The state of European Telcos: What left Europe behind in the race?

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The steady decline of traditional telecommunication services over many years might be reaching the point of no return. Previously, competition and over-the-top players had varying degrees of impact on core service revenue erosion. The extent of decline was influenced by several market conditions including smartphone penetration, affordability and changing customer behaviors. Today, this erosion is commonplace.

However, European telcos are struggling the most and that pain shows few signs of abating. Over the past decade total mobile revenues and EBITDA have decreased 4.4% and 5.7%, on a Compound Annual Growth Rate, respectively (accounting for currency fluctuation the impact appears less pronounced). Some of the region’s most important figures are expressing their concern.

Stéphane Richard, Orange’s CEO, said the value of European telcos is now at a 15-year low, raising questions about return on investment, strict regulation and risk of retreating behind other regions.

“We are investing less in telecoms and technology than anywhere in the world. Europe is clearly not in a good position to win,” Richard said¹. Amid heavy regulation, market consolidation, inflated spectrum valuations and increased competition, European markets have performed well below their US and Asian counterparts.

¹ Financial Times
Exhibit 1: Mobile revenues growth, 2008-2018 ($ Billions)

10-year mobile revenue growth across regions
(2008 vs. 2018, $ Billions)

<table>
<thead>
<tr>
<th>Region</th>
<th>Revenues - FY 2008</th>
<th>Revenues - FY 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>50.4</td>
<td>57.6</td>
</tr>
<tr>
<td>Asia</td>
<td>273.4</td>
<td>296.3</td>
</tr>
<tr>
<td>Europe</td>
<td>296.3</td>
<td>188.0</td>
</tr>
<tr>
<td>North America</td>
<td>192.3</td>
<td>192.3</td>
</tr>
<tr>
<td>Middle East</td>
<td>44.0</td>
<td>47.1</td>
</tr>
<tr>
<td>Latin America &amp; the Caribbean</td>
<td>81.5</td>
<td>68.6</td>
</tr>
</tbody>
</table>

CAGR (08-'18)
- Africa: 1.3%
- Asia: 6.4%
- Europe: -4.4%
- North America: 3.5%
- Middle East: 0.7%
- Latin America & the Caribbean: -1.7%

Source: Ovum

Exhibit 2: Mobile EBITDA growth, 2008-2018 ($ Billions)

10-year mobile EBITDA growth across regions
(2008 vs. 2018, $ Billions)

<table>
<thead>
<tr>
<th>Region</th>
<th>EBITDA - FY 2008</th>
<th>EBITDA - FY 2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>22.5</td>
<td>23.0</td>
</tr>
<tr>
<td>Asia</td>
<td>117.3</td>
<td>107.8</td>
</tr>
<tr>
<td>Europe</td>
<td>107.8</td>
<td>59.9</td>
</tr>
<tr>
<td>North America</td>
<td>62.6</td>
<td>110.2</td>
</tr>
<tr>
<td>Middle East</td>
<td>13.4</td>
<td>26.6</td>
</tr>
<tr>
<td>Latin America &amp; the Caribbean</td>
<td>27.5</td>
<td>20.3</td>
</tr>
</tbody>
</table>

CAGR (08-'18)
- Africa: 0.2%
- Asia: 2%
- Europe: -5.7%
- North America: 2.9%
- Middle East: 7.1%
- Latin America & the Caribbean: -3.0%

Source: Ovum
Crowded markets, low data yields

European telco stocks briefly soared in 2013 on news of the creation of a pan-European infrastructure network. There were discussions between the EU’s Competition Commission and some of Europe’s biggest telecom groups including Deutsche Telekom, Orange, Telecom Italia and Telefonica. Had plans gone through, the single network would have been a real competitor to US-based internet giants such as Facebook and Google today.

Instead, as the pan-European operator dream remained elusive, market fragmentation has exacerbated. With around 830 operators, Europe has 14 times as many operators as Asia and twice that of North America for every billion customers served, as shown in exhibit 3. This is mostly because of the high number of MVNOs in some markets. Germany, France, Spain, the UK, and Denmark have close to 375 active MVNOs, which applies greater pressure on retail tariffs. In comparison, North America and China have just 130 and 14 active MVNOs respectively.

As mobile technologies evolved to offer faster speeds and as data became more affordable, an increase in data traffic was inevitable. EU mobile data usage continues to grow rapidly at around 40% annually. Average monthly data traffic per capita is 4.2 GB compared with approximately 1 GB three years ago, while Nordic nations have the highest data consumption with 22 GB each month. However, operators continue to struggle when it comes to data monetization. In fact, Europe’s data yield has decreased 75% since 2015 from €20 per GB to €5 per GB. With some 5G use cases and applications bringing even greater speeds and better experience, operators will still fail to see the desired return on investment as data traffic continues to soar.

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2 Ovum
3 Barclays

Exhibit 3: Number of mobile operators by region

Number of network providers across the world (#)

Source: Ovum
Spectrum: A European conundrum

Spectrum pricing strategy has always been a contentious issue for operators and industry bodies, such as the GSMA, since prohibitive pricing might lead to higher retail prices reflected on end users, negatively affect the economy in the longer term and deter new players from entering some markets.

The price paid for spectrum peaked in the early 2000s when British and German operators were bidding for 3G spectrum. Pricing again rocketed for 4G with a two-fold increase for the price per population per MHz and a 1.6-fold increase for reserve prices between 2007 and 2016. For example, the digital dividend band attracted the highest bids in France, Germany and Italy where SFR, Vodafone and TIM paid on average more than $1 per pop/MHz for the high-coverage band.

