
2020 Telecom Outlook

The credit outlook for the European telecommunications sector is stable. The cost of 5G spectrum auctions is set to remain within the financing capacity of Europe's operators, while 5G itself will have no significant impact on revenues or capital expenditure.

[Corporates](#), Scope Ratings GmbH



Executive summary

The credit outlook for European telecommunications operators in 2020 is stable. We expect the progressive introduction of 5G in Europe to be largely neutral for credit quality.

The cost of auctions of 5G spectrum is set to remain well within the financing capacity of Europe's telecoms operators, particularly in countries without new mobile entrants, while 5G itself will have no significant impact on revenues or capital expenditure. With room for mergers and acquisitions limited, operators will tend to focus on selective asset disposals and cautious dividend policies, protecting the sector's credit quality.

The main trends we expect for 2020 are:

- Auctions of 5G spectrum will meet the June 2020 European deadline. We expect reasonable prices for the forthcoming auctions (contrasting with what happened in Italy and Germany), as we don't foresee new bidders taking part in auctions and pushing up prices in other markets. This should prevent any general deterioration in credit quality.
- Ignoring the marketing hype surrounding the 5G introduction, we expect revenues and EBITDA margins to remain stable.
- 5G network roll-out will not be a significant driver of operators' financial performance as related capex will replace the declining spending on 3G and 4G and involve the partial re-use of existing networks.
- M&A will remain limited as there are no synergies in transnational consolidation. Europe's competition authorities have all but barred national mobile-sector consolidation. In addition, few cable operators are in a position to consolidate national fixed-mobile sectors.
- On the contrary, we anticipate some asset disposals in maturing emerging markets and the spin-off of mobile towers and fibre networks, or partial listings, that should help operators protect credit quality.
- Finally, we foresee cautious dividend policies, and possible dividend reductions, reflecting issuers' willingness to protect credit quality, if needed.

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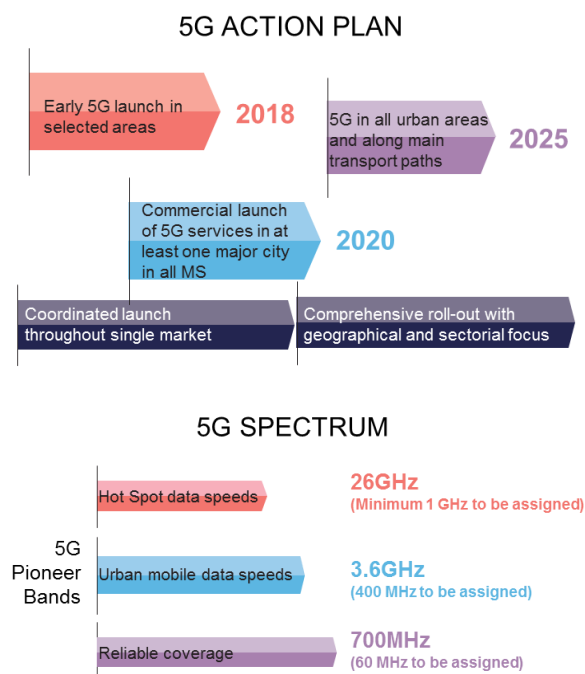
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Key themes for 2020

5G still making the headlines. High spectrum price risk driven by new entrants

The main event for 2020, as it was last year, is the continuing start-up of 5G in Europe. The EU has put in place a general framework to favour the timely and coordinated roll-out of 5G technologies. This framework includes a calendar for every country to allocate spectrum (the key new band being 3.6 GHz) and reach a certain level of 5G coverage on a specified date. In some cases, 5G spectrum might be allocated at the same time as the reallocation of some of the 2G, 3G or 4G spectrum.

