

Telecoms Sector

M&A Insights

Analysis & opinions on Global M&A activity

2009



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Welcome to the third edition of Telecoms M&A Insights from PricewaterhouseCoopers¹ (PwC). In this edition we explore the impact of the downturn on telecom transactions in 2008, with analysis and comment on each of the key global regions before addressing some of the key trends set to shape the outlook for 2009 and beyond.

The financial crisis has had an impact on confidence and the telecoms sector has noticed a marked downturn in both the volume and value of deals globally. However, our research offers hope that the telecoms industry is relatively resistant to recession with consumers choosing other ways to cut back on spending.

The future outlook for 2009 is promising with telcos learning from the previous downturn and building strong balance sheets. As an industry that requires a significant amount of debt, the result of less debt falling due is encouraging. We expect to see cost reductions across the sector which will reveal the gap between the stronger and weaker businesses.

The PricewaterhouseCoopers' Telecoms team has been busy around the world including deals in Europe, Africa, US and Asia.

Our global team offers clients a wide range of deal services; valuation & strategy, commercial, financial, tax and pensions due diligence, post deal carve-out, merger integration and lead Corporate Finance advice.

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

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Recession will reveal winners

The magnitude of the debt financing problem will define the nature and scale of M&A in 2009

Telecom's reputation as a defensive sector was reaffirmed through most of 2008 as share prices and transaction volumes held up well. However this year-on year view masks the impact of the sharp decline in conditions since September 2008; after a lag period of just a few weeks, telecom transaction volumes fell to their lowest levels in November and December 2008, and the market for large telecom transactions effectively closed.

The lack of liquidity (particularly in debt) is likely to be a big barrier to M&A activity across all sectors in 2009, but these cyclical issues are complicated by some telecoms-specific issues. In particular, EMEA based telcos will face an upturn in the amount of senior debt due to mature in the upcoming 2009-2012 period. Our analysis suggests that the amount of telecom senior debt falling due in the coming four years will rise to over €180bn in EMEA alone. We can expect cost reductions across the sector, but even the best prepared telcos will find refinancing harder and more expensive, while weaker businesses may be forced into disposals and mergers.

Even in a challenging environment such as this one, investors should take some comfort from the fact that telcos remain highly cash generative operations. Having dealt with its own downturn in 2001-2003, most balance sheets are in good order with net debt at half its peak level in 2000. Together with the famed relative resilience of the sector to withstand consumer downturns, the industry is well placed to stay stronger for longer, but the magnitude of the debt refinancing problem will inevitably define the nature and scale of M&A opportunities in 2009 and beyond.

We think the challenges of debt refinancing could then turn out to be something of a proving ground for the industry where the longer term winners will emerge. History tells us that, in a recession, not only do profit margins come under pressure, but the spread of results between firms widens. We expect it to be no different this time round. Operators who demonstrate superior understanding of the drivers of cash, eschew forays into areas outside their core business and crack the problem of how to partner with 'over the top' broadband application and content providers will be doubly rewarded with opportunities to purchase distressed assets at attractive prices particularly in debt markets.



An end to the global telecoms mega-deals in 2008

2008 deals cannot compete with previous years in terms of the value of transactions

Year-on-year analysis suggests a relatively modest impact from the downturn

The chart below shows completed global deal values and volumes from 2003 to 2008. From this analysis we can see transaction values are down significantly from the 2006 peak.

The data is skewed by the three 'mega deals' that took place in 2006, causing a significant peak in deal activity for that year. The deals in question were AT&T/BellSouth (€58bn), the €25bn acquisition of Viacom's cable network business and Telefonica/O2 (€25bn). Even 2007 included the €23bn acquisition of America Telecom by America Movil. By contrast 2008 was characterised by the absence of such mega-deals; just one was over €10bn (the acquisition of Intelsat by Serafina Holding), and the top five combined barely exceeded the America Telecom deal of 2007.



