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Global Telecoms Daily

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Market Summary

With a second (poorly flagged) profit warning in only 2 years & a lack of commitment to longer term improvements following restructuring, we have finally had our fill of disappointment and **downgrade BT to Neutral (LINK)** this morning. Following numbers, **we cut our FY19 EBITDA by 2.3%, and our FCF by 14% (guidance: £2.3-2.5bn)**, however assume the divi (yield +7.1%) remains. This still gets us to a 300p value. Meaningful, but with a distinct lack of catalysts and an accident prone recent past we decide to sit on the side-lines and wait for more visibility and compelling narrative.

Global telco headlines -14th April 2018

BT: Was Buy, £3.65; Another cut in expectations, so we cut too.

Mothers' Day Updates On AT&T, T-Mobile/Sprint and Sinclair.

Global Cable: Bright Spots In The Misery.

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Wind Tre continues to see challenges in Italy.

Bharti-Telenor deal approved by the DoT.

Indonesian mobile.

Full Details:

BT (Neutral, £3.00) Was Buy, £3.65; Another cut in expectations, so we cut too (LINK)

- BT's profit warning surprised us, as we believe the issues surrounding the downgrade could have been flagged earlier. The new chairman tried to stress the long-term nature of BT's restructuring and turnaround, and yet for a regulated business that should be relatively predictable, no longer-term guidance has been given, which doesn't engender much confidence in the speed or magnitude of the turnaround upside. As a result, despite there still being deep value in the stock, we downgrade to Neutral until we see more evidence that expectations have at least stabilised. Our price target moves from £3.65 to £3.00/ share.
- In this note, we run through all our latest estimate changes and what this means for dividend cover; the latest outlook for the pension deficit; where there might be upside from the restructuring; and the changing strategy at BT Consumer.

Mothers' Day Updates On AT&T, T-Mobile/Sprint and Sinclair (LINK)

- Over the last week we have read a number of pieces in the media about the relationship between the DOJ complaint and litigation seeking to block the AT&T/Time Warner deal and other deals that are pending that we think contain errors. Earlier in the week, we addressed some of the misconceptions about the relationship between the litigation and a potential bid by Comcast for the Fox assets (LINK).
- In this weekend update we provide a similar analysis, with an update, on the T-Mobile/Sprint deal. We also provide a couple quick thoughts on the week's news flow on AT&T and the Sinclair deal

Global Cable: Bright Spots In The Misery – Global Weekly Review (LINK)

- For many of us focused on Cable stocks, it has felt like the industry is collapsing. We focus on two things in this edition of the weekly review: first, there are markets where broadband growth is accelerating, ARPU is rising, margins are expanding, the stocks have been doing well, and they have a long way still to go. Cable investors exhausted by the fear and loathing that has roiled the group in developed markets should look to Latin America. Second, there are also opportunities for those of us that can't look away from the US and Europe and, while the path ahead may be tricky, the rewards may be enormous.
- **Cable in Mexico is like the US five years ago…** While cable concerns, rightly or wrongly, abound in the developed world - LatAm feels like DM cable five years ago. Mexico, in particular is showing cable broadband subs growing 20% y/y, while pay TV is still nudging up despite penetration of 65%. Pricing is moving up with inflation (and at least offsetting Content inflation) providing for expectations of double digit revenue growth as we move through the year. See LINK. Megacable (small, less liquid) and Televisa (large, liquid, cable diluted by Content) remain the ways to play Mexico directly.
- **…And Not All Malone Cable Assets Are Struggling** Liberty Latin America (LLA) is a more regional play. Q1s at LLA were solid this week (quietly avoiding the drama of its former parent) – see LINK - while new management is now in place with a fresh team (and has impressed us thus far). LLA and the rest of LatAm isn't showing Mexican-style growth, but Malone is no doubt aware of this and could find a fix through M&A; current efforts by Televisa to spin out cable creates an opportunity for a MEGA-"TV cable" tie-up and a potential route into this buoyant market.
- **US Cable: Because Of Sky Its Falling…** The group has been swathed in negativity for the last three months. The principal fundamental concern is that broadband growth is slowing for the industry, perhaps exacerbated by wireless substitution, and there is a threat of new competition from Verizon and others with 5G. These concerns have been around since the autumn of last year; however, the dramatic shift in sentiment seemed to be precipitated by Comcast's bid for Sky. It was read as a tacit admission that all is not well in US Cable.
- We suspect reports of the death of broadband growth have been greatly exaggerated. In meetings this week I have encountered the common perception that the Cable companies all missed broadband expectations. In fact, they didn't. Comcast beat expectations with a result that puts them firmly on track to meet their 1MM add target for the year. What is more, in looking at consensus net adds for 2Q18 following results, we think Comcast will beat expectations again this quarter. If broadband growth expectations move up for Comcast two quarters in a row, could it help reverse the awful sentiment weighing on the group?
- It is true that Charter and Altice delivered awful broadband subscriber results, but what if these were attributable to self-inflicted integration missteps, as the management teams claim? Trends at Altice USA should improve in 2Q18, which should provide some support for this version of the narrative. We will probably have to wait another quarter to see an improvement at Charter, but if net adds and

