Stock Market Review

Go swings to profit but decision on investment in Greece looms

Edward Rizzo

Mr Rizzo is a director at Rizzo, Farrugia & Co. (Stockbrokers) Ltd.

Go plc's 2012 interim financial report published last Friday reveals a pre-tax profit of €20.4 million during the first six months of the year. Go had last reported a profit in the first half of their financial year in 2007. Losses were incurred for four consecutive periods since 2008 as the group was impacted first by the costs associated with the pension provision, and in each of the following years by the voluntary retirement costs together with the impairments on the ill-fated Greek investment.

Financial observers and Go shareholders who attended the lengthy annual general meeting last May ought to have expected this turnaround since at the AGM it was announced that the company will book a gain of €11.4 million from the transfer of properties with the government of Malta. Moreover, the strong turnaround was also brought about by the significant decline in the Greek impairment after this investment was practically completely written-off by the end of 2011. Chairman Deepak Padmanabhan provided ample reference to the future limited impact on Go's performance from this write-off during the last AGM.

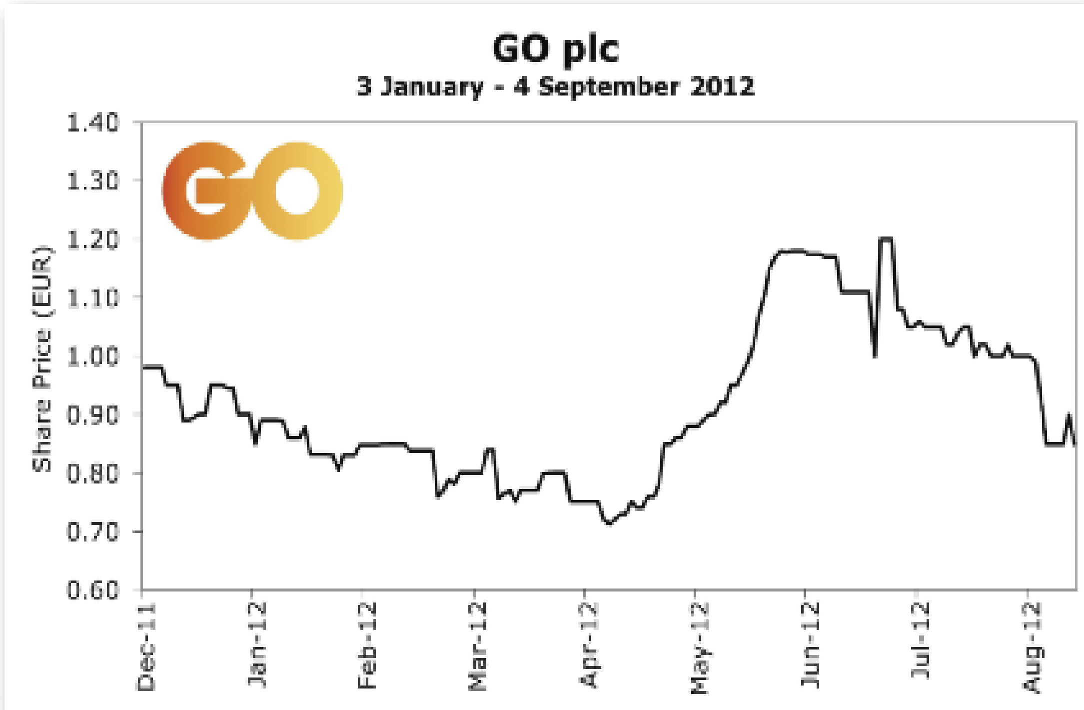
The core operations of the group reveal a 6.3 per cent decline in EBITDA to €24.5 million as revenue eased by 2.4 per cent and some exceptional one-off costs were incurred from the migration of the mobile network onto the new platform. Otherwise, administrative and distribution expenses dropped by 6.2 per cent to €14.2 million as the group pursued cost reductions in various areas and continued to reduce its headcount which is now just above 900 employees.

The profit generated during the first half of the year helped shareholders' funds rise by 19.3 per cent from the December 2011 level to a value of €99.4 million giving a net asset value per share of €0.981. Go's equity (currently trading at €0.85 per share) is therefore trading at a 13 per cent discount to the NAV.

