CONSULTING

Analysys Mason's predictions for M&A activity in the telecoms market in 2021

2020 was the year when Covid-19 disrupted our lives, but it is also the year that demonstrated how important the telecoms, media and technology (TMT) sector is in the modern world. The mergers and acquisitions (M&A) deal flow continued throughout the year, largely unaffected by the pandemic. Investors showed strong appetite for digital infrastructure (in particular) and all stakeholders involved in transactions – from investors to advisers – demonstrated resilience by quickly adapting to a new modus operandi.

2021 is expected to be a year of great dynamism with opportunities across the TMT value chain for an even wider audience of investors than seen before. Analysys Mason is pleased to present its top 10 M&A predictions.

Prediction 1: Investors will re-balance their portfolios towards digital infrastructure

Covid-19 had different impacts across the infrastructure verticals. Some verticals proved to be more exposed than others to the downturn created by the Covid-19 outbreak, whilst digital infrastructure, along with renewable energy, was one of the most resilient. The pandemic accelerated some positive dynamics, especially the digitalisation of many sectors and the demand for high-speed and reliable connectivity. This acts as a stimulus to the demand for new-generation networks and improves their economics (e.g. more certainty around the demand). As a result, digital infrastructure is more than ever a sought-after – yet scarce – commodity that every long-term investors want in their asset portfolios. Sponsors that have not historically considered digital infrastructure as part of their remit are now expected to re-evaluate their position, while many generalist investors already active in the space will likely look to invest a higher share of their capital in telecoms infrastructure.

Prediction 2: Operators' lower valuations will trigger 'take-private' deals

Another side effect of the pandemic is that the trading value of public (non-infrastructure) operators has taken a hit. Many operators are in fact trading at lower values than they used to pre-Covid-19. Bold investors are expected to consider the buy-out of public companies with unexploited growth potential. This is especially true for those companies that have been capex constrained in the past. Private ownership could offer them the opportunity to plan more aggressive investment strategies than when they were public and accelerate network deployments and upgrades (especially on 5G and fibre) to exploit the positive dynamics discussed in the previous prediction. There have already been a few examples of this happening: the acquisition of MásMóvil in Spain by a consortium including KKR, Cinven and Providence, Patrick Drahi de-listing Altice Europe NV, and hedge fund Toscafund Asset Management making an offer to take TalkTalk in the UK into private ownership.

This expected wave of acquisitions has so far spared the largest operators despite many incumbents' share prices having decreased significantly at the beginning of 2020. However, this might not last if share value remains low in 2021. Some management teams are expected to defend the public positioning of their companies with bolder strategies. These are likely to include the usual efficiency measures (also through digitalisation of processes), but also further investments in new-generation networks that will further boost deployment and increase competition.

Prediction 3: European mobile consolidation will resume

European mobile operators are facing the perfect storm: rising capital requirements for spectrum, 5G deployment (and fibre deployment for converged players), saturated and highly competitive retail markets and additional pressure on financials driven by the Covid-19 outbreak. In this context, in-market consolidation is increasingly attractive to operators and their shareholders.

To overcome the hurdles imposed by competition authorities that opposed many consolidation deals, operators have signed an increasing amount of RAN (radio access network)-share deals as an alternative approach to reduce cost and increase efficiency. However, the 28 May 2020 General Court ruling that overturned the previous European Commission decision to prohibit the merger between Three and O2 in the UK is likely to radically affect the way future proposed mergers will be evaluated by the relevant European authorities. Once the dust has finished settling, we predict that there will be one or more consolidation attempts in the larger European markets to reduce the number of mobile network operators (MNOs) from four to three.

Prediction 4: Focus on mobile and fixed connectivity in rural and remote areas

Bridging the digital gap will play an increasingly central role in the agenda of policy makers and, subsequently, regulators in a post-pandemic environment. The roll-out of new-generation mobile and fixed networks in rural areas and the associated opportunities for investors in the fibre and tower spaces are common knowledge and have already been extensively discussed. The difference is that there used to be a rural threshold beyond which these traditional models were ineffective to produce the required returns on capital invested. This threshold is now being challenged and pushed back by the increased visibility/predictability of future cashflow due to the positive long-term dynamics created by the pandemic. As a result, rural connectivity is attracting more funding and well-designed subsidy/voucher policies could further boost the operators' appetite for deployment in rural areas. However, traditional infrastructure approaches are unlikely to be sufficient to tap into the opportunity offered by connecting most remote areas (beyond the aforementioned threshold).

