M&A Insights

Telecoms Sector

2007

Analysis & opinions on European M&A activity from our network of local advisers*

*connectedthinking

PRICEWATERHOUSECOOPERS

Welcome

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Welcome to the first edition of Telecoms M&A Insights from PricewaterhouseCoopers, complementing our recent publications covering both Media and Technology M&A. In this edition we assess and analyse the trends driving M&A activity in the European telecoms market over the last two years and offer our predictions for 2007 and beyond. We have considered deals that have either a European acquirer or vendor and we have also included the telecom equipment vendors in our analysis.

European Telecoms M&A has clearly been restored to health since 2004 when it reached a total value nadir of €36 billion. Each subsequent year has exceeded €150 billion in deals. While there has been much public attention on the growth and power of private equity, the principal driver of deals has in fact been the large European incumbents' return to acquisition activity. These players have rationalised their portfolios, strengthened the ownership of their separate operations and increased their footprint overseas. The last two years have also seen an increasing level of domestic consolidation.

The PricewaterhouseCoopers' Transaction Services team has been busy across the region supporting buy-side and sell-side due diligence on a number of landmark deals. These included the due diligence for the acquisition of TeleDanmark by the Nordic Telephone Company (the private equity consortium of Apax, Blackstone, KKR, Permira and Providence Equity), the due diligence of Telsim on behalf of Vodafone, the due diligence of Infonet for BT Group, the due diligence of Com Hem and UPC Sweden for Providence Equity and Carlyle plus the vendor due diligence of Bite in Lithuania.

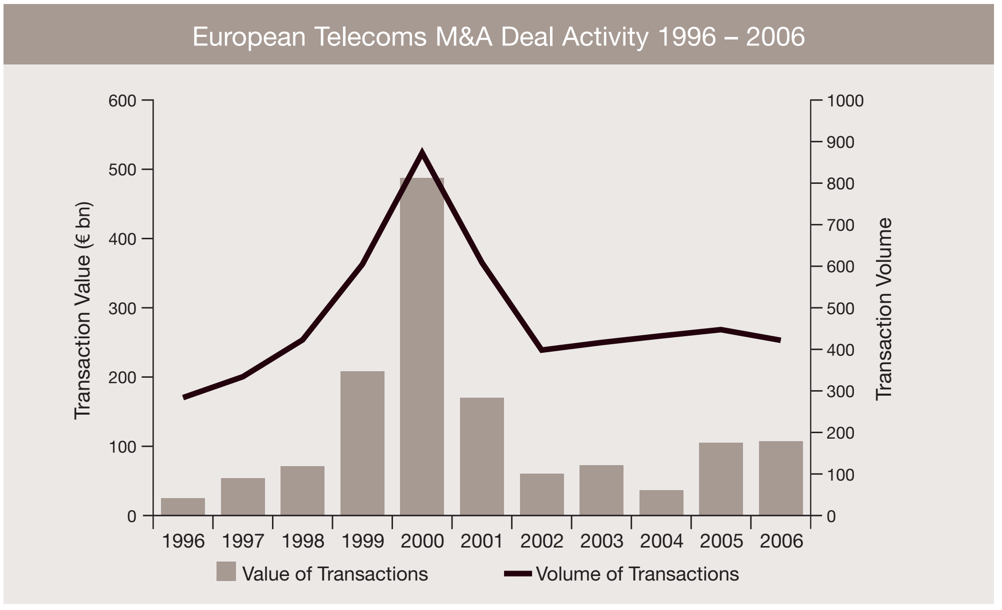
Our team across Europe offers our clients a wide range of deal services: strategic, financial, tax, pensions, post-deal support, all with specific industry expertise. We have a presence in over 30 European countries.

If you would like any further information or would like to comment on any aspect of this report please do not hesitate to contact us.

Front cover image courtesy of Motorola.

Deal value makes strong recovery

While deal volumes have remained generally stable since 2001, both 2005 and 2006 have seen marked increases in value.



