TELECOM, MEDIA AND TECHNOLOGY

Q2 2016

July 2016

ALVAREZ & MARSAL

Telecom

After a relatively quiet period, telecom deal activity picked up in Q2 2016:

- Telia Sonera announced the sale of Spanish operator Yoigo to MÁSMÓVIL in June. Earlier this year, MÁSMÓVIL acquired the mobile virtual network operator (MVNO) Pepephone, and as a result it is now the fourth largest operator in Spain with potential to consolidate further with numerous MVNOs in the country.
- TDC sold its Swedish B2B business to Tele2, which wants to grow its business beyond the consumer market.
- Leading French telecom and TV towers operator TDF announced the acquisition of competitor ITAS in early July.

The Wind/3 merger in Italy appears to be on track for completion; However, it will require remedies in the form of asset sale (approximately 8,000 mobile towers) in order to be approved. As a result, Iliad is bidding for those assets with a view of creating a new Italian mobile operator.

In the UK, the announced acquisition of Telefonica O2 by 3Hutchison was abandoned following regulatory pressure and stakeholder objections.

Other European deals are expected to progress further:

- Play the Polish mobile operator, is rumoured to be on the market again having deprioritised its IPO plan.
- Deutsche Telekom is planning the sale of its telecom towers, as is Telefonica.
- Telenor is actively pursuing the sale of its VimpelCom assets.

Regulation may have a significant impact on the telecom sector in the short term as roaming fees in the EU will significantly reduce from 2017 onwards. Also, the Brexit vote may have a significant impact on the UK telecom market depending on the position UK regulator Ofcom takes regarding roaming and sector consolidation.

A&M VIEW

A more active deal space with consolidation in Europe

After a few months of many deals stalling, the telecom sector has started to show the first signs of consolidation:

- MÁSMÓVIL is leading the consolidation of Spain's fragmented MVNO landscape and combining them with a fixed line Internet fibre offer, becoming Spain's fourth largest operator.
- The TDC acquisition may be the first indication of consolidation in the Nordics after the proposed merger of TeliaSonera and Telenor units in Denmark was blocked by the European Commission last year.
- The Wind/3 merger would consolidate Italy's third and fourth largest telecom companies into the largest player with over 30 million subscribers.
- The telecom infrastructure space is becoming increasingly active with numerous operators spinning off their network assets.

Will Brexit change the UK telecom landscape?

The post Brexit position of Ofcom on roaming charges and competition is yet to be defined. It may have a significant impact on the UK telecom market, as well as on applying different rules to roaming charges. Vodafone announced it may move its headquarters from London to the EU.

Media

The fast growth of Netflix and its roll-out to most countries globally (announced at the Consumer Electronics Show in Las Vegas this January) have given rise to a sharp increase of local competitors and to a much richer OTT (Over-The-Top) offer. As a result, one emerging idea is the concept of a single OTT platform per country. The concept is that a single technology platform would host all the OTT services under one roof. Each OTT service would then focus on content and marketing and would not need to duplicate efforts in order to build its own infrastructure. This would be similar to TV situation where most of the television distribution infrastructure (TV masts) is generally controlled by a single player (Arqiva in the UK, TDF in France, Abertis in Spain, etc.).

Special/visual effects (VFX) has been a very active part of the market with transactions in the past year involving The Mill and The Foundry (VFX software). The VFX sector is proving appealing due to its fast growth (more films are VFX-intensive) and attractive customer profile (large US film studios). As a result, the sales process of leading independent VFX company Framestore, which worked on *Gravity* and *The Martian*, has attracted large interest from both private equity and strategic investors.

Leading studio operator Pinewood (where the latest *James Bond* and *Star Wars* episodes have been shot) was featured heavily in the media recently as it conducted a strategic review. A number of potential suitors have been identified including several Chinese strategic investors. In the US, the recent acquisition of Starz by Lionsgate for US$4.4 billion also seems to show that media deals could be on the rise again.

