S&P Global Ratings

RatingsDirect®

Credit FAQ:

Why Telecom Companies Across Europe Are Selling Their Towers

October 11, 2019

PRIMARY CREDIT ANALYSTS

Mark Habib
Paris
(33) 1-4420-6736
mark.habib
@spglobal.com

Osnat Jaeger
London
(44) 20-7176-7066
osnat.jaeger
@spglobal.com

Lukas Paul
Frankfurt
+ 49 693 399 9132
lukas.paul
@spglobal.com

Sebastian Sundvik
London
+ 44 20 7176 8600
Sebastian.Sundvik
@spglobal.com

SECONDARY CONTACTS

Xavier Buffon
Paris
(33) 1-4420-6675
xavier.buffon
@spglobal.com

Justine Miquee
Paris
+ 33 14 420 6794
justine.miquee
@spglobal.com

See complete contact list at end of article.

A large number of telecom operators across Europe are executing or considering tower asset monetizations. S&P Global Ratings has not yet taken any rating actions on operators as a direct consequence, but the trend poses broad and challenging questions for the industry in terms of what role infrastructure has in differentiating mobile operators, how to compare Europe's tower strategies and tower companies to those in the U.S., and what 5G portends for these transactions.

While we are still in the early days of Europe's tower monetizations, operator and investor interest is high, and for good reason. We estimate tower assets still embedded with operators have a potential value of more than €90 billion. To realize that value, we expect telcos will employ a greater variety of structures compared to the U.S. to balance their priorities for value realization, operational simplification, asset differentiation versus peers, and retaining leverage against the growing clout of tower companies. Telco investors are keen to understand these different structures and their credit implications, while tower investors weigh rising valuations against the strong, utility-like credit attributes of tower infrastructure.

We believe today's tower decisions are occurring at a pivotal time for the sector and may have even greater consequence than those made in the past. 5G could change a mobile network architecture that has been relatively stable for over a decade, and on whose economics current valuations are being based. Although the timing and scope of 5G's impact are likely to vary by market--depending on the pace of 5G rollouts, consumer adoption, and use case development--telcos, towercos, and investors are placing long-term bets just as the sector is poised on the cusp of change.

Frequently Asked Questions

Why are European telecoms monetizing their tower assets, and what options do they have?

Segregating and crystalizing the high valuation of tower assets can enhance financial flexibility. Operators have several approaches available, depending on their objectives.

Telecoms can generate substantial proceeds by selling off their tower assets. Recent tower transactions have had high and generally rising valuation multiples, often 2x to 3x that of integrated telcos (see table 1). This suggests that demand and competition for such assets is intensifying. The latest agreed transaction merging Vodafone's passive infrastructure in Italy into

INWIT had a multiple as high as 24x, compared to Vodafone's presale valuation multiple of 6.8x, a premium of 350%.

Table 1

Recent Tower Transactions

Tower transaction	Country	Date	Number of towers	Transaction size*	Price per tower (000s)	EBITDA multiple (tower transaction)	EBITDA multiple (MNO, pre-tower sale agreement)
Vodafone agreed to merge Vodafone Italy Towers, its passive tower infrastructure in Italy, into INWIT SpA.	Italy	H1 2020 (expected completion); July 2019 (announced)	11,141	€2.1 bil. cash, plus 37.5% stake in INWIT SpA	€473	24.0x	6.8x
Iliad S.A. agreed to sell 70% of its portfolio in France and 100% of its portfolio in Italy to Cellnex Telecom S.A.	France, Italy	H2 2019 (expected completion); May 2019 (announced)	c. 5,700 (France), c. 2,200 (Italy)	€1.4 bil., plus €600 mil. (Italy)	€323	N/A	5.6x
Matterhorn Telecom Holding S.A., the ultimate parent of Salt Mobile, sold 90% of its towers infrastructure company to Cellnex Telecom S.A.	Switzerland	August 2019	2,706	CHF836 mil.	CHF343	23.9x	N/A
Altice France sold a 49.99% stake in SFR TowerCo to KKR Group.	France	December 2018	10,198	€1.8 bil.	€353	18.0x	6.9x¶
Altice International sold 100% of tower company Teletorres del Caribe to Phoenix Tower Interntional.	Dominican Republic	October 2018	1,049	$170 mil.	$162	18.3x	7.0x¶
Altice International sold a 75% stake in Towers of Portugal to Morgan Stanley Infrastructure Partners and Horizon Equity Partners.	Portugal	September 2018	2,961	€540 mil.	€223	18.9x	6.9x¶
Telefónica S.A. sold 9.99% of Telxius, its telecom infrastructure company, to Pontegeada Group.	Spain, Germany, Brazil, Chile, Peru	July 2018	16,453	€379 mil.	€231¶¶	12.9**	6.4x
Masmovil agreed to sell 551 towers to Cellnex Telecom S.A.	Spain	December 2017 - January 2018	707	€42 mil.	€59	N/A	10.4x