Source: Thomsom Financial, deals where the target or acquirer was in Wireless, Telecommunications Services, Telecommunications equipment, space and satellites, other telecom, cable networks (not channel management), in Europe (Western, and CEE) between 1/1/96 to 31/12/06

The volume of European telecom deals in 2005 and 2006 has remained stable with 447 transactions in 2005 and 422 in 2006 compared with 433 in 2004. However, this is still some way short of the volumes at the market peak of 2000 when nearly 900 transactions were recorded.

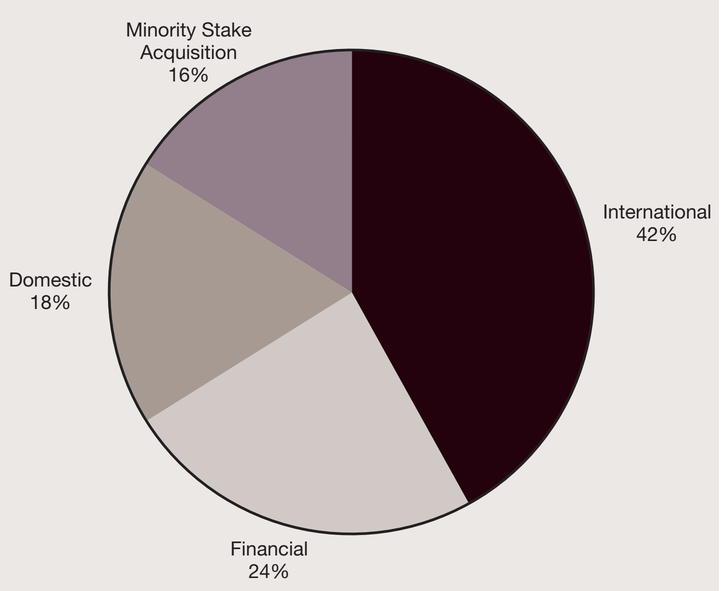
In value terms there has been a more marked improvement, with total deal value of over €150 billion in both 2005 and 2006 compared with a low of €36 billion in 2004. 2005 witnessed the return of some substantial deals such as the €6 billion-plus acquisitions of Wind in Italy and Amena in Spain, while in 2006 the landmark transactions were the €25 billion acquisition of O2 by Telefonica and the €8.5 billion acquisition of TDC.

Top European Telecoms Deals in 2005 & 2006					
Date	Value (€m)	Target	Target Country	Acquirer	Acquirer Country
Jan 06	25,293	O2 PLC	UK	Telefonica SA	Spain
Jun 05	23,187	Telecom Italia Mobile SpA	Italy	Telecom Italia SpA	Italy
Nov 06	10,858	Lucent Technologies Inc	US	Alcatel SA	France
Aug 05	10,297	Wind Telecomunicazioni SpA	Italy	Weather Investments Srl	Egypt
Jan 06	8,483	TDC A/S	Denmark	Nordic Telephone Co ApS	USA/Europe
Nov 05	6,215	Amena	Spain	Orange SA	France
May 05	5,678	Snecma SA	France	Sagem Communication SA	France
Nov 05	5,270	Turk Telekomunikasyon AS	Turkey	Oger Telecom	Turkey
Mar 06	4,757	Telewest Global Inc	UK	NTL Inc	UK
Jan 05	4,023	Intelsat Ltd	Bermuda	Investor Group	UK
May 06	3,640	TELSIM Mobil Telekomunikasyon	Turkey	Vodafone Group PLC	UK
May 05	3,540	Oskar Mobil as	Czech Rep.	Vodafone Group PLC	UK
Jul 06	3,367	Telefonica Moviles SA	Spain	Telefonica SA	Spain
Jun 06	2,844	T-Online International AG	Germany	Deutsche Telekom AG	Germany

Source: Thomson Financial, deals where the target or acquirer was in Wireless, Telecommunications Services, Telecommunications equipment, space and satellites, other telecom, cable networks (not channel management), in Europe (Western, and CEE) between 1/1/05 and 31/12/06

International cross-border acquisitions continue to represent the largest share of deal value, accounting for 42 percent in 2005 and 2006, although domestic activity such as buy back of minority interests and consolidation has also been a major value driver. The largest growth has been the scale of transactions by financial investors. These have risen from 6 percent of the total in 1999 to 24 percent combined over the last two years.