A&M VIEW

Over-The-Top (OTT) is becoming more like TV

The original focus of OTT was convenience and ease of use (watch whenever, wherever you want) compared to TV's fixed schedule. As broadcasters now routinely offer similar OTT services for their content, technology is less of a differentiator, hence the attractiveness of a single common platform generating clarity for consumers.

Visual effects 'buy and build' opportunities

The growth of US studios' expenditure on VFX, together with the emergence of large independent players, is encouraging consolidation, for example Technicolor purchased three VFX businesses in the last 24 months. Also, US film studios are now comfortable dealing with large VFX providers rather than a collection of smaller businesses. For the VFX providers, size matters as it provides deeper studio relationships, better balance of resources between projects, and recruiting and . As consolidation commences, there are numerous opportunities for a 'buy and build' approach to create a large independent player.

Unclear impact of Brexit on media deals

It is not clear yet what impact Brexit will have on UK media deals. The uncertainty about the situation of the UK is likely to reduce the flow of M&A activity in the short-term in most sectors including media. At the same time, the currency fall will make the assets in GBP cheaper, especially for USD buyers. As a result, rumours of potential interest in UK based broadcasters' from American strategic investors have restarted. Also US cinema chain AMC entertainment reportedly took advantage of the sterling fall following the Brexit vote to buy London-based Odeon UCI cinema chain in early July.

Technology

The data centre and web hosting market has been very active recently. On the deal side, Germany's United Internet continued its acquisition spree with its recent purchase of Home.pl, Poland's market leader. Similarly, Host Europe Group is reportedly coming to market in 2016 with a valuation of over US$1.8 billion, though the Brexit vote may affect this process. This consolidation phase is occurring globally; for example, market leader GoDaddy has acquired seven companies since 2013 to increase its reach and service offering, with two main objectives:

1. Extend its services reach: more domain names under management (Marchex), more domain name related services (domain parking: SmartName, marketplace: Afternic, hosting: Media Temple).
2. Enrich its set of services to complement domain name activity (email service: Mad Mimi, calendar services: Canary).

Endurance, the second largest web hosting company, followed a similar approach in 2015 with its acquisition of Constant Contact (email service) and numerous other acquisitions for domain name and hosting services (Site 5, Verio, HostGator, Bluehost, etc.).

At the same time, the sector is moving into more sophisticated services. Originally focused on basic domain names and hosting, it is now offering services with higher value add (e.g. managed services) and more virtualised services (cloud applications and virtual private servers) versus the historic colocation or shared hosting services.

A&M VIEW

Growth opportunities in Data Centre and hosting businesses' top line ….

The hosting sector shows further growth opportunities driven by ever increasing infrastructure and network speeds, growing penetration of internet services in emerging countries, new products coming to market (e.g. new domain extensions) and more sophisticated services (managed hosting, virtualised hosting, cloud applications, mass email, sophisticated ecommerce and social).

… and bottom line

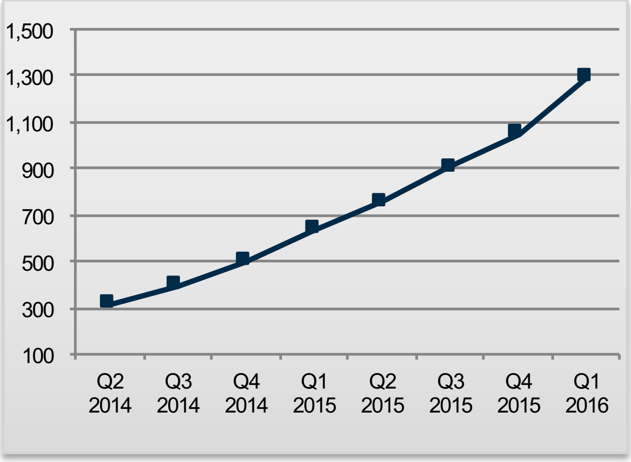
The acquisition trail by many leading host providers has led to significant opportunities for EBITDA performance improvement. The web hosting industry was born out of inherently dynamic, fast-growth and entrepreneurial founder-driven businesses, and the speed of consolidation within the sector has resulted in multiple acquisitions that are not internally integrated. As a result, Alvarez & Marsal believes there are material opportunities for value creation by driving operational and infrastructure efficiencies and realising synergies within these multi-platform businesses.

