Telecom tycoons on the move?

An analysis of recent M&A trends shows the direction of travel for the European telecom industry. And large telecom tycoons hold the key. We expect consolidation within two countries to materialise, subject to remedies. Further consolidation may happen if the two transactions get cleared. We also expect some smaller deals, such as asset sales

Large, entrepreneurial shareholders have been pushing telecom companies such as Vodafone and Altice International to improve their operational focus. Other entrepreneurs, such as Digi's Zoltán Teszári, are likely to expand their footprint. Companies may also want to increase (or decrease) their ownership share of strategic assets. It would make sense for Liberty Global, where John Malone is the chairman, to be evaluating its options.

In Italy, Iliad, founded by Xavier Niel, has made a proposal to acquire Vodafone Italia. Although the offer has been rejected, we do expect progress in other countries, with proposed M&A transactions in Spain and the UK likely to be cleared (subject to conditions), in our view. In any event, we think industry consolidation is needed in Denmark, Spain, the UK and Italy.

Outside the large corporate M&A, we expect infrastructure assets to remain in demand, while ownership of some tower portfolios could change hands. Further consolidation among mobile tower companies is likely somewhat further away. Tower companies, for now, are looking to enhance the yield and other (financial) metrics of their current portfolios. Finally, we observed last year that governments have shown a willingness to step in if the control of a strategic asset is at stake. This has happened in Spain and Italy.

In-market consolidation

Because economies of scale are an important opportunity for value creation, especially in markets with extremely strong competition, an updated view on the topic of telecom M&A remains relevant. Nevertheless, the financial environment has changed substantially, with higher interest rates and a decline in risk-seeking behaviour.

Industry consolidation remains a delicate process, not least given the competition legislation. Previously, the European Commission allowed for a four-to-three merger in the Netherlands, as well as in Ireland, Austria, and Germany. Nevertheless, obtaining regulatory clearance depends on a review of competitiveness after the merger, and therefore remedies have often included the creation of a new number four operator or spectrum sales (competitors may look for opportunities to have their share). Also, favourable wholesale access terms for new competitors (mobile operators without their own network) could be part of a remedy package.

Typically, the market leaders in countries have a comparative advantage in terms of scale, and operate both a fixed and mobile network. The deployment of leading fixed and mobile networks is a relatively challenging endeavour for smaller operators since they do not generate the necessary cash flows to fund the network investments. This is troubling on a stand-alone basis with relatively small market shares. M&A will help the smaller operators to gain scale, which will enable investment in the networks needed to offer competitive products from a superior network. This remains a good argument to allow for consolidation, in our view.

Consolidation by country

Spain

Masmovil and Orange Spain announced a merger in Spain back in 2022. Also, Bloomberg reported that Digi has signed an agreement to purchase assets from them, subject to the merger being cleared. A cleared merger would imply that the market consolidates from four large operators to three. Given the pending asset sales, Digi could then develop into a stronger, fourth-largest, competitor. Today, the merger in Spain is still pending regulatory approval, but if it were to be cleared, it would likely be subject to conditions.

UK

In the UK, Vodafone UK wants to merge with Hutchison 3G UK and is awaiting clearance from the British competition watchdog. We deem this merger to be a necessity for both operators. They face two large operators (BT and Virgin Media O2) with an extensive fixed network which makes it difficult to compete. The transaction is still pending regulatory approval. We expect that competitors will push for remedies that are favourable to them, such as favourable mobile network wholesale access terms.

France

The French market has been quite competitive from time to time. Altice France has shown negative revenue growth, while Orange has faced pressure in its business segment. Nevertheless, consolidation in France has proven difficult. An explanation for delayed consolidation could be that the market players first want to see how regulators treat the proposed transactions in Spain and the UK. Also, the revenue opportunities from the fibre rollout may have softened market pressures. Nevertheless, the mobile and fixed network build-out still needs to be funded. Given its substantial debts, Altice France may at some point have to make a move. According to La Tribune, Patrick Drahi (through a banker) approached competitors, Free and Bouygues, in October last year, about a transaction.