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) between 01/01/03 to 31/12/08
Note: Disclosed and completed deals only

Largest Global Telecoms Deals 2008

Date	Value (€m)	Target	Target Segment	Target Country	Acquirer	Acquirer Country
Feb-08	11,693	Intelsat	Satellite	Bermuda	Serafina	United Kingdom
Jul-08	5,813	NAVTEQ	Internet Software & Services	United States	Nokia	Finland
Feb-08	3,092	Golden Telecom	Telecom Services	Russian Fed	VimpelCom	Russian Fed
Mar-08	3,033	Cosmote	Telecom Services	Greece	Hellenic Telecom	Greece
May-08	2,930	OTE	Telecom Services	Greece	Deutsche Telekom	Germany
Jun-08	2,791	Neuf Cegetel	Telecom Services	France	SFR	France
Jun-08	2,229	Sogecable	Cable	Spain	PRISA	Spain
Jul-08	2,083	Oger Telecom	Telecom Services	UAE	Saudi Telecom	Saudi Arabia

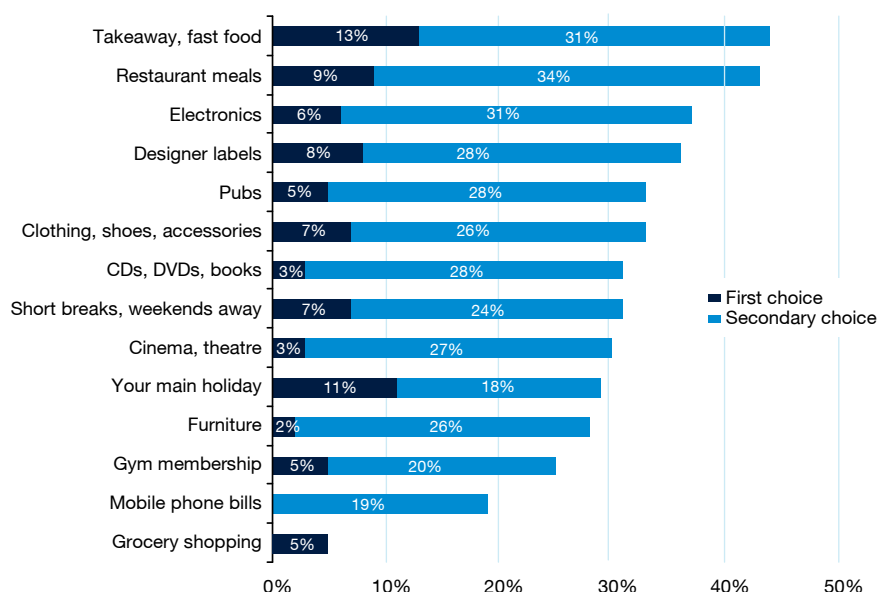
Source: Thomson Financial, PwC analysis

Telecoms stronger for longer?

Investor confidence in telecoms relatively resistant

Despite the absence of the largest deals, transaction volumes and values are better than could have been feared, with average disclosed transaction values in 2008 only c20% down from the 2003/04 levels. This reflects, in part, investor confidence in telecoms as relatively resistant to recession. During the last major UK recession in the early 1990s, telecoms proved to be remarkably resilient as the economy slowed, as consumers proved less willing to cut back on their fixed phone bills than other categories. Mobile telecom is arguably more discretionary and therefore more vulnerable than fixed, but PwC's own UK consumer research offers hope:

Which, if any of the following, would you be most likely to cut back on, if you had to reduce your spending over the next 12 months?



