CONSULTING

Analysys Mason's predictions for M&A activity in the telecoms market in 2020

The telecoms sector will experience plenty of activity in mergers and acquisitions (M&A) in 2020 spurred by the development of the infrastructure wholesale business model and new technologies that will create wider opportunities for investors. Here are Analysys Mason's top ten predictions for M&A activity in the telecoms market in 2020.

Prediction 1: we are in the golden age of infrastructure carve-outs and the vertical dis-aggregation of the industry will continue in 2020

In 2019, we predicted a strong year for the carving out of infrastructure assets: operators were looking for financial partners to support capex plans that they would not be able to deliver through their own balance sheet. The tide duly swept in, starting with mobile towers and moving on to fibre and data centres, and is not expected to recede in 2020, macroeconomic conditions permitting. Unsurprisingly, we expect carve-outs to continue to account for the bulk of M&A activity, but the most interesting thing is that we are seeing plenty of interest to expand beyond the 'big three' asset categories (see Prediction 3).

Operators are increasingly interested in retaining the right degree of control over their assets. Retaining some control of assets will lead to a larger number of deals structured to attract long-term financial investors rather than strategic partnerships. Partial divestment will act as a means to highlight the cashflows generated by these infrastructure assets whilst the operator can still exert a large degree of control. Having said that, strategic investors have demonstrated their ability to make compelling financial bids that can change the mind of the seller (see Cellnex with Iliad's towers and SFR's FTTH with Covage). Strategic investors can also offer a partnership that goes beyond providing capital and will continue to leverage this to expand their footprint.

Prediction 2: Broadcasting towercos will plan the spin-off of mobile co-location business

Various broadcasting towercos are looking for buyers in Europe. Many sale processes have fallen through because of a valuation mismatch between the seller and the potential, largely due to differences in expectations regarding the longevity of the TV broadcasting revenue stream.

Most broadcasting towercos have diversified into mobile co-location, fibre and data centres. There is an opportunity for investors to sell non-broadcasting assets separately to take advantage of the difference in valuation between the different businesses. The broadcasting business can still attract interest from specialist investors, thus creating additional value from the distinction of very different businesses. For 2020, we expect to see more deals like the one Arqiva closed with Cellnex in the UK in 2019.

Prediction 3: Infrastructure investors will start looking for new asset classes

Deal volumes in traditional assets are unlikely to decrease in the short term, but investors are already considering what the next tower, fibre or data-centre asset class might be that will define the next wave of M&A. This will be driven by the natural interest in staying ahead of the curve and anticipating emerging trends to close deals and build a portfolio before the new asset class becomes mainstream and prices soar.

This will inevitably raise the question of what 'infrastructure' is and how it should be re-defined within the investor community. Some creativity may be required to be competitive, but it is already clear that spectrum and active networks (e.g. electronics) will come under scrutiny from investors – but they will not be alone.

5G will continue to arouse the interest of investors with new business models. For example, the 'landlord pays' model could be used in order to address the coverage deficit for the 'great indoor' and other high-footfall locations, which can be enabled by more flexible licensing regimes. Digital Colony has already started developing a comprehensive UK capability in this area through its acquisitions of Stratto, Opencell and Spyder but it is a geographically specific market and this model is much more nascent in other markets.

Prediction 4: Deals to aggregate assets from different infrastructure asset classes will be experimental rather than transformative

In our article last year, we predicted that convergence between infrastructure vertical sectors would become a more significant talking point. Indeed, a good degree of activity has been recorded by Analysys Mason, typically involving small deals that proved the appetite among existing players to experiment and gain knowledge of adjacent vertical sectors. However, we have not yet seen a 'wave' of related M&A deals.

Towercos, fibrecos and data centres all operate in vertical sectors that present large opportunities for organic and inorganic growth. The decision to allocate large capital amounts to diversify is not easy, especially as the business case for convergence is still limited and/or immature. On the other hand, the aforementioned players will need to continue to experiment in order to be primed for the moment they need to commit to this strategy more completely. We do not expect transformative deals in 2020, but in 2021 we may tell a different story...

Prediction 5: The use of unlicensed frequencies will create more interest in FWA, although opportunities remain limited

We note a renewed interest in fixed-wireless access (FWA) assets thanks to the improved capabilities of wireless technologies and the use of unlicensed frequencies. FWA can address attractive market niches (e.g. rural/remote areas) where the timeframe and the economics of fibre deployment make the business case challenging.

The speed of execution and the competitive economics of FWA networks deployment is expected to attract fresh capital, including from those investors who have historically preferred fibre assets. FWA networks can be upgraded to full fibre as required by take-up or competitive pressure to protect the territory that has been gained.

