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Global Telecoms Daily

Market Summary

Some head scratching yesterday on **S (-13.7%) & TMUS (-6.2%)** moves, we think driven by two main concerns – **Regulation & valuation (LINK).** On regs; We see odds of approval closer to 50/50 (**LINK**) skewed in slightly favour of a block, although political element makes it very difficult to call, however it was clear yesterday in conversations some investors assuming as approval odds as low as 30%. Even more concerning was pro-forma guidance for NewCo suggesting a material step down in Ebitda; If all the shortfall is down to S, which isn't unlikely given Masa's willingness to accept 10:1 4-months after rejecting 8:1, then **S would generate ~$11BN making equity on standalone worthless.**

What the mkt might be missing however is the link between the two; if standalone prospects are so bleak, it increases the prospect of approval.

In Europe: Cable regulation creeping back on to the agenda? German regulators comments yesterday would be a material step change in approach, likely driven by imminent announcement by VOD/LBTY.

Global telco headlines -30th April 2018

German Cable Regulation rears its head – potential increase in M&A price tension.

Full Details:

T-Mobile / Sprint - The Logical Flaw In The Market's Reaction (LINK)

- We argue that the share price reaction is driven by the market's view that 1) the deal has very low odds of approval, 2) the pro forma projections that management published suggest a bleak view of standalone prospects, and 3) natural volatility around deal stocks with tough, potentially lengthy regulatory processes ahead of them. We can accept #3, but believe the first two form a paradox; if the standalone prospects are so bleak, approval odds should increase.
    - **Odds:** We have assumed 50/50 odds in our analysis versus implied odds of less than 20% based on market prices. We do believe the deal has

better arguments now than in 2014, and understand that investors may start below that level but view less than 20% as too pessimistic. Blair Levin covers the difficult process at the FCC and DOJ and the additional political risk the deal may face HERE

- **Standalone Prospects:** Management's pro forma guidance taken in conjunction with their synergy guidance suggests materially lower EBITDA for the two companies. Masa's rejection of an 8:1 exchange ratio four months ago and his acceptance of a 10:1 ratio today suggests that Sprint's standalone prospects have worsened. If all of the shortfall in guidance is to Sprint, Sprint would generate ~$11BN in reported EBITDA in 2021 and even less if lease depreciation is adjusted out.
- **The Paradoxes:** If Sprint generates $11BN in EBITDA in 2021 then the standalone equity is likely worthless. The first paradox is that Sprint's inability to compete on its own should improve deal odds and raise market prices. While a "failing firm" argument is less applicable to the threat of restructurings (vs. liquidations), there is a convincing argument that Sprint, even in debt-free form, may not have the resources to compete effectively. The second is worsened prospects and low approval odds should have pressured Sprint's credit spreads; they have compressed since deal rumors returned and held steady today.
- **The Conclusion:** Neither company has strong incentives to paint positive pictures of their standalone prospects when making their case to the regulators. We don't know if this is a conservative view, or reflective of reality. What we do know is that dismal standalone prospects for Sprint should result in higher approval odds.

NSR PolicyUpdates On Trial Of The Century, Broadcast Deal Of The Century, And The Return Of The Wireless Deal Of The Century (LINK)

- Last week there was more excitement outside of the court room than in it. While AT&T and the government rehashed previous testimony, the Sinclair deal got an uplift from two Comissioners' comments; and, T-Mobile and Sprint agreed to combine. In this note we highlight the key items investors should focus on this week in AT&T's trial, summarize and analyze the latest news related to the Sinclair / Tribune deal, and discuss the factors investors may need to consider in evaluating the regulatory merits of a T-Mobile / Sprint deal.