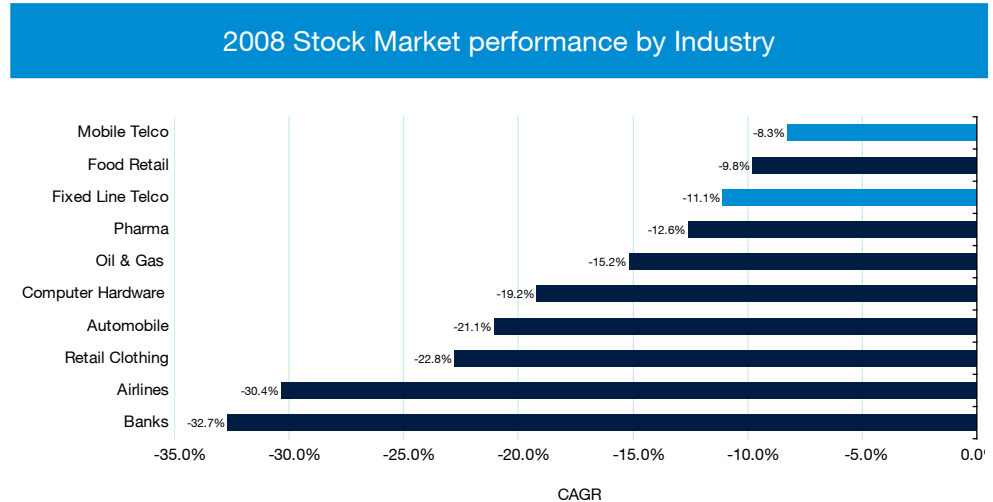
Source: PwC UK consumer research 2008

In addition our research shows that consumers seem to differentiate between usage (i.e. calls, text and browsing) and the device itself, which appears to be more sensitive to macro conditions. The continuation of this trend could have important implications for telcos and investors: as consumers defer mobile handset upgrades or switch to prepay/SIM-only offers, ARPU will fall as consumers are no longer effectively paying back the initial subsidy of the handset. The profit and cash impact however could be more muted or even positive as upfront handset subsidy levels fall.

Telecoms faring well versus other industries

Telecoms defensive properties reflected in public markets

Capital Markets appreciate the defensive qualities, which was reflected in the sector's relative performance on public markets

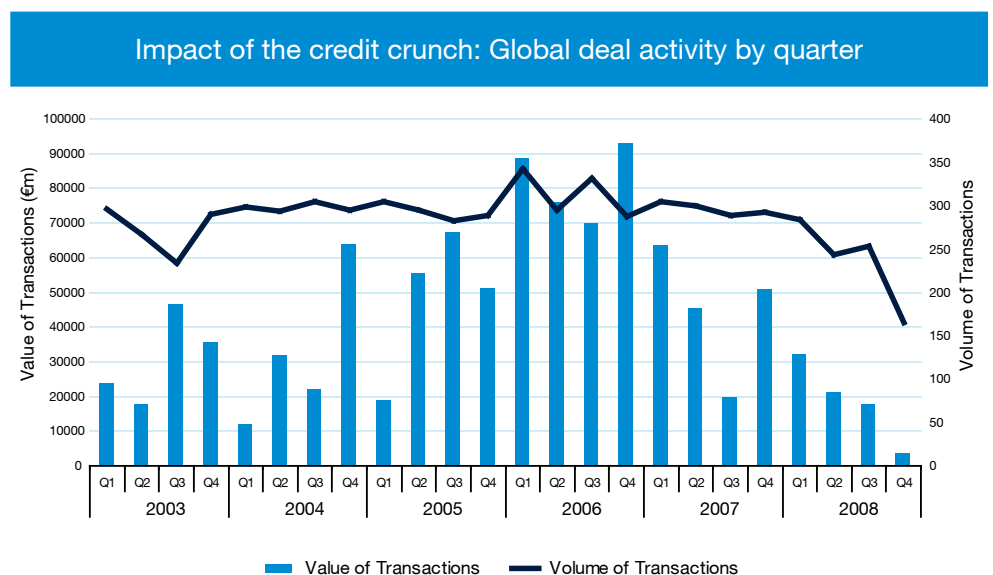


Source: Thomson Datastream, Dow Jones World Indices

Capital markets have suffered through 2008, but telecoms less than most. Perhaps cognisant of its defensive qualities, both fixed and mobile stocks have held up well, affirming telecoms status as a relatively defensive play in recessionary times.

But behind the headlines, more detailed data shows just how quickly the markets closed

Even as late as the third quarter of 2008, transaction values were still at 2003/04 levels. But as 'recession resistant' as telecoms may be, the market was unable to absorb the shocks of late 2008, and fourth quarter volumes were already at record lows.