Italy

The Italian telecom market has probably been the most difficult in Europe for a while. In Italy, there are more than four mobile operators, while there are also multiple (local) broadband networks. As a result of intense competition, there is a transaction underway through which the fixed network will be carved out from Telecom Italia, according to Bloomberg. Moreover, Iliad has made an offer for Vodafone Italia, which has been rejected by Vodafone because it is involved in other talks. Also, Fastweb and Wind Tre are evaluating consolidation opportunities, according to Bloomberg. Note that there are quite a few cooperation agreements in place in Italy, complicating a merger agreement. Vodafone Italia and Telecom Italia have combined their towers into Inwit. Iliad and Wind Tre are cooperating on the 5G rollout in certain rural areas, while Wind Tre also has a 5G partnership with Fastweb. We think there is scope for consolidation in Italy, but two mergers at a time are possibly a bit too much.

Denmark

The acquisition of Telia Denmark by Norlys brings scale, but there has been no consolidation among the four mobile network operators. A previous merger in Denmark between Telia and Telenor had been blocked by the European Commission. According to the Financial Times, Hutchison was in talks with Telenor about merging operations in Denmark and Sweden, in March 2023.

Belgium and Germany

While we see scope for consolidation in some European markets, market shares can, of course, change down the road. We have seen consolidation in Belgium and Germany, but it has now become increasingly probable that we'll see a fourth contender again with growing market shares: Digi in Belgium and 1&1 in Germany.

Telecom tycoon targets

- Liberty Global, with John Malone as Chairman

Liberty Global could increase its ownership stake in joint ventures such as VodafoneZiggo or Virgin Media O2. It could sell or list Switzerland. In a CNBC interview at Davos, CEO Mike Fries mentioned that Liberty Global may also evaluate possible value-enhancing strategies by separating networks from service companies. Earlier, at the Morgan Stanley TMT conference, Fries said the company was able to slowly take the company private through buybacks. According to the FT, the CEO also said earlier in the year: "For the longest time we felt we could be a mile wide and an inch deep", but now "we'd rather be in a handful of markets and a mile deep".

- Iliad, founded by Xavier Niel

Iliad has shown an entrepreneurial spirit. Nevertheless, its companies are not market leaders, which means it has more flexibility to merge in Italy or France, for example. Niel could also push for change in the industry through an equity stake in Vodafone, held by Atlas Investissement.

- Digi, founded by Zoltán Teszári

The company is expanding its footprint in Spain, Belgium, Portugal, and Italy beyond its Romanian home base. It is already relatively large in Spain but managed to acquire a spectrum block (subject to conditions) that Masmovil and Orange Spain may have to sell as a result of a remedy package, as has been reported by Bloomberg.

- Altice, founded by Patrick Drahi

Altice France and Altice International could change course. Altice International has announced it could sell its operating company in Portugal. According to Bloomberg, Xavier Niel is among the suitors looking to acquire the asset. Also, according to Le Monde, Altice France is looking for another investor in its equity, while, according to The Times, Saudi Telecom may approach Patrick Drahi with the intention of acquiring a stake in BT (Altice UK holds a stake).

Minority interests show where the interests lie

We also expect to see changes to the strategic stake-building that has happened over time. Atlas Investissement (related to entrepreneur Xavier Niel), Liberty Global, and Emirates Telecommunications Group continue to own a stake in Vodafone, while Niel also bought a stake in Proximus. Altice UK and T-Mobile Holdings (Deutsch Telekom) own equity in BT.

