ANALYSYS MASON'S PREDICTIONS FOR M&A ACTIVITY IN THE TELECOMS MARKET IN 2023

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2022 was another important year for Analysys Mason. The company has continued to grow according to plan. We supported another record number of mergers and acquisitions (M&A) deals, and added senior experts to further strengthen our team.

Analysys Mason itself played a role in the M&A flow by acquiring Northern Sky Research, whose expert team adds specialist satellite and space competencies to our product offering, and through the completion of our partnership with Bridgepoint Development Capital. Both deals will be vital to our ongoing development as industry thought leaders so valued by the financial community.

We start 2023 with our customary passion and our traditional top-ten predictions. While many of our previous years' predictions still apply, we have avoided repeating them here. If you are curious, you can consult them on our website or ask your Analysys Mason contact about them. In this article we focus on new trends and dynamics whose expected influence on the sector have greatly increased.
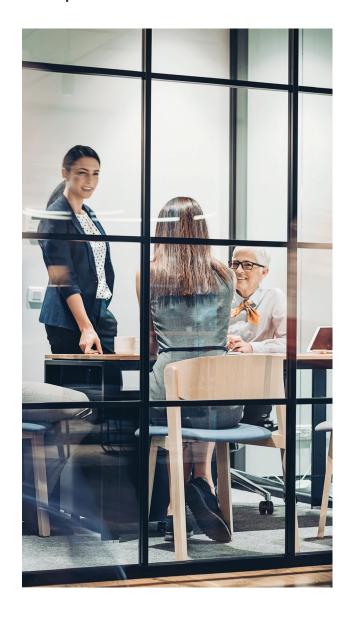
The slowdown in equity deals will not last and will vary across vertical sectors and regions

The changing macroeconomic environment (most notably the higher interest rates and inflation) is having an impact on the financial markets – the number of equity deals in the telecoms, media and technology (TMT) sector fell at the end of 2022 compared to the same period in 2021.

This trend is expected to continue in 2023. This slowdown is expected to have a particularly marked impact on those vertical sectors that benefit most from the availability of a large supply of low-cost capital – so digital infrastructure and developed regions look set to suffer more than private equity investors and emerging markets.

The reduced number of deals can be explained by the mismatch of price expectations between buyers and sellers in a changed macroeconomic environment. Analysys Mason is still bullish on the long-term outlook for M&A deals in the TMT sector as we continue to observe financial sponsors raising new capital, and there is still a long list of existing (and new) assets that are looking for new backers, or that are in need of capital injections.

Operators will focus on debt management and structured refinancing deals

With recent rises in interest rates, companies may need to spend more money on serving debt. Firms with a lower cost of debt than their industry peers will enjoy a more pronounced competitive advantage than usual (see Prediction 4).

Companies that can postpone refinancing deals will do so. Others will have to refinance because their debt will come to maturity and,

as a result, they will undergo deeper scrutiny by the lenders. These companies stand to gain from more independent due diligences to prove their merits to lenders and secure competitive financing terms.

Lenders will pay close attention to ensure that capital is used efficiently and companies are operationally sound

Project financing – or similar financing approaches – have been popular in certain markets (e.g. France) to support greenfield investments (i.e. new deployment) in digital infrastructure. These operations are more exposed to financial downturns than brownfield assets (where for the most part the infrastructure already exists) and so need to be monitored more closely.
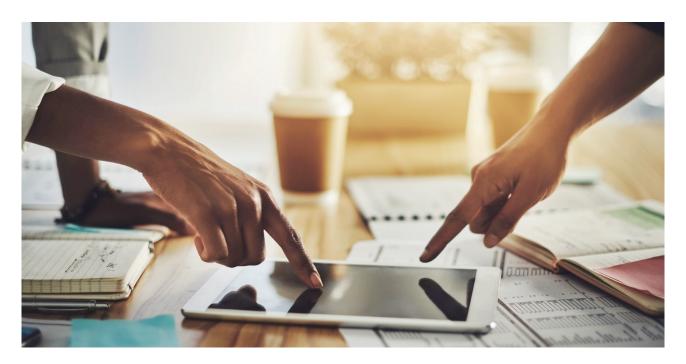
Lenders will demand closer monitoring of how businesses are progressing against the

business plans they invested in. This monitoring will need to be done by independent experts who are able to comment authoritatively on technical, operational and commercial aspects of the business. This requirement will become more common among lenders around the world and equity investors will also start adopting this more frequently to make sure that their capital is being used efficiently and where it is needed the most.

