Telecommunications Capital Confidence Barometer

Executives look farther afield for game-changing deals
## Key findings

<table>
<thead>
<tr>
<th></th>
<th>Telecommunications</th>
<th>Global</th>
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</thead>
<tbody>
<tr>
<td>43%</td>
<td>expect to actively pursue acquisitions in the next 12 months</td>
<td>50%</td>
</tr>
<tr>
<td>62%</td>
<td>have three or more deals in the pipeline</td>
<td>55%</td>
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<tr>
<td>17%</td>
<td>have deals of US$1b or more planned in the next 12 months</td>
<td>12%</td>
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</table>
see attracting and retaining customers as their primary focus for growth

cite advances in technology and digitalization as the greatest disruption to their core business in the next 12 months

have elevated cybersecurity on their boardroom agenda
Customer behavior and digital disruption drive dealmaking intentions

In this edition of the Capital Confidence Barometer, fickle consumers, new technologies and digitalization dominate dealmaking for telecommunications companies as they look to drive growth in a persistent low-growth environment.

With the majority of megadeals complete following a wave of industry consolidation, telecommunications companies are now looking for strategic acquisitions and alliances that allow them to address changing consumer preferences and leverage emerging technologies to compete more effectively with nimble and disruptive industry players.

Deal volumes remain above 100 per quarter, and while deal intentions are down from six months ago, with 43% of telecommunications executives indicating that they expect to actively pursue acquisitions in the next 12 months, they remain above the Capital Confidence Barometer average of 41%. At the same time, deal pipelines remain robust, with 62% of telecommunications executives indicating that they have three or more deals in the pipeline versus 55% cited by global executives.

Adjacent markets become prime targets for M&A

Given the disruptive forces buffeting the telecommunications industry, more than half of executives are pursuing deals in adjacent markets to help offset pressure on their core revenue streams. More than a third are looking to gain access to new materials or digital technologies, while slightly less are pursuing adjacent market deals that address changes in customer behavior. Almost three-quarters of telecommunications executives are also considering deals outside of their home markets. Operators are focused on maximizing their addressable markets within their footprint, which for many companies means scaling up in non-domestic geographies.
While M&A appetites remain robust, executives show discipline in dealmaking

However, as keen as telecommunications executives are to make deals that keep them competitive in a fast-changing market, they are discerning about the deals they make. Nine out of ten telecommunications respondents indicate that they have walked away from a planned acquisition in the past 12 months, largely because of issues uncovered during due diligence.

Telecommunications seek alliances across sectors to reach new customers

Where an M&A deal may not serve the right strategic fit, telecommunications companies are considering alliances. They are particularly attracted to partnerships with companies that can boost their R&D capabilities as they look to take advantage of opportunities related to the Internet of Things (IoT), video and cloud. Telecommunications executives are also attracted to horizontal partnerships with other telecommunications companies that can help them build scale into their existing propositions.

In a mature industry and facing a host of both opportunities and risks that today’s disruption brings, telecommunications companies are shrewdly considering deals that will help them create new experiences in an effort to retain existing customers and entice new ones in an increasingly crowded business landscape.

Gaeron McClure
EY Global Telecommunications
TAS Leader
For telecommunications companies, confidence in the economy moves to stability

In an ongoing environment of low growth, telecommunications companies express a shift in their outlook on the economy, with 40% seeing modest improvement and 46% believing the economy and key fundamentals are stable and expecting the GDP growth in 2016 to be the same as in 2015. A rigorous focus on costs and efficiencies, combined with bold organic and inorganic growth plans, is a prerequisite for surviving in a low-growth, low-inflation, low-interest-rate environment. This is a contrast from six months ago when 86% viewed the economy as modestly or strongly improving and 10% as stable.

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<th>Telecommunications</th>
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<tr>
<td>See the state of the global economy today as stable</td>
<td>48%</td>
</tr>
<tr>
<td>Believe increased volatility in commodities and currencies to be the greatest economic risk to their business over the next six to 12 months</td>
<td>32%</td>
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Yet, although a third (32%) of telecommunications executives cite concern around increased volatility in commodities and currencies, they are not indicating any rapid deterioration in capital markets, such as credit markets freezing, which suggests they see no systemic shocks on the horizon.
Regional differences highlight uneven performance

At a regional level, telecommunications companies in the European Union (EU) continue to experience strong performance following recent consolidations and fading structural pressures. However, they remain in a state of watchful waiting as the EU considers regulatory reforms around pricing and competition. For these executives it is an issue that looms large and is creating a level of uncertainty when it comes to strategic decision-making, at least in the short term.