Figure 1: EU framework for 5G roll-out

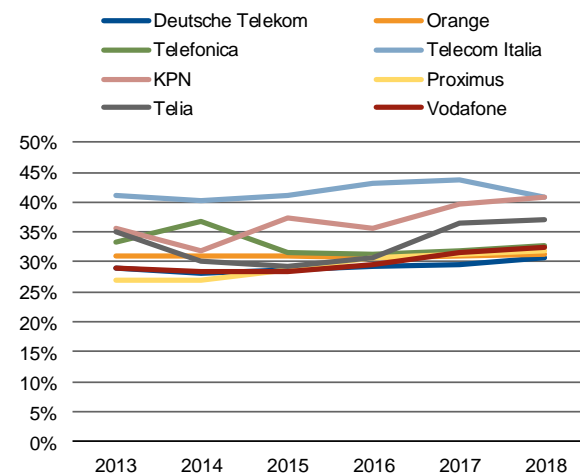


Source: European Commission.

We expect little change in revenues for European telecom operators with the introduction of 5G technologies in the coming years. First, in many countries the spectrum for 5G is either yet to be or only partially allocated to operators, as discussed below. Secondly, 5G networks are only at the early stage of roll-out, with limited coverage to date. As of end-December 2019, Deutsche Telekom reported initial 5G coverage in just eight cities in Germany, with around 450 antennas. Thirdly, consumers have a small selection of 5G handsets to choose from – about 1% of mobile handsets shipped worldwide in Q3 2019 were 5G-compatible, according to research firm IHS. Prices are at the high end – EUR 900 or about three times the average price for a smartphone –, which is an obstacle for mass-market take-up. European 5G mobile subscribers might reach 4.7 million by the end of 2020, representing less than 1% of total EU mobile

subscribers, according to research firm Analysys Manson.

Figure 2: European telecoms operators' reported EBITDA margins, 2013-18



Sources: Company reporting

We also don't expect 5G to result in significant new mobile usage, as its main appeal will be the offer of higher speeds, providing extra momentum for growing data-consumption per user, as 4G did for 3G. We expect the much-hyped claims for areas of extra usage – such as the Internet of Things, e-health or virtual reality – to remain niche markets with no significant revenue streams. In an industry characterised by strong stability in revenues and margins, we do not expect 5G to have a significant impact on EBITDA trends.

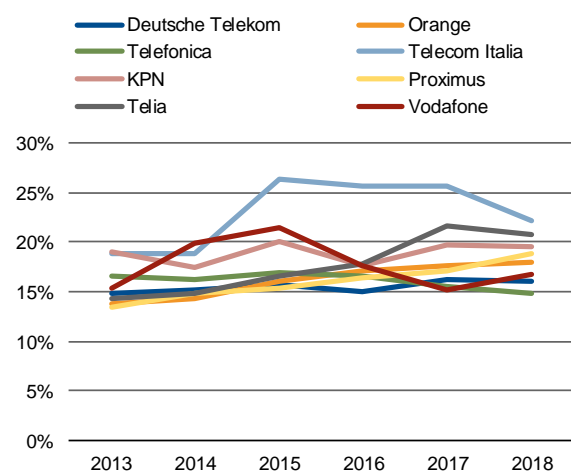
The introduction of 5G is also unlikely to result in a significant pick-up in capex for European telecoms operators on average, given that capex for the fixed network (broadband, fibre) represents about 60-70% of total telecoms capex.

The recent increase of capex is mostly due to higher investment in the fixed network, as operators move to fibre. In France, total telecoms capex has increased by 58% since 2005, but 95% of this increase is due to fixed networks. Regarding mobile capex, we expect no real surge as 5G will simply progressively replace the lower 4G capex and disappearing 3G capex. In Finland, one of the most advanced mobile markets in Europe, mobile capex has been largely stable over the past eight years at about EUR 200m, or 11% of revenues. At the same time, mobile data traffic over the same eight years grew by more than 36 times.

Such a disparity can be explained by the continued decline in wireless-equipment prices. Another reason for the relative stability of wireless capex is that a new generation of mobile technology like 5G does not require a network to be built from scratch, but instead involves the significant re-use of existing assets (masts, fixed connections, network management tools).

According to Orange, there will be no single 5G antennas for the next four to five years, as all will be located on existing 4G sites.

Figure 3. European telecoms operators' capex (excluding spectrum), as % of revenues, 2013-18



Sources: Company reporting.

