

September 4, 2023

## The possible prospects for the European telecommunication sector

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The 2023 will certainly be remembered as the year of artificial intelligence on the technological front. We are still in the exploration phase of the infinite applications of this system, but one thing is certain: to fully express its potential, AI will need infrastructures capable of guaranteeing the maximum reduction in latency, i.e. the time between question and answer of data, indispensable in applications such as autonomous driving. But above all it will need networks capable of supporting an increasingly large flow of data: i.e. **in Italy, data traffic on the fixed network has doubled in just three years**, going from 25.1 zettabyte – or a trillion bytes – of 2019 to 46.5 Z bytes in 2022 (source: Agcom communications observatory).

On the **strategic infrastructures** front, such as networks, Europe is however **lagging behind**. In an excessively crowded sector such as the telecommunications (TLCs), in the last twenty years the competition has played out on the prices of the services offered. This dynamic has progressively eroded the margins of the operators, compromising their investment capacity. In the old continent today there are still over 100 operators against the three in the United States where the average prices of services are equal to over **\$60**, a value which can be compared, for example, with the average **25 euros** in Italy (Source: Bloomberg).

Low margins are not the only problem that European telecommunications companies have to face: the sector's financial leverage reached a record level in 2022 equal to **2.8 times the sector's aggregate net debt** to EBITDA. Furthermore, the current phase of rising interest rates makes both debt and its refinancing more onerous (Source: Bloomberg).

The stock market performance of the sector in the last 5 years is a direct consequence of these dynamics: the European TLCs have, in fact, recorded a marked **underperformance, equal to -35%**, compared to the stock markets of the old continent (Source: Bloomberg, Europe Telecom Service index Industry vs MSCI Europe). The underperformance appears even more marked and equal to **-50%** if the sector is compared with the global market (Source: Bloomberg, Europe Telecom Service Industry vs MSCI Europe index).

In this scenario, the strategic development of network infrastructures could in part pass through the evolution of business models which could lead to the growing diffusion of **"networks as a service"**. This is a flexible model of use of the network infrastructure open to partners who support its development, in particular on the so-called last mile, which should lead the various players in



the supply chain to collaborate more efficiently in the use of capital while remaining in competition on services.

At the same time, in the sector there is an increasing trend towards the **separation between the physical infrastructure and the services**, since the purchasers of the networks have the financial capacity necessary to support investments in infrastructures which guarantee a return over 10-12 years.

At Plenisfer, however, we believe that the sustainable future of European telecommunications and the consequent correct development of strategic infrastructures, requires the start of a crucial phase of **consolidation** of the sector, as has already happened in the USA - where mobile operators have gone from 5 to 3 - as well as in **China**.

For over 15 years the Chinese government has imposed significant cuts in the prices of services, but faced with the need to support the development of 5G, since 2020 it has facilitated the alliances necessary to build two networks: alongside the dominant China Mobile, there has been merger between China Telecom and China Unicom and partnerships in the development of infrastructure in suburban areas.

In the light of this change of pace, the **Chinese telecommunications sector has returned to growth** and to generate cash with obvious benefits also in terms of stock market performance: over the last 3 years China Mobile and China Telecom have appreciated by 87% and 48% outperforming MSCI China by 120% and 84% respectively (Source: Bloomberg).

In Europe we observe attempts at consolidation both in Italy, with Iliad's renewed interest in Vodafone, in Spain (where operators could go from six to four) and in the UK, where the merger between Vodafone and TRE could be concluded.

The consolidation appears to be a path that can no longer be postponed in a scarcely dynamic sector such as telecommunications that is characterized by high "enter" and "leave" barriers, connected with the investments necessary to start up the business - from the purchase of licenses to the development of the network infrastructure.

The consolidation phase will need the **support of the regulation** which has however so far gone in the opposite direction, supporting the multiplicity of offers and operators and consequent downward pressure on the prices of services.

As investors we are convinced that **the development of strategic infrastructures can no longer be postponed and that the sector will be able to play a decisive role. But we also believe we have to stay on the sidelines**: it is necessary to monitor the evolution of the dynamics described. If there is a change in the attitude of the regulator towards the consolidation of the sector, interesting opportunities could open up.



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