Split of European M&A Activity by Type 2005 & 2006

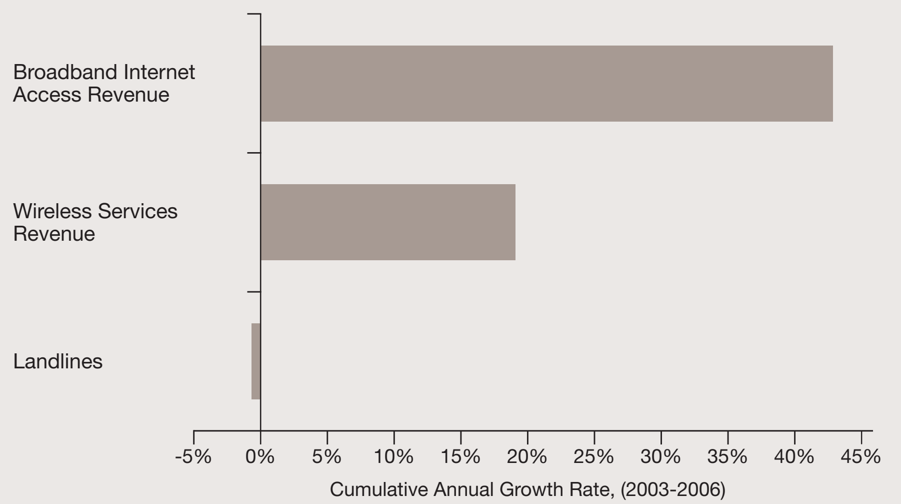


Source: Thomson Financial, deals where the target or acquirer was in Wireless, Telecommunications Services, Telecommunications equipment, space and satellites, other telecom, cable networks (not channel management), in Europe (Western, and CEE) between 1/1/05 and 31/12/06

The resurgence in value over the last couple of years has been characterised by three drivers: consolidation, fixed-mobile convergence and international expansion. As major European telcos have seen their balance sheets restored to relative health through disposals and increasing profitability, they have been able to undertake some significant transactions, enabling them to execute strategies that provide users with, not only fixed and mobile services, but access to a range of high-speed data and content as well.

Fixed-mobile as a concept has been around for a while, but the drivers behind this renewed focus have developed. The percentage growth of wireless revenues has in many markets slipped to single figures, and fixed-line voice revenues are falling for many operators while broadband penetration has accelerated (see chart below). Telecoms providers are therefore looking at opportunities beyond their core markets, trying to build complementary businesses that capture a greater share of increasing consumer spend on communications, media and entertainment, blurring the traditional divide between communications and media markets.

Key European Telecoms Revenue Driver Growth (2003-2006)



Source: TIA '2006 Telecommunications Market Review and Forecast'

First time around, the idea of platform convergence did not deliver the value that was widely discussed and hoped for by many. Mobile operators, for example, saw far greater value in focusing on their core markets – which were still showing high rates of growth – than they did in offering new services. But with mobile markets reaching saturation, is fixed-mobile convergence more likely to deliver on its promise in today's market? There are a number of indicators that suggest pursuing convergence will yield a considerable prize to the successful.

