fisher funds

Fisher Funds

Our Thoughts

12/02/2010

Independent Report Misses Growth

Shareholders considering the Scheme of Arrangement merger proposal between Pipe Networks and TPG Telecom might do well to consider the earnings power of their business before deciding which way to vote their shares.

The Independent Report commissioned, by the Directors of Pipe and conducted by Ernst and Young, comes out in favour of the transaction being "Fair and Reasonable." To make this determination the "expert" conducted a valuation of Pipe Networks. At the core of this analysis the report suggests that Pipe Network's normalised earnings are $42.9m. This estimate appears to be based on an EBITDA forecast for Pipe's International business for next year (FY11) of $15.4m added to this year's domestic business EBITDA forecast of $27.5m. Ernst & Young then applies a valuation multiple to these earnings to arrive at a fair value range for the transaction. This analysis, which is presented in the table below, delivers a valuation range of $6.00 to $6.72.

Figure 17: Valuation summary

Currency: $ 000	Low	High
Future normalised EBITDA	42,900	42,900
Capitalisation multiple	9.5	10.5
Enterprise value	**407,550**	**450,450**
Less: net interest bearing liability	(29,724)	(29,724)
Add/(less): Surplus assets/(liabilities)	(22,584)	(22,584)
Equity value	**355,242**	**398,142**
Shares on issue ('000)	59,221	59,221
Value per share ($)	**6.00**	**6.72**

Source: Ernst & Young Transaction Advisory Services

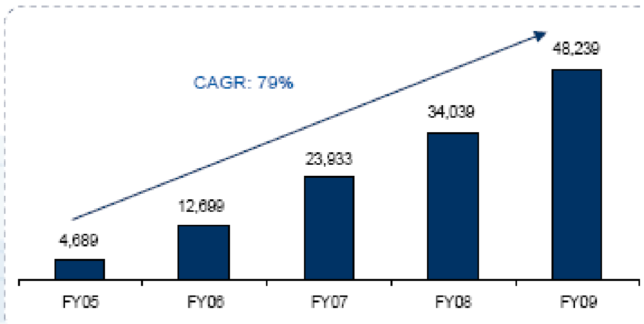
Analysts who have followed Pipe Networks for years have a hugely different view on the future profitability of this firm. This dramatically changes the valuation arithmetic. According to IRESS the average forecast for Pipe's 2011 EBITDA is $56.3m. Presumably this reflects the profitability of the international business as outlined in the independent report as well as growth in the domestic business (it must be remembered that the domestic business has grown EBITDA at a compounded annual rate of 91% over the past five years). Feeding this higher forecast into the same valuation approach used in the Independent Report delivers a fair value (using the low end of the range multiple) of $8.14, almost a 30% premium to the proposed merger price. Fair and reasonable, I don't think so.

Valuation Summary

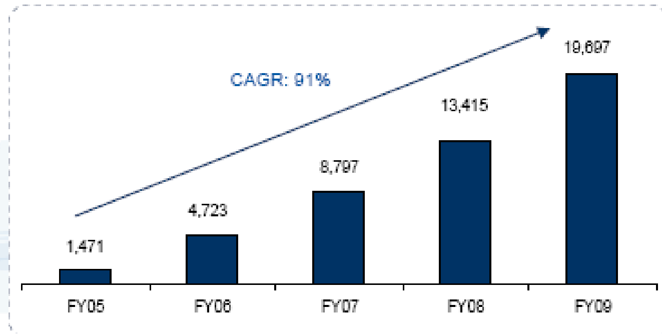
Currency: $ 000	*Low*
Consensus EBITDA from IRESS for FY11	56,250
Capitalisation Mulitple	9.5
Enterprise Value	**534,375**
less net interest bearing liability	(29,724)
Add/(less):Surplus assets/liabilities	(22,584)
Equity Value	482,067
Shares on Issue ('000)	59,221
Value per Share ($)	**8.14**

Review of Operations – Domestic Business (Continued)

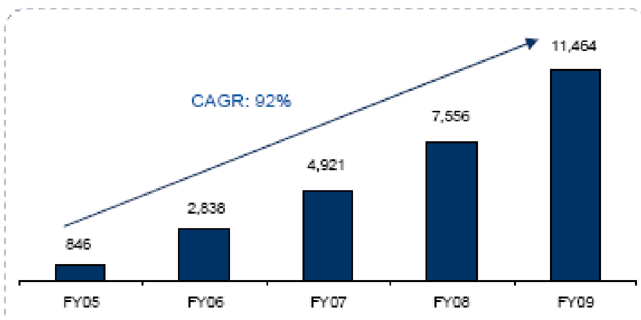
Revenue ($'000s)



EBITDA ($'000s)



NPAT ($'000s)



Customer Concentration