Prediction 6: New wave of investments in submarine cables

Additional international bandwidth will be required to support the growth in global data traffic, including for emerging markets. Despite the continuous upgrades of the active equipment, existing submarine cables will soon be unable to fulfil demand on many routes, and additional systems will need to be rolled out in parallel. Moreover, the capacity offered by new transmission technologies makes it more economically convenient to deploy a new cable than upgrading existing ones.

New routes will need to be opened to reflect the changing global dynamics of the connectivity market: emerging economies will start playing a more central role by contributing to the production of content and IP services. Internet giants will invest in a more distributed network of points of presence to create regional hubs that will need to be efficiently interconnected.

We predict significant investments for the next two to three years, with important announcements to be made in 2020, likely to be dominated by co-investments between the internet giants and traditional players.

Prediction 7: Multi-national groups are likely to retreat to core markets, providing opportunities for new investors with appetite for the geographical and political risks

Multi-country operators are predicted to reconsider the portfolio of markets in which they operate. Similarly to carve-outs, the divestment is driven by the need to fuel capex in the core markets. A large disparate footprint could be considered a distraction rather than an opportunity if the peripheral markets do not contribute sufficiently to growth in EBITDA.

A notable example is Telefónica, which announced its intention to focus on four markets, and treat the others as financial rather than strategic investments. Similar motivations can be seen in Liberty Global and Telenor selling their operations in Central and Eastern Europe (CEE), Tele2 refocusing in the Nordic region, while the destiny of Telenor's Asian assets is still unclear due to the difficulties in closing the deal with Axiata.

This trend could lead to the emergence of new regional conglomerates (e.g. PPF Group and United Group in CEE) and interesting investment opportunities for private equity firms.

Prediction 8: The European infrastructure divestment spree will start spreading to Greece and CEE

CEE was not unaffected by M&A activity in 2019. In addition to (BC Partners-backed) United Group buying Vivacom in Bulgaria, and the acquisition spree of PPF Group buying CME, Orange has been active in the region, with the acquisition of Telekom Romania. However, infrastructure investors have so far not played a large role in the region compared to other regions (perhaps with the exception of Poland), due in part to operators' preference towards vertically integrated business models.

We believe that the markets are reaching a sufficient level of maturity for investors to challenge the status quo and for operators to consider alternative options. We would expect these operators to look at successful carve-outs in Western Europe. This could be further encouraged by the changes of ownership discussed in Prediction 7 above, and there could be an interesting opportunity for transformative strategies that include the participation of long-term infrastructure investors.

Similarly, we see great potential in certain countries previously considered difficult to invest in: the Greek market, for example, has suffered from historical economic difficulties that have blocked many deals in the past. Signals of economics improvements and business confidence should attract the investments that are required to fund the deployment of new infrastructure (e.g. fibre tenders in rural areas).

Prediction 9: Network evolution to 5G will see new winners emerging in software telecoms, prompting further M&A deals from both vendors and private equity firms

5G deployments requiring cloud-native telecoms software creates more opportunities for smaller vendors of next-generation platforms. These companies will rapidly become targets for the larger companies who have under-invested in their platforms, but the two fundamentals remain – price and performance. There are many innovations in optics and radio technology that increase performance with lower power consumption, smaller footprint and higher performance. Software innovations are automating a broader scope of network functions with more data and better, AI-led analytics.

In all these areas, start-ups flourish while larger vendors and network operators seek innovative acquisition. While vendors will lead in terms of M&A volumes, there will be further opportunities for technology-focused private equity firms to back companies able to carve out market niches (and perhaps more). The challenge will be to gain sufficient understanding of the trends and the rate of adoption of new technologies in telecoms that has often been misjudged in the past.

We also see growing interest in open-source technologies such as Open-RAN which mobile operators will increasingly look to use to solve some of the cost-based problems associated with low traffic and rural sites. Towercos could play an important role in this space but they have not fully embraced this business model yet. In the meantime, new bankable players are emerging, such as Internet Para Todos in Latin America and Africa Mobile Networks and Vanu in Africa.

Prediction 10: Very lively M&A activity in cyber security

The competition between 'security-as-a-feature' models and full suites of security products evolves and intensifies. By security-as-a-feature, we mean Microsoft bundling anti-virus protection with Windows, or offering cloud security information and event management with Azure Sentinel. By a full suite, we mean the offerings of pure-play security companies, the model followed by companies from Sophos to Palo Alto Networks. Opting for a single, best-of-breed product is losing its appeal to many businesses as they seek to reduce the number of vendors whose solutions they use and simplify their security operations.

More M&A activity is driven by the above competitive trends. Companies from other parts of the value chain will buy security firms (as we have seen in 2019 with deals by VMware and Broadcom), while security specialists will continue to make smaller, 'bolt-on' acquisitions to strengthen their portfolio. We will continue to watch the activities of specialised technology investors in the small and medium-sized market.

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Do you have any comments on our M&A predictions for 2020? Please get in touch with the author, Alessandro Ravagnolo (alessandro.ravagnolo@analysysmason.com).

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