Table 1

Recent Tower Transactions (cont.)

Tower transaction	Country	Date	Number of towers	Transaction size*	Price per tower (000s)	EBITDA multiple (tower transaction)	EBITDA multiple (MNO, pre-tower sale agreement)
Telefónica S.A. sold 40% of Telxius, its telecom infrastructure company, to KKR Group.	Spain, Germany, Brazil, Chile, Peru	Sep. - Oct. 2017 (sold); Februry 2017 (announced)	15,870	€1.3 bil.	€201¶¶	11.4**	7.1x
Bouygues S.A. agreed to sell 600 towers to Cellnex Telecom S.A.	France	July 2017	600	€170 mil.	€283	14.0x ***	5.9x
Sunrise Communications Holdings S.A. agreed to sell 100% of Swiss Towers AG to Cellnex Telecom S.A., Swiss Life Asset Managers and Deutsche Telekom Capital Partners.	Switzerland	May 2017	2,239	CHF500 mil.	CHF223	14.0x	8.6x
Bouygues S.A. agreed to sell 3,000 towers to Cellnex Telecom S.A.	France	February 2017	3,000	€854 mil.	€285	14.0x ***	6.8x

*Consideration for the transacted portion, not an EV. ¶Using EV and LTM EBITDA for Altice Europe N.V., excluding Altica USA (separated from Altice N.V .in Jun. 2018). **Multiple on a blended basis for the Tower business and Cable business (i.e. not only for the Tower business). ¶¶Price per tower is lower if value of the Cable business is excluded from the calculation. ***Tower EBITDA multiple based on Cellnex reporting.

While we do not expect tower transactions to drive upgrades, they can nonetheless strengthen balance sheets and increase financial flexibility and ratings' headroom, and even boost equity valuations. The structure of the transaction itself can take several forms, as we describe below. Although we are largely agnostic as to the differing structures, we place a priority on comparability and will exercise adjustments, when appropriate, to ensure that substantively similar operational and economic arrangements do not yield varying rating outcomes simply because of different accounting treatments.

The most straightforward are majority or outright tower portfolio sales to a third-party independent tower operator such as Cellnex. Such transactions carry the benefit of realizing the majority, or even all of the tower portfolio's valuation at once, and of exiting direct operation of the tower business. In a world of declining tower differentiation, this can allow operators to focus resources on their core operations in search of other competitive advantages, including new spectrum or active equipment upgrades to differentiate mobile quality, content or additional services, or through marketing and promotional campaigns. Third-party sales can be particularly attractive to operators with credit metrics that are near rating triggers and looking to create more breathing space, as has been the case for telcos such as Vodafone, Altice Europe, Telefonica, and Telecom Italia (TIM), among others.

In a variant or combined with the above, companies with expensive buildout programs can break down the cash flow impact into more digestible bites. A telecom operator can build a phase of towers and then sell them to a towerco under a lease-back before moving on to the next build phase. The sale proceeds replenish telco cash, helping the operator avoid the cash flow drain of financing an entire multiyear tower development program. Examples of this include the Build To Suit (B2S) programs at Free, Bouygues, Wind, Sunrise, and Salt.

Another common structure is for operators to put their tower operations into a subsidiary and sell off minority stakes. Minority owners may include infrastructure funds or financial sponsors, as we have seen with Altice and Telefonica. Compared to a majority or outright sale, a minority sale forgoes the larger monetization opportunity to retain control, and may be appealing to operators looking to maintain an advantageous portfolio position. Below, we examine distortions created by full consolidation to ensure comparability.