In the current TMT environment, many companies need the support of experienced professionals who can work alongside management to deliver solutions to complex problems.

Founded in 1983, Alvarez & Marsal is known for its distinctive restructuring heritage, hands-on approach and relentless focus on execution and results. A&M works with clients across the TMT investment life-cycle in the following ways:

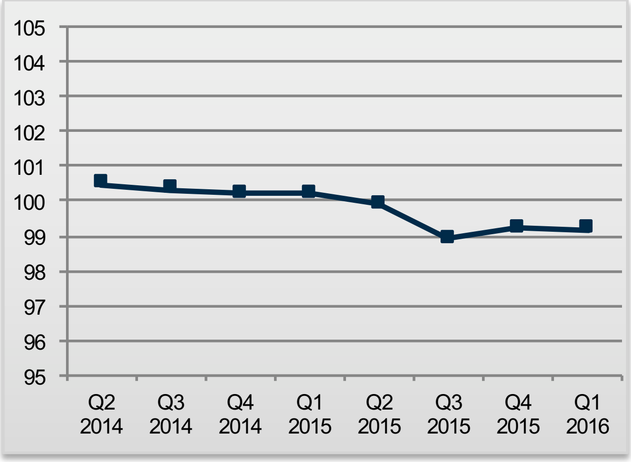
- Assisting companies pursue acquisitions, mergers or divestitures with financial and operational due diligence, valuation, tax structuring and acquisition/carve-out integration planning and execution.
- Working with management to grow revenue, optimise cost and CapEx, analyse asset performance and portfolio prioritisation, identify divestiture opportunities, and improve the company's planning and financial control processes and systems.
- Supporting management, legal and financial advisors of distressed companies to stabilise operations and cash flow, thereby extending their 'liquidity runway.'
- Providing interim management positions as appropriate.
- Providing expert advice such as on economic, accounting and forensic technology issues in relation to regulatory investigations and disputes.

4G/LTE Subscribers – Global
(Million Units, Q2 2014–Q1 2016)



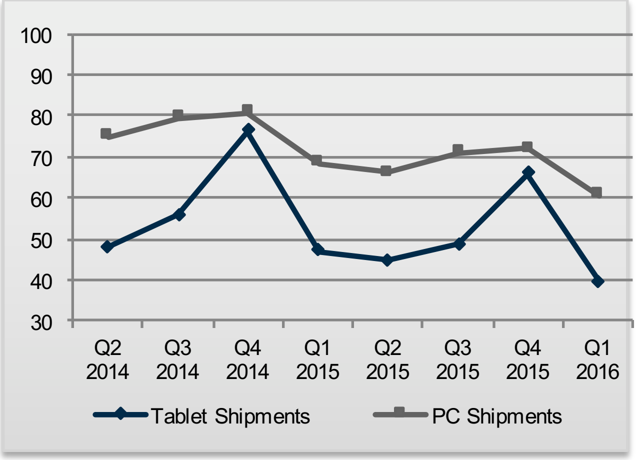
Source: Ovum

Pay TV Subscribers – US
(Million Units, Q2 2014–Q1 2016)