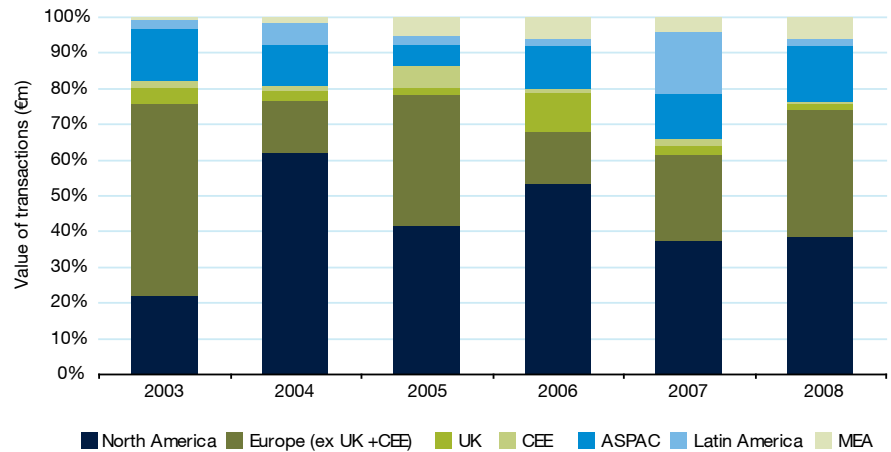
Source: Thomson Financial, PwC analysis

The M&A market was effectively closed by November

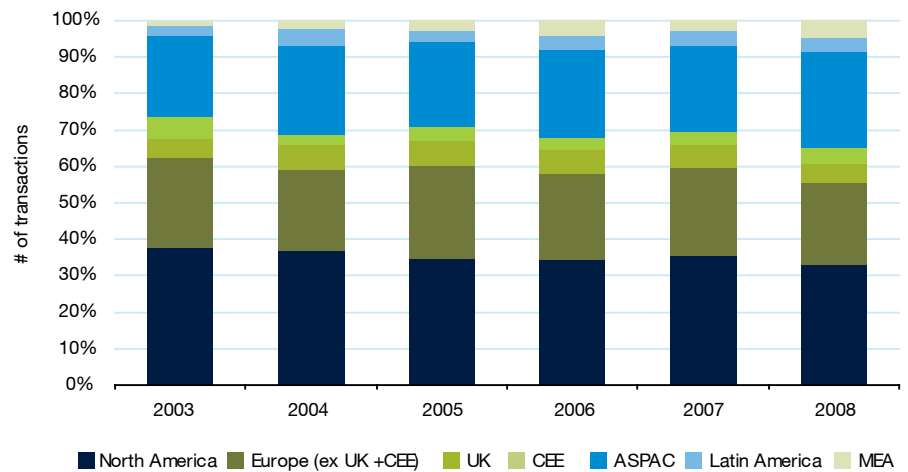
However, during the fourth quarter conditions had deteriorated to such a point that the market for telecoms transactions had effectively closed by November.

Geographical analysis and trends

The value of deals transacted in the emerging markets of Central & Eastern Europe, Latin America and Middle East and Africa regions have grown rapidly as a proportion of global deal value, from 5% in 2003 to 17% in 2008.



Source: Thomson Financial, PwC analysis

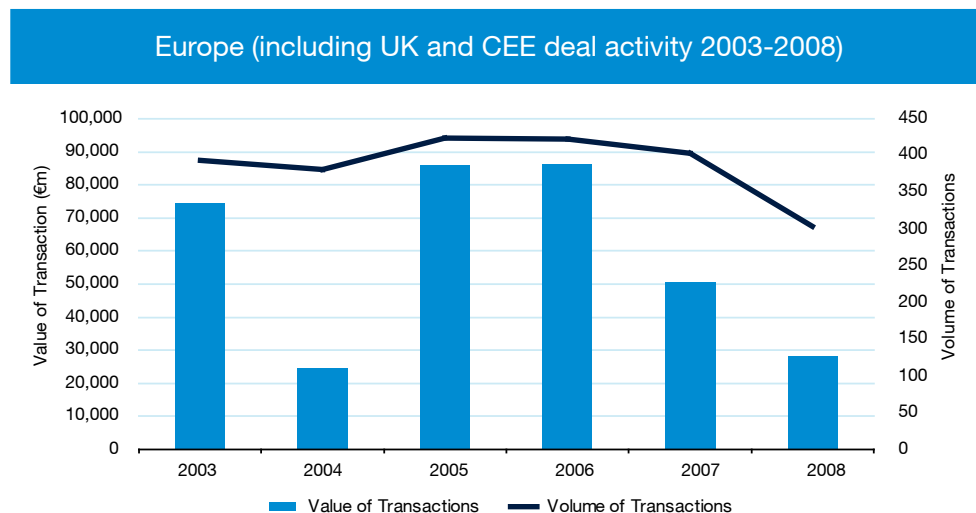


Source: Thomson Financial, PwC analysis

Without the ‘mega-deals’ in Europe of 2006/07, CEE took centre stage

2008 was the year that the Central and Eastern Europe (CEE) region finally took centre stage. The biggest transaction in Europe was VimpelComs’ €3bn acquisition of Golden Telecom, and all the top three deals in the year involved either Greece or the Russian Federation.