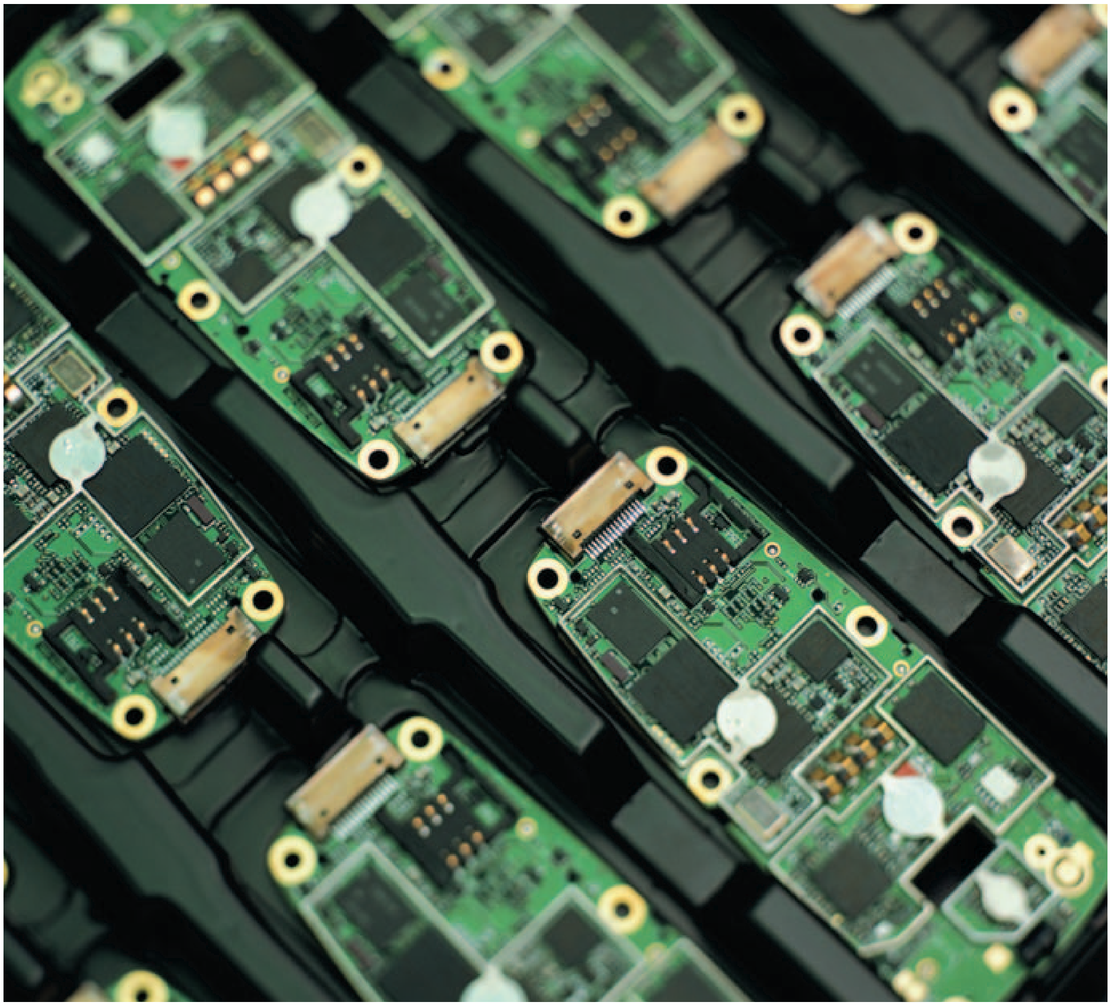
In the more developed markets of Western Europe telecoms operators are being affected by a number of factors that are intensifying competition. High levels of mobile penetration have reduced the scope for growth from traditional voice services while data has yet to have a meaningful impact. At the same time fixed to mobile substitution has begun to bite hard causing declines in fixed voice revenues while the growth of broadband encouraged by LLU (local loop unbundling) has opened up the further threat of VoIP.

Smaller single-service players in those markets are finding life increasingly tough. National incumbents have also set about positioning themselves for convergence with the last two years seeing a number of deals involving the reacquisition of shares that were disposed of only a few years previously.

European players chase domestic consolidation to build integrated platforms

Major European players have returned to the acquisition trail accounting for 39 percent of deal activity.

2005 saw the completion of France Telecom's buy out of minority shareholders in mobile operator Orange, with Telecom Italia following suit with its buy-back of the outstanding 44 percent of Telecom Italia Mobile (TIM) for €23 billion. Deutsche Telecom completed the acquisition of outstanding shares in ISP T-Online that it spun off in 2000. Similar consolidation in the Irish market saw incumbent Eircom re-enter the mobile market with its acquisition of Meteor for €420 million, Belgacom bought out Vodafone's 25 percent stake in Belgacom Mobile for €2 billion and Swisscom acquired Vodafone's minority stake in Swisscom Mobile. This reversal of the trend to divest assets responds to the decline in revenues for fixed services and the perceived importance of capturing a customer base that is increasingly seeking to use one provider for all its communication needs. Having control of fixed, wireless and broadband networks looks to be a major priority, as triple-play and even quad-play converged services are designed and rolled out to consumers.