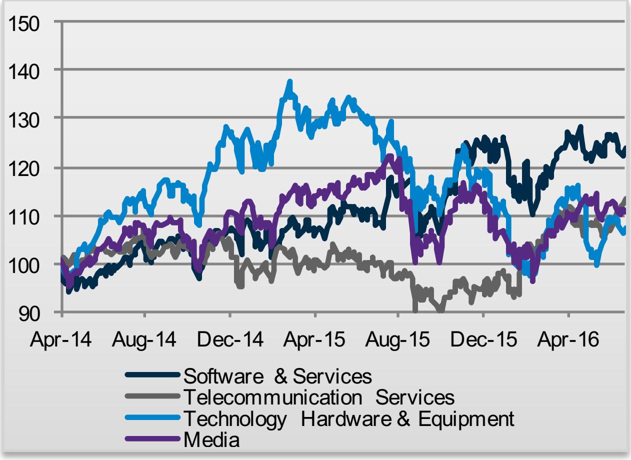
Source: Leichtman Research Group

Tablets & PC Shipments – Global
(Million Units, Q2 2014–Q1 2016)



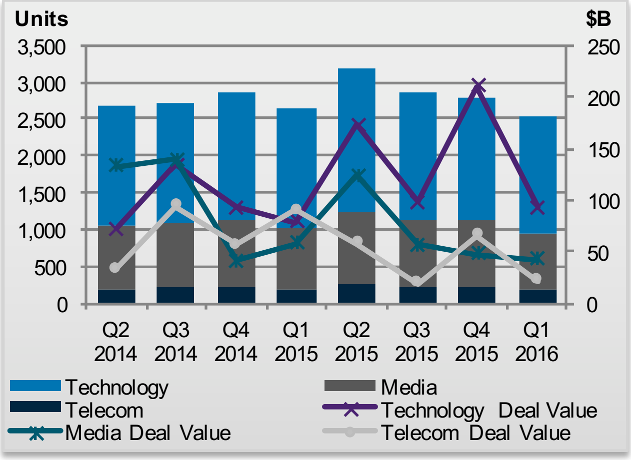
Source: IDC

TMT Stock Price Performance – S&P 500
($, April 2014–June 2016 YTD)



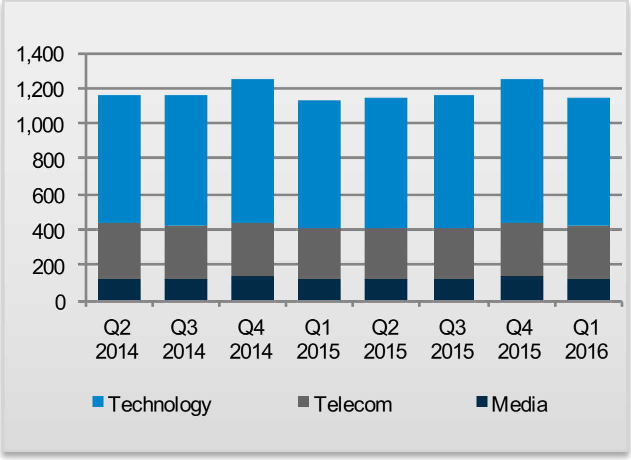
Source: IC Subscribed Database

TMT Deals and Value – Global
(Units, $ Billion, Q2 2014–Q1 2016)



Source: IC Subscribed Database

Public TMT Companies Revenues
($ Billion, Q2 2014–Q1 2016)



Source: IC Subscribed Database

Question and Answers with Adam Bradley, A&M Managing Director focused on the TMT sector.

Adam, as a seasoned telecom advisor, what do you think are the key areas that mobile operators should be looking at to improve performance?

I have worked across the sector for almost 20 years as an advisor and have held interim management positions in multiple TMT businesses including mobile telecoms operators, pay television and enterprise software. My recent experiences in mobile telecom and infrastructure gave me a good perspective on the challenges and opportunities facing mobile operators.

Mobile operators have faced increased pressure on revenues. This will continue to apply as a result of regulatory interventions and competitive dynamics (MVNO, OTT, etc.). To preserve margins, operators need to ensure that their cost base is well managed both in terms of commercial operations (e.g. 4G monetisation, portfolio simplification) and in reducing operating costs. Outsourcing support services, network sharing and greater procurement focus will be key, including power and transmission.

What other key trends do you see the rest of the TMT companies to improve performance?