Financially sound companies will have a chance to consolidate the market

Companies will handle the increased cost of debt with different degrees of success. The most financially diligent companies with successful business models will be able to refinance at low rates, and so gain a competitive advantage.

This advantage is expected to translate into opportunities to grow inorganically through bolt-on acquisitions of players that have come under balance-sheet pressure or have struggled to find adequate capital to support their own organic growth.

This acquisition opportunity will be important in those market segments that are more fragmented, and characterised by multiple sub-scale players (e.g. fibre to the home (FTTH) in certain markets, Internet of Things (IoT), co-location data centres). The major benefits will be for those operators that have developed the ability to integrate and restructure target companies smoothly and efficiently. This will be an increasingly important requirement to pursue inorganic growth strategies.

Commercialisation opportunities will help telecoms nodes emerge as a new vertical sector within digital infrastructure

There is life beyond the three main digital infrastructure pillars – towers, fibre, data centres – that have dominated the scene in the last decade. Mobile and fixed telecoms operators will realise that their telecoms nodes (e.g. switches, exchanges, transmission) offer substantial monetisation opportunities, and they will likely bring in financial and/or strategic partners for the carved-out entities that are better designed to address the opportunity.

Telecoms nodes are typically high-value real-estate assets that are strategically positioned across a network footprint. They boast fibre connectivity, well-dimensioned industrial power equipment and a lot of floor space freed up by the downsizing of equipment when fixed and mobile networks moved from analogue to digital and from physical to virtual machines. Beyond hosting telecoms equipment, they are ideally suited to be repurposed as edge data centres. Analysys Mason has already identified, and seen appear in the market, further business opportunities within and beyond the TMT space (e.g. energy communities, distribution, vehicle to grid).

Space M&A will continue in 2023

We are seeing exponential growth in satellite capacity supply and the entry of new players, boosted by innovations in rocket launches and the increasing sophistication of satellite systems, which can be achieved at significantly reduced capex.

Incumbent players are reacting by forging strategic partnerships and consolidating to cement their market-share positions. Meanwhile, new entrants are pursuing acquisitions to reduce time to market. Viasat's acquisition of Inmarsat and Eutelsat's announced merger with OneWeb highlight the trend in 2022, alongside other M&A activities disclosed during the year.

Analysys Mason predicts that this M&A wave will continue in 2023, driven mainly by the need to secure distribution for the enormous capacity supply and strategic geographical expansion. Operators seeking greenfield opportunities in niche or developing segments through application-level differentiation will seek to acquire strategic assets.

There are marked differences in the competitive positioning and revenue streams of legacy prime contractors relative to start-up space companies and those that recently emerged from Special Purpose Acquisition Company (SPAC) status. These differences will be exacerbated as the macroeconomic environment (interest rate hikes, inflation, supply-chain challenges and recession fears in 2023) places pressure on revenue streams.

As a result, these trends will disproportionately affect companies with negative cashflow in 2023, forcing more assets to become available for sale. Analysys Mason expects the search for complementary intellectual property and talent to drive M&A activity around space infrastructure during the coming year.

We will see deals to develop new green energy infrastructure generally, as well as divestments away from energy infrastructure in countries with less green focus

Momentum is gathering globally behind the transition to green infrastructure, and so we expect to see increased differentiation at a local level.

The renewed drive to boost investment in green infrastructure (generation and distribution of renewable energy, electric vehicle (EV) charging, etc.) will see new opportunities arising in most regions. Some regions and markets may have less of a focus on, and ambition for, a low-carbon future; as a result, some players with high green ambitions may look to exit these markets and regions in s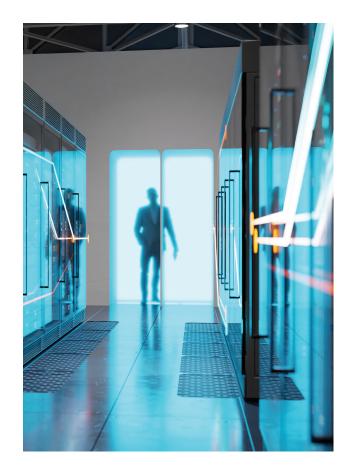earch of a more favourable environment. The generation of new opportunities, both from new investment and from gaps in the market, will lead to several transactions relating to energy infrastructure. Those players with a focus on sustainability will invest in new green infrastructure. Those players with less exacting standards for sustainability may invest in existing infrastructure, though this will still need to be aligned with the Paris Agreement's trajectory for decarbonisation.

