WHITE PAPER

The Future Role of Technology in Telco M&A Transactions

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How to better include the Technology function into an M&A transaction and increase expected deal value

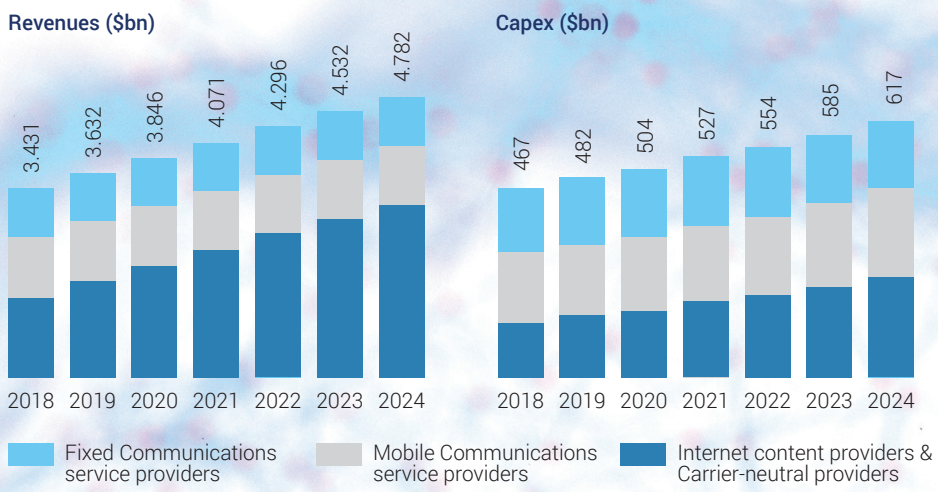
The Telecom landscape is rapidly changing since the last decade. Through their transformation efforts Telecom companies are moving away from traditional connectivity activities as a Connectivity Service Provider (CSP) and into digital services & platforms as a Digital Service Provider (DSP). The main driver of this change is, as most of the time, profitability. Telecom operators are facing increased pressure to invest in costly upgrades to their networks, incl. 5G, further amplified by an exponential increase in data usage. In parallel, revenue streams on traditional connectivity (services) are stagnating, especially in more mature markets, and new revenue streams ought to be found to turn around the yearly decline on core business.

Most operators are confident that they can manage this transformation well and develop new lines of business to offset the decline. As such, this change is not only supported through internal measures, but also through M&A - and the industry is looking for new opportunities very actively.

Future of Telecom M&A deals – A brief overview of the years ahead

Technology is a key factor in competitive differentiation in today's world. This is especially true in the telecommunication industry, where fast networks (5G) and a sophisticated customer experience are deemed must-have conditions in order to effectively serve demand and navigate competition.

Figure 1: Revenues vs. Capex of all communications providers



Source: Ovum

As we pointed out in our recent M&A spotlight, telecom deal activity is mainly driven by three factors.

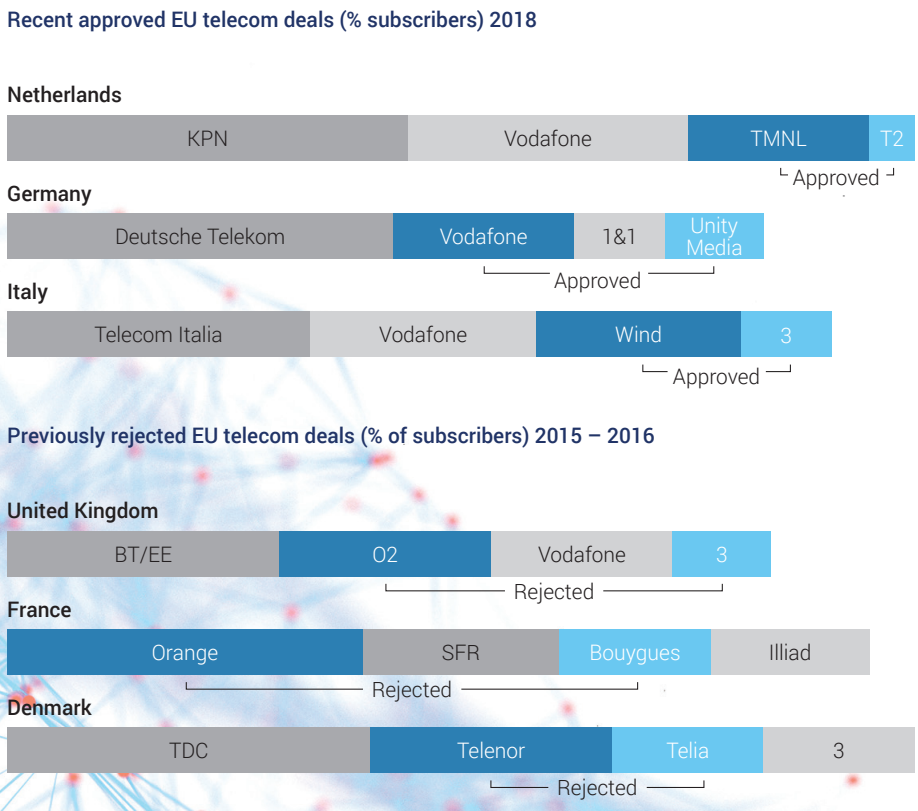
1. By infrastructure (e.g. 5G, TowerCo);
2. Consolidation into multi-play;
3. Investments in adjacent industries or geographies.