State investment funds are also active. Saudi Telecom has bought a stake in Telefonica, while, according to Bloomberg, an investment company related to the Spanish State has been ordered by the Spanish government to do the same. Telefonica itself is looking to buy the minority interests in Telefonica Deutschland (Bloomberg). Furthermore, the Italian government has stated its intention to acquire a stake in the Italian fixed network as part of the transaction that is underway through which the fixed network will be carved out from Telecom Italia (Bloomberg). Contrary to this stake-building, there was an article in Der Spiegel that the German government is contemplating reducing its ownership in Deutsche Telekom.

An important question can be raised about the ownership of some large joint ventures. We deem it unlikely that VodafoneZiggo and Virgin Media O2 will remain joint ventures forever. Our current thinking is that Liberty Global would not mind acquiring full ownership of both joint ventures. This would bring them greater control, while Vodafone and Telefonica may need the cash. For the right price, Liberty Global will likely also be tempted to sell its equity stakes in Virgin Media O2, VodafoneZiggo or UPC, possibly through a listing.

Consolidation impact on selected companies

Vodafone

Vodafone has been actively looking for solutions in markets where it has had a relatively weak market position, such as Spain, the UK and Italy. Vodafone has already sold its operation in Spain. Since competition is very tough in the UK, and Vodafone lacks its own broadband network, we think there is a good chance that the proposed transaction with Hutchison 3G UK will go through. We also believe that it would make sense for Vodafone to strike a deal in Italy, while the emerging markets probably remain part of the group. Vodafone definitely has the potential to be one of the leading telecom operators, again, in a couple of years. Nevertheless, we remain underwhelmed with Vodafone.

BT

We think Altice UK and Deutsche Telekom will continue to push for change. BT could unlock substantial hidden value through the (partial) divestiture of assets, such as the broadband network. Unless free cash flows improve, we think such a move will happen at some point. Given lumpy pension payments, leases and a unionised workforce, we do not see a quick turnaround for BT. Nevertheless, we do expect the new CEO to bring positive winds of change, as her realm at Telia shows.

Telefonica

The Spanish state has ordered state-related entity SEPI to buy up to 10% of Telefonica's equity. This follows the acquisition of a stake by Saudi Telecom, which wanted to acquire up to 9.9%. Telefonica could also sell its technology unit, as it tries to achieve full control over Telefonica Deutschland, according to Bloomberg, and may possibly want to acquire the Oi cable assets in Brazil, according to Reuters.

Generally speaking, it is a positive signal for creditors when investors buy large equity stakes in a company. Nevertheless, we maintain a cautious stance with respect to Telefonica.

Swisscom

Swisscom is included in this M&A review, not because of expected consolidation in Switzerland, but because of possible future events in Italy, where it has a growing operation in Fastweb. According to Bloomberg, Fastweb has been linked to a merger (or acquisition) with Vodafone Italia or Wind Tre. Consolidation in Italy could be good for Fastweb because it could well soften the strong competition. If it were to merge, there are economies of scale and scope. Note that the impact on Swisscom will probably be limited, given the relatively small size of its Italian operations compared to the operations in its home country. Nevertheless, these operations are sufficiently large to be able to benefit from synergies with Vodafone Italia.

Orange

Orange is building strong franchises in Belgium and Spain through M&A, while the stake in TOTEM (tower business) gives strategic flexibility.

Proximus

Proximus has fallen out of favour with investors. This is probably caused by the uncertainty brought about by the new competitor Digi. We think the chances of a full buyout by a private investor are low, given the current government equity stake and that privatisation is not something most governments want for their critical infrastructure.

Our M&A expectations for 2024

As this article shows, there are still many M&A options in the European telecom space. Nevertheless, we do not foresee the creation of a Pan-European telecom operator in the near term and expect the market to focus on M&A within countries. Although we probably have to await the outcome of the pending M&A transactions in Spain and the UK first, we wouldn't be surprised by consolidation in France and Italy, thereafter. Finally, there is still some appetite to do smaller transactions, for example in the tower space. We do not expect many such transactions in the near term, because the private equity market has been quiet, lately.

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