Deutsche Telekom (Neutral, TP: €17, +17%) TMUS & Sprint: A good deal, but DPS uncertainty (LINK)

- After much flirting, and a change of bride to groom, and groom to bride, DT has announced the long-awaited merger (takeover) of T-Mobile USA and Sprint. DT will end up with 42% economic right and 69% voting rights (via a proxy over Softbank's 27% shares). There is significant regulatory risk (we think the deal is 50%-50% to be approved), and synergies are back-end loaded (US$6bn run-rate) with large integration costs (US$15bn), which may be the reason for the lukewarm share price reaction today.
- In addition, for DT, leverage will go above target; the deal won't be accretive until year 3; and there is a good chance that DT has to pay another US$7bn+ to Softbank after 4 years to lift its stake over 50% to keep the ability to consolidate NewCo if Softbank decides to sell down, as is its right when the lock-up ends.

- In that way, although the deal has significant value creation potential, it is also risky with significant uncertainties, including around the group dividend, where policy may have to be amended. We think it's the right deal for DT and TMUS, but it is not without issues.

SBAC (Buy, TP: $190, +19%) 1Q18 Quick Take: Strong Results; New Leasing Activity Should Ramp From Here

- SBAC reported a solid set of results, beating Consensus on revenue, EBITDA, and AFFOPS. Disappointingly, mgmt. left guidance for new leasing activity unchanged despite backlogs that are at their highest levels in years. Additionally, mgmt. seemed less confident in their ability to achieve their long-term target of $10 in AFFO per share by 2020, due to higher interest rates and a higher price for share repurchases than they had initially modeled (EBITDA is ahead of their forecast).
- We aren't concerned about either of these: we expect new leasing activity to ramp steadily from here; and, we see a high likelihood that mgmt. can still achieve their long-term AFFO per share aspirations. We recently lowered our price target due to the pending T-Mobile / Sprint merger (LINK to report); however, we continue to recommend owning SBAC because we believe the potential negative impact is already priced in, and we believe accelerating organic growth over the next few years will support the equity. No change to thesis.

German Cable Regulation rears its head – potential increase in M&A price tension

- The Head of the German telecoms regulator (BNetzA) is quoted by Reuters as saying that it is "not out of the question" that a newly-started market investigation may find German Cable operators to be dominant in broadband in specific geographic regions, which could result in resale obligations and "price controls" (wholesale prices we assume);
- This appears to be a clear change of stance, shifting Germany into the small group of EU markets where cable regulation is a feature. (NL, Belgium and Denmark). The shift may be related to the prospective merger of Unity and Vodafone/KDG and is likely to be one of the remedies demanded by O2D in the event of a deal being announced.
- Although the overall broadband market shares of Unity and KDG in their footprint appear to be a little below the generic threshold for 'dominance' (~40%) there may be localities where they exceed 40%, and both are continuing to gain share.
- Generally, EU regulators are reluctant to split a market geographically (due to the extra risk and complexity) but it is permissible if the case is properly made.
- We note that this is quite separate from the ongoing EU debate about 'joint dominance' – this report is just saying that in some areas Cable may now have enough share of broadband to be dominant in its own right.
- Our general view is that cable regulation's bark is much worse than its bite – It's not clear that regulating German cable broadband would either be materially bad for cable or good for anyone else. However, sentiment will almost certainly shift negatively if this story has substance.
- We would note that in the case of Telenet where cable regulation has been a reality, the stock has performed well despite this investor concern. Since it was considered in 2013, Telenet's share price has increased by 42%, and since

it was introduced in 2016, Telenet's share price has been broadly stable (vs. the SXKP down 10%). Telenet also trades at 8.4x EV/ EBITDA, an 18% premium to Liberty.

- A BNetzA market investigation shouldn't have any bearing on, or linkage to, cable M&A approval as this is likely to be an EC decision, but it is likely to be part of that chess game in some way. Recall a long history of hostility to cable M&A at the Bundeskartellamt, the German competition regulator. Jurisdiction for approval of a Unity/KDG combination would be with the EC (DG COMP), so BNetzA may be flexing a nationalist muscle as a signal to Brussels
- We believe Vodafone could use this to either argue for a lower multiple in a Unity acquisition, or even reconsider the merits of the deal given investor concerns over the concept of cable regulation. However as we have seen in the case of Telenet, we believe this risk can be overstated, especially as the cable operator wins back on the wholesale front, and hence Liberty would be arguing that this shouldn't impact the multiple. There is the risk that this could add to tension over any price agreement.