In all these areas, technology plays a major role for deal success. This is further emphasized by the ongoing digital transformation, wherein technology is the enabling factor to ensure success in changing from a traditional CSP to a (more) Digital Service Provider.

As technology asks for an increasing amount of CAPEX, driven by a.o. spectrum licenses, network rollouts, and IT transformation, it becomes more difficult for incumbent telecoms to operate with the same profitability results as before.

Further consolidation in the market aims to break through the challenges of (limited) scale & capability vs. increasing CAPEX requirements. In Europe in particular, the regulatory climate for consolidation looks more favorable after recent approvals in telecom deals that were previously blocked in the years before. This is helping European operators retain their market shares in both fixed and mobile segments and increasing their focus on offering multi-play services.

Figure 2: Regulatory climate looks more favorable towards consolidation in Europe, following approvals on telecom deals in 2018 that were previously blocked

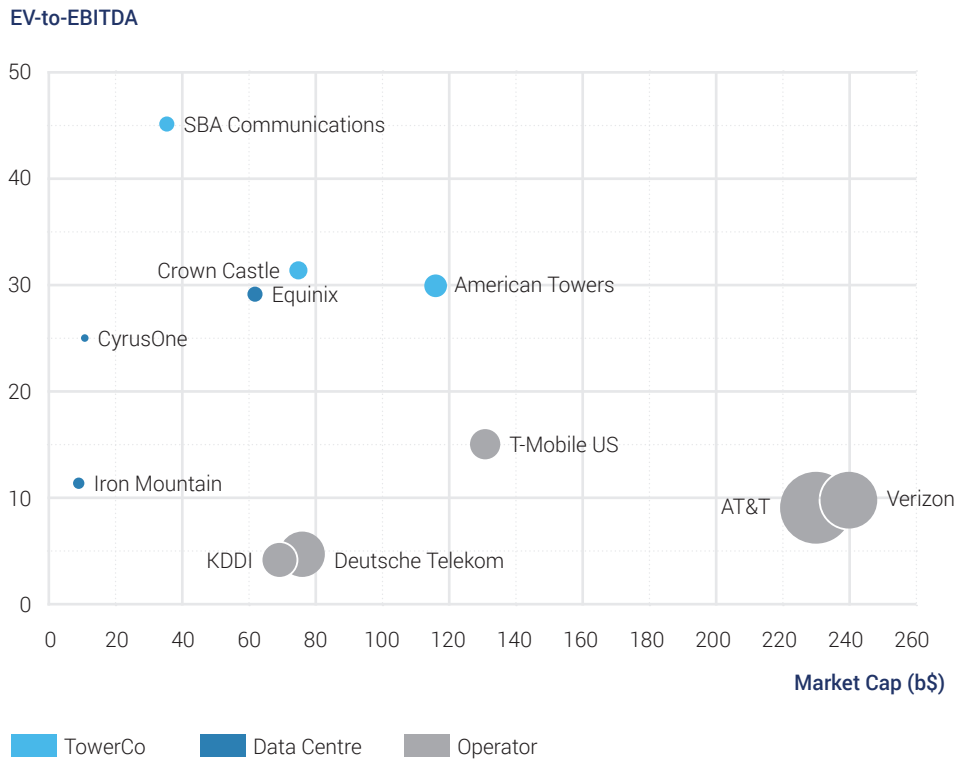


Source: Company reports, Telegeography

Looking ahead we believe that future M&A activity is likely to be focused on network sharing through asset sales (e.g., Sunrise Switzerland sold its mobile towers to Cellnex, and Altice is planning to sell about 13,000 tower sites in France through SFR and Portugal through MEO) or separation (e.g., BT–Openreach, Telecom Italia–NetCo, Inwit and Telefonica–Telxius) – besides the hunt for expansion and/or adjacent markets.