Fewer players, higher stakes

Maturing markets and fierce domestic competition have spurred another round of in-country consolidation across fixed and mobile sectors.

Creating scale through in-country consolidation has been at the heart of several other headline deals of the last couple of years. In 2005, 23 percent of deals by value would be classed as consolidation, although this percentage dropped with only 13 percent of deals in 2006 representing some form of in-country acquisition.

As markets mature, consolidation will increase as smaller operators find themselves struggling to compete, with most markets leaving room for only two or three major players. This is particularly the case as we move into next generation networks and services that will require significant investment.

Mobile

In the mobile market there has been a widespread recognition that the fourth and in some cases third operators will struggle to compete in national markets.

TeliaSonera acquired Orange Denmark from France Telecom for €600 million to consolidate with its existing operation in Denmark; T-Mobile in Austria bought mobile operator tele.ring for €1.3 billion. In the Netherlands, KPN sought to bolster its mobile business with the €1 billion acquisition of Telfort, the ex-O2 Netherlands business, and in Greece, TIM Hellas merged with its smaller competitor Q-Tel to create a mobile business with a subscriber base in excess of three million.

Altnets

Against a background of continued pricing pressure, the alternative providers look to be acquiring scale in order to square up against the incumbents with converged offers.

In the UK, Cable and Wireless acquired Energis with the express intention of ensuring that it was able to build a network to compete with incumbent BT's 21st Century Network (21CN) to provide high-speed converged services. In a similar move across the channel, Vivendi Universal's subsidiary Cegetel merged with Neuf Telecom to create the second largest fixed-line operator in France and a major player for high-speed internet services. The acquisition of altnet Invitel in Hungary by HTCC typifies the type of transactions that are seeing smaller providers combining to take on incumbents both in their home markets and regionally.

Cable

European cable operators have also pursued consolidation in their efforts to compete with incumbents.

In Spain, ONO, one of Spain's leading cable companies, acquired Auna TLC, the cable division of Grupo Auna for €2.2 billion, Liberty Global acquired NTL Ireland and the largest European cable deal of the last two years saw NTL acquire Telewest for €4.75 billion to create a single national cable operator in the UK.

Major European Cable Deals 2005/2006

Date	Value (€m)	Target	Target Country	Acquirer	Acquirer Country
Mar 06	4,757	Telewest Global Inc	UK	NTL Inc	UK
Nov 05	2,196	Auna	Spain	Grupo Corporative Ono SA	Spain
Sep 06	2,099	Casema NV	Netherlands	Cinven/Warburg Pincus	US
Oct 05	1,783	Cablecom Holdings AG	Switzerland	Liberty Global Inc	US
Jun 05	1,674	ish GmbH & Co KG	Germany	iesy Hessen GmbH & Co KG	Germany
July 06	1,196	UPC France SA	France	Altice/Cinven	UK
Jan 06	959	com hem AB	Sweden	Carlyle/Providence Equity	US
Mar 06	954	Sogecable	Spain	PRISA	Spain

Source: Thomson Financial, Largest deals where the target was a cable network
(not channel management), in Europe (Western, and CEE) between 1/1/05 and 31/12/06

Private equity has had a significant role to play in the European cable market. Cinven, a major player in the cable space, has completed acquisitions in France: Altice One (including Videocom) which serves the Alsace region and Coditel that provides telephone, broadband and digital TV to subscribers in Belgium and Luxembourg; as well as the cable operating subsidiaries of France Telecom and Canal+, and the Dutch cable operator Casema in a deal that brought together Casema – the third largest cable provider in the Netherlands – with Multikabel, the fourth largest.

The new shape of global ambitions

The major European operators have returned to growing their international footprint, either to seek emerging growth markets or to ensure a presence in the main western markets reflecting a scarcity of options.