Following years of widespread B2C fibre transactions, the focus will shift towards B2B

The ongoing transition of public and private data and processing into the cloud (and associated data centres) will drive demand for symmetrical fibre-based broadband connections (i.e. with the same uplink and downlink speeds). This will apply to companies' day-to-day operations, even if not located in city centres or very densely populated areas. This trend requires the deployment of geographically granular business-to-business (B2B) fibre networks that have different properties from business-to-consumer (B2C) fibre connections (more secure, with redundancies and providing symmetrical, or at least very high upstream, speed). Hyperscalers also require further fibre connections (on separate redundant routes) to connect submarine landing stations to their data centres (and to interconnect their numerous data centres).

After many B2C fibre transactions in a range of countries over the last few years, B2B-focused companies will require further capital to expand their activities, connect the increasing number of data centres in fully meshed networks and provide on-net fibre links to connect companies to their main data centres and the internet. We expect this to drive further M&A.

The wave of IoT M&A activity will not stop

A number of M&A deals and investments occurred in the IoT market in 2022. Most notably, Semtech bought Sierra Wireless and Unabiz took ownership of Sigfox. Several high-profile deals are already planned for 2023; among these might be the spin-off of Vodafone's IoT unit, potentially worth billions of euros, which will be watched closely by other operators that are considering a similar move. Aeris should also complete its acquisition of Ericsson's IoT unit in Q1 2023, and Soracom plans to list on the Tokyo Stock Exchange, making it just the second IoT connectivity firm to list publicly (after KORE in 2021).

As the IoT sector continues to mature, this will create opportunities for investors that do not focus on early-stage investments and so have not looked at this space before. Further deals in 2023 will include the acquisition of small players by larger IoT mobile virtual network operators (MVNOs) such as Wireless Logic and KORE, as well as operators' investments in, or acquisitions of, innovative connectivity disruptors to gain new capabilities. We also expect to see telecoms operators spinning off their IoT divisions to highlight the value of the business and, potentially, attract investors.

Retail operators no longer burdened by network operations will look for M&A options

The trend towards de-layering network businesses (NetCos) and service provider businesses (ServCos) will continue. A great deal of attention has been paid to the creation of, and experimentation with, various NetCo/InfraCo business models.

Over the coming year (regulation permitting), this process should also allow B2C ServCos to be reconfigured, both to generate economies of scale (e.g. by removing duplicated IT assets), and to expand and seek co-investment.

Freed from the obligation to monetise a particular NetCo's local or national infrastructure investment, ServCos will think more independently, evolve into more digital and platform-focused businesses, and therefore develop different expectations and ambitions. For example, they could develop a common set of, or platform for, containerised in-home services. These service provider federations are likely to be a precursor to full-blown M&A. De-layering will lower the barriers to national and transnational ServCo consolidation; this is likely to play out in Europe and in other regions with small national operators.

We would be pleased to have further discussions on our top predictions, as well as other – no less important – predictions that did not make the shortlist this year. We expect 2023 to be another exciting year for deal makers, with a completely new set of challenges to be overcome. We look forward to sharing this journey with our clients as a trusted commercial and technical adviser, especially in light of our expanded capabilities in emerging sectors such as satellite, environmental, social & governance (ESG), technology & operations, energy and utilities, among others.

Analysys Mason

Analysys Mason is the commercial and technical adviser of choice of multiple major financial investors and industry players due to our focus on TMT, convergent digital vertical sectors and the experience that we have gained in over 750 transaction support assignments worldwide during the last five years. 2022 was our biggest year ever with ~250 transaction support assignments that cover the full investment lifecycle of our clients, demonstrating marked acceleration of activities and the expansion of our team across domains and geographies.

Do you have any comments on our M&A predictions for 2023? Please get in touch with the author, Alessandro Ravagnolo (alessandro.ravagnolo@analysysmason.com).

> **Do you want to read more predictions for the TMT industry in 2023? See link below.**
> **https://www.analysysmason.com/about-us/news/predictions-2023/**

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