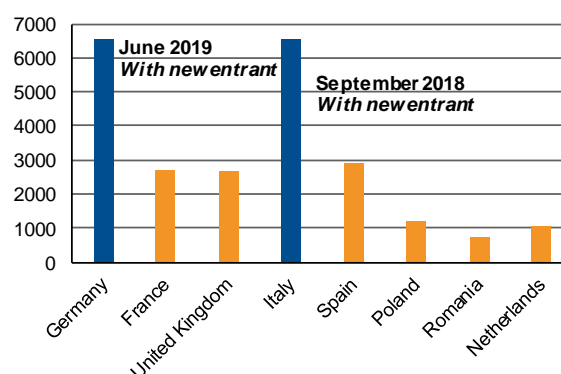
The main 5G-related issue for the sector's credit outlook will be the outcome of 5G (and other spectrum) auctions in the coming quarters. In September 2018, the auctions in Italy raised EUR 6.6bn, almost three times the expected amount. In June 2019, after a long bidding process in Germany, the spectrum auction raised EUR 6.5bn, again almost three times the expected amount. Those auctions contrasted with the 5G auction in October 2018 in Finland, where three incumbent mobile operators bid a total of just EUR 77m. We believe the main reason for the elevated auction prices in Italy and Germany was the participation of new bidders. In Italy, Free Italy was created a year before as an anti-trust remedy to the Wind-Hutchison merger. In Germany, 1&1, an MVNO (virtual operator), wanted to become a fully fledged operator.

The prospect of new entrants emerging in other European countries seems poor. The mobile market is mature, with a high penetration rate of around 130%. The German and Italian cases are real exceptions as the competitive auctions arose from previous mergers (E-Plus-Telefonica Deutschland, and Wind-Tre), which led to remedies being imposed by the European Commission. In the coming year, chances are slim that spectrum auctions in Europe will reach levels that would significantly change the financial structure of European telecoms operators.

5G spectrum: timetable and details of 2020 auctions

The table below (figure 5, page 5) includes the 5G auctions outcome or, for the one taking place in 2020, expected outcome, in the eight largest EU countries (representing almost 80% of the EU population). For each 5G auction, we have included the names of the groups that secured, or might secure, some spectrum.

Figure 4. 5G spectrum auctions in the eight largest EU countries (EUR m)



Sources: National regulators, European Commission, operators, press, Scope estimates.

Price for spectrum also depends on the specific features of each auction (duration of licences: 10, 15 or 20 years), coverage and calendar obligations, and other licencing features such as the possibility of deferred payments or obligations to share spectrum with third parties.

Spectrum auction results have been also very different from those for the 3G auctions in 2000. The 3G auctions in 2000 raised EUR 37.8bn in April 2000 in the UK (EUR 53bn in today's terms), and EUR 42.8bn in August 2000 in Germany (EUR 60bn in today's terms). In both countries, new entrants helped push prices higher: Hutchison in the UK, and Mobilcom-France Telecom and Quam-Sonera-Telefonica in Germany. Additionally, there was a general – but unrealistic – assumption that the introduction of 3G would increase the average revenue per user (ARPU), which, until then, had only decreased. Finally, any comparison involves an extra caveat: the excessive leverage of the earlier period stemmed mostly from exuberant M&A, rather than 3G spectrum acquisition (worth EUR 100bn, of which EUR 80bn was in the UK and Germany), as M&A deals represented about four times the amount invested in spectrum.

Figure 5. Detailed 5G spectrum auctions in the eight largest EU countries (EUR m)

