disruptive Innovation usurping a Sustaining Business Model.

History will show that the sale of Yellow Pages to a US-based private equity firm for NZD \$2.24 billion was timed to near to perfection. At the time of sale in 2007, print directories were still a cornerstone aspect of telecommunication businesses. The Yellow Pages in particular had experienced constant revenue growth prior to the sale. And it's also not hard to understand this, most people remember getting their White and Yellow pages in the late 1990s and early 2000s – and actually using them. Supplementing this, it was before the Global Financial Crisis, a period of cheap capital, in particular for private equity firms.

Table 1 – Financial Performance of Yellow Pages Prior to Sale (2003-2006)

NZD M		FY 2003	FY 2004	FY 2005	FY 2006	FY 2007
Revenue	\$	207	221	230	260	278
Y-o-Y Growth Rate	%	n/a	6.8	4.1	13.0	6.9

Note: 2007 Revenue has been annualised as Telecom held Yellow Pages for 10 months of the 2007 financial year.

During the sale process there were two business types competing to acquire Yellow Pages; directory businesses and private equity firms. How they valued Yellow Pages is where it gets really interesting. At its very core, valuation comes down to the cashflows of the acquisition and the acquirers cost of capital (discount rate). In this case the sale went to the private equity firms because of their access to cheap debt and therefore lower discount rate (roughly 6% versus 10% or more) even though both parties were using similar cashflows.

Jump forward to 2014, Telstra, Australia's biggest phone company, sold a 70% stake in Sensis, their online directories unit, for AUD \$454 million (total Enterprise Value of AUD \$649 million) to a US-based private equity firm, a transaction bearing close resemblance to the deal done seven years prior for the sale of Yellow Pages. At face value, the figures suggest that the Yellow Pages was a much larger beast than Sensis. But that simply isn't the case. Sensis had revenues 5.1x larger than Yellow Pages and their EBITDA was 3.6x larger for the subsequent last financial year prior to their deals.

Table 2 – Key Metrics, Yellow Pages and Sensis

Telecom/Yellow Pages		Telstra/Sensis
Date	April 2007	January 2014
Currency	NZD	AUD
Enterprise Value (Billion)	\$ 2.24	0.65
Revenue (Billion)	\$ 0.26	1.34
EBITDA (Billion)	\$ 0.16	0.57
EBITDA Margin	% 60%	44%
EV/Revenue Multiple	x 8.58	0.49
EV/EBITDA Multiple	x 14.30	1.14

So, what has happened over the last 7 years? Why did Yellow Pages fetch a far higher price? Well, when was the last time you picked up your Yellow Pages?

Recently falling revenues and falling EBITDA margins for both Yellow Pages and Sensis show that the hardcopy directories is not the business model it once was. Not only is growth slowing, there has been year-on-year reductions in growth - all of this coinciding with the internet really starting to kick-off. For example, online auction sites like Trade Me.

Table 3 – Financial Performance of Yellow Pages (2008-2013)

NZD M		FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Revenue	\$	293	297	274	222	210	181
Y-o-Y Growth Rate	%	5.4	1.4	(7.7)	(19.0)	(5.4)	(13.9)
EBITDA	\$	167	163	163	100	87	81
EBITDA Margin	%	57	55	60	45	41	45

Table 4 – Financial Performance of Sensis (2008-2013)

AUD M		FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013
Revenue	\$	2,127	2,251	1,900	1,787	1,492	1,336
Y-o-Y Growth Rate	%	8.0	5.8	(15.6)	(5.9)	(16.5)	(10.5)
EBITDA	\$	1,094	1,173	1,096	994	746	588
EBITDA Margin	%	51	52	58	57	50	44

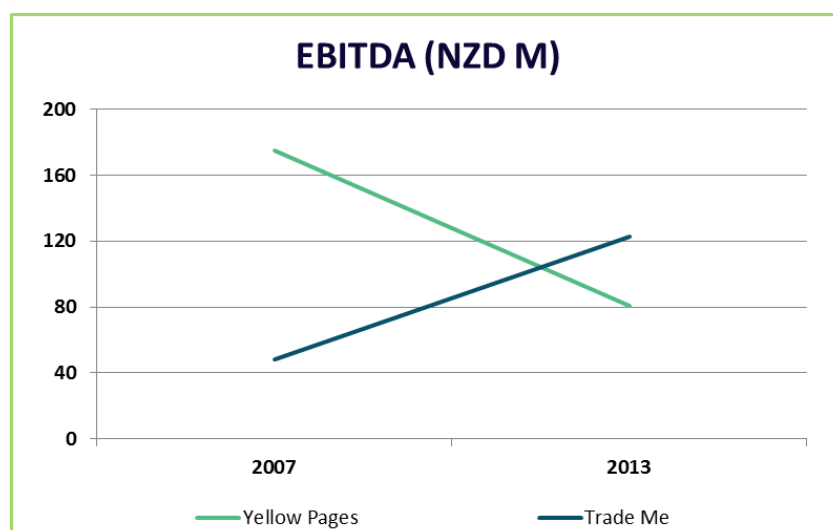
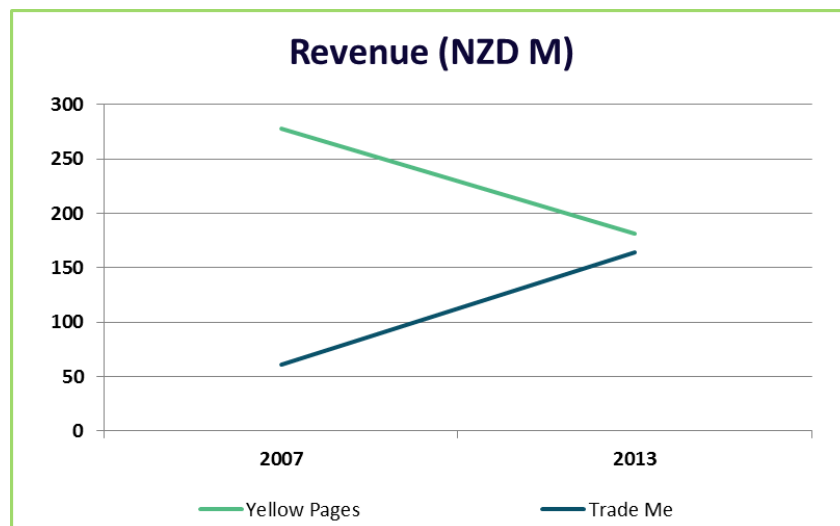
Note: All of the Financials and Ratios relate specially to the Target Asset and not the Target Company itself.

Compounding the problems for the Yellow Pages, private equity deals tend to be financed through debt. This is fine when cash flows are high providing the ability to service the debt through the constant stream of cash. However, when things get bad like they did for Yellow Pages in the late 2000s, early 2010s – they get really bad. As cash flows dried up, there is

the inability to repay the debt. Given the pecking order of capital structures, the banks now own Yellow Pages. In order to re-coup some of the losses from the deal, the banks try to extract the last ounce of cash flow each year rather than take the one-off hit. Either all, it's a loss-making exercise.

So how much would the Yellow Pages deal been worth using the current 2014 metrics? Employing the Sensis 1.14x EBITDA multiple (lets be generous, make it 1.5x), Yellow Pages today would be worth NZD \$122 million, a far cry from the NZD \$2.24 billion paid in 2007 – 95% value destruction in seven years.

And finally, coming back to the very first paragraph of this post, we think these charts show quite distinctly the disruptive influence Trade Me has had on the print-form directory business.



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