In yet another iteration, an operator may leverage the value of its tower assets to gain access to larger combined networks, as in the case of Vodafone and TIM combining their networks within INWIT. While Vodafone will receive direct proceeds for their contribution, TIM exchanges part of its ownership in INWIT for Vodafone's contribution with no direct cash outlay. These transactions can be used to consolidate a strong network position or leapfrog to a better position without the time and expense of an organic buildout. In many ways, this is similar to passive tower-sharing arrangements that have existed for years, for example in the U.K., but the joint venture (JV) is a more formal structure with greater independence and ability to monetize through minority sales.

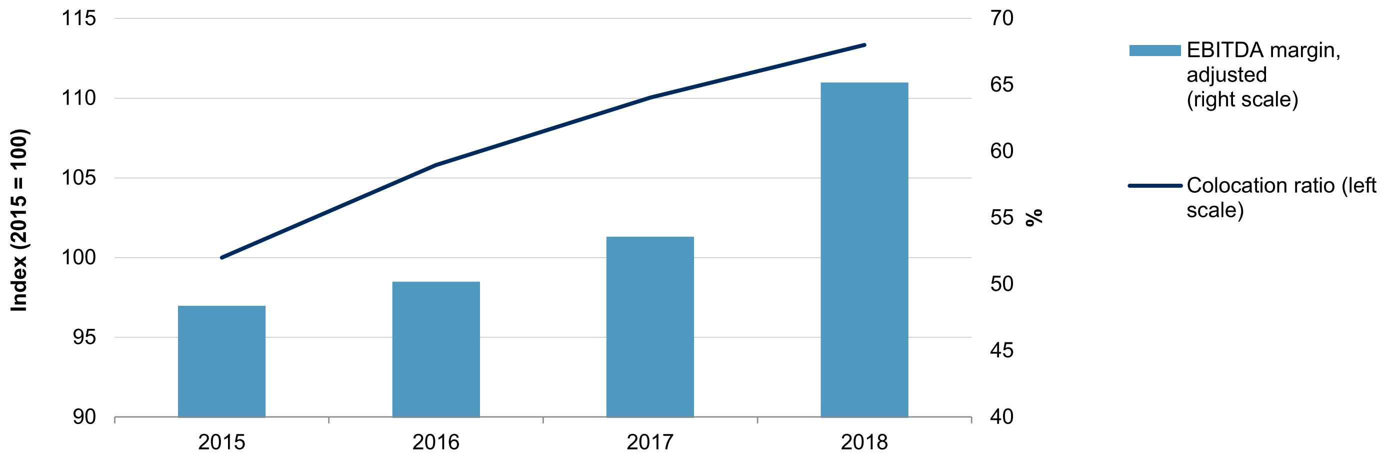
Why are investors interested?

With €90 billion of towers still integrated at mobile network operators (MNOs), based on recent transaction prices, investors are attracted by the size of the market, a stable demand, and strong cash flow profile, as well as the upside opportunity available from greater scale and more efficient utilization. With more favorable demand dynamics than the stagnant core telecom business, towercos generally have long-term contracts with price escalators and high renewal rates. With high revenue and cash-flow visibility, towercos can be levered up and return on equity maximized, enhancing their appeal to investors. And if investors are able to hoover up and combine enough tower assets, scale advantages begin to accrue in terms of better economics on costs, and better market power in pricing. Portfolio efficiencies also provide compelling upside because colocation and tower closures can increase utilization, driving up profitability and cash conversion (see chart 1), helping to fuel the high valuation multiples. Independent towercos hold an advantage here in their ability to court all operators without appearing biased.

