

Case Study

# Assessing Attractiveness of the Combined Entity Formed by a Potential Acquisition



## About the Client

- The client is a leading European telecom service provider

## Business Objective

- The client wanted to augment its service portfolio with the addition of broadband services. They wanted to achieve this inorganically and had zeroed in on a company, which was under consideration for a proposed demerger with another at the time
- The client wanted to understand the target company's business profile, looking at its historical performance, future plans, and assess the attractiveness of the company as a standalone entity
- They also needed to understand the potential implications of the proposed demerger for the target company

## Results & Value Add

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The deliverable enabled our client to:

- Develop an understanding of the target company's historical performance and future plans, and form a view on its attractiveness as an acquisition target
- Assess the value of the company based on M&A broadband deal multiples in Europe
- Understand the potential pitfalls of the proposed demerger

# Research Methodology and Approach

The study was divided into two phases:

- Phase I: Profiling the target company to look at:
  - Strategy employed by it for growing its subscriber base
  - Financial performance of the company
  - Operational performance of the company
  - Strategies and future growth plans
- Phase II: Attractiveness of the target company and implication of the proposed demerger:
  - Value assessment of the company
  - Potential risks of the demerger

# Screenshots

**Q.1 How attractive is TalkTalk? Looking at its customer base, infrastructure and...**

*Sample Only Displayed and Abridged*

	Facts and Explanations	Our Point of View (POV)
<b>Customer Base</b>	<ul style="list-style-type: none"> <li>With almost a quarter of the broadband market, TalkTalk has a valuable appreciating asset under its belt</li> <li>As broadband itself becomes a commodity, ISPs are gearing to unlock the true value of their customer base through triple-play, value-added services, which will enable them to acquire more customers, reduce churn rates and increase ADSL<sup>2</sup></li> <li>With the acquisition of Tiscali in May-09, TalkTalk gained entry into the IPTV services segment</li> <li>By 2009-end, Tiscali offered IPTV services over HomeChoice<sup>2</sup> network to ~0.1 million customers</li> <li>Even though the existing triple-play base for TalkTalk is small, the company is well-placed to expand</li> </ul>	<ul style="list-style-type: none"> <li>Given the competitive threat and the rapidly-changing customer mind, TalkTalk is amidst compelling 'pivot' and 'buff' factors to step into triple-play offerings at a national level</li> <li>There may be an explicit triple-play intent, even though TalkTalk is keeping its cards close to the chest on its plans and business model to provide IPTV services, while in the background it can be assessing the viability and timing up its strategy</li> </ul>
<b>Network Infrastructure</b>	<p><b>CHART REMOVED</b></p> <ul style="list-style-type: none"> <li>TalkTalk has invested in migrating customers to its own networks, expanding its fully-fibered network to XX exchanges and partially unbundled to XX exchanges</li> <li>This provides company ~80% coverage of the UK population</li> <li>At present TalkTalk offers 8Mbps ADSL, although ADSL<sup>2</sup> capability is being installed as a part of its 'Next Generation Network' roll-out</li> </ul>	<ul style="list-style-type: none"> <li>With an extensive independent coverage of the UK market and technology upgradation, TalkTalk will have a robust infrastructure</li> <li>Even though the company does not have its own fibre optic network and may have to rely on BT's, that disadvantage will be moderated by market and technological changes</li> </ul>
<b>Customer Support</b>	<ul style="list-style-type: none"> <li>TalkTalk has invested in upgrading servers to run its core systems including CRM, billing and reporting applications</li> <li>It has focused on reducing the time for different processes and controlling costs</li> <li>The company has maintained a mix of outsourcing and in-house facilities for call center support</li> <li>In 2009, it operated three call centers in the UK and invested in building another one in Ireland</li> <li>Also outsourced services to call centers in South Africa</li> </ul>	<ul style="list-style-type: none"> <li>Since 2006, TalkTalk has invested tens of millions in setting up and expanding its customer support infrastructure, now present in the UK, South Africa and India</li> <li>This mix of onshore and offshore, in-house and outsourced sourcing strategy, in reduction of cost management and quality focus</li> </ul>

Note: 1, 2, 3, 4) Please refer to slide notes for details

**...aimed to reduce its capex, drive earnings, and increase free cash flow, ahead of the parent...**

*Sample Only Displayed and Abridged*

<p><b>CAPEX...steadily reducing after a period of high investments</b></p>	<ul style="list-style-type: none"> <li>During 2006-09, the capex declined by ~30% as TalkTalk had to make a reduced investment in its network infrastructure</li> <li>Earlier, to keep pace with a triple-digit CAGR growth in its residential subscriber base<sup>2</sup> the company had doubled its capex outlay during 2004-07</li> <li>A further reduction in Capex is expected in 2009-10, as the company's investment in a new CRM and billing platform was completed during 2008-09</li> </ul>
<p><b>EBIT<sup>2</sup>...sustained factors at play to drive margins</b></p> <p><b>CHART REMOVED</b></p>	<ul style="list-style-type: none"> <li>Migration of residential customers to company's own network from BT and a shift towards higher margin business streams is driving EBITDA</li> <li>However, this has been partially offset by an increase in infrastructure-related depreciation and the amortization of subscriber acquisition costs (SAC)</li> <li>TalkTalk Group achieved EBIT of £124m, whilst representing an increase of 52% on the previous year (2008: £81m), this was some way below our aspirations at the start of the year and reflected an unexpected slowdown in the rate of growth in the broadband market, principally as a result of a markedly less active housing market. - John Gilderleeve, Chairman, Capstone Warehouse</li> </ul>
<p><b>Free Cash Flow...picking pace after remaining below the mark</b></p>	<ul style="list-style-type: none"> <li>Debt servicing (interest) outgo to finance acquisitions made during 2004-07 and capex reflected in a negative cash flow for 2008</li> <li>During 2009-10, free cash flows are projected to increase by 150% driven by operational efficiencies and economies of scale</li> <li>The company plans to maintain robust working capital and reduce the Capex, to increase the operating free cash flow</li> </ul>

Note: Refer to slide notes for details

A satellite is shown in orbit against a background of Earth's horizon and a starry space. The satellite has a central body and several solar panels extending outwards.

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## Contact Us

Business Enquiries – [sales@rocsearch.com](mailto:sales@rocsearch.com)

General Enquiries – [info@rocsearch.com](mailto:info@rocsearch.com)

[www.rocsearch.com](http://www.rocsearch.com)