

The Appeal of Telco's to Private Equity

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A Contrarian View

- Babcock & Brown believes there is significant “un-tapped value” in incumbent telcos; the risk of delivering that value varies depending on the particular circumstances
- Fundamentally, we believe that the fixed line (in an NGN context) will be best placed to deliver the bandwidth capable of supporting:
 - IPTV, broadband, voice and other value added services in the home
 - Data transfer required in government/enterprise
- Therefore, we believe that the right way to look at an integrated telco is
 - Network; asset heavy, engineering cost focus business
 - Consumer; asset light, mass market retail business
 - Government/enterprise; managed service business
- We believe that this aligns the required management competencies with consumer and regulatory expectations and, as a result, will achieve the best capital markets outcome

Historical Perspective

“All telcos are the same” with only minor further refinement around fixed line and mobile businesses, and mature and emerging markets

Capital Markets

- Monopoly businesses with high multiples, which became eroded with the introduction of wireless and resulted in a bearish outlook around technology risk and voice revenue decline
- Dot-com boom led to a short-lived re-rating on the expectation of new revenues which did not materialise as quickly as actual voice decline from mobile substitution and internet-based services

Regulatory Regime

- Revenue decline exacerbated by regulatory intervention which sought to reduce the retail margin provided by monopolistic ownership of network
- The capital markets saw the regulator as a “cheese grater” that would eventually reduce that margin

Management

- The capital markets have remained unconvinced about the capacity of incumbent telcos to
 - Migrate their business model to a customer demand driven business
 - Migrate their operations from a public service engineering mentality to an FMCG mentality
- Management has supported these concerns with arguments, primarily directed towards the regulator, exaggerating the cost (through loss of synergies) of an open access or separated network

Private Equity Landscape

- Private equity requires:
 - Strong cash to paydown leverage
 - Bottom line growth from either cost reduction or top line growth
 - In capital intensive businesses, extraordinary growth from either emerging or changing markets
- The range of this participation was accelerated by the regulator facilitating access to network and allowing “asset light” service providers:
 - Fixed line voice and broadband resellers
 - Infill fixed wireless technologies around broadband
 - Mobile MVNOs
- The question then becomes whether, given the scale of private equity, incumbent telcos in developed markets are or will become of increasing interest to private equity
- Traditionally the answer to this question has been “no”, because while incumbent telcos are seen as highly cash generative in the short term, the consensus is that there will be negative growth over the long term

The Opportunity for Re-rating

- We believe that if you look at an integrated telco in the right way you will find un-tapped value
 - Network; asset heavy, engineering cost focus business
 - Consumer; asset light, mass market retail business
 - Government/enterprise; managed service business
- If you look at the sales path for each customer group you have to go deep into the network before you find any real synergy benefit

Network Re-rating

- Driven by the certainty of cash flows and the existence of or potential for alternative networks
- The factors that drive the certainty of cash flows will be
 - Presence of an alternative network (eg. Cable)
 - Population size and density
 - Land and labour costs, and local government permissions
- Different countries have different mixes of these factors and the balance will determine whether all or only part of the network constitutes a monopoly asset
 - UK: large and highly dense population with existing cable network, little of BT's network other than the local loop capable of a re-rating
 - US: extremely high cable penetration, no competitive telco capable of re-rating
 - Ireland: all the network capable of re-rating

The Opportunity for Re-rating cont

Government & Enterprise Re-rating

- Increasingly government and enterprise are looking for a holistic managed services solution for their IT and telco requirements (BT Global Services)
- Such a business is only capable of being considered as a managed service business if it is able to acquire network on an open access basis
- With increasing globalisation, there are considerable scale advantages for international players in such a business

