

Americas: Telecom Services

FTR acquires VZ lines: VZ aims for growth, FTR targets synergies

News: FTR announces acquisition of VZ spinoff lines

This morning, FTR announced an acquisition of 4.8 mn access lines from VZ for \$8.6 bn (\$3.33 bn in cash/debt; \$5.25 bn in shares). Based on the conversion price collar (\$7.00-\$8.50), FTR will own between 29% and 34% of the pro forma company. Per pro forma numbers from FTR, this implies a 4.5X EV/EBITDA multiple and 2.6X leverage. FTR expects the deal to close in 12 months (FCC/10 state/ shareholder approvals), FCF accretion in year 2, and plans to cut its annual dividend to \$0.75 at deal close (from \$1.00 now).

Deal analysis

Based on FTR's FCF, synergy guidance (\$500 mn, 21% of acquired opex) and the expected dividend cut, this deal would imply a pro forma FCF payout of 43% post-synergies (52% pre-synergies). This is a reduction from stand-alone FTR's current 65% payout based on a \$1.00 dividend (would be 49% payout on a comparable \$0.75 dividend). Line loss trends and broadband penetration at VZ acquired assets benchmark below FTR core trends, so operational upside exists.

Given the acquirer/acquiree size and scale relationship, a precedent deal here would be CTL's acquisition of the more urban EQ, which CTL expects to yield opex synergies of about 9% of EQ's opex (vs. 21% for this deal). FTR has a strong management team, in our view, which is important here given the execution and regulatory risks that surfaced in prior VZ spins (Hawaii, Idearc, Fairpoint).

Industry implications

RLECs – More consolidation, but now most have made their

moves: The three most logical consolidators among the RLECs have all made moves, with CTL and FTR going for much larger deals, while WIN has opted for the smaller deal. In this respect, we believe a sale of Qwest's ILEC business (following press reports of potential asset sales) is of low probability, as the logical acquirers have all made moves already.

VZ – Great progress in refocusing the business on core

wireless/FiOS/enterprise: Pro forma for the deal, Verizon's 2010 wireless revenue exposure increases nearly 250 bp to 47% (proportionate for VOD stake). Assuming it is completed, this deal would tweak Verizon's revenue model away from businesses in secular declines, and should benefit the revenue and EBITDA growth profile for the company.

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Frontier / Verizon pro forma financial and operational analysis

Exhibit 1: Frontier pro forma financials (analysis per company guidance)

Data as of 2008YE (\$millions)	SpinCo	FTR	Pro forma	Comments
Deal price (EV)	\$8,580			\$3.3bn in debt/cash; \$5.25bn in shares
Revenues	\$4,287	\$2,237	\$6,524	
EBITDA	\$1,918	\$1,214	\$3,132	
Margins	44.7%	54.3%	48.0%	
EBITDA post synergies	\$2,418	\$1,214	\$3,632	
EV/EBITDA	4.5x			
EV/EBITDA post synergies	3.5x			
FCF	\$930	\$493	\$1,423	
Opex synergies			\$500	
FCF payout post synergies (taxed)			\$1,733	
Net debt	\$3,333	\$4,547	\$8,005	Includes \$125mn in integration costs financing
Net debt/EBITDA	1.7x	3.8x	2.6x	
Net debt/EBITDA post synergies			2.2x	
Shares	684	312	989	Assuming midpoint of collar
Dividends			\$0.75	
FCF payout		65%	52%	
FCF payout (post synergies)			43%	
Ownership post deal	68%	32%		Assuming midpoint of collar

Source: Company data, Goldman Sachs Research estimates.

Exhibit 2: Verizon / Frontier pre- and post-spin operational metrics (analysis per company guidance)

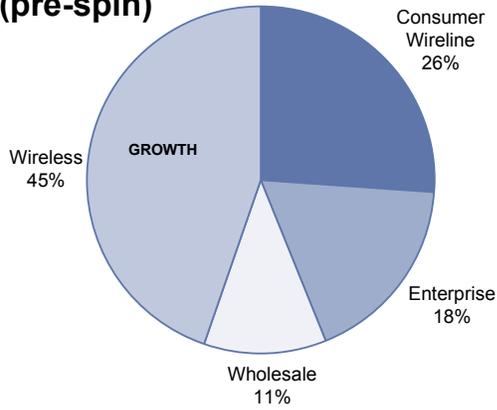
Data as of 2008YE (in 000s)	Current Verizon	SpinCo	VZ post-spin	Legacy FTR
Access lines	36,161	4,791	31,370	2,254
YoY access line decline rate	-9.3%	-10.2%	NM	-7.2%
Broadband subs	8,673	1,001	7,672	580
Broadband penetration of total access lines	24.0%	20.9%	24.5%	25.7%
% of access lines broadband enabled	NA	About 60%	NA	92%
FTTN homes passed (assume total Video + Internet)	12,700	600	12,100	NA
FiOS Internet subs	2,481	110	2,371	NA
FiOS Internet penetration of FTTN homes	19.5%	18.3%	19.6%	NA
FiOS Video subs	1,918	69	1,849	NA
FiOS Video penetration of FTTN homes	15.1%	11.5%	15.3%	NA

Source: Company data, Goldman Sachs Research estimates.

Exhibit 3: Following the announced spin of 4.8 mn access lines to Frontier, Verizon's 2010 wireless revenue exposure (proportionate for VOD stake) would increase from 45% to 47%...

Verizon 2010 revenue breakout, pre line spinoff to Frontier

VZ (pre-spin)

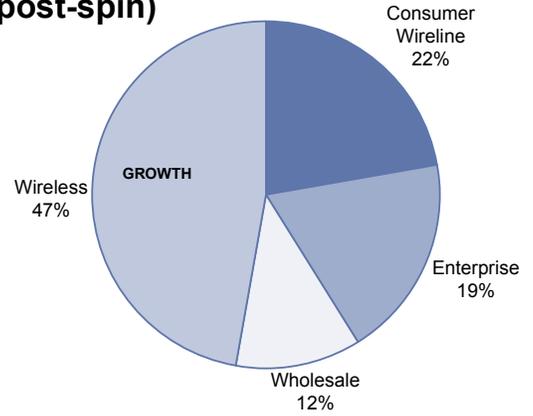


Source: Company data, Goldman Sachs Research estimates.

Exhibit 4: ...while its exposure to the declining Consumer Wireline segment would decline from 26% to 22%

Verizon 2010 revenue breakout, post line spinoff to Frontier

VZ (post-spin)



Source: Company data, Goldman Sachs Research estimates.

Reg AC

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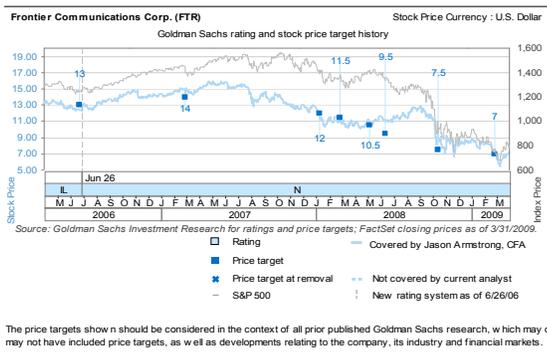
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Price target and rating history chart(s)



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