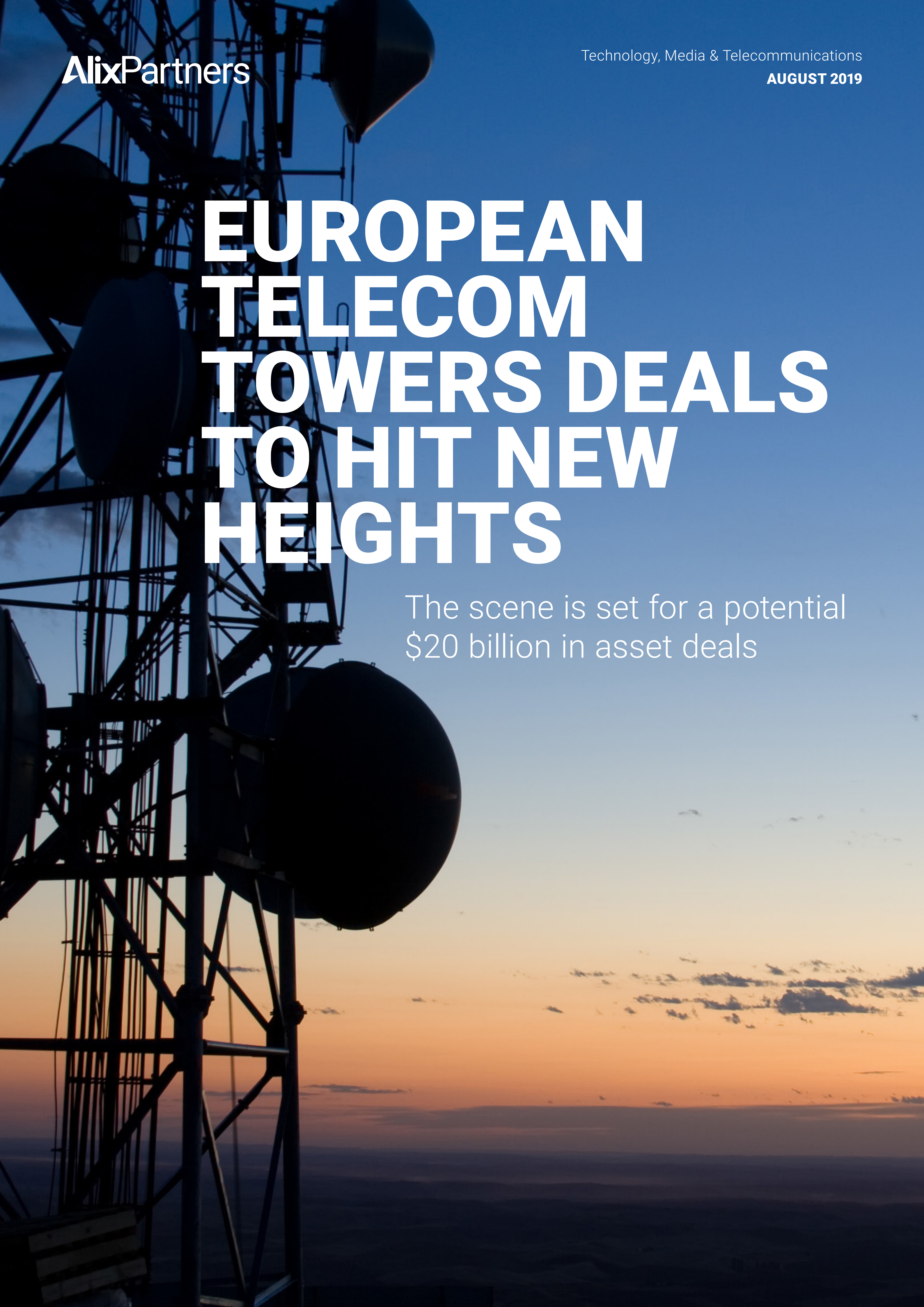


AlixPartners

Technology, Media & Telecommunications

AUGUST 2019

EUROPEAN TELECOM TOWERS DEALS TO HIT NEW HEIGHTS

The scene is set for a potential $20 billion in asset deals

Telecom tower owners and prospective investors are gearing up for a frantic period of deal-making in a European market full of opportunity. As activity heats up, AlixPartners has identified that a potential $20 billion in asset deals could be on the table in the next 12 to 24 months. But how do investors and divestors alike get the most value from these deals?

