new|street RESEARCH

Could Vodafone Be AT&T's Next Big Deal?

May 19, 2019 by Jonathan Chaplin

AT&T would tell you that they have created value over the last 20 years by doing deals. We aren't sure they have created value over the last 20 years, but if they have, it certainly isn't through operating prowess. So, sure…let's say they have a special competence in acquiring things.

AT&T closed the Time Warner deal in June 2018, after a longer than expected fight. We are coming up on the one-year anniversary, which means we are probably a year or so away from them looking for their next deal.

Finding deals is getting harder for AT&T as they swell in size and as their multiple swoons relative to assets they might like to buy. They are hobbled by an enormous dividend and a core business that has been declining. Whatever they buy has to be cheap. Very cheap. AT&T is trading at less than 10x earnings and FCF.

So, could Vodafone be next?

So, when James published a note last week declaring Vodafone to be "the cheapest telecom company in the developed world" (LINK), it caught our attention. Because, we thought AT&T might have noticed too. It's the sort of thing they like. Actually, they thought about buying Vodafone in late 2013 / early 2014, when it was trading at around 260p. That was before Vodafone had acquired a very valuable collection of Cable assets across Europe. If they liked it then, they ought to love it now at 125p. It's a half-price sale. Or, maybe…two for the price of half. BOGO on steroids.

Vodafone has other advantages for AT&T. It's actually a business that AT&T knows well. And it is one that James has always thought had bloated costs (articulated HERE). AT&T knows how to cut costs too. And Vodafone isn't in America. AT&T pissed the current White House off with their acquisition of Time Warner and its scurrilous news channel. They may think it wise to shy away from deals in the US for the next two to six years.

We took a quick look. A debt funded deal would be 8% accretive in year one, growing to 18% in five years. And that is without synergies. That might push leverage to a level that the debt markets can't swallow. Debt to EBITDA of 3.1x may not seem high for a telecom company, but the total debt load would be $280BN. AT&T would be the largest non-financial issuer on the planet, by a lot. It would also take a very long time for New AT&T to get down to a more palatable leverage range of around 2x.

With a mix of stock and cash they could be breakeven in year one and still see close to 10% accretion five years out. Leverage would start at 2.8x, falling to 2.3x in five years. That is still without synergies. If AT&T can go to work on Vodafone's $50BN of costs, the deal might be more accretive, and New AT&T may return to more normal leverage levels very quickly.

AT&T might not be the only one interested in Vodafone at these prices. We hesitate to say it, because we would hate to see it happen, because we just want them to focus on their US Cable business, and use excess cash to buy back shares, but Comcast must be curious. They have a pay-tv business that is inconsistently paired with some fixed and mobile offerings in a handful of big markets in Europe. Vodafone’s largest markets compliment Comcast’s – the UK, Germany, Italy, Spain.

This would be a deal with real synergies. The deal ought to be accretive at the outset, given the disparity in multiples, and synergies could make it very accretive. Unlike AT&T, the Comcast team are great operators. Imagine what they could do with the Vodafone assets, which are mostly great assets that could be better managed. Comcast will be attracted to Vodafone’s cable assets in particular – these account for one third of EBITDA now. In fact, if we apply a European cable transaction multiple to these assets of, say 10x, the wireless assets can be had for just 4.5x EBITDA.

It would be complicated. Some assets would have to go in Germany, and the UK regulators could make a mess of things. Investors would hate it. We would hate it. We would really hate it. But Comcast and their bankers have to be watching, as Vodafone’s stock price plumbs new depths.

And Softbank!? They were in the mix back in 2013 / 2014 when AT&T last looked at Vodafone. We doubt this would be a deal for the Vision Fund I or II, but Softbank KK could show up again. There would be delightful irony in this transaction. Or continuity. Masa built the first leg of his fortune by turning around an undermanaged Vodafone asset. Why not go after the rest of Vodafone?

The asset Masa acquired from Vodafone for $12BN is now worth $92BN. If Vodafone had hung onto the asset and fixed it themselves, our target price for the stock would be worth 500p rather than the 190p it is now.

The presence of potential buyers makes it easier to buy Vodafone on James’ turn-around thesis (most comprehensively articulated HERE). They provide insurance. If AT&T can buy the assets in a year or two in an accretive deal at these prices, there ought not to be downside, even if the turnaround thesis doesn’t pan out.

For the full weekly review and updated comp sheets, see HERE

For our global multiples in excel, see HERE