

Mobile consolidation in Europe: still a very long road



Scope
Ratings

The European Court of Justice's recent decision to delay a ruling on domestic mergers of mobile operators is yet another drag on consolidation in Europe, which will remain elusive.

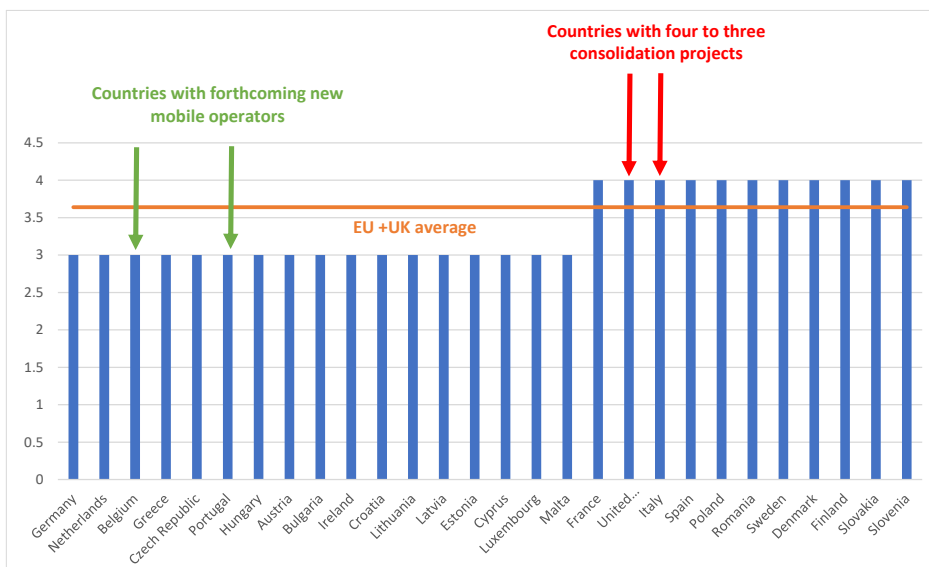
Domestic mergers between fixed-mobile operators are already difficult as there are no more cable operator targets available while cross-border telecoms acquisitions offer no real synergies. We consider that sector M&A risk, with the associated increase in leverage, remains limited from a credit point of view.

The ECJ ruled on July 13 that the EU General Court must re-judge¹ Hutchison's 2016 appeal of the European Commission's veto of the proposed merger between two British mobile operators: Hutchison's Three and O2 (Telefonica). The proposed merger would have reduced the number of operators in the UK from four to three.

The General Court cancelled the Commission's decision in May 2020. But following an appeal from the Commission in August 2020, the ECJ counter-cancelled the General Court decision, saying that it had committed numerous errors, in particular in being too demanding on standards of proof. The General Court has been ordered to re-judge the case using guidelines provided by the ECJ. The Commission's original veto looks to be in a much stronger position now. The ECJ decision seems highly critical ("*breadth, nature and scope of the errors made*") of the General Court. We do not expect the General Court to reach its final decision until summer 2024 at the earliest; probably later.

In these kinds of cases, the only way to allow a merger is to re-create a new mobile operator. This is exactly how the Commission approved the Hutchison-Wind consolidation in Italy, requesting that a new fourth mobile operator (Iliad) enter the market. This remedy was also requested by the US Department of Justice to allow the Sprint-T-Mobile merger. A fourth national mobile operator was created around the satellite-TV operator Dish with the hope of creating a new competitive force.

Mobile network operators per country in the EU and the UK (2023)



In Germany, 1&1 Drillisch was not yet included. Source: Scope Ratings.