KPN: Fixed price increases

- KPN has announced plans to increase back book broadband and TV prices form July. KPN has a "more for more" strategy in fixed, and price increases across front and back-book are key to and supportive of our Buy recommendation, where we see the continuation of annual price rises (we have +2% ARPU growth y/y to terminal) thanks to the favourable fixed market environment. The price increase looks to be slightly bigger than last year (6% vs 3%), but until we know mix, spin-down, promotional activity and churn, it's a little difficult to draw too many definitive conclusions. We would expect Ziggo to lift prices in January of next year.

Red Compartida: Call with Altan - fixed wireless in Mexico gaining traction

- We had a call yesterday with Nicolas Borges from Altan Redes, which is running Red Compartida , the 700 MHz wholesale project in Mexico. The company launched its wholesale network on March 21st with population coverage of 32%, slightly over the 30% mandatory requirement. At this stage there are discussions with 50-60 interested parties, a number of which are much developed, although there is no live launch yet.
- The initial enthusiasm is coming from operators looking to offer fixed wireless services. This has surprised Altan which assumed, as a potentially more rural project, interest here would come as its network developed into the regions (and ultimately passed 92% as mandated, which would represent coverage ahead of Telcel).
- Fixed wireless is developing some momentum in Mexico with the existing MNOs involved: AT&T announced the launch *Internet en casa* on April 18th . Telefonica has similar product in the market, having started trials at the beginning of the year. Both these services are using existing 4G spectrum. Televisa – through its SKY-umbrella'd band, blue telecom, has said it is pursuing fixed wireless this year, in parallel to more traditional wholesale and ULL plans.
- These latest developments are worrisome for AMX's fixed operations, which are already seeing the bulk of broadband growth in Mexico going to cable.

With 22m homes passed with cable in Mexico, fixed wireless can target the 6-8m estimated homes not passed with a high speed broadband product.

- The good news for AMX in the near-term is that traditional "mobility" offers over 700 MHz are unlikely to come to the market until later this year. There remain more challenges integrating the 700 MHz network with the necessary roaming agreements, while handset availability is still more limited (all handsets sold in Mexico from April 1st will however need to be 700 compatible, so this should wash through with the next handset cycle). The market is most likely to be worried about TEF signing a deal with Altan which sees it try to reinvigorate its traditional mobility efforts in Mexico – this for now seems unlikely.
- The tilt in the Red Compartida business model toward fixed wireless means network density and tower count may need to increase: this is conceptually positive for Telesites. Red Compartida launched with 2600 sites (32% POPs; 90% are connected to fibre) with the next milestone of 50% POPs coverage (January 2020) needing another 1700 sites. Altan reiterated tower needs of 12,000 to get to 92% coverage but believes it may need an additional 3,000 for fixed wireless densification; this was previously thought to be a back-end loaded add-on but now 1-2,000 of these may come sooner rather than later.
- Fixed wireless isn't developing much momentum in the rest of LatAm – TIM is pushing efforts in Brazil but is explicitly constrained by the need to manage capacity for its traditional wireless customers. Initial efforts on fixed wireless were very popular and usage had to be quickly capped to ensure network stability. We spoke to Millicom yesterday who confirmed limited initiatives in Colombia or in its smaller markets across the region.

FORTHCOMING EVENTS

24th-25th April- Broadband Forum Asia- Bangkok. New Street are sponsors of this conference, with presentations from Axiata, Vodafone India, Google, Indosat, HKBN, Telenor, Chunghwa, MyRepublic, Optus and TRUE.

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

3rd-7th December- Asian Telco Tour

12 month historical recommendation changes are available on request

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