In stagnating markets, where growth is limited and sometimes non-existent, Mobile Network Operators (MNOs) are finding their cashflow under growing pressure. This is exacerbated by telcos being pushed to increase the speed and reach of fibre deployments, and find vast sums for new spectrum investment. With revenue increasingly de-coupled from costs, telcos need to think differently.

Most European operators have already realised significant capex savings and operational efficiencies from sharing network infrastructure. The time may now be right to look at not just sharing, but offloading.

Until now, many MNOs have been jealously guarding their tower assets, with the goal of better coverage and speed differentiation. But the tables are turning. 5G deployment looks set to be rather different to previous iterations of mobile technology, as operators seek to differentiate and monetise through focused B2B use cases, rather than mass consumer deployment. This changing focus supports a rethink of the traditional logic of tower ownership.

Reducing expectations for 5G-related tower deployment in some markets supports the offloading of tower assets for cash. It also challenges core business cases and key value creation levers for investors. Many investors are potentially keen to take advantage of telcos' willingness to sell. Assets offer a strong guaranteed return that the markets like, and whole business models (TowerCos) have been built up to take advantage of this. And financial investors - Private Equity and Infrastructure funds - are interested, too. But investors should be careful – if changing 5G ambitions means MNOs are willing to divest, then the business case they are assuming might not be there.

AlixPartners' analysis suggests that in the next 12 to 24 months we could see deal activity involving assets worth more than $10 billion in Western Europe, including those of European powerhouses Vodafone, Deutsche Telekom, and Orange; and a further $10 billion in Eastern Europe, including Russia. These huge numbers are supported by the fact that tower assets can still command more than $100,000 per tower.

MNOs, TowerCos, and investors need to deliver on the value promise that towers present. But it's far from easy, and each group must overcome a variety of strategic, competitive, technical, and financial considerations to develop their towers' business case and navigate the operational challenges to deliver on that promise:

- **MNOs** must maximise asset value realisation, while retaining sufficient operational control and not diminishing any strategic market advantage.
- **TowerCos** must be careful to acquire assets at a value and under market conditions that allow successful execution of value creation levers.
- **Financial investors** face the same challenge as TowerCos, with the added complexity of multiple investment models available to them to assess.

What's the MO for MNOs?

Several key factors are driving the decision for MNOs to suddenly start selling off the family silver. Primarily, it's the need to free up cash, supporting the requirement for additional investments that are de-coupled from growth curves, and resolve debt issues on the balance sheet.

On this new playing field, retaining passive infrastructure and a cash-poor position is unlikely to keep MNOs ahead of their competition.

MNOs need to understand which assets to carve out, at what price, to who, and under what model, without limiting their options in further network sharing or 5G deployment, factoring in local market constructs.

