

FONE LOGISTICS

DISTRIBUTION
TAKEOVER

WITH THE SHOCK PURCHASE OF DEXTRA LAST MONTH AND A SECOND ACQUISITION IN THE PIPELINE, FONE LOGISTICS MD IAN GILLESPIE EXPLAINS HIS RISKY STRATEGY.

BY SOHEB PANJA AND ELINA MATTILA

Fone Logistics held a board meeting at its offices in Cramlington late in December last year, with little by way of Christmas cheer in the air.

In the meeting, Fone Logistics' directors, MD Ian Gillespie, finance and commercial director Michael Fitzpatrick and sales and marketing chief Julien Parven, discussed a way out of the mess it was in.

As far as Gillespie was concerned there were only two options: go big, or go small.

Sales had fallen from £107m in 2006 to £79m in 2007. The company looked like it was one of the most vulnerable distributors and would struggle in what looked set to be a tortuous market for airtime distributors.

Vodafone's decision to terminate Fone Logistics in December 2006 was seen as a critical factor. The distributor made 14 people redundant as a result and saw a £1m drop in profits. The general downturn in dealer connections and the cashback meltdown also had a major impact.

Fast forward six months, and Fone Logistics has catapulted itself to become a major player after acquiring Dextra airtime for no upfront fee, and is on the verge of buying another distributor.

The company had already seen a restructure at the top.

Ian Gillespie bought out fellow 33% shareholder Gary Fawcett in recent months, leaving Gillespie with 66% of the company. The remaining 33% is owned by Mike Bower.

Gillespie, who formed Fone Logistics in 1996, is clear on the rationale for the 2008 strategy. 'For us to survive in the next three to five years, there's got to be fewer of us [distributors]. We've all got management teams, administration teams, so you need to use that fixed cost to get more volume.'

The writing has been on the wall with Fone Logistics consolidating internally too. It had a sprawling business of a handset distribution division, consumer dealers and business dealers, with separate sales teams in each entity.

The downturn in handset trading and consumer connections through independents has focused Fone Logistics entirely on the b2b sector. It is arguably some way behind the likes of Redstone, Avenir, and Vodafone's own Yes Telecom in the b2b airtime sector in terms of heritage and expertise.

Fone Logistics now connects O2 and Orange on business, and 3 and T-Mobile for consumers.

The distributor also bears a relatively large cost in terms of salaries. It has 15 account managers, while Avenir has between eight and nine, and Hugh Symons Communications has between five and six.

Gillespie believes scaling up is a simple but essential business strategy in the current climate.

'The market has shrunk considerably. It isn't big enough for all of us. My personal view is that in these kinds of market conditions you either consolidate or you get out.'

'We've needed consolidation in distribution for some time, and we've decided to lead it.'

The Dextra deal

The next phase was to consider companies that Fone Logistics could buy and try to put values on other distributors. That exploration opened up a few surprises; companies that were previously thought 'unbuyable' were, in fact, ready to be acquired.

A conversation between close associates Fitzpatrick (pictured, far right) and Dextra CEO James Browning in early

What the dealers say

Fone Logistics' acquisition of Dextra hasn't changed things much for its dealers. 'There hasn't really been much of an impact, because there was a diminishing number of contracts anyway,' one dealer says.

Fone Logistics' ownership of Dextra does give the dealers some more backing in terms of selling data connections to their corporate clients, he says. The possible HSC takeover would have a more significant impact. 'If they take Hugh Symons that would give them good ammunition in new areas such as data products.'

April opened up the idea of a potential acquisition.

At the time of the conversation, Doughty Hanson, Dextra's private equity parent company, was carrying out a strategic review of all areas of the business. Dextra's airtime business had just absorbed a debilitating period of financial pain after some of its major dealers had gone under through unpaid cashbacks. It left Dextra with a hefty clawback bill, a sudden drop in volume and some bad publicity.

The airtime business didn't fit with new CEO Meinie Oldersma's future strategy and Doughty Hanson had a chance for an easy exit.