The share price of Go has been particularly volatile over recent months. After sliding steadily during the first four months of the year touching fresh all-time lows on a regular basis, the equity rebounded by 71.4 per cent in a two-month period from the all-time low of €0.70 on May 14 to a high of €1.20 on July 16. However, the price has since slumped by 29.2 per cent to €0.85. The equity broke the €1 resistance level on August 24 as Forthnet confirmed that its €30 million rights issue was approved by shareholders at the extraordinary general meeting held the previous day.

Forthnet's announcement confirmed that its largest shareholder Forgendo (a joint venture between Go and its parent company Emirates International Telecommunications) expressed its intention to participate in the rights issue. On the other hand, its second largest shareholder indicated that it is not willing to participate in the rights issue and additionally it does not intend to retain its current shareholding.

The Go share price responded immediately and the downturn gathered momentum early last week as soon as Go announced that its board of directors will meet by the end of September to decide on participation or otherwise in the rights issue through Forgendo.



The renewed share price decline as the announcement hit the market reflected the nervousness among the local investing community on the possibility of Go advancing further funds to the Greek company. Such nervousness had been made clear to Go's board at the AGM and should not be overlooked when a final decision is taken in the coming weeks.

The Forthnet results announced last week vindicate the caution being expressed by some general public shareholders on a possible further investment in Greece.

Although Forthnet's financial statements show a clear improving trend in cash flow generation, the economic conditions in Greece are becoming more challenging and this is now starting to hit the company's revenues which declined by 1.2 per cent in the first half of the year. Furthermore, the working capital shortfall of the company as at June 30 has widened to €40.5 million, so the €30 million rights issue alone will not suffice in this respect.

The decision on Go's participation in the capital raising exercise of Forthnet must also be seen in the light of developments at Go's AGM last May when there was significant pressure by a number of general public investors for increased communication by the company and consultation with them before important investment decisions being taken. Is this going to take place as suggested at the AGM or will shareholders simply be informed after the final decision is taken and announced to the market?

A further investment in Forthnet ought to be clearly explained to all shareholders

Moreover, Go's chairman had clearly indicated at the AGM that any further negative impact of the Forthnet investment on Go's 2012 financial statements cannot extend beyond the €3.6 million revised value after the significant impairments taken in 2011. Mr Padmanabhan had also publicly expressed his regret at the difficulties encountered by the company and its shareholders from the repercussions of the Greek investment but he had stated that "Go remains in very good shape and is certainly robust enough to sail through without sustaining any further serious damage".

More investment by Go into Forthnet could once again haunt investors by further impairments in future financial periods. Once the value of the investment has now being practically written-off and the downside is limited to a mere €3.1 million (after the €0.6 million impairment again in the first half of 2012), why should Go consider injecting further funds and therefore expose the group to additional unwarranted risks?

Go's auditors PricewaterhouseCoopers also included an "emphasis of matter" relating to the Greek investment in its review of the 2012 interim financial statements. This should not be overlooked when debating whether or not to participate in the upcoming rights issue in Greece.

What is the position of Go's bankers? Should Go shareholders not be made aware of any further consequences on the group's current banking facilities should an additional capital injection into Greece be made?

The very challenging Greek economic situation merits a very cautious stance on any new investment in the country at this time. As was advocated by a group of minority shareholders of Go at the AGM, a further investment in Forthnet ought to be clearly explained to all shareholders outlining the investment rationale used in the decision and the justification for continuing to pursue the matter further. Has the board understood the shareholders' requests and are they prepared to openly discuss the merits of a further capital injection?

Go's ill-fated Greek investment brings back memories of the sour experience suffered by shareholders of Middlesea Insurance plc through the company's investment in Italy in previous years. The serious challenges faced by Middlesea's Italian subsidiary had a very detrimental effect on the local company and in spite of an additional capital injection in December 2009, the Italian company ceased operations a few weeks later causing Middlesea to lose tens of millions of euros in shareholders' funds in the process.

While in no way indicating that Forthnet can suffer the same fate especially if they do eventually succeed in merging with one of their competitors in Greece, the Middlesea story ought to be a good case study of a company retracting from growing internationally and refocusing on its core local business.

Go's financial results for the first half of 2012 have probably given some hope to its 8,000-strong general public shareholders that, over time, the group can gradually rebuild shareholder value after the massive losses incurred to date on its Greek investment. Go's directors ought to take this into consideration when deliberating whether or not to risk further shareholder funds by investing additional monies in a company operating in a country that is clearly still struggling to solve its huge economic problems.