Telecom Outlook: Will we see more mergers and buyouts in 2022?

Expect further consolidation in the European telecom industry, but not the creation of a pan-European telecom operator

Telecom operators are often the target of leveraged buyouts

Europe's telecom operators focus on core markets

Using the telecom market in the US as an example, the possibility that the European market could converge to a few large pan-European operators has frequently been discussed in the past. However, over time, the market has moved in a different direction, as most telecom operators are focusing on their core markets today, where they have scale. Recently, Deutsche Telekom sold T-Mobile Netherlands to private equity, while KPN divested its operations in Germany and Belgium a while ago. Telefonica abandoned its stake in Telecom Italy many years ago, while Orange and DT sold their stakes in EE to BT. An exception to this story is Altice, which has two large telecom companies in France and Portugal and is building a stake in BT.

Two trends continue: operators will try to build scale in local markets, possibly through the integration of fixed and mobile networks, and there will likely be leveraged buyouts of either smaller operators or networks. There could also be some activity involving a tie-up with the number four operator in some markets, as these face a very difficult position. Owners could pitch to regulators that consumers will benefit from higher investment if they allow in-market consolidation among smaller operators.

Pan-European mergers are unlikely despite possible innovation benefits

To some extent, it is disappointing that pan-European mergers do not take place. Companies need scale to develop new products and services and European telecom operators are relatively small compared to the operators in North America, and especially compared to large technology platforms. However, the operational benefits of cross-country mergers in Europe are relatively small. Despite European regulations, which aim to create a common European marketplace, there are many differences among the different European telecom markets.

There are local competition authorities in the different countries (besides a European competition regulator). But there are also differences with respect to the infrastructure that is in place and differences in spectrum allocations. Most importantly, consumers in most markets differ and require different advertising campaigns. The list can be extended by differences in labour and tax regulations. Therefore, it is not easy to pull off a merger between two large telecom operators. Also, the public and governments do not like to see the headquarters of a telecom operator disappear.

Leveraged buyouts

Nevertheless, throughout the years, telecom operators have been the target of leveraged buyouts. The combination of relatively predictable cash flows, low-interest rates and, in some cases, perceived corporate inefficiencies make telecom operators an attractive target. The traditional playbook of private equity involves a corporate restructuring in combination with increased financial leverage. More recently, strategies have focused on the value of the assets owned by telecom operators, such as mobile towers and fixed networks. A case in point was the privatisation of TDC in Denmark, where the owners aimed to split the network from a consumer-focused business. The bid by KKR for Telecom Italia also seems to focus on strategies involving a separation of the fixed network. Market talk of private equity interest in KPN or BT was also linked to such strategies. Besides the private equity interest for incumbents, telecom tycoons have been acquiring companies with leverage. Notable examples are the three telco titans Drahi, Neil and Malone. Many telecom transactions in recent years, however, involved private equity for smaller companies, as can be seen in the chart below.

Another option for private equity would be the acquisition of cable networks. VodafoneZiggo, Virgin Media O2 and Telenet own a fixed network that was originally based on coax technology. We deem it a possibility that owners are going to evaluate cable network separation strategies. Note that Telenet has announced a non-binding agreement to create a network company in Flanders together with Fluvius, which will be jointly owned. Across Europe, there are multiple smaller fibre network companies, which obviously could also change ownership.

Recent Leveraged Buyouts

New owner	Orange Belgium	Xavier Neil	Private equity	Private equity	Patrick Drahi	Private equity
	↓	↓	↓	↓	↓	↓
Company	VOO	Iliad	T-Mobile NL	TalkTalk	Altice	Masmovil
Year (announced)	2021	2021	2021	2020	2020	2020

Source: Reuters, Company data

Ownership of joint ventures could change

The European market has witnessed a couple of fixed-mobile converged challengers to the incumbents. In the UK, the Netherlands, Belgium, Germany, Switzerland, Sweden, Spain and France, former cable operators joined their operations with a mobile operator, either through a merger or acquisition. The resulting companies are Vodafone in Spain and Germany, Virgin Media O2 in the UK, Tele2 in Sweden, UPC in Switzerland, Altice in France, Telenet in Belgium, and VodafoneZiggo in the Netherlands.

Interestingly, some of them have two industrial owners. We expect this to change over the coming years, with the market often moving quicker than initially expected. In the case of VodafoneZiggo, either Liberty Global could buy the shares of its partner, or Vodafone could do that. In the case of Virgin Media O2, either Liberty Global could end up as the owner, or Telefonica, although the latter faces difficulties getting leverage down, even without acquisitions. For both entities, an initial public offering (IPO) is also an option. To gain scale, it is also an option to merge VodafoneZiggo in the Netherlands with Telenet in Belgium, although strategies to enhance the value of their networks seem a priority.

In market consolidation

There are a couple of markets in Europe where price pressures are very high. Consolidation would be a possible way out. Italy is characterised by strong competition while the three largest operators face revenue pressures. Competition is also strong in France, the UK and Spain, where at least four operators are active. These markets are ripe for consolidation, despite the challenges involving competition authorities. However, companies could show that a merger also has benefits for consumers, if they are able to show that those cost opportunities could be used to fund network investment and better speeds for consumers.

An interesting acquisition was announced by Orange Belgium at the end of 2021. Orange (through Orange Belgium) announced the acquisition of a 75% stake in Nethys, the owner of a fixed cable network in Wallonia. This acquisition will allow Orange to complement its mobile network operator with its own fixed network capabilities in parts of Belgium. This would create a third fixed-mobile converged operator in Belgium, in addition to Proximus and Telenet.

The need for consolidation has been voiced by Vodafone chief Nick Reed, who pleaded for consolidation in Spain and possibly the UK. Vodafone has also been linked to consolidation in Italy. Ramon Fernandez, Orange's chief financial officer, thinks that at some point in time the French market will also see consolidation, which has become easier now that Iliad and Altice France are private companies.

Throwing in the towel?

Given the difficulty that smaller operators face in being profitable, it is also possible that the fourth biggest operators could consider throwing in the towel. They could consider taking a first step, as Masmovil in Spain did with its acquisition of Euskatel. Some operations of Hutchison Europe and Iliad are relatively small. Could it be attractive to sell them to private equity, or an industrial player? Will the network rollout of 1+1 Drillisch be a success? Or will the number four operator go into acquisition mode?

Other M&A candidates

In 2022 the owners of TDC could possibly sell their consumer-facing business while retaining the network company. Also, Bloomberg has reported that Altice International could sell Altice Portugal, although this probably requires a relatively high valuation. Finally, it is likely that Telefonica will try to sell an operation in Latin America or other assets.

The future is uncertain, but 2022 will likely bring more clarity.

Mobile Telecom Operators in European markets

Germany	· Deutsche Telekom · Vodafone · Telefónica Deutschland (O2) · 1&1 Drillisch
France	· Orange · SFR (Altice) · Bouygues Telecom · Free (Iliad)
Spain	· Telefónica · Vodafone · Orange · Masmovil
UK	· BT · Vodafone · Virgin Media O2 · Three UK (Hutchison)
Italy	· TIM · Vodafone · Wind Tre (Hutchison) · Iliad · Fastweb
Sweden	· Telia · Telenor · Tele2 · Three (Hutchison)
Norway	· Telenor · Telia · Ice
Denmark	· TDC · Telenor · Telia · Three (Hutchison)
Finland	· Elisa · Telia · DNA (Telenor)
The Netherlands	· KPN · VodafoneZiggo · T-Mobile
Belgium	· Proximus · Telenet · Orange Belgium

Source: ING Research

Author

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com