Chart 1

Colocation Can Increase Profitability

Cellnex colocation ratio* and EBITDA margin (%), 2015-2018

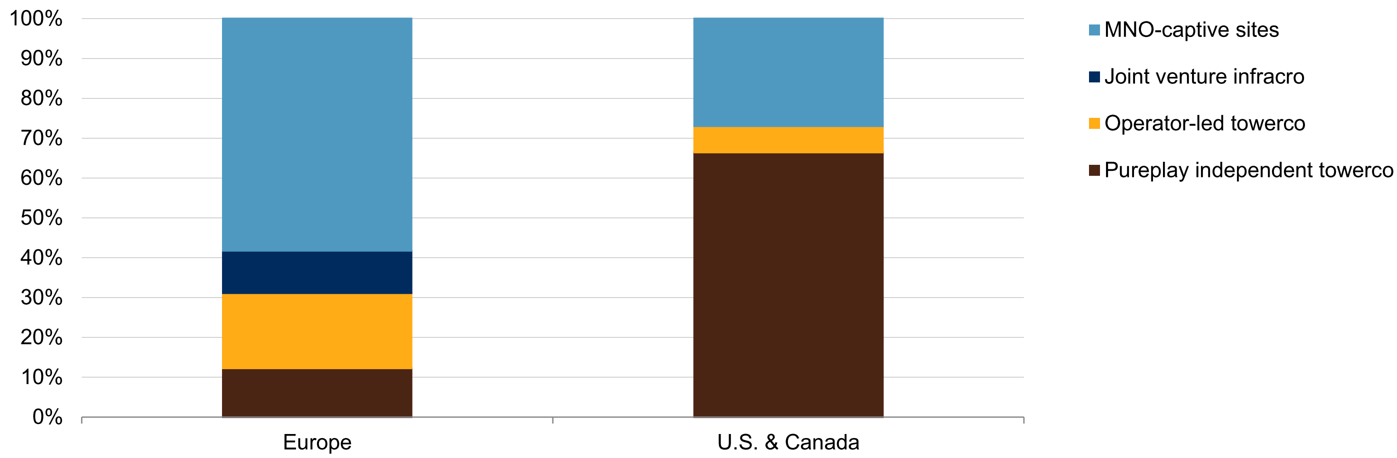


*Excluding change of perimeter (organic growth only, including BTS). Source: S&P Global Ratings, Cellnex Telecom S.A.

The U.S. has already transitioned to an outsourced model, with around two-thirds of towers owned by independent towercos. By comparison, in Europe nearly 60% of towers are still MNO-captive sites, with a further 30% majority-owned either directly or in a JV among operators (see chart 2). If Europe follows the example of the U.S. with further tower sales by MNOs to independent towercos, the 350,000 towers still residing within the MNO perimeter could represent significant potential to companies such as Cellnex, looking to consolidate their position in Europe. Acquisitions and building of new sites are part of their strategy. Should European independent towercos succeed, they too could benefit from some of the market concentration and pricing power advantages of their American peers.

Chart 2

The U.S. Has Already Transitioned To The Independent Towerco Model
Breakdown of tower ownership



Source: TowerXchange.

How do towercos compare to other infrastructure assets in terms of credit quality?

We think the tower business has robust business characteristics, but we differentiate it from other infrastructure asset classes that have stronger protections. We generally view the business of tower companies as incrementally weaker than utility network operators. We score most tower companies' businesses either strong or excellent, compared with excellent for the vast majority of energy and water distribution or transmission system operators. The primary drivers of this distinction are the utility networks' undisputed natural monopoly position and associated regulation, which we view as effective barriers to competition and technological disruption.

The sheer size of fixed costs in transmission and distribution networks represents extremely high barriers to entry and precludes commercial viability of a second network operating in the same area, which is why utility network operators' returns are regulated in accordance with clearly defined and transparent frameworks. In our view, this provides a very high degree of certainty for network operators' revenues and earnings over a multiyear timeframe. Tower companies also enjoy a high degree of revenue visibility due to the long-term nature and pricing provisions of their contracts with telecom operators. However, telecom operators' ability to service their obligations ultimately depends on their success in a commercial market subject to competitive threats and reliant upon a highly competitive telecom end-user market. In our view, this does not result in the same degree of stability as a regulatory framework that allocates the cost of network operation, including a fair return on capital, across the ultimate user base.