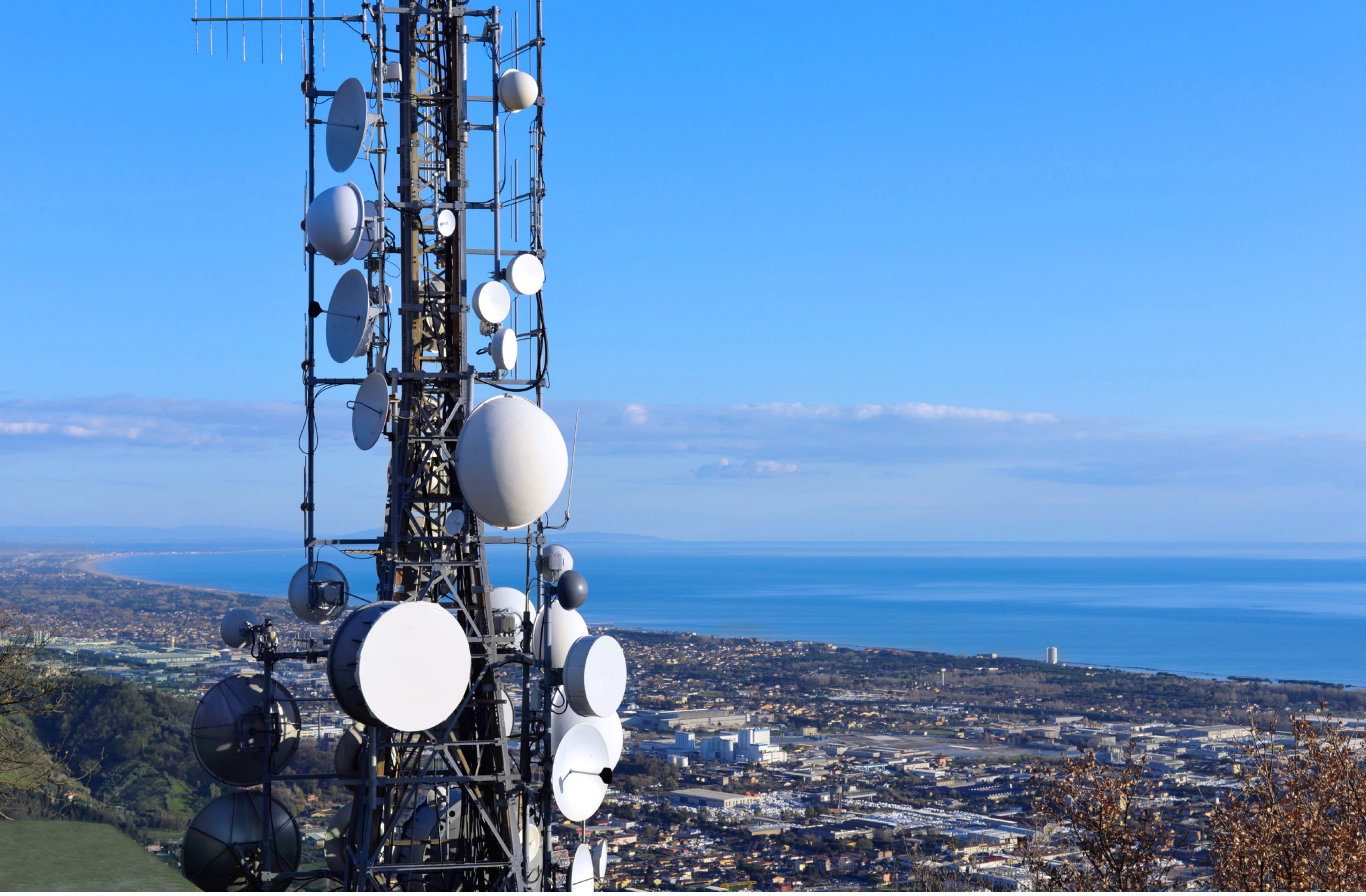
A number of different business models have emerged, with different levels of external investment and operational control. At one end of the scale, some operators have set up a wholly-owned subsidiary – such as DTAG's Deutsche Funkturm and TIM's INWIT – potentially as a precursor to further activity, to manage, control and drive value from the assets. This model can still provide a vehicle for external investment and cash injection.

At the other end is full tower sale to an independent third party that manages assets and leases back space to operators. This model is commonplace in the US, where American Tower controls more than 40,000 sites and in China, where China Tower operates a mammoth 1.9 million sites. Here, cash realisation for MNOs is at its highest, but the risk of ceding operational control and flexibility is obviously much higher.