Country	Price per MHz per pop (€)	Total
Germany 83.0m pop		
700 MHz (60 MHz) 2015	0.20	1,000
900 MHz (70 MHz) 2015	0.23	1,346
1500 MHz (40 MHz) 2015	0.10	330
1800 MHz (100 MHz) 2015	0.29	2,405
2 GHz (2 x 60 MHz)	0.24	2,374
3.6 GHz (300 MHz)	0.17	4,175
Total (June 2019)		6,549
Deutsche Telekom (2,150), Vodafone (1,907) Telefonica Deutschland (1,422), 1&1 (1,070)		
France 67.0m pop		
800 MHz (60 MHz) 2011	0.72	2,640
2600 MHz (140 MHz) 2011	0.10	936
700 MHz (60 MHz) 2015	0.70	2,800
To be allocated in H1 2020		
3.6 GHz (310 MHz)	0.14	2,700
Total 5G in 2020		2,700
To be allocated later		
26 GHz (1,000 MHz)	Not scheduled yet Orange, Altice, Bouygues, Iliad	
United Kingdom 66.7m pop		
3.5 GHz (150 MHz) 2018	0.13	1,307
2.3 GHz (40 MHz) 2018	0.09	231
To be allocated in H1 2020		
700 MHz (80 MHz)	0.2	1,256
3.7 GHz (120 MHz)	0.15	1,412
Total 5G in 2020		2,668
BT, Vodafone, Telefonica, Hutchison		
Italy 60.4m pop		
700 MHz (96 MHz)	0.35	2,040
3.6 GHz (200 MHz)	0.36	4,350
26 GHz (1,000 MHz)	0.003	164
Total (September 2018)		6,554
Telecom Italia (2,400), Vodafone (2,400), Wind-Tre (517), Iliad (1,194)		
Spain 46.9m pop		
3.6 GHz (200 MHz) 2018	0.05	438
To be allocated in H1 2020		
700 MHz (96 MHz)	0.5	2,899
Total 5G in 2020		2,899
To be allocated later		
26 GHz (1,000 MHz)	Not scheduled yet Telefonica, Vodafone, Orange, MasMovil	
Poland 38.0m pop		
TO BE ALLOCATED IN MID 2020		
3.6 GHz (320 MHz)	0.10	1,216
Total 5G in 2020		1,216
26 GHz (1,000 MHz)		
	Not scheduled yet Orange, Deutsche Telekom, Play, Plus	
Romania 19.4m pop		
3.6 GHz (255 MHz) 2015	0.002	10
To be allocated in H1 2020		
700 MHz (75 MHz)	0.08	116
800 MHz (10 MHz)	0.06	12
1500 MHz (40 MHz)	0.08	78
2600 MHz (80 MHz)	0.08	124
3.6 GHz (90 MHz and later 400 MHz)	0.04	310
2100 MHz (120 MHz) lic. Extension 2031	0.05	110
Total 5G in 2020		750
To be allocated later		
26 GHz (1,000 MHz)	Not scheduled yet Orange, Deutsche Telekom, Vodafone, DiGi	
Netherlands 17.3m pop		
800 MHz (60 MHz) 2012		
900 MHz (70 MHz) 2012	all bands average	
1800 MHz (140 MHz) 2012	0.61	3,802
1900 MHz (15 MHz) 2012		
2100 MHz (75 MHz) 2012		
A total of 360 MHz allocated in 2012		
To be allocated in H1 2020		
700 MHz (60 MHz)	0.22	228
1400 MHz (40 MHz)	0.08	55
2100 MHz (150 MHz)	0.12	311
3500 MHz (150 MHz)	0.17	441
Total 5G in 2020		1,036
KPN, Deutsche Telekom, Vodafone		

Source: National regulatory authorities, European Commission, operators, press, Scope estimates.

Consolidation in European telecoms sector reaching limits

We see little chance of significant further telecoms M&A in Europe. First, mergers between the major established national players are very unlikely given that transnational deals offer negligible synergies. Secondly, many operators are still considered strategic national assets, and governments are unwilling to see them taken over by foreign companies. Recent rumours of a merger between Orange and Deutsche Telekom may merely reflect the hopes of investment bankers rather than the realistic expectations of management and shareholders.

At the national level, the EC's competition position is clear: any consolidation that would reduce the number of mobile operators in national markets will be blocked. And we do not expect this stance to change in the short to medium term. The only real opportunity lies with the consolidation of national mobile and fixed operators (mostly cable operators), as illustrated by the acquisition of cable operator ONO by Vodafone in Spain, mobile operator Base by cable operator Telenet (Belgium), mobile operator SFR by cable operator

Numéricable (France), and, more recently, Vodafone acquiring cable assets from Liberty Media in Europe (Germany, Czech Republic, Hungary and Romania). With the small number of independent cable assets remaining in Europe, we believe that further cable consolidation in Europe is also very limited.