Despite the level of activity in the CEE, overall deal activity in Europe declined in both value and volume, the market not being inflated by mega deals (the largest deal in 2007 was the €4.4bn Telefonica paid for Olimpia).



Source: Thomson Financial, PwC analysis

Largest European Telecoms Deals 2008

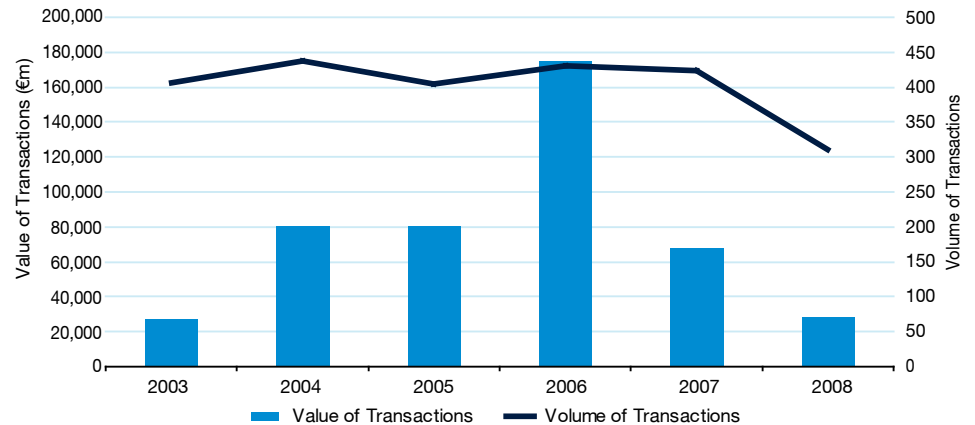
Date	Value (€m)	Target	Target Segment	Target Country	Acquirer	Acquirer Country
Feb-08	3,092	Golden Telecom	Telecom Services	Russian Fed	VimpelCom	Russian Fed
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Jun-08	2,791	Neuf Cegetel	Telecom Services	France	SFR	France
Jun-08	2,229	Sogecable	Cable	Spain	PRISA	Spain
Jul-08	1,861	debitel	Wireless	Germany	Freenet	Germany
Jun-08	1,253	Weather Investments	Telecom Services	Italy	Investor Group	UK/US
Mar-08	1,250	NC Numericable	Cable	France	Carlyle Group	United States

Source: Thomson Financial, PwC analysis

North America: deal volumes holding up

From a significant peak in 2006 – largely the result of a handful of major deals including AT&T's acquisition of BellSouth for €58 billion and the €25 billion acquisition of Viacom's cable network business – the value of North American deals declined substantially year-on-year, though deal volumes showed a more modest decline.

North American deal activity 2003-2008



Source: Thomson Financial, PwC analysis

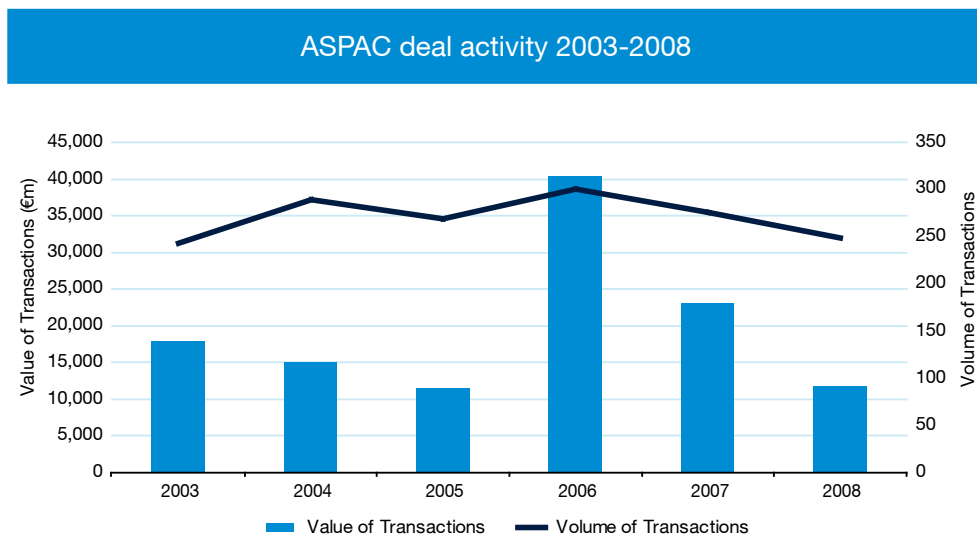
Largest North American Telecoms Deals 2008