BOOSTING TOWERCO VALUATIONS

With markets significantly undervaluing assets within a telco, there is the opportunity to realise tower valuations within TowerCos of more than three times that of the same asset under MNO ownership. The reasons for this include:

- A simpler business model
- More stable revenue flows than that of an operator
- The ability to monetise the asset better – charging subsequent site tenants the same price as the first, something which operators cannot do
- Improved management focus



View from the towers – looking to the future

Financial pressures make further consolidation in the European MNO market highly likely, potentially even bringing in versions of the much-discussed Netco/Servco model. Any sharing, and indeed asset sales, should consider what could be on the horizon, and ensure that options are not overly limiting for choices of business model or partner in the future.

Network sharing is a strong tactical move for MNOs and can offer significant benefits – but it can be a double-edged sword. While the benefits of easing cashflow concerns and driving operational efficiencies are clear, MNOs can find it challenging to grow if they and their sharing partners have different market ambitions or fiscal outlooks. If a partner does not share growth ambitions, an MNO's deployment plans could be hampered, and/or divestment options reduced. Low levels of sharing present an opportunity to drive further efficiencies and revenue streams. But, as levels of sharing increases, asset valuations can fall, given the increased difficulty for investors to create further value.

An MNO's deployment ambition and technology choices as part of a 5G strategy will also significantly impact tower divestment selections.

For MNOs, a successful transaction requires the negotiation of complex steps, from business case to value realisation. The key strategic issues operators must navigate, which inform asset, price, and business model decisions, are:

- **What to sell** – should MNOs include all towers and rooftop sites or carve out regions/ locations that still offer differentiation potential?
- **What model to adopt** – how do MNOs balance cash opportunity with retaining sufficient operational control and flexibility to drive independent deployment strategies and realise savings from other possible levers, including sharing?

And, of course, once divestments are in place, operators will still face the challenge of managing the transaction and establishing workable operating/governance models with the new asset owners.

Lofty ambitions – how can TowerCos tap into high expectations?

Independent TowerCos are actively looking to grow their presence and volume of assets in European markets. Once acquisitions are complete, they seek to bring them on board and drive operational efficiencies as standalone assets and as part of their wider regional portfolio.

The market has witnessed a significant number of TowerCo transactions in recent years, the focus of which has been to capture consolidation and optimisation synergies. Cellnex in Europe and American Tower in the US, for example, realise the simplicity of an operating structure, and maximise value through the deployment of automation technology.

Italy, France, and the Netherlands have been hotspots for consolidation, and eyes are now turning to major markets, such as the UK and Germany, for further acquisition opportunities.

REALISING TOWER VALUE

TowerCos have a seemingly straightforward business model – akin to any infrastructure management fund – with the challenge to deliver value via four key levers. Overall, these levers can increase value anywhere between 2x and 2.5x, depending on the current maturity of the asset, and each lever will contribute to this increase to a different degree:

1. Consolidating a portfolio by delivering the same revenues from a reduced set of towers with a lower cost base.
2. Increasing tenancy through the addition of equipment from other operators or next-generation equipment, plus gaining more revenue from the same cost base.
3. Driving operational efficiencies through automation, better support systems and processes, and a more productive workforce.
4. Increasing revenues by opening up towers to other industries, including media broadcasters or Internet of Things (IoT) networks.

While the key levers may appear simple, TowerCos face a similar set of challenges around a potential investment as those divesting: what to buy, at what price, and with what value creation assumed to be possible.

Key for TowerCos is not just the commercial due diligence of an asset (what value can be realised over time) but also the technical due diligence – asset age and condition, how much spare capacity exists, and if and how they could be upgraded.

The technological transformation of towers doesn't come cheap. Reaching a position where automation and cutting-edge inventory management squeezes every last drop of optimisation from an asset requires a long-term investment strategy, committed to the delivery of regular steady revenues, as opposed to a simple buy-and-hold position.