expectations are on a positive trajectory for two of the three, we may just be at the trough in sentiment for the group.

- **What Will Reverse The Trend?** We still need positive catalysts. With Altice, it is the spin-off in early to mid-June, coupled with improving subscriber trends in 2Q18 and improving ARPU trends in 3Q18 (see summary of thesis HERE). Operations are far from perfect, with management facing a tricky balance between maintaining sub growth and ARPU (details in last quarters report HERE); however, current prices imply something far worse. We would be poised to take advantage of any additional pressure that comes with the spin.
- With Comcast, its more complicated. Nevertheless, we see a great opportunity for investors with a stomach for uncertainty. By the end of June one of two things are likely to be true: Comcast will have won the contest for Fox and Sky or they will have lost. We think a loss would be a positive catalyst that would put the stock on a path to the $40 it was at before the Sky bid (hopefully on track to $50). Ending an unpopular deal is not enough on its own; broadband trends have to hold up, but we think they will.
- What if they win? We now think this is a real possibility. We think there are three ways it could play out: Comcast could succeed in acquiring all of Fox and Sky, creating a global powerhouse of content and distribution; they could split content and distribution in the US to get the deal approved, and; they could split the assets with Disney, taking all of the international assets while Disney takes the domestic ones, in a bid to appease regulators and avoid a bidding war. In a scenario where they win, Comcast may languish as an unloved "deal stock" for much of the rest of the year, but the opportunity coming out the other side could be phenomenal.
- An acquisition of all the assets would be 15-20% accretive (analysis HERE). Comcast would at last be a levered equity compounder with perhaps the best set of assets in US Cable and global Media. A successful acquisition that comes with a splitting of Cable and Media would be even better. And an acquisition of the international assets at Fox and Sky that Comcast wants most, would be pretty good too. There was some excitement this week that reports of administration opposition to a deal may quell Comcast's appetite. We wouldn't bet on it. We think the Company has avenues to avoid DOJ opposition (see two compromises proposed above), and if opposed, we think Comcast could fight and win (see Blair's analysis HERE).
- So, Comcast is complicated: there are a range of possible outcomes that all offer positive expected returns, but over different timeframes. We could see a very quick payoff following deal failure in June, or we could have to sit out the uncertainty of the deal process for another 6-12 months.

Liberty Global (Buy, $49, +68%): SPA agreement shows expect up to 18 months for deal to close

- Liberty Global has filed the Sale and Purchase Agreement for the disposal of assets to Vodafone with the SEC. While the majority of the document looks relatively standard for an SPA, we would flag two new pieces of information:
    - The break fee of €250m will be payable to Liberty Global, only in the event of the regulators blocking the transaction on anti-trust grounds. Relative to what we have seen in other deals, this is reasonably low break fee, but the two businesses don't really compete against each other in a significant way and there aren't clear other M&A deals for them to do in Germany, so on that basis, one wouldn't expect a huge break fee anyway. We expect an 80% probability for the deal to clear.
    - The SPA is also valid for 18 months, ie the time Vodafone and Liberty give themselves to close the deal, but this could be extended by another 6 months up to 24 months, suggesting that both companies expect a relatively lengthy regulatory review period.
- For further details on the deal itself, please see our recent detailed note on the transaction: LINK

- We see Liberty post-disposals now trading on 6.2x EV/ EBITDA, which we view as too cheap for a business that still has growth potential with Project Lightning and further M&A optionality.