Pure infrastructure companies like TowerCo and data centers trade at much higher multiples, EV-to-EBITDA at +20, compared to a fully integrated telecommunication operator which trade in single digits. Operators strategies are to carve out their towers and data centers to allow them to better raise funds and to be able to sell them at a much higher valuation when they do asset sales.

Figure 3: Value relative to EBITDA of selected Telecom industry players in 2019. Bubble size represents EBITDA



Source: Detecon analysis

This year: COVID-19 delays M&A, but telecom & digital opportunities remain very relevant

This year, several themes will determine global M&A activity. In the short-term, the COVID-19 pandemic has already had a direct effect with deals being delayed or pulled to allow the market to recover or to delay anticipated deals still at an early deal phase. For instance, general M&A levels in the United States fell by more than 50% in the first quarter to **USD 253 billion compared to 2019**, but most of those transactions were entered into or closed earlier in the quarter, before the crisis spread worldwide.

In the post COVID-19 era, we expect telecom, digital and communication services to be more relevant than ever before as the world is growing more connected and businesses are better prepared for such calamities. Coming out of COVID-19, millions of users worldwide will be more connected and more familiar with digital tools. Businesses are quickly adapting, and first companies are already showing signs to permanently relinquish (part of) their office space with remote working seen as a feasible alternative. **Estimations** indicate that **25-35%** of the workforce will be working at home on a multiple-days-a-week basis by the end of 2021, For instance, Twitter and Facebook offer their employees a mixed reality workspace, which could help its employees work from home in the future and in the office, when required. This trend, together with lowered company valuations, may offer Big Tech and telecom opportunities worth pursuing. A recent example from April is the acquisition of **BlueJeans,** an enterprise-grade video conferencing and event platform, by Verizon to expand the company's immersive unified communications portfolio. This deal was already prepared before the COVID crisis started, however turned to be more relevant than estimated before. Beyond video connectivity, the company intends to integrate the platform into Verizon's 5G product roadmap, providing secure and real-time engagement solutions for high growth areas such as telemedicine, distance learning and field service work.

> "As the way we work continues to change, it is absolutely critical for businesses and public sector customers to have access to a comprehensive suite of offerings that are enterprise ready, secure, frictionless and that integrate with existing tools." Verizon Business CEO Tami Erwin

As M&A remains relevant, also post-COVID era, how could we improve the results of M&A transactions? Our research shows that technology has been underappreciated for a longer time in M&A deal making and integration support. Perhaps now more than ever, we should aim to improve the positioning of this domain within M&A deals.

Value creation in Telecom M&A largely depends on Technology – however most deals have a poor track-record

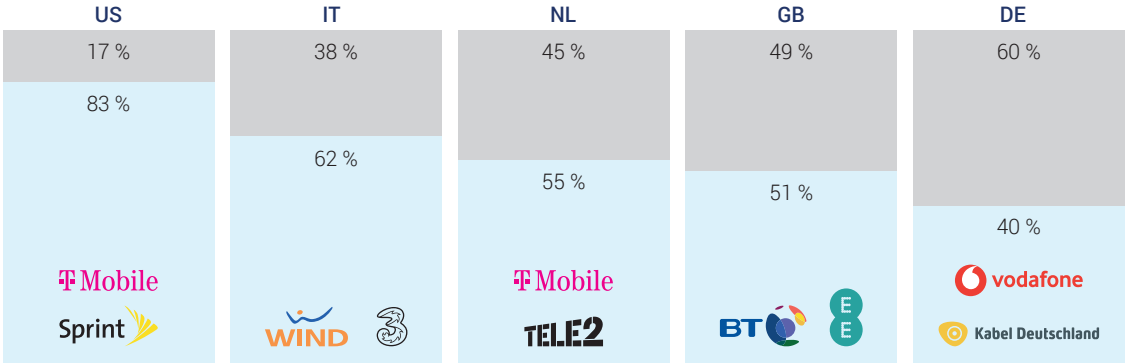
Technology plays a pivotal role in value creation for most telecom M&A deals, both directly and indirectly. Directly, as most of the cost synergies are realized through asset integration and FTE optimization measures within the technology domain. Indirectly, as revenue synergies cannot be realized without the proper support from Technology in product & service development, channel development and appropriate campaigns & promotion. The current merger of **T-Mobile US and Sprint** is a good example of this. More than 80% of total synergies are directly created through technology optimization measures. Of the technology related synergies, the majority belongs to network (~70%), such as site decommissioning & capex savings, and with a relative minor part of IT synergies (~30%). In addition, the merger seeks to find more revenue streams through the deployment of the first nation-wide 5G network. To realize this, Technology's mission is to roll out its 5G base-stations rapidly – in the hundreds per week, a rate that has been unprecedented in the US and rest of the world.

