TELECOM MERGERS 2016: A ROAD MAP FOR ENTERPRISE USERS

David Rohde, TechCaliber Consulting

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Telecom Mergers 2016: A Road Map for Enterprise Users

There's little question that the US telecom industry is going to transform itself in 2016 and 2017.

There are suppliers that are aching to get into the enterprise market, notably Comcast, whose path to simply rolling up more cable companies was blocked by regulators last year.

There are suppliers that people fear are aching to get *out* of the wireline side of the enterprise market. Verizon is an obvious candidate.

And then there are companies that are just aching. Sprint is a hot mess. It doesn't do the enterprise market much good to have SoftBank constantly "saving" Sprint via cost cuts, layoffs, and corner-cutting network builds that leave Sprint behind its rivals in network quality and customer confidence. SoftBank will eventually decide whether to go all in or cut its losses and find a new buyer who will invest the required dollars and be a wireless value player for both consumers and businesses. Until then, the Sprint brand continues to flounder.

The ***good*** news from a user standpoint is that industry deals that could be real negatives for the enterprise market have been stifled to date by valuation disagreements between prospective buyers and sellers. And merger deals that could benefit the enterprise market are the kind where you see a motivated buyer pay real money for an asset that matters.

With all of that said, let's unpack the story. It's practically a drama where an enterprise customer such as yourself is on the edge of his or her seat as to whether there's a happy ending or not. The carrier line-up is eventually going to change, but what's at stake is whether any given logical, large-scale procurement in the future – say, a global wireline transformational network procurement, or a critical domestic US wireless competitive RFP – ends up with several highly motivated and fully qualified bidders or a bunch of wannabes who can't produce because they don't have the money, the experience or the internal cohesion to stack up.

And that's the ultimate question regardless of what the "names" of these future players ends up being.

VERIZON

Many people have asked about persistent reports that Verizon will sell what amounts to their Terremark acquisition, i.e., a key portion of their cloud, data center and colocation businesses. This is a subset of the generalized fear that Verizon will someday go all-wireless in its business.

Well, just as the big Verizon wireline sale story last fall traced back to a single source, so does the Terremark report now. Reuters reported at the beginning of the year that Verizon wants this deal. But other financial media, notably the Wall Street Journal and the Financial Times, haven't bitten, even though Verizon executives themselves say the unit is expendable at the right price.

In the intersecting worlds of business, politics and journalism that means we've got a trial balloon on our hands. Verizon wants to know the market value of their wireline assets, including data center and cloud. A rumor reported in the financial press helps them figure that out. But a real

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pending merger story, like the ones you see in the Wall Street Journal when a named seller and buyer are nearing agreement on price and terms, is something else.

So far in the Verizon wireline saga, we can say this: Selling the data centers for $2 billion (a number recently bandied about) or the whole enterprise business for $10 billion (the number discussed last fall by Reuters) won't work for Verizon. As everyone knows Verizon is all about wireless, but the priority for Verizon Wireless is to raise Verizon's credit rating back to A-minus so it can make a killing in the upcoming 600 MHz wireless auction. A company like Verizon with $130 billion in debt needs much more than a $12 billion reduction to move the credit rating needle. And Level 3's stock market value, with no wireless to its name, is $17 billion. Verizon wireline can't be worth less than that, right?

There's no question that is tilting in one direction because it needs a fantastic sum of ongoing dollars to maintain its US wireless network lead – just reaffirmed by RootMetrics in its second half of 2015 extensive measurements – and the associated perception that it can charge higher prices and earn 50%-like wireless operating margins. Customers with any kind of Verizon wireline service should watch for any key market moment where Verizon wireless needs lots of money, fast – like once the next spectrum auction is completed, much later in 2016, and Verizon has to pay up. Right now the odds are much greater for piece-parting of the Verizon asset base, which is to say that they're more likely to sell the data centers than the entire "MCI" business. But if there's a new "revolution" in wireless, such as the need to upgrade to 5G fast, Verizon is liable to do anything to stay ahead. By that time we'll know who is likely to actually take on Verizon wireline, so maintain contact.

