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Telecommunications Thought Leadership

MERIDIAN CAPITAL
INVESTMENT BANKERS

The Art & Science of Valuing a Communications Service Provider

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Classic business valuation, as taught in every business school, is a dry mathematical equation. It consists of a spreadsheet that applies a discount factor to anticipated future cash flows. The discount factor is tied to a premium above the cost of funds for an acquirer. The net present value of those future cash flows is posited as the current value of the business.

That's the science. The art of valuation comes from evaluating the numerous assumptions and risks behind the forecasted cash flows. Asset values, customer lists, area growth, historical performance are just a few of the assumptions that go into a comprehensive valuation approach. Each assumption is weighed against the impact it will have on future cash flows and the risks incurred if the assumption is wrong.

Over time, every industry builds up a shorthand approach to valuation based upon actual transactions. These are stated simply as multiples of EBITDA or Sales. Multiples come in a broad range across the CSP space. A small ISP with a dwindling customer base may sell for less than 3x EBITDA. A large nationwide fiber operator, exclusively with FTTH, or Fiber to the Home, customers may sell for 25x EBITDA. An ILEC with copper, fiber, cable TV and wireless customers would have a blended valuation, as each service has a different cash flow future.

Likewise, a review of comparable transactions can reveal a rough understanding of how buyers, sellers and the investment community tend to value CSPs.

The chart on the next page features a series of factors that someone valuing any CSP would typically incorporate into establishing a valuation. This list is, by no means, complete. It shows that certain variables, when negative, will lower the valuation; when positive, will increase it. Taking the time and effort to fully understand the target business is a necessity for any serious seller or buyer.

Looking through the lens of this chart a buyer can quickly discern why one fiber or wireless operator would be so much more valuable than another similar business. A seller can consider its own prospects, and perhaps see paths to increasing valuation over time, by moving operations closer to one or more elements on the right side of the chart.

Calvin Swartley, Managing Director of Valuations at Moss Adams, an accounting, consulting, and wealth management firm, sees CSP valuations evolving as market forces impact the sector. "We continue to see robust deal activity in the communications sector, with valuations steady to rising based on continued historically low interest rates and competition in the marketplace. The science behind valuations hasn't changed, but the art of projecting future cash flows and the expectations around returns continue to evolve along with greater competition. As always, we continue to advise that clients follow a well-reasoned valuation approach that utilizes a combination of time-tested methodologies, including discounted cash flow, asset-based, and market comparable analyses."

Interest rates are a factor that must not be overlooked in valuation. The Prime Rate, the interest charged by banks to their best borrowers, is literally half of what it was before the market meltdown at the end of 2008. In an attempt to forestall a deep recession, the Federal Reserve cut interest rates drastically. This lowered the cost of funds for buyers, which has equated to lower "discount factors" as described in the first paragraph of this white paper. The lower the discount factor, the higher the valuation, as represented by the net present value of projected cash flows.

While the Fed had suggested that interest rates will remain near zero until 2024, real world factors are in play that recently moved the Fed to imply rate increases in 2023. These factors include a post-Covid booming economy, supercharged with stimulus money, that is raising inflation expectations. The Fed's response to inflation has always been to raise interest rates, and when this happens, market valuations may decrease as discount factors follow interest rates to higher ground.

Meridian Capital is a FINRA-registered investment bank providing strategic merger and acquisitions (M&A) advisory and corporate finance services. The firm has an industry-focused coverage model serving nine different industry verticals, including telecommunications. Pete Sokoloff leads Meridian's telecom practice. Pete has 40+ years of service to the telecom industry and is always happy to talk with fellow telecom professionals.