Meanwhile, in the Middle East, Africa and Latin America, telecommunications stocks have suffered based on macroeconomic performance and political instability. US telecommunications companies exhibit the strongest showing as they have continued to outperform the sector over the last six months.

Operator share performance by region

Source: S&P Capital IQ
Attracting and retaining customers remains job one

Rapidly advancing technology and shifting consumer behaviors has telecommunications executives on edge as these disruptive forces continue to threaten traditional business models. This is particularly true for operators, who view start-up innovation as more disruptive than cross-sector convergence.

As a result, for half (50%) of telecommunications companies, attracting and retaining customers is job one. Operators in particular are proportionately more concerned with enticing new customers and keeping them happy as growth slows in their market. This largely explains why almost as many executives (49%) are focused on strategic transactions and alliances to drive growth, as well as making better use of digital technology and analytics (45%).

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<tr>
<td>27% see advances in technology</td>
<td>21%</td>
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<td>and digitalization as having the</td>
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<td>greatest disruption to their core</td>
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<td>business in the next 12 months</td>
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<tr>
<td>50% say their company is focusing</td>
<td>44%</td>
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<tr>
<td>most on attracting and retaining</td>
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<td>customers to drive growth in the next</td>
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<td>12 months</td>
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Organic growth centers on core products and existing markets

Like their global counterparts, telecommunications are more rigorously focusing on core products and existing markets to drive organic growth in the next year. They are also looking to exploit technology to develop new products and explore new markets as a means of growing their customer base.

Telecommunications cite more rigorous attention on core products and existing markets as their primary focus for organic growth in the next 12 months

Global

Reducing costs sits atop the boardroom agenda, but cybersecurity presents increasing concerns

Meanwhile, although reducing costs and improving margins sits atop the boardroom agenda for more than half (52%) of telecommunications companies, cybersecurity has board members increasingly concerned as they face ongoing challenges to guarantee data security and privacy for their customers.

The ongoing tension between national security agencies requiring access to customer data and customers demanding their digital privacy is only one example of the challenges telecommunications companies face in an effort to find the right balance between security and privacy.

Telecommunications have elevated cybersecurity on their boardroom agenda in the last six months

Global

have elevated cybersecurity on their boardroom agenda in the last six months

31%
Telecommunications executives find alliances increasingly attractive

As telecommunications companies seek to keep costs down, bolster R&D capabilities, move into new markets and compete with more nimble operators, they are finding alliances with other companies or competitors increasingly attractive. The majority of alliances cited by operators relate to monetizing both tangible and intangible assets, yet partnerships predicated on intangible assets alone – such as data and brands – represent only a small proportion of agreements.

Some telecommunications companies have seized on alliance opportunities with auto makers to provide end-to-end solutions that connect IoT to the connected car for premium buyers, while others have worked with banks to deliver mobile banking and micropayment options to their customers. Still others are teaming with media or technology companies to bring new products and services to market. We expect to see many more alliances of this nature as emerging technologies become ubiquitous.

As alliances prove increasingly popular, telecommunications companies may need to overhaul existing partnering frameworks to ensure that they deliver long-term benefits to both parties. Assessing the right balance between partnerships, M&A and other forms of value creation, such as incubator initiatives, will be vital.

As alliances prove increasingly popular, telecommunications companies may need to overhaul existing partnering frameworks to ensure that they deliver long-term benefits to both parties.
Deal intentions dip slightly but remain robust

Although deal intentions continue to decline, with relatively buoyant deal volumes of 100 per quarter, they remain well above the long-term average.

Q: Do you expect your company to actively pursue acquisitions in the next 12 months?

At the same time, although confidence has fallen slightly, nine out of ten telecommunications executives, or higher, remain positive or stable regarding the quantity and quality of acquisition opportunities (95% and 91% respectively), as well as the likelihood of closing acquisitions (90%).
Telecommunications executives look at a wide range of deal opportunities, small and large

As disruptive forces continue to untether traditional business models, telecommunications executives are looking at a wide range of potential targets, with 62% of executives indicating they have three or more deals in the pipeline, and 90% expect that to either remain the same or increase in the coming year.