The last major boom in telcos' corporate activity in 2000 saw the execution of deals designed to achieve truly global businesses operating across all major markets. The picture today has developed and we are seeing a more selective international strategy being pursued by some of those businesses that had previously sought to bestride the entire world. With developed markets showing signs of saturation and revenues under pressure from intense competition, telcos are turning their attention to fast-growing markets which have significantly lower penetration rates than Western Europe.

Value of acquisitions by Deutsche Telekom, Vodafone, France Telecom, Telecom Italia & Telefónica 2001-2006

Source: Thomson Financial, Deals involving Deutsche Telekom, France Telecom, Vodafone, Telefonica or Telecom Italia as acquirer between 1/1/01 and 31/12/06

Vodafone, for example, has made significant disposals in Japan, Belgium, Sweden and Switzerland. Rather than competing against established players in all markets Vodafone appears to be consolidating its position in the markets in which it has a leading operation and focusing on other markets that suggest significant growth opportunities. These include acquisitions in Turkey – where it bought mobile operator Telsim for €3.64 billion. It has also made acquisitions in Central and Eastern Europe, including Mobifon in Romania and Oskar Mobil in the Czech Republic for €3.5 billion. Completing the deal to buy a majority stake in Hutchison Essar in India will transform the group's growth profile.

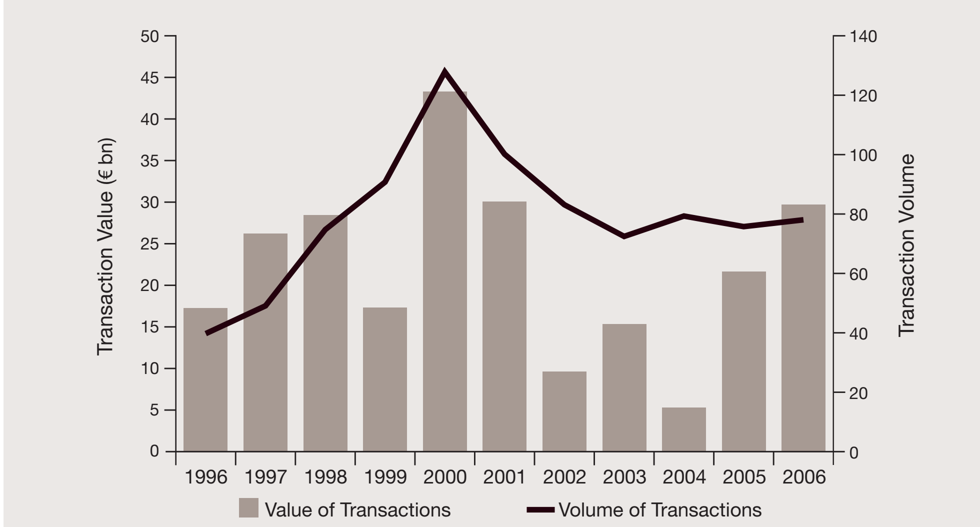
In addition to making the largest acquisition of 2005 and 2006 (the €25 billion paid for O2) Spain's Telefónica has also expanded into Eastern Europe with the acquisition of Cesky Telecom from the Czech Government for €2.8 billion. Others too have joined the race into potentially higher growth markets in Eastern Europe; Telekom Austria buying MobilTel in Bulgaria and Telenor buying Mobi63 in Serbia and Montenegro to bolster its existing holdings in the region. Elsewhere in Europe, France Telecom successfully acquired Amena in Spain for €6.2 billion in 2005.

A noticeable trend in the European region has been the expansion of the Middle Eastern operators. Orascom acquired Wind in Italy for €10.3 billion and recently acquired TIM Hellas in Greece. Noticeable by their absence have been the US operators, reflecting their focus on domestic consolidation and integration of recent deals.

The rise and rise of private equity

Private equity and infrastructure fund interest in the European telecom sector has intensified with 28 percent of the deal value in 2006 being attributed to financial investors.