Some players will further divest or spin off some of their emerging-market subsidiaries, particularly as these markets are now maturing. For some operators, the process has been underway for some time: Telia's long-running divestments in Central Asia; Telenor's sale of its Central European assets to private-equity investors in 2018 and attempted 2019 merger of its Asian subsidiaries with a partner group; and Orange's recent creation of a common subsidiary regrouping its activities in Africa and the Middle East, paving the way for a possible IPO.

Operators are also eager to dispose of infrastructure assets, typically their mobile towers.

- Telecom Italia created tower company INWIT in 2015 (with 11,500 towers) and listed it on the stock market, raising EUR 0.9bn.

- Telefonica created Flexius in 2016, a company owning 15,000 towers in Spain and some submarine cables, and then sold 50% of the business to private-equity investors in two transactions.
- Orange recently said it would sell around 1,500 towers in Spain to Cellnex for EUR 260m and create a pan-European tower company with about 40,000 units, opening the door to a possible sale or spin-off.
- Vodafone Italy sold its towers to INWIT for EUR 5.3bn last year.
- Altice Europe sold 49% of its French fibre-to-the-home network to financial investors for EUR 1.8bn and in December 2019, then sold 49% of the FTTH network in Portugal to JP Morgan for EUR 2.3bn.
- Orange said in December 2019 that fibre networks built for French departments will be partly sold and deconsolidated.

Tower or fibre disposals could give some financial flexibility for European telecoms operators in the coming years, depending on how the deals are structured. Sale-and-leaseback transactions would see liabilities retained on the telecoms operators' balance sheets. Some transactions might be structured as service agreements rather than operating leases.

Operators take a more cautious approach to dividends

Several European telecoms operators are opting for increasingly cautious dividend policies, announcing reductions or alerting shareholders to the prospect of possible flat or reduced per-share pay-outs in the future:

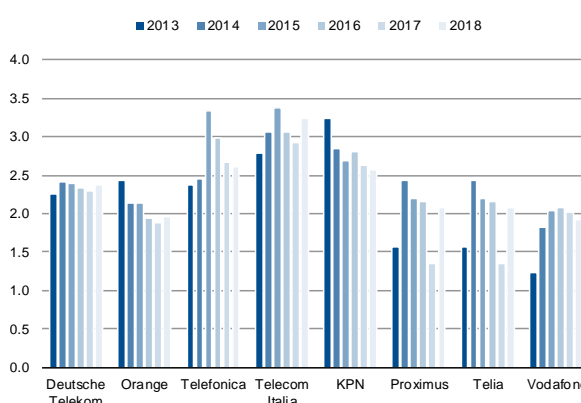
- Vodafone said it would cut its dividend by 40%, following a decrease in margins and due to the high costs for 5G auctions in Italy and Germany (May 2019).
- Deutsche Telekom said that its dividend for FY 2019 would be EUR 0.60 a share, below the consensus analyst expectation of EUR 0.75. Management said that for the coming years, the EUR 0.60 level would be growing in line with EPS, with this figure as a minimum (consensus was expecting EUR 0.80 for FY 2020). The group said it had decided to manage the remaining uncertainty linked to the T-Mobile USA-Sprint merger and the expected investments in 5G; management explicitly said that these decisions are also aimed at maintaining its current credit rating (November 2019).
- Telefonica Deutschland said it would pay a dividend of EUR 0.17 a share for FY 2019, instead of EUR 0.27 for FY 2018 (-40%), as the group anticipates a rise in capex for the next two years (from 13-14% of

revenues to 17-18%) before it declines again (December 2019).

- Orange said it would distribute a minimum dividend of EUR 0.70 a share for the years 2019-23 (it paid EUR 0.70 in 2018), pointing to dividends that are possibly lower than consensus expectations for the period (December 2019).

The sector's increased cautiousness in dividend policy underscores issuers' willingness to stabilise leverage and protect credit ratings.

Figure 6. European telecoms operators, net debt/EBITDA, 2013-18



Sources: companies. Figures as reported by companies.

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