Date	Value (€m)	Target	Target Segment	Target Country	Acquirer	Acquirer Country
Feb-08	11,693	Intelsat	Satellite	Bermuda	Serafina	United Kingdom
Jul-08	5,813	NAVTEQ	Internet Software & Services	United States	Nokia	Finland
Mar-08	1,971	Verizon	Wireless	United States	FairPoint Communications	United States
Feb-08	1,753	SunCom Wireless	Wireless	United States	T-Mobile USA	United States

Source: Thomson Financial, PwC analysis

Asia Pacific dominated by intra-region M&A

Asia Pacific (ASPAC) remains a region dominated very much by intra-region M&A: of the top 18 deals, all 18 were in-region and 8 were in-country. The largest Asia Pacific deal in 2007 was Vodafone's €9.3 billion acquisition of Hutchison Essar in India.



Source: Thomson Financial, PwC analysis

Conspicuous by its absence though in this data is the restructuring of the Chinese telecom market. Each of China Mobile, China Telecom and China Unicom now has separate fixed and mobile networks, with the three companies using different 3G technologies.

Largest ASPAC deals 2008

Date	Value (€m)	Target	Target Segment	Target Country	Acquirer	Acquirer Country
Jun-08	1,315	Indosat	Telecom Services	Indonesia	Qtel	Qatar
Aug-08	1,249	Idea Cellular	Wireless	India	TM International	Malaysia
Mar-08	1,069	C&M Communications	Cable	South Korea	Kookmin Cable	South Korea

Source: Thomson Financial, PwC analysis

Latin America could not repeat its record breaking 2007

In many respects, 2007 was an outstanding year for Latin America, which saw the single largest completed transaction of 2007 anywhere in the world with America Movil (Latin America's largest mobile operator) paying €23 billion to acquire America Telecom in Mexico. 2008 saw a return to more normal levels, albeit impacted by the global year-on-year decline.



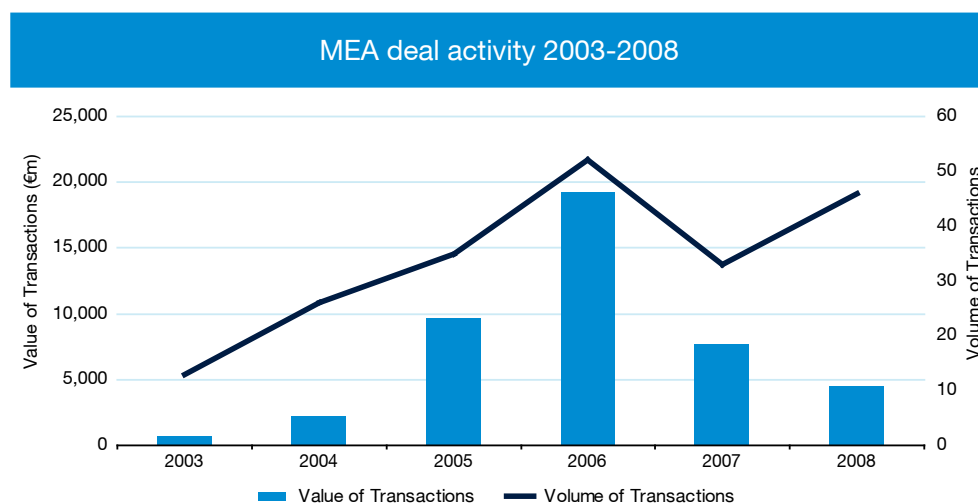
Source: Thomson Financial, PwC analysis

Largest Lat Am deals 2008						
Date	Value (€m)	Target	Target Segment	Target Country	Acquirer	Acquirer Country
Nov-08	635	Compania de Telecomunicaciones	Telecom Services	Chile	Telefonica	Spain
Apr-08	455	Telemig Celular	Telecom Services	Brazil	Vivo	Brazil

Source: Thomson Financial, PwC analysis

Middle East & Africa (MEA) shows growth potential

MEA has doubled its importance over 5 years, accounting for 7% of M&A volume in 2003, and 14% in 2008. Furthermore, MEA looks set to continue to attract investment given its profile as a high-growth market. With the lowest number of telephone connections per capita of any region of the world MEA clearly has the highest potential for growth.