Financial Investors European Telecom Deal Activity 1996-2006



Source: Thomson Financial, deals where the target was in Wireless, Telecommunications Services, Telecommunications equipment, space and satellites, other telecom, cable networks (not channel management), in Europe (Western, and CEE) and the 'Acquirer Macro Description' was 'Financial' between 1/1/96 and 31/12/06, with the NTC acquisition included

The last two years have seen significant development of interest and activity from private equity houses and more recently the infrastructure funds operating across the telecoms sector. The biggest single private equity deal saw the Danish incumbent TDC acquired for €8.48 billion by a consortium comprising KKR, Blackstone, Apax Partners, Permira, and Providence Equity Partners. One member of that consortium, Blackstone, also acquired a stake in Deutsche Telekom for €2.65 billion. Nonetheless, despite the constant speculation of private equity involvement in most transaction processes the actual amount successfully concluded is relatively small. In 2005 and 2006 private equity accounted for 17 percent of deals by volume. However, in value terms in 2006 they accounted for 28 percent – significantly higher than in the previous five years (which ranged from 15-20 percent).

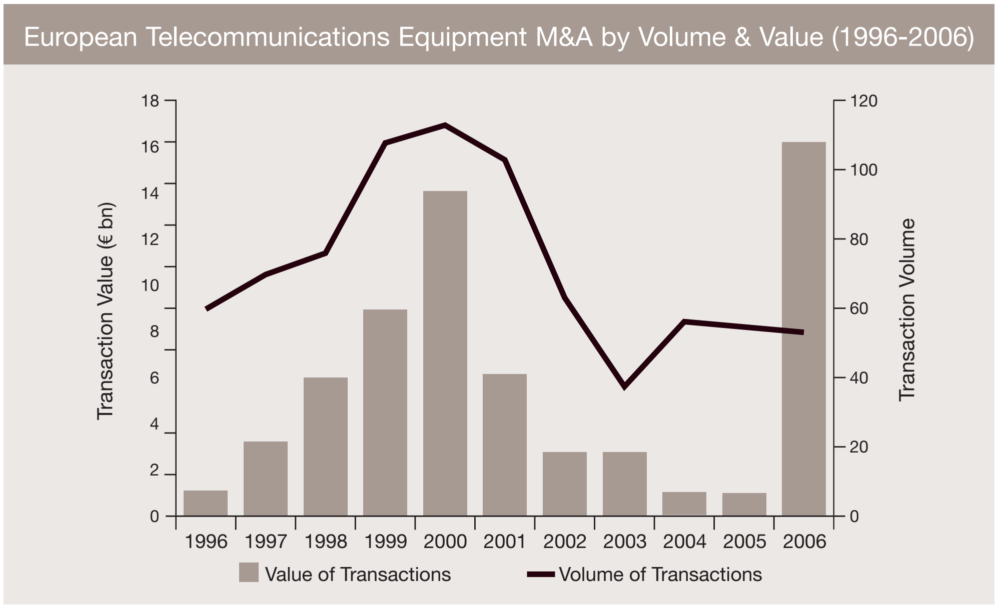
As noted above, private equity players have been particularly active in cable, but there has also been significant interest in other telecoms assets, with infrastructure attracting particular attention as demonstrated by the €5.1 billion announced investment by Texas Pacific Group and AXA Private Equity of French mobile tower and digital broadcast group TDF in October 2006 (and expected to complete in 2007).

Infrastructure funds have also taken a shine to telecoms assets. The highest-profile deal was Macquarie's €1.9 billion acquisition of NTL Broadcast (now Arqiva). Other major investment houses have set up dedicated infrastructure funds and their activities will see their influence grow as the infrastructure market develops.

Some private equity industry commentators have predicted that there will be a PE deal in excess of $100 billion within the next two years. Telecoms assets, including even some of the larger national incumbents, have been discussed as possible targets for such a transaction. Though there are some barriers to such a deal taking place – including regulatory obstacles – there seems to be little doubt that the disciplined and value-focused approach that private equity brings to the market will continue to exert a strong influence. Add to this the growing willingness of private equity houses to work together (as shown in the TDC acquisition) and there would appear to be few limits to what they can achieve in the telecoms sector.

Equipment manufacturers scale up to compete

2006 saw a substantial increase in deal activity from the equipment vendors with deal value at €15 billion exceeding 2000 levels.