In the technology sector, there is likely to be a big change in the enterprise software market over the next few years. European incumbents will need to focus on transitioning their customer base from an on-premises licensing model to software as a service, with potential revenue benefits as well as scope for efficiencies in support and service operations. In the web hosting and data centre space, there will be opportunities for consolidation and cost optimisation in technology, customer care and marketing effectiveness.

In the media sector, I believe the computer generated (CG) sector will grow in numerous directions including special effects, video games and virtual reality, driving huge opportunities for investors. Also, A&M's recent advisory experience in live entertainment shows that dynamic pricing and data-driven marketing, together with optimised production, can increase profitability.

How do you think TMT companies will be affected by the results of the UK referendum on the EU?

The impact on TMT companies may be less than other more labour intensive sectors which have physical supply chains. In mobile telecoms, the regulatory control on 'roaming' will become more complex. While M&A activity is likely to slow down in the short-term due to uncertainty, currency movements mean that UK broadcasters, telecom companies and technology businesses may be looking more attractive to US investors.

The Business of Media - Quarterly breakfast series

In Autumn, Alvarez & Marsal and the Ivy Club are hosting a quarterly breakfast series for senior executives on 'The Business of Media'.

Aimed at an audience of media leaders and Ivy Club members, a panel of commercial leaders will discuss how the media industry is changing and what this means for the business of media.

While each session examines a different facet of the media industry, digital disruption remains the constant factor. By hosting these sessions, we aim to encourage cross-sharing of thoughts, ideas and business models so that our industry continues to evolve and thrive over the years to come.

The first session is on the Business of News. Moderated by Krishnan Guru-Murthy, panellists include the COOs of BBC News and CNN International as well as commercial leaders from the digital world.

Future sessions look at how digital is changing the business models of international production, data-driven personalisation and monetisation, print and publishing, and pay-TV.

If you would like an invitation or to find out more, please contact Paul Naha-Biswas at pnahabiswas@alvarezandmarsal.com

Amongst other issues, A&M's team of competition and regulatory experts is able to assist its clients with competition and regulatory due diligence exercises, engagement with the EC and other regulatory and competition authorities through the course of merger clearance processes and expert advice and/or testimony support through the course of a dispute with an authority.

Tasneem Azad, Managing Director in A&M's competition and regulatory team, provides her views on the recent O2/ 3 Hutchison blocked merger

On 11 May 2016, the European Commission (EC) blocked the proposed acquisition of O2 by Hutchison under EU merger regulations. The deal would have combined Telefónica UK's "O2" and Hutchison 3G UK's "Three", and would have created a market leader in the UK mobile market alongside Vodafone and BT's Everything Everywhere (EE).[1] The EC considered that the takeover would have reduced competition in the market and hampered the development of mobile infrastructure and the ability of mobile virtual operators to compete. In particular, the EC thought that the takeover would have meant less competition - from four players in the market to three players - with higher prices and reduced choice and quality for consumers; risks to the development of mobile infrastructure, for example with respect to next generation technology (5G); and a reduction in the number of mobile network operators willing to host virtual operators on their networks.

To address the EC's concerns, Hutchison had offered a number of remedies in exchange for the EC allowing the deal to go ahead, including:

- A set of remedies aimed at strengthening the development of existing mobile virtual operators, for example by granting access to a share of the merged entity's network capacity to one or two mobile virtual operators, a wholesale agreement for a share of capacity to Virgin Media and a divestment of O2's stake in Tesco Mobile (along with an offer of a wholesale agreement for a share of capacity to Tesco Mobile);
- Behavioural remedies[2] in relation to UK network sharing agreements; and
- Behavioural remedies aimed at granting mobile virtual operators access to 4G and future technologies.

However, the EC concluded that the remedies were insufficient to address its concerns. For example, in respect of the UK network sharing agreements, the EC noted that Three and O2 would have kept their respective stakes in the two network sharing agreements, MBNL and Beacon.

