

Orange Spain's Merger with MasMovil

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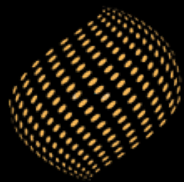


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DEAL INTRODUCTION

DETAILS ABOUT THE DEAL

The combination of the activities of Orange Spain and Masmovil will take the form of a 50-50 **joint venture** co-controlled by Orange and Masmovil, with equal governance rights in the combined entity. The agreement between parties includes a right to trigger an **IPO** under certain conditions for both parties after a defined period and, in such a scenario, an option for Orange to take control of the combined entity at IPO price.

The transaction is supported by a €6.6 billion non-recourse debt package that will finance, among other things, a €5.85 billion payment up-streamed to the Orange Group and Masmovil shareholders. This distribution to the shareholders will be asymmetric as it also embeds an equalisation payment in favour of Orange to reflect the different levels of indebtedness of the two standalone businesses. This debt package is mainly bank debt, provided by a large pool of banks. Masmovil's existing debt will remain in place. Post closing, the financial policy agreed between Orange and Lorca JVCO includes a **leverage** target of 3.5x Net Debt/EBITDA ratio to facilitate an IPO of the joint venture in the medium term.

Lazard acted as financial advisor to Orange. Goldman Sachs Bank Europe acted as financial advisor to Masmovil and BNP Paribas acted as debt advisor to Masmovil.

Jones Day has advised Orange while Freshfields Bruckhaus Deringer has advised Masmovil during this merger.



INDUSTRY OVERVIEW - TELECOMMUNICATIONS

The telecommunications industry is a broad and complex sector critical in modern society. It includes many businesses facilitating global communication and information exchange via voice and data communication, mobile services, broadband, and television. Moreover, the industry has experienced a substantial expansion in the last decade, which has fuelled technological advancements, rising connectivity demand, and growing populations. Being one of the largest industries globally, telecom companies operate in a highly competitive market that is heavily regulated, with government agencies often shaping the nature of the M&A landscape.

Currently, four major companies, Telefonica, Orange, Vodaphone, and Mas Movil, control most of the Spanish telecom market. In 2022, increased consumer demand for 5G devices, operators' marketing initiatives, and the development of greater network coverage accelerated 5G and fibre infrastructure expansion. As this transition to 5G gathers momentum in Europe, telecom operators in 2022 faced significantly higher energy prices and, thus, lower profitability because of the conflict in Ukraine. To maintain sustainable network operations, energy efficiency, and renewables have moved up the investment agenda from now on.

Market uncertainty, fuelled by high inflation and geo-political tensions, will likely continue for the rest of 2023, posing interesting challenges to key players. However, due to the consistent demand for essential voice and data services and extensive subscription plans, large operators enjoy a relatively dependable income stream, even during volatile economic times. Thus, the sector's stability will enable operators to continue investing in projects supporting high-speed mobile internet and communication infrastructure. As a result, in terms of the wider industry, the global telecom services market has an optimistic outlook and is expected to grow at a CAGR of 6.2% in 2023 (Grand View Research).