On fixed broadband connectivity, we see fixed-wireless access (FWA) and satellite providers to benefit from increased demand and, therefore, take-up. In particular, we see an increasing interest in investment models where, through FWA, operators gain control of the subscriber base to then migrate customers to more scalable full-fibre platforms where the success rate or competitive threat demand it. This approach can be successful in de-risking deployment in rural areas where high up-front capex is required.

Mobile connectivity requires new business models to deal with the different economics of deploying networks in more challenging and less dense environments. Government subsidies are also less common in the mobile space than in the fixed space, thus further putting into focus the need to reduce the total cost of ownership of the infrastructure (taking into account both deployment and running costs). Existing players (e.g. towercos) can exploit this opportunity by changing their relationship with their MNO customers in remote areas. This could involve adopting a wider perimeter of operations. One example could come from taking advantage of the future virtualisation of radio access networks that will make the ownership of the hardware at the sites less relevant since hardware is more likely to be shared between MNOs. Opportunities could also be created by financial investors interested in supporting rural-focused, mobile neutral-host business models. Most success stories involve emerging markets, but at Analysys Mason we see advantages in replicating these models in developed economies as well.

Prediction 5: Larger tower carve-outs and innovative tower perimeters

We are going to see new large towercos in Europe in 2021. Vodafone's creation of Vantage Towers and the sale of CK Infrastructure tower assets to Cellnex are expected to pave the way for other large carve-outs and potential divestments in Europe and in other regions. Of interest is the fact that the wave of tower deals is predicted to expand to regions that have not been as active before. The two aforementioned deals showed increasing interest in Central and Eastern Europe (even beyond Poland) and the Nordics, but there are indications that Australia will become of interest and that Africa will see a higher number of deals than it has seen on average in the last few years.

Finally, we predict that we will see more sale-and leaseback deals with an innovative perimeter of operations.

Prediction 6: MNOs looking for wholesale revenue will increasingly target MVNOs

MNOs have been spending a lot of money on 5G between spectrum auctions and network deployment. The monetisation of 5G within the consumer segment remains unclear and subscriber take-up takes time to build up, thus resulting in low utilisation rates of mobile networks. In this context, MNOs are seeking ways to monetise this spare capacity by filling the pipe with more traffic.

One approach could be to offer FWA services in certain areas. Especially for MNOs without a fixed network, this is an attractive proposition because it does not cannibalise existing revenue streams and could reduce wholesale cost from avoiding to buy access from a wholesaler. However, the traffic generated by fixed broadband subscribers is much higher than that of mobile customers, and MNOs can only push this service to the extent that they do not jeopardise the quality of experience offered to mobile users.

A second option available to MNOs is to attract mobile virtual network operators (MVNOs) on their network. MNOs have fiercely fought for MVNO wholesale contracts in the recent past with notable MVNOs switching host networks. Alternatively, MNOs can buy the MVNO, which could allow them to maintain more steering on the positioning of the operator to reduce the revenue cannibalisation risk. This strategy has been followed by several operators that needed to build a subscriber base from scratch such as MásMóvil in Spain and DISH in the USA (each operator buying several MVNOs as a result). However, this strategy was also adopted by more established MNOs simply interested in the wholesale revenue stream, such as Verizon with the acquisition of Tracfone in the USA, Bouygues with the acquisition of Euro-Information Telecom in France, and Plus with the acquisition of Virgin Mobile in Poland.

MVNOs are primarily attractive to MNOs on the surface; however, they present interesting opportunities to private equity firms looking for assets with a robust market positioning but with room to improve the financial performance through improved wholesale terms with the host MNOs, which could also provide an interesting exit strategy.