At the same time, with the majority of megadeals and large-scale consolidations complete, telecommunications companies are primarily focusing their dealmaking intentions on US$1b or less. That said, telecommunications companies continue to outscore their global counterparts in pursuing transformational deals of US$1b or more (17% versus 12%).

### Telecommunications

- **62%** have three or more deals in the pipeline
- **83%** are looking at deal sizes of US$1b or less

### Global

- **55%**
- **88%**
Cross-sector and cross-geography deals account for a larger percentage of M&A activity

Digital disruption and changing consumer preferences has telecommunications executives considering not only cross-sector alliances, but also cross-sector deals, with access to new materials or technologies the primary driver for their pursuit. In fact, as a percentage of the total M&A deal volume within the telecommunications sector, cross-sector deals accounted for more than fifty percent (54%) of the activity in 2015.\(^1\)

Similarly, telecommunications are looking across geographies for the right strategic assets to drive growth, with almost three-quarters (73%) looking to pursue cross-border acquisitions. Unsurprisingly, top-tier developed markets remain very popular, with the US, the UK and Canada topping executives' list of preferences as telecommunications companies look to take advantage of adjacent market opportunities such as enterprise services and fiber optic infrastructure. In terms of emerging markets, Brazil and India represent top choices.

Top five destination countries for telecommunications

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<td>1. United States</td>
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<td>2. United Kingdom</td>
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<tr>
<td>3. Canada</td>
<td>3. India</td>
</tr>
<tr>
<td>4. Brazil</td>
<td>4. China</td>
</tr>
<tr>
<td>5. India</td>
<td>5. Germany</td>
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1. Source: EY analysis, CapitalIQ, Thomson, Merger Market
Due diligence roars to the fore as telecommunications executives show discipline in dealmaking

As active as telecommunications companies are in pursuing opportunities that help them attract and retain customers and maximize their competitive advantage in the face of unprecedented digital disruption, they are unwilling to do deals at all costs.

Nine out of ten telecommunications executives indicate that they have walked away from planned acquisitions in the last 12 months, with almost three out of ten (29%) citing issues uncovered during due diligence, up from only 3% six months ago. One in five executives cited concerns about regulatory or antitrust reviews as a reason for failing to complete a transaction. Although this is down from six months ago, the regulatory landscape for in-market consolidation remains an unpredictable factor in the sector.

For deals that were completed, but for which telecommunications companies felt buyer’s remorse, 21% indicated that price and margin deterioration was the most significant contributing factor.
About the Global Capital Confidence Barometer

The Global Capital Confidence Barometer gauges corporate confidence in the economic outlook and identifies boardroom trends and practices in the way companies manage their Capital Agendas – EY’s framework for strategically managing capital.

It is a regular survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU). Our panel comprises select global EY clients and contacts and regular EIU contributors.

- In February and March, we surveyed a panel of more than 1,700 executives in 53 countries; nearly 50% were CEOs, CFOs or other C-level executives.
- Respondents represented 19 sectors, including financial services, consumer products and retail, technology, life sciences, automotive and transportation, oil and gas, power and utilities, mining and metals, diversified industrial products, and construction and real estate.
- Surveyed companies’ annual global revenues were as follows: less than US$500m (16%); US$500m–US$999.9m (25%); US$1b–US$2.9b (21%); US$3b–US$4.9b (12%); and greater than US$5b (26%).
- Global company ownership was as follows: publicly listed (65%), privately owned (31%), family-owned (2%) and government/state-owned (2%).
- In this survey, we had 110 respondents from telecommunication companies; 59% were CEOs, CFOs or other C-level executives. The telecommunication companies’ annual global revenues ranged from less than US$500m (21%), US$500m–US$999.9m (25%); US$1b–US$2.9b (12%); US$3b–US$4.9b (11%); and greater than US$5b (31%). Company ownership was publicly listed (65%); privately owned (33%) and government/state-owned (2%).

Buying and bonding: Alliances join M&A as engines of growth

Our latest Global Capital Confidence Barometer continues to find a strong acquisition appetite together with a growing inclination to forge new alliances. Prolonged economic challenges are driving investment decisions and leading companies to ally and cooperate for growth, as well as compete for and acquire for market share.

Connect with us at ey.com/ccb.

Telecommunications contact

For a conversation about your capital strategy, please contact:

Gaeron McClure
EY Global Telecommunications TAS Leader
Ernst & Young LLP
+1 212 773 9988
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