

Millicom (Buy, TP: \$21), Telefonica (Buy, EUR 4.7)

Apollo discussions off; Merger in Colombia (maybe) on

Apollo discussions finish

- Millicom last night announced that discussions with Apollo as regards an acquisition of all of Millicom's shares, and as previously announced on Jan 25th, have been terminated.
- At the time, the FT had reported that a bid was potentially in the range of mid-teens on the \$ quote.
- Simplistically, this is less helpful for the shares in the near-term, although we would suggest expectations had begun to dwindle of a deal close given the duration of discussions.

Xavier Niel >25% - might have moved toward 30%

- The departure of Apollo from the scene leaves Xavier Niel as the remaining interested party (to the best of our knowledge).
- His last declared stake was 24.4% as of May 31st. Disclosures show that Niel had been buying regularly in the market since February, when his stake was declared at 20%. Niel's average in-price over this Feb-May period was SEK193 per share vs the current price of (SEK173).
- Additionally we know from the May 31 filings by Millicom that a 10b-5 was set up which allows banks to continue to buy on Niel's behalf up to 8.5m shares under conditions not disclosed. This gives Niel the potential to move (or be moving) toward the 30% level – which is perhaps a factor in Apollo's decision to withdraw from talks.

Merger in Colombia

- Aside from other views on valuation and monetisation, the interest of both Apollo and Niel in Millicom has been assumed to incorporate an interest in market repair in Colombia through consolidation. Apollo's balance sheet was a factor in this, likewise Niel's wealth also.
- Colombia is one of the toughest mobile markets in EM right now, given a combination of new entrant pressure (WOM Colombia makes it a 4-player market) and perhaps, more significantly, significant spectrum expense anticipated. This is coming from both re-issuance as well as an anticipated 5G auction.
- Mintic yesterday (Jun 15th) confirmed it was set to launch the 5G auction on 20th December 2023, with submissions due on November 10th. Previously Mintic has indicated that it plans to make 700MHz, 1900MHz, 2.5GHz, 3.5GHz and 26GHz bands available for bidding. The Colombian government has historically tried to extract a high payment for spectrum from the industry. It's fair to note also that the date for the 5G auction has been something of a moving target.
- More recently, Colombia has also been subject to amongst the toughest macro conditions in the region.
- Furthermore, it was announced at the end of May that the shareholders in TIGO Une/Colombia (Millicom is a 50% shareholder, with Medellín-based public utility EPM owning the other 50%) were exploring ways to ensure the financial viability of TIGO Une following a sixth successive year of losses (and negative \$106m of net income). The inability of Une to therefore pay a dividend to the local council is likely to be significant. It was suggested therefore that some sort

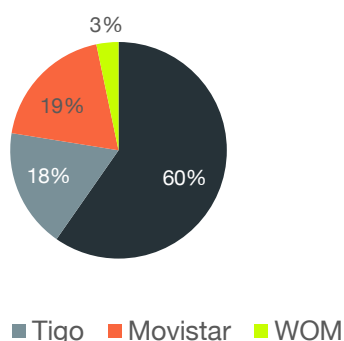
of recapitalisation might be needed (as was mandated at Telefonica Colombia a few years ago). An undercapitalised industry has arguably moved from a regional problem (Medellín) onto the nationwide agenda.

- Against this backdrop, it was announced in the last couple of days ago that Telefonica and Millicom have signed a MoU to explore integrating their mobile access networks in Colombia. There was no formal disclosure from either parent company, but rather a release from Telefonica Colombia (a separate debt issuing entity)
- The agreement will be subject to approval from the Superintendencia of Industry and Commerce (SIC) – consumer protection and anti-trust combined in Colombia - and, subsequently, from the Ministry of Information and Communication Technologies (MinTIC). The timeline on this is unclear, although it seems hard to conceive of the 5G auction proceeding this December with this merger still under review.

How might a deal in Colombia look

- We speculate here on how a deal in Colombia might ultimately look based on the limited release from Telefonica Colombia. We note that Telefonica referred to this transaction as the sort of deal recently seen in a number of markets (UK, Germany, Mexico and Peru). In reality this looks like a pretty full merger of the two businesses.
- Neither Millicom nor Telefonica report Colombia mobile revenue separately, but we can get wireless service revenue data from the Regulator (available through to Q4 22). This suggests that the two businesses are of relatively similar size at the revenue level, with 18/19% market share (although Millicom has a more significant spectrum holding – see below). We note also that Claro remains the dominant provider in the market whilst WOM is building from close to zero with 3% revenue share as of Q4 (likely a shade higher today).

Mobile Service revenue market share (Q4 2022) -



Source: *Comision de Regulacion de Comunicaciones*

- What is proposed is then the creation a new mobile infrastructure company which will serve also as a driver for 5G. In this sense, we could envisage an entity which includes all existing spectrum, all existing active elements (RAN) as well as existing towers (though much if not most of the towers have long since been sold off by the telcos). And future 5G spend would come through this entity.
- We would assume 50/50 ownership of the JV with the potential for this to be deconsolidated assuming control is equally split at some point in the future.

