Stock Market Review

Go's strategy effective as customers increase

Edward Rizzo

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

The intensifying competition across the local telecoms industry has been very evident in recent years, with three operators seeking to offer better value to customers to win market share. The quarterly statistics published by the Malta Communications Authority (MCA) provide valuable information for analysts to gauge the progress achieved by the operators across each segment of the telecoms sector, i.e. fixed, mobile, broadband and TV.

Go's CEO Yiannos Michaelides made reference to these statistics during the meeting with the financial community convened on the same day that the company published its 2013 annual financial statements.

Last Tuesday, March 18, Go revealed that during 2013 overall revenue declined by four per cent to €122.14 million. The CEO attributed the drop in revenue to downward pressure on retail prices from the intense competition prevailing in the local telecoms market, as well as regulatory pressure on mobile termination rates.

In fact, the MCA statistics reveal the decline in the Average Revenue per User (ARPU) level across all services. As an example, the ARPU in the mobile market declined to €13.80 per month during 2013 from €18.18 per month in 2009. The reduced ARPUs across the TV, broadband and fixed line were not as intense as that in the mobile market.

Go's CEO explained that most European incumbent telecom operators reported lower turnover and Ebitda levels. He claimed that Go performed "extremely well" in the prevailing circumstances. Mr Michaelides added that this performance was the result of the strategy that was in place in 2013 and which has started to show results. Last year the CEO delivered a detailed presentation to financial analysts explaining the four main focus areas (product positioning, customer experience, operational efficiency and human resources) forming the strategy aimed at enabling Go to reverse the downward trend in customer connections.

Mr Michaelides noted that the new product line for the mobile portfolio, i.e. the Limitless plans, was a huge success and this is showing up in the market share statistics. In fact, the MCA report for 2013 shows that Go registered an increase in mobile customers during each of the four quarters last year and the highest gains were seen in Q4. Mobile connections of Go grew by 20 per cent during 2013 and the market share improved from 35.98 per cent in 2012 to 39.55 per cent at the end of 2013.

In the broadband market, customer connections also rose but to a lesser extent than in mobile. Go currently has a broadband market share of just under 49 per cent. With respect to other efforts on the product positioning front, Go's CEO mentioned the importance of the sports content in the TV offering and the achievement of winning the rights for the UK Premier League.

Mr Michaelides confirmed that the investment in sports content is now a profitable one for Go following the increase in the number of sports subscribers. Go's market share in the TV segment improved to 45.8 per cent in 2013 from 44.7 per cent in 2012. This had been as low as 32.2 per cent in 2009.

Despite the higher customer connections across all business units, improved market share as well as cost reduction efforts, this was not sufficient to maintain the group's earnings before interest, tax, depreciation and amortisation on the same level as in 2012. In fact, Go's normalised Ebitda for 2013 of €48.4 million represents a 5.7 per cent drop from the previous year's comparable figure. The Ebitda margin only declined minimally to 39.6 per cent from 40.3 per cent in 2012.

A comparison of the financial performance between 2013 and 2012 must take into consideration the one-off items that featured in the financial statements in both years. The 2012 performance was boosted by the gain of €11.4 million recorded on the property exchange with the government of Malta. Meanwhile, on the other hand, in 2012 Go was negatively impacted by the €4.7 million in impairments largely relating to the indirect investment in Forthnet, which is now completely written off. The net one-off gains in 2012 amounted to €6.7 million while in 2013 these extraordinary or one-off items amounted to a net loss of €2.8 million.

To a large extent, this explains the wide discrepancy in the profitability registered between one financial year and the next, although, as indicated by the Ebitda figure, the actual performance in 2013 was also weaker.

Notwithstanding the decline in profitability on a like-for-like basis, Go maintained its strong cash generation as normalised cashflow from operations was practically unchanged at almost €40 million. This was also sufficient to cover the cash outflows in connection with the investment programme (mainly in technology) and financing activities (mainly repayment of debt and the 2012 dividend payment of €9.9 million). In fact, the statement of financial position as at December 31, 2013 shows a high level of cash as at the year-end of €30.4 million. The financial position remains strong with shareholders' funds of €103.5 million and net debt of only €41.9 million.