High prices have typically been linked to poor auction design and bidding policies rather than competition-driven bidding where players that value the spectrum the most would invest more in securing the bands they require. The high fees for 4G spectrum can also be linked to poorer future coverage and penetration - there’s a negative correlation between prices paid in both middle- and high-income European markets and 4G availability, penetration and coverage.

When it comes to recent 5G spectrum auctions, some markets seem to have achieved reasonable pricing levels. However, the imposing valuation of the mid-band spectrum, which is in high demand for 5G deployment, was found in some countries like Italy. An October 2018 auction attracted $0.43 per pop/MHz from Telecom Italia and Vodafone, compared to lows of $0.04, $0.16 and $0.18 per pop/MHz in Finland, the UK and South Korea respectively.

"We are investing less in telecoms and technology than anywhere in the world. Europe is clearly not in a good position to win"

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4 GSMA
Is 5G the answer?

With decreasing data yields, high spectrum prices and increased CAPEX requirements for future generation networks, the potential light at the end of the tunnel comes from improved cost efficiencies with 5G and the right use cases to monetise the spend on the new technology.

Globally, operators and governments have begun 5G pilots to explore potential use cases such as connected cars and autonomous vehicles (Austria and France), industries digitization (Germany), smart tourism (the UK), remote surgery (China Mobile/Huawei) and public safety (the US).

However, there’s seemingly a lack of clarity on which applications will generate the desired return on investment. In the US, Verizon has launched its ‘Built on 5G Challenge’, a nationwide search for the best products, services and applications for the new technology. In return for $1 million, the best ideas will gain access to Verizon’s 5G Lab with investment earmarked for the winning company⁵.

Another topic that operators are mulling is 5G pricing and how a premium over older technologies can help recoup the costs incurred by operators. Initially Verizon planned to charge a $10 premium for 5G plans with the first three months free of charge. However, now it will waive the fee altogether for the Samsung Galaxy S10 5G phone users⁶. Similarly, T-Mobile pledged unlimited 5G plans at rates similar

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⁵ Verizon

⁶ Android Central
to the current 4G tariffs in the market\(^7\) while AT&T’s initial pricing for 5G might come at a lower price/GB compared to their current LTE offer\(^8\).

In addition to identifying the right use cases and the right pricing strategy, a new challenge has emerged, with a potential impact on overall CAPEX - the use of Huawei’s equipment for 5G. US pressure to ban the Chinese vendor has led some countries to ban its use in 5G networks, such as Australia, New Zealand and Japan, or exclude it from core network like KPN in the Netherlands. Germany and the UK will use the equipment if it complies with security requirements.

A blanket ban across Europe is unlikely since the impact would be more pronounced on challengers and smaller operators. From a regulatory perspective, the European Commission recommended in March to place the security of 5G networks at the forefront. For the first time, security and not price and commercial terms will be the driver for any decision made with respect to 5G networks as European regulators focus on data privacy and digital infrastructure security.

When you can’t compete, cooperate?

In order to cope with higher costs, fierce competition (from other telcos and OTT players), and diminishing returns, operators have pushed for consolidation, network sharing and asset disposal when allowed by regulators. When it comes to mobile consolidation, EU regulators have typically approved M&A activity that sustains retail prices at a competitive level and protects consumer welfare.

Conditional approval of some deals came with remedies such as wholesale MVNO in Germany or divestment of some assets, like spectrum. However, approved mobile-mobile mergers have not always resulted in improved market conditions for consumers. This was the case in Austria where Hutchison’s €1.3 billion takeover of Orange actually increased retail prices in the few years following the deal. A similar situation occurred in Germany and Ireland, suggesting that better tariffs in the market cannot always be guaranteed as a result of consolidation\(^9\).

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\(^7\) TmoNews  
\(^8\) FierceWireless  
\(^9\) Financial Times

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**Exhibit 6: Mobile-Mobile M&A deal remedies in Europe – Last 10 years**
Another attempt at controlling costs focuses on network sharing, including passive and active sharing and joint deployment. While the sharing agreements cover a combination of 2G, 3G and 4G networks, some planned to include future 5G rollouts. For instance, Vodafone has held talks with O2 in the UK to share active and passive 5G infrastructure, with the initial terms covering 14,000 sites outside London and major cities\(^\text{10}\).

A similar strategy was adopted by the operator in Spain with Orange and in Italy with Telecom Italia. In addition to infrastructure sharing strategy, some operators have also considered offloading or structurally separating some of their assets. For instance, Vodafone has created a ‘virtual TowerCo’ with 58,000 towers and is looking for opportunities to monetise this asset. In Italy, Telecom Italia has been in discussions with the regulator to separate some of its network assets but has yet to receive approval.

**The way ahead …**

One size does not fit all, and this is no truer when it comes to discussions on regulation, spectrum and consolidation. Spectrum was awarded based on an administrative approach in Hong Kong and Japan due to abundance of some bands and the same cannot be expected in Europe. Consolidation activity in some countries may not reap the same benefits in others.

However, for telcos to remain competitive and have a solid data monetization strategy, an idea that seems to fit most, if not all, is moving from selling connectivity to selling experiences. This is best seen in some disruptive emerging market players, like Turkcell and RJio, and is anticipated with Rakuten Mobile’s launch in Japan.

EU telcos might still figure the way ahead by adapting such disruptive propositions to their market reality.

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\(^\text{10}\) Vodafone 3Q 2019 Analyst presentation
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