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Communications Service Providers Value Drivers Matrix

EV/EBITDA*:	Lowest Multiple	3.0x 5.0x 8.0x 10.0x 15.0x 18.0x 20.0+	Highest Multiple
Company Size (EBITDA)	Less than $3M		$50M+
Revenue Growth	Flat to Declining		Demonstrated history of high growth and actionable future revenue opportunities with clearly predictable visibility.
Retail vs. Wholesale	Short term, low margin wholesale contracts		Long-term, contracted, retail customer base with strong gross margins. High revenue per unit (ARPU) likely driven by many larger commercial customers.
Facility vs. non-facility based; copper vs. fiber	Non-facility based; twisted pair copper plant		100% state-of-the-art owned fiber or wireless infrastructure from transport through the last mile to the end-user.
Other Construction Cost Variables	High cost of construction per unit passed		Low cost of construction per unit passed. High unit density per mile, cost efficient against other factors such as aerial vs. underground, costs of rights of way, permitting, bridge crossings, tower leasing, etc.
Pricing Elements	Low-income residential customers		High-income areas with lots of commercial buildings and low competition generate more income per unit and provide many opportunities for upgrades and new services.
Area Growth	Flat or declining population		Growing areas that add homes and businesses create additional customer opportunities, resulting in incremental opportunities for revenue & profit growth.
Strategic Importance	Of no interest to other providers		E.g., A national provider lacking footprint in the PNW is likely to pay a premium in valuation for this geography. Conversely, a network in an overbuilt area with heavy competition would have less value.

EV is "Enterprise Value." Enterprise Value is the combined total of debt and equity, less cash. EV is divided by Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)

Select Telecommunications M&A Transactions

Date	Target	Acquirer	Target Description	EV ($M)	EV/Revenue	EV/EBITDA
May-21	Hargray Communications Group	Sparklight (Cable One)	Advanced communication and entertainment services.	$2,200	-	17.2x
Apr-21	Gibson Technical Services	Orbital Energy Group	Optic telecommunication services.	$48	1.2x	8.7x
Apr-21	Morris Broadband	Altice USA	Internet service provider.	$310	-	-
Apr-21	Otelco	Oak Hill Capital	Telecommunication service provider.	$105	1.7x	5.1x
Jan-21	SkyWave Broadband Internet	Nextlink Internet	Wireless high-speed internet provider.	-	-	-
Dec-20	DERYtelecom	Cogeco Communications	Space-based cellular broadband operator.	$313	3.0x	7.1x
Nov-20	Sunrise Communications	Liberty Global	Internet service and broadband operator.	$5,427	2.6x	8.5x
Sep-20	Windstream	Elliot Management	Phone and broadband services.	-	-	-
Oct-20	Paxio	Columbia Capital	Provider of fiber optic internet.	$15	2.6x	-
Jul-20	Boost Mobile	Dish Network	Wireless communication services.	$1,346	-	-
May-20	North State Communications	EQT	Telecommunication network services.	$240	-	-
May-20	Ziply Fiber	British Columbia Investment Management	Fiber optic internet services.	$2,000	-	-
Mar-20	nexVortex, Inc.	BCM One	Cloud communication services.	$40	-	-
Mar-20	Cincinnati Bell	Ares Management	Telecommunication service provider.	$4,959	3.2x	13.5x
Mar-20	Zayo Group, LLC	Ardian	Communications infrastructure.	$20,019	7.7x	17.1x
Jan-20	Summit Broadband, Inc.	Grain Management	Broadband communication services.	$333	6.1x	21.0x
Jan-20	Arrow Business Comm. Ltd.	MML Capital Partners	Communication services.	$65	2.3x	-

Source: PitchBook, Company Press Releases, Meridian Research

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Meridian Capital has been helping middle market business owners achieve their M&A and corporate finance goals since 1995.

INDUSTRY EXPERIENCE

Meridian's Telecommunications practice has strong strategic investor and financial sponsor relationships, deep sector expertise, proven transaction experience, and a commitment to maximizing shareholder value.

TRANSACTION EXPERTISE

- Mergers & Acquisitions
- Growth Capital
- Strategic Advisory

TAILORED PROCESSES

- High-Touch Approach
- Multidisciplinary Deal Team
- End-to-End Services

About Meridian Capital

Meridian Capital (www.meridianllc.com), a Seattle-based M&A advisory firm, has served as a trusted advisor to business owners on complex corporate finance, M&A, and strategic challenges for over 20 years. The firm differentiates itself through its deep industry insights, highly customized service approach, and end-to-end commitment to execution.

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