Source: Thomson Financial, PwC analysis

However this growth opportunity has significant attendant risks. Accommodating growth requires network expansion, which in turn requires access to funding. As sources of funding become ever scarcer, expect some smaller operators to struggle, stimulating consolidation opportunities.

The consolidation trend is likely to be good news for the largest operators in the region such as South Africa's MTN, Egypt's Orascom and Kuwait's Zain, which recently created Telecel Globe to seek out potential investments in Africa and Asia.

The largest deal completed in 2008 was Saudi Telecom's €2bn acquisition of Oger of UAE, which was considerably smaller than the largest acquisition in 2007, which was Qtel's €3.8 billion acquisition of Kuwait's Wataniya.

Largest MEA deals 2008

Date	Value (€m)	Target	Target Segment	Target Country	Acquirer	Acquirer Country
Jul-08	2,083	Oger Telecom	Telecom Services	UAE	Saudi Telecom	Saudi Arabia
Jan-08	877	IRAQNA	Telecom Services	Iraq	Zain	Kuwait
Aug-08	658	Ghana Telecom	Telecom Services	Ghana	Vodafone	United Kingdom
May-08	293	Bayanat Al Oula	Internet Software & Services	Saudi Arabia	Etihad Etisalat	Saudi Arabia
Sep-08	231	Bezeq	Telecom Services	Israel	Investor Group	Israel

Source: Thomson Financial, PwC analysis

Outlook for 2009 and beyond

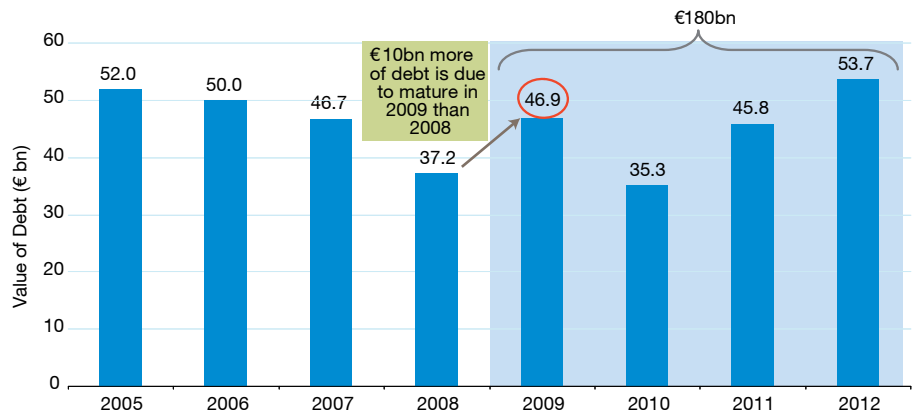
Refinancing to define 2009?

In addition to the wider macro-economic conditions, the prospects for Telecoms M&A in 2009 will be determined in large part by some industry-specific factors, such as how the industry and investors respond to the impending upturn in Telecoms senior debt due and the limits of consolidation.

Debt maturity

Telecoms as a large, capital intensive industry will always require a significant amount of debt. The industry has been fortunate in 2008 in that the total amount of debt falling due was less than in previous years. However the longer-term trend will reassert itself in 2009 as €47bn in senior debt falls due (up €10bn on 2008) and €180bn will fall due over the next four years. The resilient nature of the telecoms industry offers hope, but the capacity of banks to renew and extend debt is not at all clear, and few can expect debt to be renewed at the same margin.