Prediction 7: A major mobile operator will buy one of the IoT market disruptors

More than 30 innovative providers have shown that there is a market for Internet-of-Things (IoT) connectivity that is cost effective and simple to acquire. 1NCE, for example, sold over five million SIMs in less than two years thanks to its simple pricing plan and sales model, including online sales. Operators have so far failed to provide an answer to such offers, but at least one major operator will respond to this threat in 2021 by buying one of these players.

Prediction 8: Bright outlook for Latin America

We expect to see a solid pipeline of deals in the fibre space in the region. Fixed-line infrastructure in Latin America has been lagging behind North America and Europe, but this was partially compensated by dynamic mobile markets. This is no longer sustainable in such competitive markets and operators are expected to increasingly seek financial or strategic partners to fund their fibre expansion ambitions. This will pave the way for pure wholesale fibre infrastructure players that will certainly be interesting to investors used to the crowded American and European markets.

The tower landscape in Latin America has always been very lively with a long list of tower developers that have expanded their portfolios over time. The high fragmentation of most tower markets offers consolidation opportunities to aggregators such as ATC, SBA, IHS, Phoenix Tower International and Digital Colony, while the high demand for new sites also creates a favourable environment for the rise of new towercos which financial investors will use as growth platforms.

Prediction 9: Private networks will become a hot topic for financial sponsors

The deployment of private networks has quickly become a hot topic in the industry given the interest displayed by several industry verticals. To date, most of the deployments have been bespoke and led by vendors and, to a lesser extent, mobile operators, as shown by our private network tracker. However, specialist players have been emerging to fulfil the different technical requirements that the various industry parties are likely to have. These specialist players might partner with other companies across the value chain, including MNOs, to deliver end-to-end solutions customised to different service needs (e.g. healthcare, energy, etc.). By providing edge compute capabilities to support network cloud, players can also provide a cloud platform for an emerging set of secure, scalable enterprise applications, further monetising this investment. We expect the emergence of private-network specialists able to provide network platforms that can be leveraged to avoid duplications and make the roll-out of private networks cost effective and, in turn, more widely adopted.

These players will offer investment opportunities to venture capital or private equity firms interested in a space with significant growth potential. The sector could offer interesting exit strategies to vendors, operators and also infrastructure companies (e.g. Cellnex acquired Edzcom).

Prediction 10: RAN vendors will become targets of private equity firms

The future virtualisation of the radio access network (RAN) creates opportunities for smaller vendors to challenge the dominant position of the incumbents: Ericsson, Huawei, Nokia and ZTE. Mobile operators have made clear that the diversification of vendors is a strategic priority and that they are happy to make selective deployments to support emerging solutions that could gain a larger role in the future. Vodafone, Telefónica and MTN, among others, are showing their support to smaller vendors by deploying virtualised solutions in rural areas. These could also be ideal testbeds for Open RAN solutions too given (1) the potential cost savings that could be realised fit with the need to reduce costs to make rural investments economically sustainable and (2) the lower amount of traffic and revenue in these areas is compatible with taking risks associated with the deployment of a technology that still lags behind the one deployed by more traditional vendors according to many analysts.

R&D to support the evolution of the technology roadmap towards virtualisation can be expensive. We predict opportunities for investors to provide financial aid to new smaller vendors and, potentially, to invest in those vendors that have struggled to defend their market shares with the arrival of 5G and offer them a new opportunity to re-position their business towards virtual RAN solutions.

Narrowing down our predictions to just ten from an initial, comprehensive list of interesting trends and forecasts was a challenge, which reflects both the dynamic nature of the industry and the continuously expanding breadth of Analysys Mason's transaction support services. We would be pleased to further discuss our top predictions and those, no less important, that did not make the shortlist this year.

Analysys Mason is the commercial and technical adviser of choice of several major financial investors and industry players thanks to our exclusive focus on telecoms, media and technology (TMT) and the experience that we have gained in over 450 transaction support assignments worldwide during the last five years.

Do you have any comments on our M&A predictions for 2021? Please get in touch with the author, Alessandro Ravagnolo (alessandro.ravagnolo@analysysmason.com).

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