The dividend recommendation of €0.07 net per share for 2013 compared to the €0.10 net per share distributed last year in respect of 2012 must be viewed in the context of the recent track record and the one-off gains registered in 2012. The dividend for 2012 could be regarded as an outlier given the lack of a dividend in respect of the 2011 financial year and the property gains registered in 2012. In fact, the dividend payout ratio for 2013 of 60 per cent is reasonable, given the financial situation of the group.

> **While core business remains under intense pressure, developments in Greece and on the local property front could be interesting for shareholders**

During last week's meeting, Go's CEO also spoke about the importance of continued investments across the various business segments to ensure Go remains competitive. Mr Michaelides singled out the full upgrade of the fixed-line business, the mobile network as well as the maintenance of the broadband network and the investment in new data centres.

Two other important developments were also mentioned during the meeting. With respect to the Greek company Forthnet, Go's CFO Edmond Brincat mentioned that the latest financial information for Q3 2013 indicated significant growth in Forthnet's customer base. However, revenue declined due to pricing pressure, reflecting the economic and competitive landscape in Greece.

Mr Brincat indicated that the full-year financial statements will be issued by the end of March. He also delved into the recent rights issue and the decision that Go needs to take by July 15, 2014 on whether the loan provided to Forgendo (equally owned by Emirates International and Go) will be converted into equity of Forgendo or repaid to Go.

If Go decides not to convert this loan into equity, it will imply a significant dilution in its indirect equity stake in Forthnet. This decision must be taken by the Go directors in the coming months in the light of recent developments in Greece and also taking into consideration developments across the European telecoms sector, especially following Vodafone's sale of their US investment and the change in their business strategy.

Some days ago, Vodafone plc agreed to purchase the Spanish cable operator Ono for €7.2 billion. Vodafone is already present in Spain offering mobile services, but the new combined unit with Ono will become Spain's second-biggest telecoms operator, challenging the dominance of the incumbent Telefonica.

In September 2013, Vodafone had agreed to a £6.5 billion takeover of Germany's Kabel Deutschland. Vodafone is also investing £7 billion into "Project Spring", the development of its own infrastructure. The recent acquisitions and investment programme are seen as a major step towards Vodafone's goal of also becoming a major quad-play operator – selling broadband, landline and television services apart from its traditional mobile services.

Interestingly, Vodafone also built up a minority equity stake in Forthnet. Forgendo remains the single largest shareholder with 41.27 per cent, followed by Wind Telecommunications at circa 33 per cent. Given the inevitable consolidation across the Greek telecoms sector and the interest by both Vodafone and Wind, it would seem to be in the interest of Go shareholders to take the option and maintain their current indirect stake in Forthnet. Forgendo could be in a position in the coming years to sell its stake to Vodafone, Wind or any other suitor interested in the Greek telecoms industry.

If this materialises, Go would then manage to recoup a part of the sizeable sum invested in Greece over the years. However, it is very unlikely for the entire amount to be recovered. Nonetheless, since the investment in Forthnet was fully written off by Go, any recovery would boost its financial statements as a one-off gain.

Go would also be in receipt of several millions of euros to distribute to shareholders as a one-off dividend and/or to partly reduce bank borrowings. Go shareholders should hope that a bidding war emerges so as to maximise the value of the investment following the many painful years they have had to endure.

The property segment is another area where Go can extract value for shareholders. Mr Brincat indicated that work is ongoing on vacating certain buildings from office use and the centralisation of offices. A decision was taken for the Mosta and Żejtun premises to host the main exchange facilities. In this respect the CFO noted that investments are taking place to upgrade these properties. Meanwhile, the Sliema and St Paul's Bay exchanges should be in a position to be sold in 2016 once all equipment is transferred to other sites.

Mr Brincat stated that works are ongoing on other properties and Go will hopefully provide further updates during the course of 2014. The possible value creation from the sale, development and/or rental income stream from the current idle property could prove to be lucrative in the years ahead.

While Go's core business remains under intense pressure, developments in Greece and on the local property front could be interesting and rewarding for shareholders.