Spectrum position in Colombia

MHz	700	850	1900	AWS	2.5	2.6	Total	Split
Claro	20	25	30		30	30	135	32%
Movistar		25	30	30			85	20%
Tigo	40		50	30			125	29%
Novator (WOM)	20			30	30		80	19%
DTV						70		
Total (ex DTV)	80	50	115	90	60	30	425	
Movistar & Tigo	40	25	80	60	0	0	210	49%
as % of market	50%	50%	70%	67%	0%	0%		

The Maths – Some plausible assumptions

- We assume the creation of an Infra Co from which TIGO and Movistar acquire capacity. This is conceptually the same as a number of FTTH JVs which have been set up in the region of late (Telefonica and KKR run such a JV in Colombia).
- We assume a wholesale fee (30%) paid by the op cos and a high EBITDA margin (80%) to reflect the high capex intensity of the Net Co business.
- We assume leverage on the JV of 3x and an Infra multiple of 12x – we discount what a FTTH business could be worth given the ongoing spectrum needs of a wireless Infra vehicle
- This points to JV equity value of ~\$2 billion pre-spectrum.
- Based on revenue alone – though ignoring the spectrum imbalance – there would be a small equalisation payment required to set the JV at 50/50.

JV equity value

Wireless revenue (annualised Q4 22)	USD m	Split
TIGO	486	48%
Movistar	522	52%
Total	1008	100%

Wholesale rate	30%
Paid to JV (Revenue)	303

EBITDAaL margin	80%
JV EBITDAaL	242

Net debt / EBITDA	3.0
Net debt in JV	726

Assumed Infra multiple	12.0
EV	2,904
Equity (1)	2,178

<u>Fair equity split</u>	
TIGO	1,050
Movistar	1,128

Equalisation payment	39
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<u>Equity split after payment</u>		
TIGO	1,089	50%
Movistar	1,089	50%

- For the TIGO OpCo buying capacity from the JV but running the same brand, distribution, customer billing etc, we provisionally assume a 10% EBITDA margin, and an EV multiple of 6x.

Wireless Retail equity value

TIGO Wireless Retail	USD m
Revenue	486
EBITDA margin	10%
EBITDAaL	49
Multiple	6
EV	292
Debt	0
Equity (2)	292

- We also assume a \$1 billion spectrum bill. This is very much a place holder fee, and is not assumed necessarily to be an upfront cash requirement (rather in deferred payments) and reflects spectrum re-issuance (coming due in Colombia in 2023) as well as 5G spectrum. It is to be determined to what degree the JV could decide not to reissue existing spectrum held by the two operators (we suspect there is some flexibility here; at first read the JV will hold an excessive amount of 1900 MHz for example – see table above), and its ultimate 5G needs.
- Incorporating this as a liability we see potentially \$840m of value in the combined wireless Infra JV and the TIGO's retail business
- Adjusting this for Millicom's 50% share suggests \$2.5 of value per share
- Along with the residual fixed business in Colombia (not part of this deal) and adjusting for the debt moved into the Net Co, this would add another \$0.6 per share and take our total equity value in Colombia to \$3.1 per share

Total Wireless and Fixed equity value in Colombia

TIGO Colombia "Wireless" (Infra Co / Retail)	USD m
100% of JV equity (1)	2,178
Spectrum liabilities (100%)	1,000
Equity post-spectrum	1,178
TIGO Colombia share of JV	589
TIGO Colombia Wireless retail (2)	292
Equalisation payment	39
Total	841
Value per share	5.0
TIGO share of TIGO Wireless (50%), \$/share	2.5

TIGO Colombia Fixed	USD m
Fixed revenue	733
% margin	25%
EBITDAaL	183
Multiple	4.0
EV	733
Debt	536
Debt/EBITDAaL	2.9
Equity	197
Value per share, \$/share	1.2
TIGO share of Colombia fixed (50%), \$/share	0.6

TIGO share of Colombia, \$/share	3.1
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We don't think the market attributes any equity value to Colombia today and so this would be all upside to the market's thinking from here.

Note, given the broad equivalence here for Telefonica (where Colombia has leverage over 3x and we would assume zero equity value also after spectrum liabilities), this same upside on wireless would be worth EUR0.15 per Telefonica share.

Sense check: Synergy upside

On the one hand with this analysis we are moving value around between Infra and Retail, but our assumptions inherently attempt to capture synergies within the JV. This would be the same sort of components coming from a “full” merger on the network side and on the revenue side (though missing the retail components such as CRM, billing, distribution etc). This synergy capture is attempted to be caught within our Target Infra JV multiple of 12x.

On a margin basis, the upside is shown below: comparing EBITDAaL for the two wireless operators today versus EBITDAaL after. The analysis implied a 6% EBITDAaL margin improvement.

Sense check to margin upside

Post-deal Wireless	USD m
TIGO retail EBITDAaL	49
Movistar retail EBITDAaL	52
JV EBITDAaL	242
Total EBITDAaL	343
% margin	34.0%
Pre-deal	
TIGO EBITDAaL	121
Movistar EBITDAaL	157
Total	278
% margin	
TIGO EBITDAaL	25.0%
Movistar EBITDAaL	30.0%
Total margin	27.6%

Disclosures

12-month historical recommendation changes are available on request

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