Eyecatching moves in Europe – what's happened, and what is ahead

By James Ratzer | August 5, 2019

It's been a busy few weeks in the European telecoms sector and we wanted to draw together all our recent materials in a single blog to make sure you have a chance to catch up on all our latest views.

Momentum reversing: We're not quite through with European telecoms results season, but could we finally be at the much awaited turning point for the sector? After a dismal start to the year (in part reversing the Q4 18 outperformance), the sector has started to fare better and over the last three months, the telecoms sector performance has been the 5th best performing sector out of 19 European sectors. If broader market worries persist, then we believe the sector's defensive characteristics should prevail further.

Set-up still attractive: We continue to believe the sector looks attractive, and that the operational/ regulatory risk profile is now far lower than at any time in the past 10 years, especially as investors hunt for yield in a low interest rate environment. Even if we haven't yet reached the nirvana of earnings upgrades, a 5.5% and 8.2% dividend/ EFCF yield respectively for the sector; infrastructure funds awash with cash, and companies taking active steps to try to unlock this value, still means the combination looks very appealing.

Vodafone remains one of our top picks and is the company where we have seen the biggest recent share price move, and we remain positive on the name having increased our target from 185p to 195p following their encouraging outlook for the rest of the year; news of their plans to monetise their tower assets and the Inwit deal, where they are selling at 24x EBITDA. After a 15 month wait, we have also seen them successfully close the German cable deal which we see at up to 20% EFCF/ share accretive.

The piece on the German deal closing is HERE, and we have written on tower monetisation upside HERE, and the upside generated by the Inwit deal HERE. (O2D also made positive comments on German pricing, which is also supportive given Vodafone's increasing reliance on growth in Germany at a group level – see HERE).

Upside from towers elsewhere – maybe Orange: The share price bounce in Vodafone following the news about tower monetisation, raised the question of which other companies could do the same, and we feel Orange stands to benefit most out of the other large caps. More details on that and the potential impact on all other stocks HERE.

Whilst we are on the topic of unlocking value from infrastructure, it might be instructive to look at BT that way. The shares remain in regulatory purgatory, but with the shares depressed at 185p/ share, the market is now valuing the unregulated activities at only 5x P/E. It might take at least a year for a final resolution to be resolved on FTTP, but for those investors with that timeframe, this looks like a very attractive entry point as we believe a deal can ultimately be reached which will be in the interest of the UK and BT shareholders. See HERE for our detailed workings on this – and our past piece HERE on more details about how the economics of an FTTP migration might work.

Meanwhile, the outlook in France looks like it is improving. Altice's results were stronger than expected and leverage acts as a major tailwind for the stock with improving sentiment. More details of that HERE, and this should have positive implications for the underlying story at Iliad – see HERE for more details. We continue to publish our regular monthly tariff trackers – see HERE for fixed, and HERE for mobile – and these indicate to us that the pricing environment in France remains rational which should be a further support for both names in H2.

In the Benelux region, trends look reasonably benign. Decent earnings prints from Proximus – HERE – and KPN – HERE – help to give a more supportive message for the sector as a whole.

Looking ahead, of the large caps, we still have DT to report on Thursday, but TMUS M&A activity still remains the main driver and we think that the decision on the dividend will be delayed until after the TMUS-S court hearing - see HERE for our analysis on this. The trial itself is something on which Blair has written extensively: HERE). Arguably though **the bigger news on Thursday could relate to Liberty Global and whether they finally answer the 15-month question of what they will do with the $10bn excess capital following the Unity disposal.** We are gunning for a $3-5bn buyback combined with more investment in Lightning, but let's hope they don't disappoint with something unexpectedly left-field....see HERE for our assessment of the options.

Full 12-month historical recommendation changes are available on request

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