Table 2

Peer Comparison Of Selected Tower Companies And Utilities

	--Tower companies--			--Utilities (pure network operators)--		
Industry Risk	--Intermediate (3)--			--Very Low (1)--		
Highlights	**Within the telecom and cable industry, wireless tower leasing is characterized by a significant portion of customer customization, multi-year customer contracts, and material customer switching costs, and is thereby subject to less price competition and cylicality.**			**Within the utilities industry, network operators (gas and power transmission and distribution networks, as well as water utilities) operate under regulatory frameworks, which generally provide cash flow stability.**		
Issuer	Cellnex Telecom S.A.	Tivana France Holdings SAS	American Tower Corp.	Severn Trent PLC	Alliander N.V.	RTE Réseau de Transport d'électricité
Sector	Tower companies	Tower companies	Tower companies	Water utilities	Power and gas distribution system operators	Power and gas distribution system operators
Issuer credit ratings (as of Oct. 11, 2019)	BB+/Stable/--	BBB-/Stable/--	BBB-/Stable/--	BBB/Stable/A-2	AA-/Stable/A-1+	A/Stable/A-1
Country	Spain, Italy, U.K., Netherlands, France, Switzerland	France	U.S., India, LATAM, EMEA	U.K.	Netherlands	France
SACP	bb+	bbb-	bbb-	bbb	aa-	bbb+
Business risk profile	Strong (2)	Strong (2)	Excellent (1)	Excellent (1)	Excellent (1)	Excellent (1)
Number of telecom towers	24,078*	7,728	171,000	--	--	--

Table 2

Peer Comparison Of Selected Tower Companies And Utilities (cont.)

Highlights	• Leading independent provider of telecom and broadcasting infrastructure in Europe. • Strong earnings visibility, given its long-term contracts and sizable revenue backlog. • Increasing scale and geographic diversification within Europe. • Concentrated customer base. • European competitive landscape in telecom end markets and in the tower business, which is still fragmented and likely not yet stabilized.	• Leading position as an independent provider of telecom and broadcasting infrastructure in France. • Comprehensive and difficult-to-replicate asset base. • Strong earnings and cash flow visibility with a €2.6 billion backlog (73% telecom). • Robust profitability, albeit inferior to U.S.-based peers • Smaller scale than other EU and U.S. peers.	• Largest tower operator in the U.S. and a growing portfolio of tower assets in developing international markets. • Favorable long-term growth prospects. • Attractive tower leasing economics and healthy profitability. • Long-term contracts with price escalators and high renewal rates. • High quality and global tenant base. • Very high barrriers to entry due to zoning requirements.	• Mainly focused on low-risk, U.K.-water-regulated, monopoly activities. • Transparent, credit-supportive regulatory framework, resulting in financial stability during regulatory periods. • Top company in getting cumulative rewards in the current five-year regulatory period, AMP6. • Regulatory reset risk because regulators will focus more on operating performance in AMP7, starting in April 2020.	• Largest monopoly owner and operator of regulated electricity and gas distribution regional networks in the Netherlands. • Supportive regulatory framework and low-risk business support predictable and stable cash flow generation. • Energy transition in the Netherlands provides stimulus for core business.	•Monopolistic position operating and managing the French transmission power grid--98% of its revenues derive from regulated activities--in a supportive regulatory framework. •Strategically important to France's power system and energy policy. •Largest transmission grid in Europe. •Low cash flow volatility with a vast majority of operating cash flows derived from regulated activities.
Financial risk profile	Aggressive (5)	Significant (4)	Highly Leveraged (6)	Significant (4)	Modest (2)	Significant (4)
Modifiers (active)	--	--	--	CRA: Negative (-1 notch)	--	CRA: Negative (-1 notch)
Likelihood of government support	--	--	--	--	--	High (+2 notches)

*As of June 2019. SACP--Stand-alone credit profile.

Even though towers are similar in that they are associated with a heavy asset base and high share of fixed costs that discourage replication, we believe that at least in urban or dense suburban clusters, the economics support more than a single provider, which is different from the clear-cut natural monopoly in utility networks. Equally, we think the long-term technology risks for utility networks and tower assets are different because the transmission of data (mobile, but also fixed) is constantly evolving as new technologies emerge. For example, we expect the advent of 5G will eventually cause mobile networks to become denser, as macro sites are complemented with a high number of smaller micro sites or small cells. Although this is more of a long-term risk, a dynamic network structure can potentially reduce telecom operators' dependence on specific towers held by tower companies over time.

We note that such considerations can be mitigated by idiosyncratic characteristics of specific tower markets or issuers. For example, very strict zoning requirements or standards related to electromagnetic frequency emissions can effectively establish a quasi-monopoly for certain areas or sites. Significant scale within a country can enhance market power, and total scope and geographic diversification can improve our view of resilience. These factors can lift the business risk to excellent, as is the case for the U.S. tower companies American Tower Corp., Crown Castle, and SBA.