Source: Thomson Financial, deals where the target mid description was Telecommunications Equipment in Europe (Western, and CEE) between 1/1/96 and 31/12/06

The opening up of significant new markets for telecoms equipment – such as Africa and China – combined with the increasingly strong competition of Korean and Chinese manufacturers have seen scale becoming more and more important for equipment manufacturers. The cost of developing new technology platforms is becoming prohibitive, as demonstrated by the difficulties Ericsson initially experienced in their focus on 3G. Cost efficiency across the value chain has become increasingly critical for competitive survival and so sub-scale manufacturers are looking for opportunities to grow via acquisition or merger. A number of major players have already or are about to complete mergers, including Nokia and Siemens who are putting their fixed-line and network equipment businesses together, as well as Alcatel and Lucent who finally agreed a merger in 2006, having first discussed one in 2001. At the same time Alcatel acquired Nortel's 3G business while Nokia disposed of its TETRA infrastructure unit to EADS. As the market (particularly for hand-sets) becomes more price-driven, we expect to see considerably more activity in this space.

There are also an increasing number of smaller deals as many of the major vendors acquire intellectual property and research and development know-how to supplement their core products. An example of this was Motorola's €151 million acquisition of TTP Communications, a leading developer of mobile operating systems for low and mid-tier mobile devices.

Back to convergence

Convergence is the buzz word but in reality the scale of transactions to date is small.

Selected European Convergence Deals 2005/2006					
Date	Value (€m)	Target	Target Sector	Acquirer	Acquirer Country
Oct 05	3,448	Skype Technologies SA	VOIP Software	eBay Inc	US
Jul 06	1,357	Virgin Mobile Holdings (UK) PLC	Wireless	NTL Inc	UK
Dec 06	548	AOL (UK) Ltd	ISP	Carphone Warehouse Group	UK
Jan 06	298	Easynet Group PLC	ISP	Sky Broadband Services Ltd	UK
Jun 06	74	Be Un Ltd	ISP	O2 PLC	UK

Source: Thomsom Financial

Many of the transactions mentioned in this report can be understood in terms of pursuing a converged strategy or responding to the perceived opportunities that convergence creates. But most of these are at the preparatory stage, rather than fully-fledged convergence plays.

There is a sense of expectation in the market, but also a degree of anxiety about the extent to which convergence, this time around, will deliver on its promises. In this context, the €1.3 billion tie-up between NTL/Telewest (now Virgin Media) and Virgin Mobile in the UK to offer quad play services will be watched carefully by the industry. The deals with a distinctly convergent flavour, such as Sky's acquisition of Easynet and Carphone Warehouse's announced acquisition of AOL UK for €548 million, are of great interest strategically, but of comparatively low value.

There are also some indications that competition may arise from other sectors, for example eBay's acquisition of Skype, and Apple's launch of the iPhone. The signs are that 2007 may be the year when the promise of convergence begins to deliver.

Courtesy of Apple

Predictions for 2007

Major players remain active

We expect the major European telcos to continue with selective deal activity to rationalise their portfolios through disposal and domestic consolidation. We expect the trend of seeking growth in fast developing African and Asian markets to continue.

Increased activity in CEE

The inclusion of many CEE countries within the European Union has opened the market to many interested players. We expect to see moves towards the sale and privatisation of a number of assets in the region.

Increasing presence of Middle Eastern investors in European telecoms M&A

Major Middle Eastern operators are becoming increasingly interested in assets in Europe. There is a desire to balance the risk of investments across countries and while Western European assets do not offer high growth they do offer greater stability. The likely listing of one or two of the Middle Eastern operators on a European stock exchange will support acquisition activity.

Further rationalisation of equipment vendors

It would seem that further rationalisation amongst the equipment and device vendors will continue. Smaller handset manufacturers will be acquired if they are to survive while the increasing polarisation between vendor technology strategies will also promote further rationalisation of product portfolios. We expect to see the major vendors continuing their interest in small bolt on acquisitions to fill product gaps.

Another landmark PE deal

The scale of capital, both equity and debt, available to the PE funds means that the possibility of another major telecom acquisition cannot be excluded. Many European companies are now within the size range, though unlocking many of these at a reasonable valuation will prove challenging.

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