Telefonica (Reduce, €6.5, -20%): Masmovil strength in Q1 continues

- Masmovil has reported Q1 results, with KPIs further accelerating to 143k broadband adds in Q1 – a record high (compared to Telefonica and Orange reporting a loss of 6k and 5k respectively). Vodafone report their results tomorrow.
- We continue to believe Masmovil will exert competitive pressure in Spain, and these results highlight their underlying business momentum. They are claiming an NPS of +38, vs. their nearest rival on only +6.
- Currently Masmovil's broadband market share in Spain is only 3.8%, suggesting that they still have plenty of market growth available to them, and we believe their launch of a TV product should help to accelerate their growth further. They currently have access to 10.8m FTTH homes, and this should grow over the next few years to 14m, close to the current reach of TEF, Vodafone and Orange at c.19m.
- Last week, we saw Vodafone also cut prices suggesting that the market dynamic in Spain continues to be competitive.

Telstra 3Q18 trading update: guidance and FY18 dividend reaffirmed despite margin pressure

- Telstra said FY18 EBITDA is expected to be at the low end of A$10.1-10.6bn guidance while FCF is expected to be at the top end or moderately above the A$4.2-4.7bn range, boosted by one-off NBN DA receipts (net of cost to connect) at the mid to upper level of a $1.4bn – 1.9bn range. It expects to reduce underlying core fixed costs by 7% in FY18 and incur incremental restructuring costs of c$300m, cf guidance of A$200-300m. It reaffirmed its 22cps dividend for FY18.
- Telstra's main message today was that competitive dynamics have increased pressure on fixed and mobile margins in 3Q18, and this has continued in 4Q18 and "is expected to continue in FY19". In a typically slower qtr it added customers at an even or better rate in 3Q18 than 1H18 and 3Q17 in both mobile postpaid (20kpm v 21k pm and 5 k pm respectively) and fixed data (12kpm v 3k pm and 0.3k pm respectively). But it is costing more to do so both in acquisition cost and lower fixed and mobile ARPU. Postpaid mobile ARPU fell 3.6% in FY18, cf -2.9% in 1H18. We will review our TLS forecasts for FY18 and FY19. We think Telstra should give some consideration to regular quarterly updates in the circumstances it faces.
- Beyond the obvious NBN impact and fixed and mobile competition issues, we think there are some underlying messages in today's trading update. Telstra had floated comments on mobile bypass in two recent conferences. In April CEO Andy Penn noted that mobile BB bypass could add a further 10% to mobile-only households. In early May CFO Warwick Bray confirmed "we are targeting growth in mobile EBITDA. This is the single biggest driver of value for the company today." Since then the Government has had success in securing support from the Federal Opposition for legislation to impose a $7.10pm RBS levy on fixed line BB competitors to the NBN. While the levy wouldn't apply initially to fixed wireless and mobile BB, the government said it would review this regularly in the context of FWA and MBB substitutability of NBN services. For TPG, NBN FWA/MBB bypass is existential to its consumer business and wireless investment. But until the post-NBN environment is sorted, Telstra needs to remain circumspect about how far it responds to TPG in this aspect of its business. In short mobile margins will remain under pressure until at least post-NBN build with only moderate FWA opportunities until then.
- The second message is that to the extent Telstra can compete with TPG (and VHA and Optus) in mobile BB, which is not just price but also capacity, coverage and ability to load data, Telstra will wear erosion to EBITDA margin but remain strong in cashflow for a period, and has strong FCF generation and net debt/cash headroom. This

doesn't mean it won't have to cut dividend after FY19 (which may also depend on capex/spectrum outcomes) but it has more room to wear cash earnings impact than competitors (except possibly Optus) before it needs to look at dividend reductions. As things stand FY19F will be another down year for Australian telcos, and we think that will wear harder on TPG while Telstra can maintain its dividend while building for the post-NBN environment.

