

Critics turn up the volume on Vonage IPO: After doing serious number-crunching, analyst says 'sell'

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Come on, admit it. You were one of the people who bought into the Vonage Holdings Corp. initial public offering at US\$17 a share. With the stock now trading at about US\$9, just tell me one thing: what were you thinking? Any chance you would be interested in some swampland in Florida?

It has to be one of the great IPO mysteries of all time. How this deal ever got done with a valuation of US\$2.6-billion is a sad reflection of the intelligence, or lack thereof, of the investing public. This is a company facing intense competition, volatile pricing, regulatory challenges, and has been spending huge amount of money on advertising.

To top it off, Vonage is facing a number of lawsuits -- some from shareholders upset with the IPO process, and a patent infringement allegation from Verizon Communications Inc.

Optimists will argue that Vonage's prospects are healthy given it is the leading VoIP service provider with 1.6 million customers. They will point to analysts' forecasts that the company could have five million to seven million customers by 2009.

However, having lots of customers doesn't matter much if the losses keep mounting. And there is no indication Vonage plans on becoming profitable any time soon given its aggressive marketing plans, which include a US\$350-million budget this year.

Vonage's critics are having a good old time as the company's brand continues to suffer with one stumble after another. For some analysts, one of the most troubling developments is its recent willingness to reduce prices to keep customers. If you threaten to leave, they will cut your bill by \$5 a month.

Among the naysayers is Neeraj Monga, an analyst with Veritas Investment Research, who recently issued an extensive research report on Vonage after doing some serious number crunching that featured several subscriber, pricing and churn scenarios.

In a report titled Not Too Late to Hang Up, Mr. Monga's conclusion is blunt and succinct: "Sell." He contends the stock is worth less than US\$5. "Vonage is caught in a perfect storm," he said. "Regulatory uncertainty, competitive pressures, lawsuits, unhappy customers and a damaged brand will derail its business plan. Time to hang up," he said.

His bearish outlook is highlighted by a quality rating scorecard in which Vonage scores 2.5/5 for accounting and disclosure; 0/5 for adjusted cash flows; 0/5 for the balance sheet; 1/5 for business operations; and 0/5 for corporate governance. As Vonage adds three million to 5.4 million customers in the next three years, Mr. Monga expects it to burn through US\$777-million to US\$1.28-billion. If it is on the high end, Vonage may have to make a debt or equity offering next year, he says.

The growing uncertainty about Vonage's prospects has wiped out US\$1.3-billion of its market capitalization so far. At US\$9 a share, maybe the stock price reflects its true value or, at least, the value the investment community believes it deserves.

The looming question is how much lower would Vonage have to fall before there are suitors. No one was willing to meet Vonage's price earlier this year, which is why it was forced to do the IPO.

Maybe BellSouth Inc., which apparently walked away from a potential deal pre-IPO, will come back to the table if the is \$1-billion or, even better, US\$750-million. Anything can be sold at the right price.

For people holding out for an acquisition, the biggest problem is perception. Vonage has lost any buzz it once created and its ability to retain customers will become increasingly difficult as competitors, particularly the bundle-loving cable companies, start calling with tempting offers.

Perhaps Vonage had little choice in doing the IPO if it wanted any chance of attracting enough customers to create a viable business and/or attract a takeover offer. Unfortunately, the IPO was managed badly. Rather than giving the company a boost, it has given a growing army of critics even more ammunition.