COMCAST

The challenge for enterprises is finding truly strong No. 3 and No. 4 players in both wireline and wireless that don't get merged out of existence. And that's where the most motivated buyer of all may come in – Comcast. The cable giant claims it's in the national enterprise business now, but almost everybody believes it needs more juice to make that happen.

Comcast's involvement with any of the Verizon wireline assets would raise a torrent of political questions, since Verizon and Comcast are the two major consumer broadband choices in some key markets. Comcast doesn't need that new headache in Washington.

So, which other US telecom assets could Comcast be interested in? Some people think Comcast could make a play for Level 3. But that's also kind of a heart attack, since it took Level 3 this long to become a real enterprise alternative, and there's no competitive sense in combining these two potentially strong players into one.

The more affordable and efficient target for Comcast would appear to be the Zayo Group, with a ton of metro and intercity fiber assets and a 'reasonable' stock market value of $6 billion. As big as it is, Comcast does need to watch its pennies – well, watch its billions – on the wireline acquisition side because many people believe that Comcast is also hankering to go after T-Mobile US on the wireless side.

The takeaway here for enterprises depends unusually on your vertical market. At the moment it is still very unlikely that a Comcast can measure up to major enterprise with differentiated bandwidth needs, heavy managed services and application awareness, and certainly international coverage. But for enterprises with more uniform bandwidth needs spread over

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predictably urban and suburban locations – like many retail enterprises – Comcast and its promises of bringing together cable assets nationally not only should meet but theoretically beat traditional "telecom" players on price. You want to get that bid if only to play off AT&T and Verizon in round 2! And if Comcast acquires a facilities acquirer like a Zayo, start immediately throwing your heaviest bandwidth requirements and special projects at them and see how they do, no matter what industry you're in.

T-MOBILE AND LEVEL 3

That also could be surprisingly beneficial for our market, because T-Mobile right now still has shown little real capacity to compete for large enterprise wireless deals. Comcast wouldn't let that situation continue, because it would have to compete on both wireline and wireless if it really wants to counter AT&T in the enterprise market.

But Deutsche Telekom is bound to demand a lot for T-Mobile – probably much more than the $39 billion it thought it was getting from AT&T in 2011. So a Comcast wireline acquisition will have to be efficiently priced. That's why buying Zayo, at a third of the price, makes a lot more sense than buying Level 3.

Besides, Level 3 is expected to try to build up its own international assets this year. And with Level 3's new foothold in the large enterprise market and its growth prospects, the company's shareholder base, in my judgment, won't sell without a significant premium over its $17 billion market cap – probably $25 billion or more. A purchase by Level 3 of Colt in Western Europe wouldn't be a surprise. Level 3 senior executives have practically salivated over the idea of a European metro model that matches what they bought in the US from TW Telecom. And Fidelity, the current owner of Colt, is believed to be a willing seller.

THE BOTTOM LINE

One can't (or at least shouldn't) dismiss the headache that *all* carrier mergers and acquisitions entail for customers. But something's going to happen here. You can see a terrible wireline M&A scenario – Verizon bailing and prospective replacements Level 3 and (eventually) Comcast merging to avoid competition with one another. Or you can see a relatively golden scenario, where Level 3 and Comcast both independently bulk up and Verizon keeps its wireline assets through this decade's cycle of network transformation, culminating in a strong 4-player enterprise marketplace in both wireline and wireless with AT&T.

Early in 2016, the financial requirement to line up motivated buyers and sellers points far more to the latter, better scenario, but we'll see what happens. Right now, the first new reality is that almost every enterprise should present its requirements to Level 3 but then prepare to make a quick decision as to whether to bring them into "Round 2" or cut them loose. If there's a big merger across industry lines – wireline with an all-wireless carrier, or a cable company with a traditional telecom provider – watch the inevitably complex merger integration but be prepared to start engaging them in procurement projects within 6-9 months.

And don't be shy about telling them that you're the best test case possible! If anything, those key moments in the not too distant future will be the time where best practices in network communications and IT procurements will be especially important. It may be a white-knuckle

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ride, but everyone will be in the same boat, and whoever is best positioned to come out a winner on the enterprise customer side will gain the most from this analysis.

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