ACQUIRER OVERVIEW



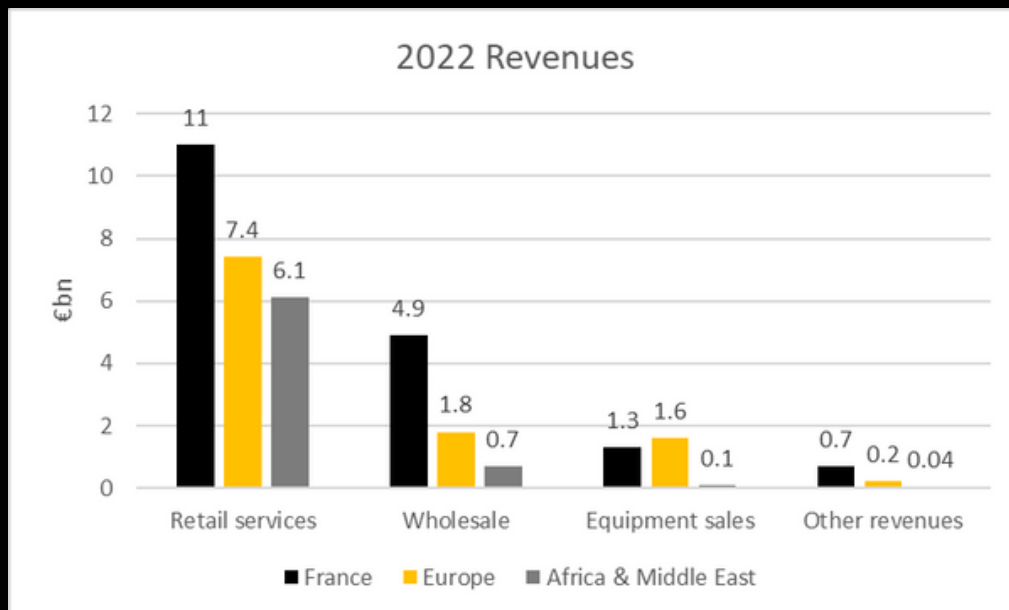
Ticker: ORAN

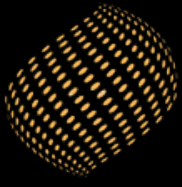
ORANGE

Orange is a global telecommunications operator and digital services provider with over 40,000 mobile towers in Europe. Founded in 1993 in the UK, the business now operates in 26 countries with 271 million customers worldwide. With 142,000 employees, 2022 saw Orange generate €43.5 billion in revenues.

BUSINESS MODEL

Orange generates revenues through retail services, wholesale, and equipment sales. For 2022, the business generated the following in its key regions:





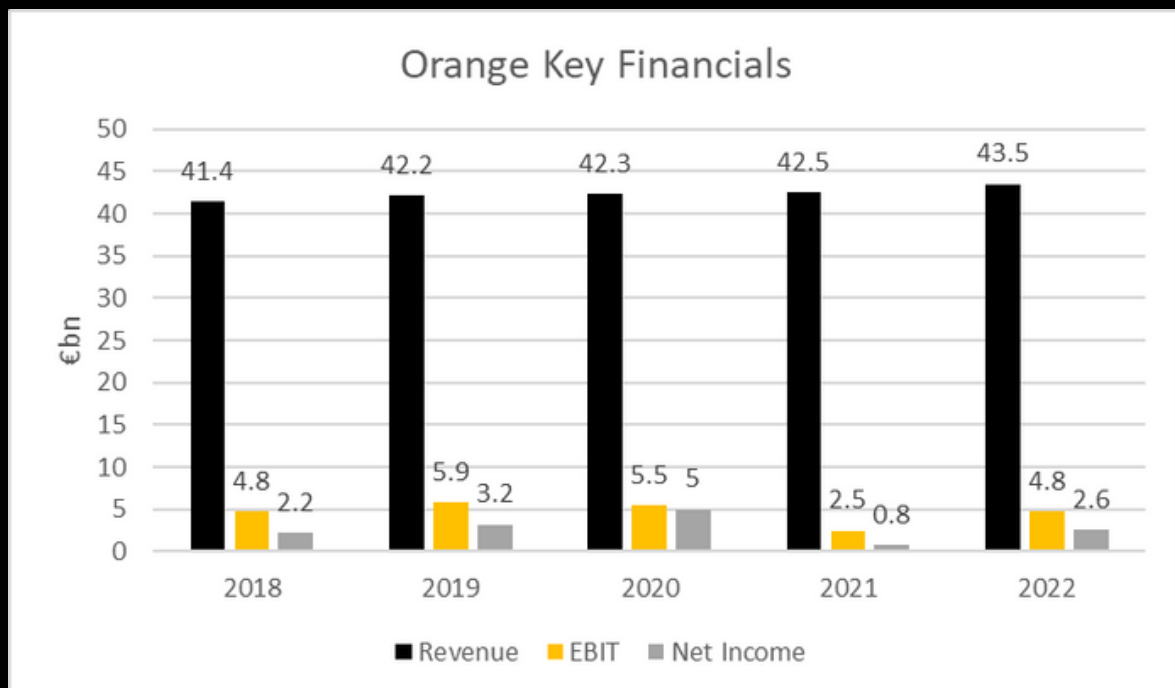
ESG PRACTICES

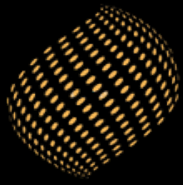
The business recently announced a new commitment to reduce CO2 emissions by 45% by 2030 as part of its new strategic plan, "Lead the future."