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¹<https://curia.europa.eu/jcms/upload/docs/application/pdf/2023-07/cp230120en.pdf>

Spain: Orange-MasMovil lost in Brussels

Meanwhile, the Commission is still reviewing the four-to-three mobile merger in Spain (Orange Spain and MasMovil). As expected, the case is under Phase 2 review as the Commission encountered some serious doubts² on June 27. The EC fears that the project might lead to significant price increases in the Spanish retail mobile market as well as the fixed internet market and multiple-play bundles. It has until September 4 to provide its final answer but as there will be some negotiation on remedies, the answer will likely be published weeks or months later.

MasMovil was originally a MVNO (Mobile Virtual Network Operator) that acquired the fourth mobile network Yoigo, a former subsidiary of Telia, which had been up for sale for years and which none of the other three Spanish mobile network operators dared to acquire for competitive reasons.

The Spanish telecom regulator (then CMT) had forced Yoigo shareholders to enter the market in December 2006 after six years of delays as the fourth mobile network operator to introduce more competition into the Spanish mobile market. It was surprising that the outgoing CEO of Orange, Stéphane Richard, decided to go for a merger with MasMovil while recognising that there were no signs that the Commission had changed its views on four-to-three mobile consolidation.

Around the same time, in two EU countries with only three mobile operators, Portugal and Belgium, new mobile operators will be launched following 5G auctions as both countries have a long history of calls from national regulators, consumer groups and political power to introduce more competition into their mobile markets.

United-Kingdom: under the gaze of the CMA

In the UK, a four-to-three mobile operator merger was announced in June 2023 (Vodafone and Hutchison). Since the UK is no longer part of the EU, the case will be reviewed the Competition and Markets Authority (CMA), which some parties expect will be less demanding than the European Commission.

The confidence of market participants was boosted by a February 2022 paper published by the UK telecom regulator OFCOM, where it dropped its earlier explicit stance of maintaining four players in the UK market to a softer approach of looking at any merger proposal on the “*specific circumstances of that particular merger, rather than just the number of competitors*”. A decision from the CMA is expected around the end of 2024. We believe that this assumption that the CMA will be less demanding is risky, because when the Commission was ending its review of the Hutchison-Telefonica project in 2016, the CMA chairman wrote a public letter to the Commission.

The letter stated that: “*The only appropriate remedy that would meet the criteria that the Commission is bound to apply [...] is the divestment of either the Three or O2 mobile network businesses, in entirety [...]. The divestment would need to include the mobile network infrastructure and sufficient spectrum to ensure a commercially viable fourth MNO in the UK. Absent such structural remedies, the only option available to the Commission is prohibition. The CMA urges the Commission to act to prevent the long-term damage to the UK mobile telecoms market, and therefore to the interests of UK consumers, that both of our authorities have predicted will result from this merger.*”³

²https://ec.europa.eu/commission/presscorner/detail/en/IP_23_3421

³https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/515405/CMA_letter_to_Commissioner_Margrethe_Vestager.pdf

Even though this statement was related the application of EU competition law, we believe it would be difficult for CMA to have now a favourable view on the recently proposed Vodafone-Hutchison merger. A change of view is even more difficult as the inflation-linked price increase by all mobile operators in the UK in 2023 sparked a row among consumers, politicians and the telecom regulator. Further, as the CMA has shown in the recent past with its blocking of the USD 69bn Microsoft-Activision Blizzard deal as well as the USD 20bn Adobe-Figma deal, it remains a pro-consumer arbiter rather than a pro-business one.

OFCOM, the UK telecom regulator, published in its February 2022 document two sets of estimated ROCE calculations for the four mobile operators, one including goodwill, and the second excluding goodwill. Some parties commented that these figures were not high enough and that it opened the door to consolidation.

We strongly believe goodwill should not be taken into account for this kind of calculation as it only reflects management expectations of future profitability post-acquisition; an assumption that can be unrealistic (as regular, but delayed, impairments have demonstrated). We are also uncomfortable with the ROCE calculations without goodwill because they still include mobile licences, which also mainly reflect management expectations of future profitability. These calculations appear to be an inappropriate basis to argue for consolidation. Most European operators, when reporting their capex figures, exclude licence costs.



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