What is the impact on the operators when they sell?

In many cases, the impact on a company's credit metrics will be marginal because cash proceeds are largely offset by lease liabilities. However, as valuation multiples rise, so does the scope for deleveraging.

The extent--assuming proceeds are used for debt redemption--depends on the price of the sale and implied multiple relative to the telco's lease commitment, with high valuations offering more scope to deleverage. Majority or complete sales with multiples in the 20x range or higher, have the potential to impact ratings, as was the case for Matterhorn (see table 3). However, in most cases to date, the deleveraging impact after our adjustments has been more modest, at less than 0.3x, due to alternate uses of proceeds (as in the case of Matterhorn), lower multiples, or smaller portfolio sales. Hence, we have viewed tower sales primarily as a way for operators to gain some headroom within their ratings rather than a path to material rating upside.

We also note that the shorter the length of the contract with the tower company, the lower the lease liability will be (and the greater reduction in leverage). However, if terms are unusually short (i.e., less than 10 years), we may consider longer periods that are more comparable with peers. For example if the renewal period and terms are agreed, we may assume the first extension is exercised. This is because, in our view, a short contract does not adequately reflect the economic life of the towers to a mobile network operator.

Table 3

Leverage Impact of Tower Sale Proceeds Offset by Lease Adjustments

Sunrise Communications Holdings S.A. (Mil CHF)

	--Fiscal year ended Dec. 31, 2017--		
	Debt	**EBITDA**	**Debt/ EBITDA**
	2,026.2	687.7	2.9x
Adjustments for tower transaction			
Accessible cash and liquid investments	(500.0)	†	
Operating leases	370.8	‡	
Total adjustments	(129.2)	0	
S&P Global Ratings' Adjusted amounts			
	Debt	**EBITDA**	**Debt/ EBITDA**
	1897	687.7	2.8x
Net Deleveraging			**0.2x**

Table 3

Leverage Impact of Tower Sale Proceeds Offset by Lease Adjustments (cont.)

	--Fiscal year ended Dec. 31, 2017--		
Matterhorn Telecom Holding S.A. (mil. CHF)			
	Debt	**EBITDA**	**Debt/ EBITDA**
	2,670.1	524.7	5.1x
Adjustments for tower transaction			
Accessible cash and liquid investments	(836.0)	†	
Operating leases	500.0	‡	
Total adjustments	(336.0)	0	
S&P Global Ratings' Adjusted amounts			
	Debt	**EBITDA**	**Debt/ EBITDA**
	2,334.1	524.7	4.4x
Net Deleveraging			**0.6x**

In cases where disclosure is limited, for example when a company signs a master service agreement, which is not reported as a lease under IFRS16, we will still seek to adjust the company's figures rather than rely on the accounting treatment. As noted in our "Ratios and Adjustments Guidance" (see "General: Corporate Methodology: Ratios And Adjustments," published April 1, 2019),, we will periodically look to the track record of service provision as these arrangements mature, to potentially reassess this approach over time.

In partial sales, a telecom operator can choose to retain either a majority or minority stake in the tower company. For example, Telefonica only sold a minority stake in Telxius and continues to fully consolidate it, while Vodafone and TIM will each only retain 37.5% in INWIT and it will be treated as an equity associate. In the Vodafone example, we expect to see the benefits of owning a minority stake in a tower company through ongoing dividends, which we will add to the company's EBITDA.

In the case of minority sales like that of Telefonica, we would generally review the accounting benefit of full consolidation to gauge materiality. For tower sales, this will proportionately reflect lease commitments to the subsidiary in addition to the more common debt and EBITDA partial deconsolidation for typical operating subsidiaries. If we deem the distortion caused by consolidation to be material, we can address this by applying proportional consolidation in our adjusted ratios (as we do with Altice), or by tightening the company's rating triggers to offset it.