It also has a target to achieve net zero, with the aid of digital technology, by 2040, 10 years ahead of the rest of the telecom sector. As part of this, Orange aims to accelerate the deployment of its recycling programme for mobile devices in Europe, increasing this from around 23% today to 30% by 2025.

33% of managers at Orange are women according to a recent update by CEO Christel Heydemann. With a target set in 2019 of 35% of women in positions of responsibility by 2025, this is looking like it will be achieved.

KEY FINANCIALS





TARGET OVERVIEW

MASMOVIL®

Ticker: MAS

MASMOVIL

The MasMovil Group is a Spanish telecommunications business that offers landline, mobile, broadband, and TV services to residential customers and businesses through its 12 brands. Founded in 1997 by CEO Meinrad Spenger, the business is one of the largest telecommunications operators in Spain. The Group has over 15 million customers, with its 4G and 5G mobile networks covering 98.5% and 54% of Spain's population, respectively.

BUSINESS MODEL

As a telecoms operator, MasMovil splits its operations into telecommunications services to end users, both residential and business, interconnection and roaming services to other operators, and trading services to wholesale customers. On top of this, the MasMovil Group further has its own infrastructure and agreements with other operators that provide it with a fixed fibre network with access to more than 26 million homes.



Source: Pixabay



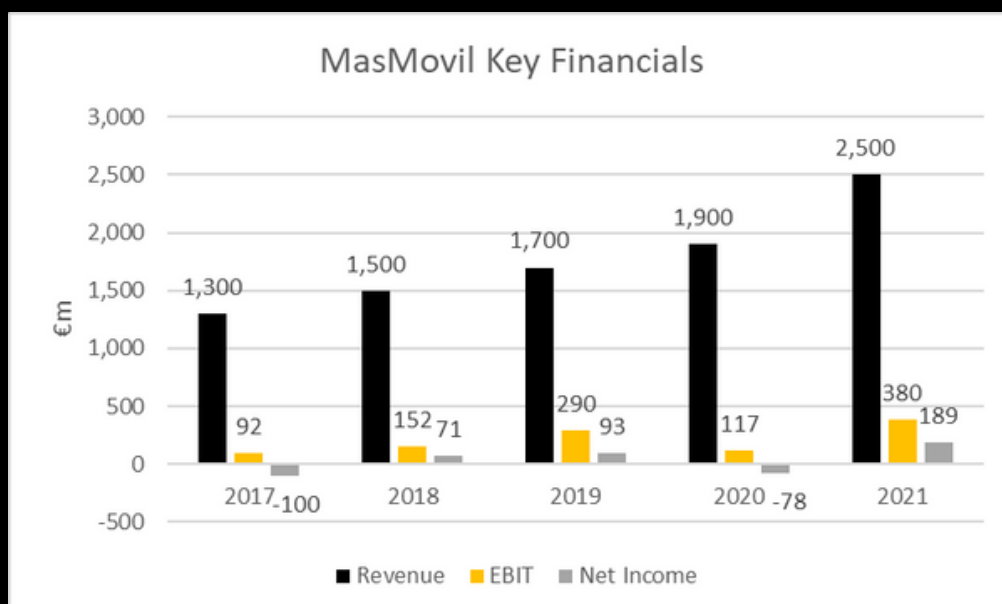
ESG PRACTICES

In 2021, MasMovil became the first European telecommunications operator and the largest company in Spain to obtain a B Corp Certification, while the year also saw the business become the first European operator to achieve net zero emissions of CO₂, with emissions level of just 1,715 tons of CO₂ equivalent.

On top of this, 100% of the electricity used by MasMovil is from renewable sources. And the Group has also taken strides to improve the efficiency of its mobile network via sharing networks with other operators to avoid overlapping alongside modernising equipment to mitigate environment impacts.

More widely, the business has also adopted five key pillars as part of its ESG Strategy Plan and in line with the UN SDGs, including the likes of environmental management & sustainability and employee engagement, culture, equality & diversity.

KEY FINANCIALS





DEAL ANALYSIS

STRENGTHS

- **Strong brand presence:** Orange is a well-established brand in the Spanish market, and MasMovil has a growing presence. The combined strength of these two brands can create a powerful presence in the market.
- **Increased market share:** The merger between Orange and MasMovil will result in a larger combined market share in the Spanish telecommunications market, which can improve their competitiveness.

WEAKNESSES

- **Integration challenges:** Merging two companies with different cultures, processes, and systems can lead to integration challenges, which may affect customer service and lead to delays and operational inefficiencies.
- **Regulatory hurdles:** The merger may face regulatory hurdles and scrutiny from competition authorities, which can result in delays and additional costs.