Debt by year of maturity, 2005-2012



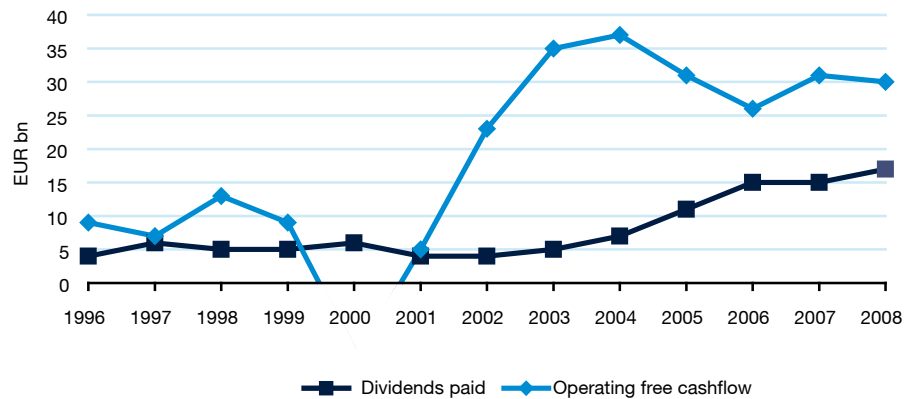
Source: Reuters LPC 2008

The cost of debt has risen even for the largest cash-rich telcos, and as a consequence the industry will need to be crystal clear about its ability to service the debt. This communication may give rise to the possibility of negotiating new structures and transactions. Telcos may be forced to clarify their thinking around divesting loss-making operations or segregate higher quality assets (such as local loop or towers) to investors. We can expect cost reductions across the sector, but even the best prepared telcos will find refinancing harder and more expensive, while weaker businesses may be forced into disposals and mergers. This though will inevitably drive opportunities for stronger operators to prosper.

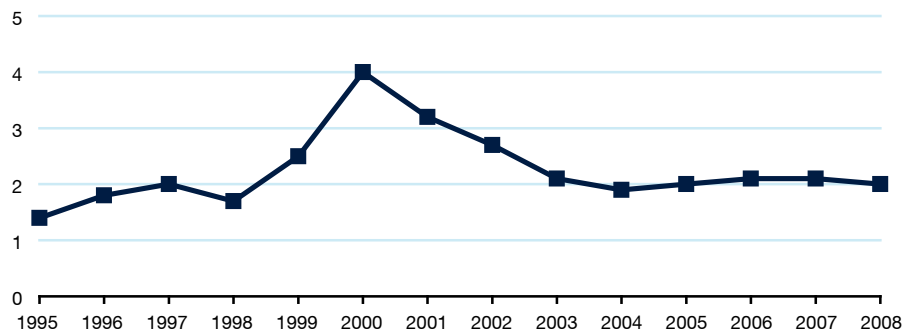
Riding the debt wave as a proving ground

The good news though is that the major telcos are well prepared this time round. Having gone through the pain of the 2001-2003 downturn, telcos have built strong balance sheets.

Free cash flow at 18 quoted European telcos



Net Debt (inc pensions)/EBITDA at 18 quoted European telcos



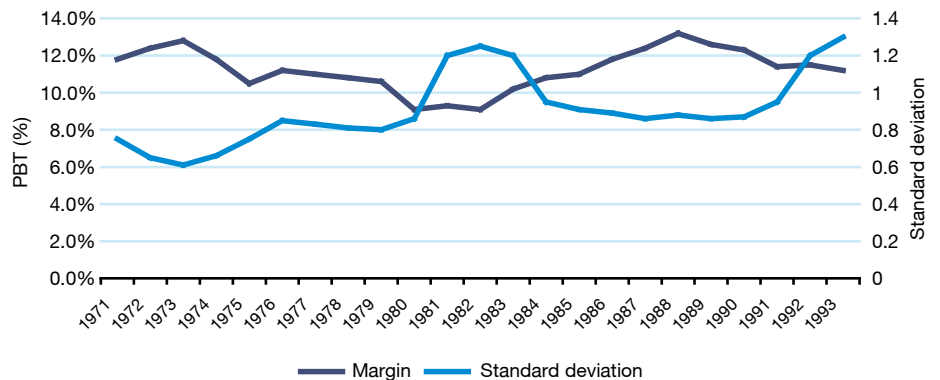
Source: Company data

As our analysis shows, Net Debt as a proportion of EBITDA has halved since its peak in 2000.

Recessions reveal winners

Received wisdom tells us that firms suffer margin pressure during recessions. Conversely, the data from UK recessions tells us that “84% of this fall (in PBT at all large UK firms during 1990s recession) was accounted for by the worst performing 10% of firms. The top 10% of firms actually increased profits. A small number of surviving firms bearing a disproportionate share of recessionary pressure is a very robust result” (Source: “Coping with Recession; UK company performance in adversity” Cambridge University Press, 1997).

PBT at large UK firms and the Standard Deviation 1971-1993



Source: “Coping with Recession; UK company performance in adversity” Cambridge University Press, 1997

We have every confidence this pattern will repeat itself.

Operators who demonstrate superior understanding of the drivers of cash, eschew forays into areas outside their true core business and learn how to partner with ‘over the top’ broadband application and content providers to crack the ‘dumb pipe’ problem will be doubly rewarded with opportunities to purchase some attractively priced assets.



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