New challenges are impacting previous assumptions about value creation, including reduced 5G deployment plans, increased network sharing from operators, 'all-you-can-eat' pricing models are also reducing revenue opportunities, and EEC code regulations are reducing the cost base to be optimised.

With all this in mind, it would be wise to focus business cases for acquisition on opportunity, where network sharing is more nascent, for example. In regions of high tenancy and more mature market consolidation, the chance for revenue growth may have passed already.

Of course, once a business case is in place, TowerCos will still face the challenge of managing a transaction and delivering the value they see – a big ask in markets where they might not have an existing presence, workforce, or systems in place.

Financial investors – an opportunity to achieve towering profits

Financial investors are more willing to invest in increasingly different tower business models. Telco towers promise a steady revenue stream from long-term reliable contracts, and there have been deals across the world in recent years where tower valuations have exceeded $300,000 per tower.

Previously, Private Equity houses were only interested in investing in tower assets managed by independent TowerCos like Cellnex – which is investing in TowerCos itself – but the burgeoning market has created interest in other areas of tower investment such as wholly-owned operator subsidiaries like Altice's SFR Towers.

The strategic assessments, opportunities, and challenges for financial investors mirror those of TowerCos, with an additional layer of complexity presented by the distance they may experience in being able to directly manage the pursuit of assets' value levers.

Beyond that concrete understanding of the assets and their value potential, it's also the ambition for potential investment partners that must be examined. Alignment is essential, as buying for upside potential and a speedy exit will clearly clash with those investors after regular cashflow for the long-term. Here, picking the right dance partners could avoid any slips and trips later down the line, as different partners could take opposing approaches in matters, such as investing more money to transform, aggressiveness in cost take-out, and when to exit and at what price.

WHEN IT REALLY MATTERS

It is a prime time in the telecom towers market for divestors and investors. AlixPartners works with MNOs, TowerCos and financial investors throughout the lifecycle of divestment, from opportunity assessment through to real value creation. We can help:

- Access an international network of investors, entrepreneurs, companies, and finance providers
- Generate deal flow through target identification and screening
- M&A lead advisory/debt advisory/valuations
- Complex integration/carve-out support
- Operational and IT due diligence
- Sale process preparation and exit readiness
- Support business through its development, including operational, organisational, and strategic support
- Quick start following acquisition

AlixPartners

AUTHORS:

John Miles
Director, London
+44 7900 163 256
jmiles@alixpartners.com

Sherwin Godinho
Senior Vice President, London
+44 7967 168 190
sgodinho@alixpartners.com

FOR MORE INFORMATION CONTACT:

Eric Benedict
Managing Director – Local Market Leader, London
+44 7774 172 668
ebenedict@alixpartners.com

Gabriel (Gaby) Chahine
Managing Director – Local Market Leader, Dubai
+971 50 617 5432
gchahine@alixpartners.com

Klaus Hoelbling
Managing Director, Munich
+49 1520 1 83 37 39
khoelbling@alixpartners.com

Claudio Baretti
Director, Milan
+39 335 5685 708
cbaretti@alixpartners.com

Jacques Rames
Director, Paris
+33 6 48 44 70 26
jrames@alixpartners.com

Olivier Troester
Director, Paris
+33 7 87 89 14 70
otroester@alixpartners.com

ABOUT US

For nearly forty years, AlixPartners has helped businesses around the world respond quickly and decisively to their most critical challenges – circumstances as diverse as urgent performance improvement, accelerated transformation, complex restructuring and risk mitigation.

These are the moments when everything is on the line – a sudden shift in the market, an unexpected performance decline, a time-sensitive deal, a fork-in-the-road decision. But it's not what we do that makes a difference, it's how we do it.

Tackling situations when time is of the essence is part of our DNA – so we adopt an action-oriented approach at all times. We work in small, highly qualified teams with specific industry and functional expertise, and we operate at pace, moving quickly from analysis to implementation. We stand shoulder to shoulder with our clients until the job is done, and only measure our success in terms of the results we deliver.

Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.