For the time being, the jury is still out on whether there are strategic reasons for retaining majority control of a towerco. We think the evidence still suggests that it could remain a differentiating factor for incumbent telecom operators, whose towers generally have superior locations, especially in non-rural areas in Europe. Supporting our view, we've not yet seen the any of the big European incumbents handing control of their towers to third-party tower companies through majority or outright sales. In the cases of minority sales monetized from towerco subsidiaries and JVs, we expect to see exclusivity or right-of-tenant-refusal provisions for key locations. In some markets, such as Switzerland or Italy with strict EMF frequency restrictions (as noted above) the selling telco may be able to maintain a de facto exclusivity. Together, such limitations may serve to retain incumbent advantages. But, conversely, they can affect valuation multiples by limiting the ability of towercos to lease sites and increase colocation.

How could the tower market mature in Europe and what risks might tower companies face?

We think tower sales will continue, but that European operators may take a more nuanced approach than their U.S. peers. Noting the concentration of assets at U.S. towercos, and their resulting market power and leverage in lease negotiations, European peers have been more circumspect with their towers, holding onto more of their prime assets. At the same time, European MNOs have begun monetizing towers, but offsetting concentration by utilizing an array of options, such as controlled subsidiaries and JVs, as well as sales to independents.

Outright sales still represent the most financially attractive route in terms of no residual ownership, maximizing the colocation-driven valuation, and a complete outsourcing of the function and all its maintenance capex and expenses. However, we think European operators will continue to take a multitrack approach. It makes sense in terms of maintaining not only a level of operational control in markets where tower assets can still play a role in differentiation, but also a market balance in terms of bargaining power with independents.

5G rollouts present a new challenge. Towercos have aggregated and built out their portfolios during a relatively stable period of network architecture. We think macro sites will be central to reach coverage requirements using low and mid band frequency, ensuring continued demand for the current tower infrastructure for at least the next five years. But looking beyond the initial rollout, as use cases mature and 5G demand intensifies, we could see a more advanced vision of 5G replete with a dense small cell network running on mmWave frequencies. In such a scenario, there is certainly still a role for macro site infrastructure. But will it command the same rents with a parallel network of small cells handling an increasing portion of mobile data traffic?

A key emerging question for the sector is: who will build and own the small cell network? We think operators could view this as the new battlefront in carrier differentiation and lead the charge. Their option to buy-or-build for every major network upgrade (unlike in the utility space) may constrain the long-term pricing power of independents.

To date, several of the major towercos have questioned the economics of building such infrastructure, with Crown Castle a notable exception. However, towercos are growing their expertise in siting, permitting, building and managing networks to desired specifications and levels of quality. They could leverage their increased clout to evolve and become a key provider of new 5G mobile infrastructure, but will need to accumulate a sufficiently long track record of building and managing networks in line with MNOs requirements.

And if towercos do build the new networks or extensions, they may have to bear greater construction, take-up, and operating risk, which could also dilute our view of the relatively strong business model they enjoy today.

Related Criteria And Research

- General: Corporate Methodology: Ratios And Adjustments, April 01, 2019
- The Future Of 5G: In Europe, Fortune Could Favor The Cautious, Oct. 17, 2018
- The Future Of 5G: Will Global Telcos Get Enough Bang For Their 5G Buck? Oct. 17, 2018

This report does not constitute a rating action.

Contact List

PRIMARY CREDIT ANALYST

Mark Habib
Paris
(33) 1-4420-6736
mark.habib@spglobal.com

PRIMARY CREDIT ANALYST

Osnat Jaeger
London
(44) 20-7176-7066
osnat.jaeger@spglobal.com

PRIMARY CREDIT ANALYST

Lukas Paul
Frankfurt
+ 49 693 399 9132
lukas.paul@spglobal.com

PRIMARY CREDIT ANALYST

Sebastian Sundvik
London
+ 44 20 7176 8600
Sebastian.Sundvik@spglobal.com

SECONDARY CONTACT

Xavier Buffon
Paris
(33) 1-4420-6675
xavier.buffon@spglobal.com

SECONDARY CONTACT

Justine Miquee
Paris
+ 33 14 420 6794
justine.miquee@spglobal.com

SECONDARY CONTACT

Kai Stukenbrock
Frankfurt
(49) 69-33-999-247
kai.stukenbrock@spglobal.com

ADDITIONAL CONTACT

Allyn Arden, CFA
New York
(1) 212-438-7832
allyn.arden@spglobal.com