Most value creation cases are set at the start of the deal and it is to be seen whether post-merger these expectations can be realized in full. In fact, study after study puts the **failure rate of M&A** somewhere between 70% and 90%. As M&A projects are intrinsically complex endeavors to undertake, there are many, often (a combination of):

- improper target evaluation
- inflated valuation
- poor post-merger integration execution

These factors are responsible, that most deals are either priced too high and/or poorly integrated resulting in missed synergy realization targets. As we pointed out, technology has a pivotal position in value creation. However, it seems that in most deals, technology is not positioned properly to create optimal value. We will discuss below that the position of technology within an M&A deal should be improved from a team, time and process & tools perspective.

Figure 4: Overview of Technology contribution to synergies in Telco M&A



Source: company reports

Technology | Other

Where involvement of Technology fails – and how it should change in order to improve M&A value creation

In the first part of this paper we talked about the remaining relevance of M&A in company value creation; however with "money left on the table" from its poor track record. To improve the track record and impact to the M&A process (e.g. Day1 readiness, detailed planning, and accurate timing in preparation and execution) we will outline some key points to take point on, based on Detecon's M&A experience in conjunction with client management feedback during deal support.

As we pointed out, technology is pivotal in value creation – but in most deals, technology is not properly positioned to create optimal value. We highlight three areas, where technology involvement is lacking, and what telecoms can do to improve their return on investment.

1. Technology involvement's priority is too low to safeguard synergies & business continuity

M&A teams are formed well before the deal closing. The capabilities typically found in these teams reflect Finance, Legal and Strategy capabilities:

- Corporate Finance. Support from M&A investment banks and related industries to "broker", value and execute the deal. The investment bankers lead the whole deal team and work with relevant parties to ensure that the transaction process is smooth.
- Legal counsel. Support from M&A legal teams, both in-house and outside counsel to facilitate legal matters, setup the deal structure and execute the deal process.
- M&A Strategy. Consulting support to facilitate the due diligence of targets, provide expertise input to the valuation process, develop & execute the integration strategy.

The successful outcome of an M&A deal depends on the ability to capture synergies as well as running a sustainable NewCo. From a technology point of view, this means: the phase-out of IT systems & network assets, optimization of contracts & licenses, and optimization of the employee footprint (both outsourced and captive). On top of this, target technology business continuity should be safeguarded along the entire process to ensure customers are receiving the same products & services as pre-merger and prevent churn. This in turn creates additional workloads especially looking at employee and customer service operations. To ensure the above, technology should be involved as fourth capability within the deal team.

2. Technology involvement occurs too late and lacks sufficient intensity

Technology experts should be involved as early as possible in the M&A team to ensure that technology matters receive sufficient attention. Our view on the consequences from insufficient involvement of Technology are as follows:

Pre-deal, the focus is on providing a complete overview of all assets of both companies in order to support legal agreements (meaningful TSAs; Transitional Service Agreements) as well as the due diligence with a valid synergy model. Typically, legal documents and the synergy model are setup by the legal and financial experts respectfully, with limited involvement of Technology. This could lead to issues such as TSA agreements that are incomplete and/or impractical from a Technology governance perspective and a synergy model that is unrealistic to achieve. Such issues could be prevented by having a Technology Clean Team present, or, at minimum, a dedicated team of technology experts that support existing Clean Teams. Our recommendation is to keep (part of this) support connected to the overall team throughout the entire deal lifecycle to reflect back on plans and business cases when needed.

Pre-Day1, NewCo technology blueprints are the foundation of the synergy case and overall merger success. Most telco's fail to develop an accurate blueprint in the pre-day1 phase as they have limited means to access information and experts in both companies due to 'gun jumping' regulations. To offset this challenge, we recommend having a close collaboration setup between the Network / IT architects of both parties. This collaboration should be facilitated through legal counsel in all cases to prevent information being shared, i.e. a violation of 'gun jumping'. If necessary, information can be shared a Clean Team, even though information is likely to be rendered less viable. In addition, we recommend to ramp up the Technology integration team with implementation teams as Day1 is approaching. This should start no later than 3 months before Day1 as ramping up a team can take time, especially on the vendor support side.