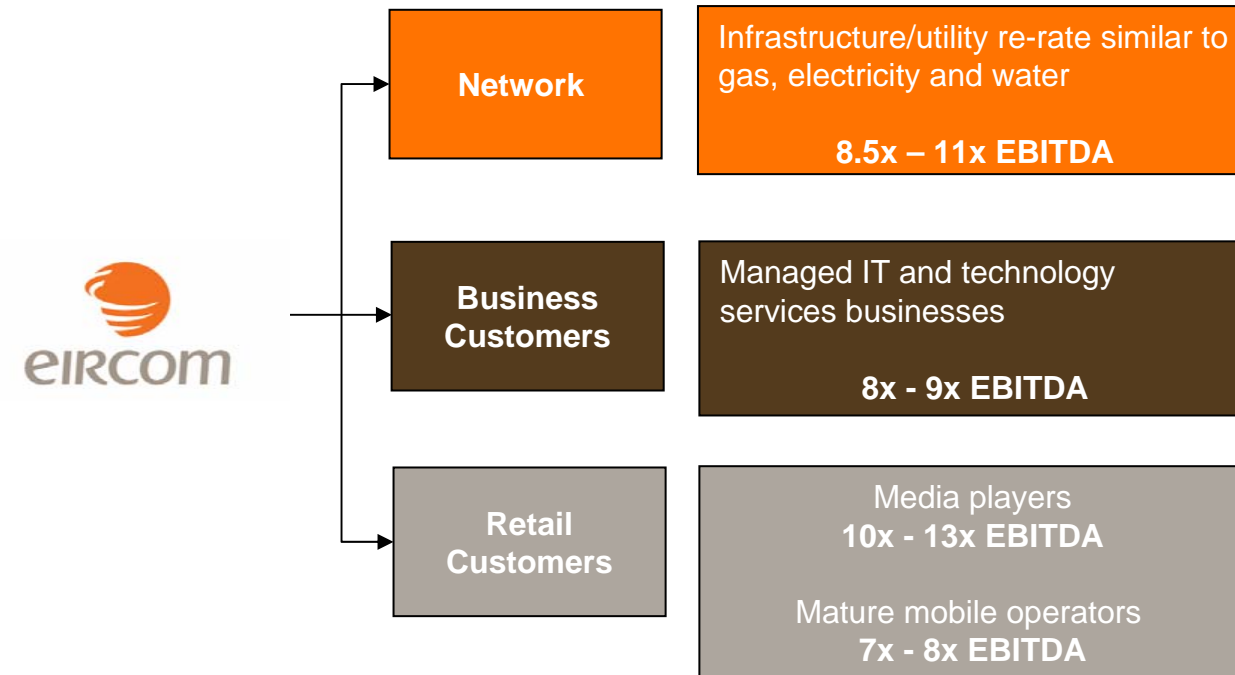
Consumer Re-rating

- While the capital markets may be shy of acknowledging the trend to convergence, content suppliers, equipment vendors and telcos all recognise that it is imminent
- Examples of convergence abound
 - Vodafone has bought assets with “light network” to enable it to bundle broadband and possibly fixed voice
 - Sky has bought the UK’s largest unbundler to give it a light network interactive delivery platform to replace satellite
- The separation of network and government and enterprise from the consumer business will facilitate a new way of looking at the remaining customer base

eircom – a case study

3-way Separation

BCM acquired eircom at a multiple of 7.2x EBITDA



eircom – a case study cont

Quality LBO base case delivering very attractive private equity returns



Fixed Line Business

Highly cash generative business due to:

- **Attractive macro-economic fundamentals;** GDP and population growth, new house starts
- **Accelerating broadband** penetration
- **Access revenues CPI linked** offsetting declining voice revenues

Stable base line EBITDA ~A\$250m per quarter

Substantial downside protection due to **potential for cost reductions**

Mobile Business

One of the fastest growing mobile businesses in Europe

Currently has ~19% market share up from 5% in Nov 05

The **Irish mobile is growing at 10% p.a.** and has an **EBITDA value of ~A\$1.7bn**

Assuming average European 3rd player operating metrics:

- ~20% market share
- ~30% EBITDA margins

Would deliver **incremental eircom EBITDA of A\$280m – A\$330m**

Conclusion

The opportunity in telco for private equity is to once again be ahead of the capital markets and look to achieve a re-rating of the components of incumbent telcos in order to realise superior private equity returns

Thank you

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