VEON (Neutral): Strong Q118 results following weak Q417

- After a very weak Q4 where management credibility was seriously tested, VEON has reported a strong set of Q118 results with revenues 1% ahead of expectations, but EBITDA 7% above of NSR (9% ahead of consensus). Whilst these are encouraging results, the market will be looking to ensure the recovery in trends is sustainable and finalise changes to the management team (permanent CEO position remains vacant) before confidence can return to the stock. We are also of the view that the dividend needs to be cut to ensure the leverage can fall given the weaker FX across the board. We therefore remain Neutral, despite the value inherent in the name. We summarise the key points below:
- Organic revenue growth accelerated from 1.2% to 3.2% following an improvement across Russia, Pakistan and Ukraine. Algeria and Bangladesh continued to show pressures
- Having seen organic EBITDA decline 6.9% in Q417, EBITDA grew 6.3% y/y. In particular, Russian EBITDA which declined 3% in Q417, grew +4.7% in Q118. Pakistan and Ukraine also saw a strong performance
- In Russia, mobile service revenue growth accelerated from +2.1% to +3.7% y/y. In addition, the fixed service revenues, whilst still declining 8% y/y, did see an improvement from the -11% in the prior period
- The stronger top-line saw EBITDA growth of 4% y/y (+80bps margin) following the disappointing 3% decline in the prior period
- In Pakistan, service revenue growth accelerated from +3% to +4.7% which when combined with continued synergies following the merger led to EBITDA growth of +15.7% y/y.
- Algeria and Bangladesh remained under pressure with service revenues declining 8.4% and 11.1% respectively. Management remain confident for a turnaround in H218, but for now the trends remain weak with Bangladesh EBITDA declining 30% y/y.
- HQ costs – which management have committed to cut by 20% y/y – increased 5% in Q118. The company claimed redundancy costs were the key driver for this and remain committed to the 20% reduction target.
- The company gave some guidance on the Yurovaya Law with a total liability expected to be RUB45bn of which RUB6bn is expected to be spent this year. This is largely in-line with our forecasted liability.

Vodacom (Reduce) FY18 results: Robust trends, and guidance reiterated

- Vodacom has reported FY18 results which were 1% above our Q418 expectations at both revenues and EBITDA. The company has reiterated its three year targets suggesting it can weather the storm of deteriorating data prices as regulation/political pressure continues to drive tariffs lower. Mobile service revenue growth came in at +5.3% which compares to +2% at MTN suggesting Vodacom continues to gain share in the market, despite MTN's increased network investment. We would expect to see Vodacom's revenue share gains come to an end following MTN's investment, but for now the company is doing well to hold of MTN. We summarise the Q418 results in more details below:

- Mobile service revenue growth for the group increased from +3.7% in Q318 to +5.9% in Q418 driven predominantly by an improvement in the International businesses, although the SA unit did see a slight improvement in growth

- In South Africa, mobile service revenue growth accelerated to +5.3% from +4.9% on the back of improved data revenue growth (+13% vs +8.7% in prior period) and continued growth in other service revenues. As in the previous quarter there were some one-off benefits in interconnect revenues from FX translation.
- In the international businesses, Tanzania continued to see limited top-line improvements as competition remains tough, but the other businesses, particularly the DRC saw a sharp improvement in growth which helped see revenues come in slightly above our expectations.
- The slightly better top-line fed into the EBITDA performance with EBITDA 1% above our expectations. In South Africa, EBITDA margins remained stable y/y with overall EBITDA growing 6% y/y – up from +3% in the prior period. Group EBITDA grew 9% y/y, which was slightly ahead of our expectations.
- Management has reiterated its three year guidance targets which we see as challenging given the tough political/regulatory environment. However, the stability in trends seen this year is encouraging, and our numbers could prove to be too pessimistic if management can sustain these trends. Although management appear confident we do worry about the impact of declining data prices on top-line trends, and the resurgence of MTN following its strategic re-focus and network investment.
- Given the expensive valuation (7.5x EBITDA), we continue to retain our cautious view on the stock.