After Day1, it is crucial to "hit the ground running". If you followed the previous advice, you would have a sufficiently accurate technology blueprint with a solid base of integration teams standing ready for its execution. Day1 is the first moment where information can be shared freely between the different teams of the NewCo. Also, we will typically find a new management team in charge to execute the 'first 100 days'. In our experience, pre-Day1 blueprints often have some degree of error and/or missing information in order to be ready for execution. We recommend to validate the pre-Day1 plans within 2 months after Day1 so that plans and synergy expectations can be met. In our experience where there are major findings, it is challenging to agree on a new strategy and associated architecture within reasonable time, as decision-making often crosses multiple domains (e.g. Commercial and Technology alignment) and is made by a new management team. To mitigate this risk, a governance model should be agreed on – ideally even pre-Day1 – to have a decision-making process in place between the different functional verticals of the NewCo.

3. Not leveraging efficient Technology M&A tools

The biggest synergies in a technology M&A transaction, especially for communication providers, is in the networking domain – typically reflecting ~70-80% of overall technology synergies. The right tools are required in order to effectively and efficiently plan these synergies. Two important factors are worthwhile to call-out, when technology M&A tooling is considered:

1. As complexity of technology grows, spreadsheets are no longer the tools that can accurately calculate (network) synergies. Having a network planning and cost modelling tool that can be used to model the technology parts of both organizations will enable the deal team to make much quicker and more accurate decisions on identifying and planning synergies. To accelerate definition of blueprints one should use pre-defined models of NT/IT topology/architecture based on previous experience. Networking tools, such as the Detecon tool **'NetWorks',** allow the deal team to model multiple scenarios and sensitivities in a single environment much more efficiently. These tools are packed with standard operating scenarios for integration cases and can model different outcomes of network architecture (cost / capacity / ...) performance. Post-Day1 this can function as a solid basis for further detailing of Network / IT architecture blueprints.

2. When it comes to the technology synergy case, the synergy model should closely track the NewCo target architecture. Such a model should be defined during the pre-deal phase. Our experience is that a business case is "only made once and quickly forgotten thereafter". Hence, our recommendation is to keep track of the synergy realization progress post-Day1 using the tools & models previously defined.

Case-studies:

Business Continuity
Detecon did a pre-Day1 BSS (Business Support Systems) assessment and planning for a multi-national operator that was buying two mobile networks and integrating them with their assets in two countries. IT was critical to ensure business continuity in the transactions, especially for BSS . BSS was critical for revenue assurance and minimizing impact and churn on the customer base. Securing the current BSS environment was a short-term strategy to avoid any disruption to the business. An as-is analysis pre-Day1 was conducted by the clean team to understand the existing solution and what potential risks and mitigations would be to ensure business continuity. This included analyzing the platform, services, resources and governance of the BSS environment. A short-term plan and commitments where agreed on to manage any of the risks on the revenue side of the operator.

Full integration or full transformation was a long-term plan that was planned for and evolved out of the business continuity strategy. It was necessary to harmonize this with the overall group strategy of the organization and use the opportunity to move away from ageing systems that don't meet the group's requirements.

Secure integration
Detecon did a pre-Day1 security and risk planning for a mobile operator acquiring the assets of another fixed and mobile operator. The full integration from Day1 was a high-risk activity that required careful planning. Both parties were not fully aware of the state of the network or the IT systems within the other parties' environment pre-Day1. To prepare for Day1 readiness, a risk analysis was conducted and the standard were set based on ISO27001. A risk governance framework with risk owners was created to identify, assess, manage, monitor and report risks. They were also assigned with the responsibility to manage and steer risk within their operative domain. A post-Day1 plan, which initially included only connections at the peering points and no full integration, was created. A plan for a complete security audit of the network and IT environment on Day1 was developed.

M&A strategic network planning
For the merger of two Tier-1 telco operators, Detecon's NetWorks team supported the strategic network planning. In a highly confidential clean team environment, Detecon managed to produce reliable results to evaluate/validate various network planning scenarios in a short amount of time. This was done on a highly granular level – base station sector level (~15,000) involving the processing of huge datasets (network performance counters). The Big Data analytics capabilities of our tools successfully evaluated optimal network design conditions against criteria such as costs, performance, and resilience.

Detecon recommendations to improve value creation in Telco M&A

This paper calls for an early involvement of Technology in the M&A deal – ideally at pre-deal stage - to respect the impact that Technology can have on the deal strategy & synergies, and protect the interests of Technology internally. The involvement of Technology is normally found late into the deal process – however, the later Technology is considered, the higher is the chance of an increasing number of challenges for the company to realize a successful merger.

Our recommendation is to place Technology as a separate capability to achieve an optimal M&A vehicle – one might argue that given the high degree of Technology's impact, it may even be the main engine for value creation.

Authors

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