The EC continues to note that there is no ‘magic number’ for the number of operators required to ensure a competitive mobile telecommunications market, and that it is not as a matter of rule averse to market consolidation from ‘four-to-three’ players. A number of market commentators however suggested that the decision will likely lead to a chilling of consolidation close to the threshold, and that future consolidation in the sector is likely instead to focus on such issues as technology convergence (for example merging fixed and mobile telephony with broadband and/or TV services) as with the recent £12.5 billion BT and EE merger.[3]

However, what appeared to be particularly pivotal to the EC’s economic assessment and decision was not just that the merged entity would have involved a reduction in the number of operators to three from four, but rather that the merged entity would have held network sharing agreements with both the remaining networks, Vodafone and BT/EE, in turn impacting on the entirety of UK mobile infrastructure. Moreover, the EC’s economic assessment of the specifics of the deal was also “consistent” with the wider view that three player markets might not lead to “higher overall investment“.[4]

In this context, all eyes ought now to turn to the imminent EC decision in respect of the proposed €21.8 billion joint venture between Hutchison’s 3 Italia with VimpelCom’s Wind Telecommunicazioni in Italy. In this case, once again, the market would be left with three operators – the merged entity, Vodafone Italia and Telecom Italia. Hutchison has again sought to address some of the EC’s likely concerns with remedies – this time around offering the sale of some radio frequencies and infrastructure assets to French telecommunications operator Iliad, in order to help it gain a foothold in Italy and take on the role of a fourth operator. Some press coverage suggests that the EC may be minded to approve the deal.[5] If this were to be the case, we will certainly have benefited from much-needed colour and clarity both around the EC’s thought processes on competition and regulatory issues in four-to-three merger cases, and in relation to the set of remedies that would likely be needed in order to secure necessary regulatory merger clearances. In clearing the merger, the EC would effectively have had to have made a judgement call on the likely success of Iliad as a potential fourth player in the market. This is by no means a straight forward task, where some consider that Iliad may struggle in getting established in the Italian market.[6]

References

1. European Commission press release: “Mergers: Commission prohibits Hutchison's proposed acquisition of Telefónica UK”; Brussels, 11 May 2016.

2. Note that the EC generally tends to prefer structural remedies (such as divestments), as behavioural remedies are considered more difficult to implement and require effective monitoring over time.

3. See “EU blocks Hutchison's deal to buy Telefonica's O2 UK”; Reuters, 11 May 2016.

4. European Commission fact sheet: “Mergers: Commission prohibits Hutchison's proposed acquisition of Telefonica UK – Factsheet”; Brussels, 11 May 2016.

5. See “EU set to clear Italian mobile telecoms merger –sources”; Reuters, 8 July 2016.

6. See “Gallic Hug”; 6 July 2016 (http://www.breakingviews.com/considered-view/french-foray-into-italian-mobile-will-be-hard-slog/)

CONTACT US

To discuss how A&M might provide assistance with Transaction Services, Operational Performance Improvement, Restructuring or Interim Management please contact any of the following:

European Key Contacts

Adam Bradley
Managing Director
+44 790 437 2660
abradley@alvarezandmarsal.com

David Evans
Managing Director
+44 207 663 0577
david.evans@alvarezandmarsal.com

Amit Laud
Managing Director
+44 790 824 7096
alaud@alvarezandmarsal.com

Martin McKay
Managing Director
+44 776 522 1489
mmckay@alvarezandmarsal.com

Renaud Fuchs
Director
+44 789 613 2614
rfuchs@alvarezandmarsal.com

North America Key Contacts

Byron Smyl
Managing Director
+1 305 798 0648
bsmyl@alvarezandmarsal.com

Pamit Surana
Managing Director
+1 212 763 1636
psurana@alvarezandmarsal.com

Tom Hill
Managing Director
+1 312 601 4226
thill@alvarezandmarsal.com

Middle East Key Contact

David Tusa
Managing Director
+971508133061
dtusa@alvarezandmarsal.com

When action matters, find us at **http://www.alvarezandmarsal.com**

Follow us on:

ALVAREZ & MARSAL

www.alvarezandmarsal.com