Veritas still warning on Yellow Pages
'YPG on a slippery slope'

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Veritas Investment Research is not backing down from its controversial call that Yellow Pages Income Fund is overvalued, issuing another report with further research that Veritas says shows the directories publisher's business outlook is troubled.

"YPG is on a slippery slope," Veritas business trust analyst Neeraj Monga wrote in the report. "Excessive debt, declining underlying business and exorbitantly priced acquisitions will impact the prospects of the unitholders adversely. Sell."

Yellow Pages units (YLOun/TSX), which slipped 8 cents yesterday to $14.30, have fallen 3.6% since the report was published on Sept. 18 under the title "The Face Off." Veritas puts a value of $13 per unit on Yellow Pages, the same as it did in a July report that counselled investors to get out of the units.

"I'm not suggesting this company is going to cut distributions, I'm suggesting that growth is slowing and the underlying operations are under duress," Mr. Monga said in an interview yesterday.

Veritas took a shot at Yellow Pages in July based on indications of sliding demand revealed by a count of more than 121,000 display advertisements and more than 33,000 pages in Yellow Pages directories from across the country. The report generated a slide in Yellow Pages units, along with criticism from the company and from other analysts who questioned the methodology.

Yellow Pages didn't return a call yesterday seeking comment, but in an interview with the Financial Post after the first report, chief executive Marc Tellier said based on counting pages "you can't [make] the kind of loose extrapolations [Veritas] was doing" as they don't provide a whole picture of the business, because Yellow Pages has been adding neighbourhood directories as well as growing its online offerings. "The momentum in our results speaks for itself."

Mr. Tellier has support from most analysts on Bay St. Eleven of the 12 analysts tracked by Bloomberg (a list that doesn't include Mr. Monga) rate Yellow Pages a "buy." The average target price is $17.95.

Yellow Pages has been good to investors who purchased the units when the company went public in an initial public offering three years ago at $10 a unit. The company has raised its distribution per unit to $1.03 annually from 82.5 cents, for a compound annual growth rate of 7.5%. The company recently said it would increase payments to investors by 6% this year and next.

Still, Mr. Monga is doubtful that can continue. To answer Mr. Tellier's criticism that "extrapolations" from the count of ads are invalid, the latest report adds counts from four more directories, bringing the total directories counted to 13, representing 25% of Yellow Pages' circulation.

Mr. Tellier also pointed to the company's growing business of producing "neighbourhood" directories to offset any declines in larger Yellow Pages books. Mr. Monga also dug into the neighbourhood niche, surveying directories from four Toronto neighbourhoods and finding a 4% decline in page count in those from November, 2004 to November, 2005.

"What we've proved through this report is that neighbourhoods are immaterial to this company's prospects -- they are insignificant contributors -- and they are declining too," Mr. Monga said.