Gillespie entered discussions at the latter stages, and the Fone Logistics' management appeared to pull off a deal with no upfront cost, but would pay Doughty Hanson a

percentage of the commissions from a set number of Dextra dealers.

The plan was to take on some of Dextra's sales team, but amalgamate it with Fone Logistics' existing back office engine, while picking up the additional volume. It gave Fone Logistics a 25% share of the market.

Asked if he was surprised by the incredible value for Fone Logistics, Gillespie jokes: 'Well, I am a Geordie.'

He adds: 'Doughty will actually make more money because they pick up commissions without any of the overhead [costs]. The real attraction for us is there is no risk.'

Doughty Hanson only gets paid if Fone Logistics sees a return from each of the Dextra dealers.

The results so far have apparently been positive as dealers are being switched over onto Fone Logistics' back office operation. 'We're getting a good reaction and nobody is saying we don't want to come with you.'

With the appetite still there for increasing Fone Logistics' share of the airtime market, there has been continued exploration of potential targets. The most obvious target is Carphone Warehouse-owned Hugh Symons Communications (HSC). An initial £3m bid was



'The market isn't big enough for all of us. You either consolidate or you get out.'

Ian Gillespie, MD, Fone Logistics (above, left)

turned down a fortnight ago, but a deal could still be reached.

The second purchase

HSC seems to have worked at making itself an attractive acquisition target by some heavy cost cutting. Last month, the company set out a consultation process with employees, which is expected to result in 17 redundancies.

Carphone bought the company in January 2006 for £5m with an additional £5m based on performance. Other candidates are few and far between.

Gillespie says he wouldn't rule out a purchase for a distributor which only connects one or two networks, but wouldn't consider a company with a network shareholding, appearing to rule in EBS but not Mainline and Midland.

'We're open to talking to other people about a similar model [to the Dextra purchase] but we're not desperate to do a deal.'

With Vodafone still missing from Fone Logistics' network offering, it would make sense to approach Redstone – the only realistic target that offers Vodafone. 'It would be nice to get Vodafone but I don't think it's critical. We've moved on a long way since then.'

Redstone or HSC would edge Fone Logistics closer to the 50% market share it covets, while also enhancing its average revenues for the networks' quality metrics.

Some observers say that the simple thing would be to identify the main rival distributor, and aggressively poach customers and staff. All distributors are believed to carry out such strategies from time to time, but Gillespie says: 'We do a bit of targeting but you stand a better chance if you take it over.'

He says dealers and staff will immediately be drawn to Fone Logistics once it increases in scale.

'The sensible dealers are already

thinking of joining a large distributor in the current climate.'

Risks in Gillespie's plan

Rival distributors say the plan is flawed. One rival says: 'You need a level of closeness with dealers that being large often loses – especially when dealers need a lot of support right now. You need account management, finance and training. Can you do that by taking on a load of dealers and ripping out the staff? I don't think so.'

Another distributor MD says: 'Dealers are notoriously fickle. They'll switch at the sight of £30 extra per connection. I don't really understand a takeover unless it gives you another network.'

It is also argued that the days of volume bonuses from networks are now gone, so the advantage of scale is not as beneficial as it once was.

Is there also a concern that networks will look dimly on a market giant

taking too much power in the airtime distribution market?

Gillespie disagrees. 'The networks definitely won't want one distributor dominating, but they have been encouraging consolidation. O2 tried it with their Advanced Programme.'

Bernie O'Beirne, 3's director of indirect sales, says: 'Consolidation within the distribution marketplace is inevitable and this joint venture makes sense.'

'Fone Logistics has done a good job of restructuring its business in the past 18 months to cope with the downturn in consumer connections and the renewed interest in business sales.'

Gillespie is taking on the role of the sector's lead in shaping consolidation, but while consolidation is risky for retailers and operators, it can be extremely dangerous in distribution, and in the volatile current market, he is taking a huge risk. But it is a risk he believes is the only option.