Wind Tre continues to see challenges in Italy

- Wind Tre has reported it Q118 results which continued to show a very challenging environment for Wind Tre in Italy. Overall revenues came in 1% below expectations, and EBITDA came in 3.8% below our projection. A lot of the call was focussed on ZTE developments, with management not being able to provide any clarity as to their strategy, merely indicating they were 'working on Plan B' whilst hoping the ZTE situation will resolve on its own. We summarise the key points from the results/call below:
- Mobile service revenue declines were largely stable at -7.9% y/y, compared to -8.1% in the prior period. The company highlighted tough below the line offers and regulatory changes (28 day billing, roam like at home) which were impacting top-line trends with limited optimism for a turnaround in the near-term;
- Fixed service revenue trends also saw continued pressure with declines of -4.1% worse than the -2.2%. The company has held back on marketing low-margin products (wholesale DSL through indirect channels) which it claims is the key reason for the weaker top-line performance
- EBITDA for the Group declined 5.3% y/y, which compared to the 3% decline reported in the prior period. With continued cost optimisation as part of the synergies associated with the merger, Wind Tre saw opex continue to decline by 11% (Q417: -15%) resulting in a 140bps margin improvement
- The company confirmed that ZTE had ceased all operations within Italy. Management would not comment on the implications this will have in for the network and plans for future modernisation given ZTE's issues. Assuming nothing is resolved, management were confident that a 'plan B' would be resolved before the end of the month. It claimed the maintenance on the network was minimal given the new equipment, and any maintenance could be done in-house. Currently 6.5k of the 19,000 sites had been modernised at the end of Q118.
- In terms of the outlook, the CEO was relatively pessimistic around any near-term improvement. Aside from regulatory issues, he indicated competition was fierce was Wind Tre has been forced to react in certain regions, but would definitely not react on a nationwide basis. Some price points were mentioned to give a flavour of the below the line offers, and some of Wind Tre's offers:
    - Kena (TI low-end brand): €5 for 1000 minutes and 10GB
    - Vodafone: €7 for 1000 minutes and 10GB
    - Wind: €10 for unlimited voice and 30GB

- H3G: €9 for 1000 minutes and 20GB

- These tariffs suggest life for Iliad will be difficult assuming the recent launch tariffs rumoured in the press are correct. Whilst Iliad offers are lower in terms of total price, for an addiitonal €2 consumers can get an additional 5Gb on the lower priced packages, and Wind has essentially matched Iliads offer at the higher end. Below is a summary of the offers:
  - €2.90 for 500mins and 5GB
  - €9.90 for unlimited voice and 30Gb
- On balance, these continue to be weak numbers for Wind Tre with very little indication that things will get better in the near-term, particularly given its ZTE exposure. For VEON shareholders, the story remains challenging, and so we continue to reiterate our Neutral recommendation.

Bharti-Telenor deal approved by the DoT

- In India the Bharti-Telenor deal has been approved by the DoT. This is the final step before the deal could close, so that should now happen in the next few days. Telenor has c. 39m subscribers, compared to Bharti's 305m. Telenor subscribers are low ARPU but should still add 7-8% to Bharti's revenues with minimal cost associated. Telenor also improves Bharti's spectrum position in 6 key circles. We retain our Buy recommendation on Bharti.

Indonesian mobile

- As with the other Indonesian mobile operators, XL Axiata's Q1 figures were Impacted by SIM registration, but nothing like as much as Indosat. Top-line growth weakened to +4.8% (Q4: +16.8%). QoQ revenues declined by 10%, but that reflects a sharp increase in revenue share given Indosat's quarterly decline of 26%. Data now contributes 72% to service revenues, and should resume rapid growth once the SIM registration issue eases.
- Despite the revenue pressure, margins rose 110bps YoY, and as a result, the company reported EBITDA growth of 7%. Despite the SIM card registration effect, the company has maintained guidance. Given the mid-term opportunity in data and ex-Java we remain Buyers.

FORTHCOMING EVENTS

May 18th: Lunch with OFS Optical – Future of Fiber Optics (NY)

May 23rd: Lunch with Cybereason – Cyber Security (NY)

May 29th: Meet the expert: Instadeep's CEO Karim Beguir - GPU, TPU, FPGA… What is the difference for a practitioner? (NY)

May 30th: Accelerated Computing Mini Conference - featuring Applied Materials (NY)

June (TBD): Visit of Tesla's Gigafactory. (Nevada)

11th June- Vodafone 5G Lunch- Lunch in London with Group CTO Johan Wibergh

June 12th: Lunch with Samsung's Patrick Chomet (London)

13th and 14th June- Taiwan Mobile Roadshow- London and Edinburgh

June 14th: Virtual Reality World Tour & Speaker (NY)

July (TBD): Meet the experts. (New York, date TBD) What to make of technology and form factor choices for car batteries?

July (TBD): Tesla Fremont Model 3 factory tour. (California)

July (TBD): Tesla Model 3 test drive. (New York Area)

July 23rd-25th: ERI Conference (SF)

3rd-7th December- Asian Telco Tour

12 month historical recommendation changes are available on request

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