Source: Pixabay



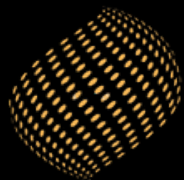
DEAL ANALYSIS

OPPORTUNITIES

- **Growth potential:** The merger can provide opportunities for growth through expanding into new markets and offering new products and services.
- **Improved customer experience:** The combined resources of the two companies can improve the customer experience through enhanced services and greater efficiency.

THREATS

- **Competition:** The telecommunications market in Spain is highly competitive, and the merger may not be enough to compete with other major players.
- **Economic uncertainty:** The economic environment in Spain and globally is uncertain, which can affect consumer spending and demand for telecommunications services.
- **Technological disruption:** The telecommunications industry is constantly evolving, and the emergence of new technologies and disruptive players can pose a threat to established companies.



VALUATION ANALYSIS

DISCOUNTED CASH FLOW ANALYSIS (DCF) (ORANGE SPAIN)

ENTERPRISE VALUE *

		Terminal Growth Rate				
		0.5%	1.0%	1.5%	2.0%	2.5%
WACC	7.5%	63,171	66,606	70,615	75,357	81,050
	8.0%	58,994	61,901	65,258	69,175	73,808
	8.5%	55,339	57,824	60,665	63,945	67,773
	9.0%	52,114	54,256	56,685	59,461	62,666
	9.5%	49,247	51,107	53,201	55,574	58,288

EQUITY VALUE PER SHARE

		Terminal Growth Rate				
		0.5%	1.0%	1.5%	2.0%	2.5%
WACC	7.5%	14.10	15.38	16.87	18.64	20.76
	8.0%	12.55	13.63	14.88	16.34	18.06
	8.5%	11.18	12.11	13.17	14.39	15.81
	9.0%	9.98	10.78	11.69	12.72	13.91
	9.5%	8.92	9.61	10.39	11.27	12.28

EQUITY VALUE

		Terminal Growth Rate				
		0.5%	1.0%	1.5%	2.0%	2.5%
WACC	7.5%	37,873	41,308	45,317	50,059	55,752
	8.0%	33,696	36,603	39,960	43,877	48,510
	8.5%	30,041	32,526	35,367	38,647	42,475
	9.0%	26,816	28,958	31,387	34,163	37,368
	9.5%	23,949	25,809	27,903	30,276	32,990

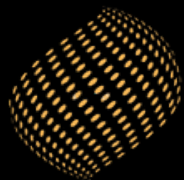
PREMIUM (DISCOUNT) TO CURRENT PRICE

		Terminal Growth Rate				
		0.5%	1.0%	1.5%	2.0%	2.5%
WACC	7.5%	29.6%	41.4%	55.1%	71.3%	90.8%
	8.0%	15.3%	25.3%	36.7%	50.1%	66.0%
	8.5%	2.8%	11.3%	21.0%	32.2%	45.3%
	9.0%	(8.2%)	(0.9%)	7.4%	16.9%	27.9%
	9.5%	(18.0%)	(11.7%)	(4.5%)	3.6%	12.9%

[Please click on the table to access full model.](#)

Based on the **WACC** assumption of 8.5% and **TGR** assumption of 1.5%, the share price for Orange was obtained to be €13.17, which represents a 21% premium compared to the current share price of €10.88.

As shown in the sensitivity analysis, the share price calculations appear to be sensitive to WACC and TGR assumptions, making the share price calculations to range between €8.92 (18% discount to current price) to €20.76 (90.8% premium to current price)



VALUATION ANALYSIS

DISCOUNTED CASH FLOW ANALYSIS (DCF)

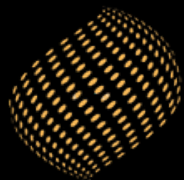
(MASMOVIL)

Enterprise Value	32,385,272
(+) Cash	152,495
(-) Debt	(7,293,838)
Equity Value	25,243,929
# of Thousands of Shares	2,051,173
Share Price	€ 12.31

[Please click on the table to access full model.](#)

Based on the WACC assumption of 11.9% and TGR assumption of 2.5% in the base case, the share price for MasMovil was obtained to be €12.31, indicating that the stock was trading at a premium of 45%.

When the assumptions on income statements are applied, the share price calculations range from €3.43 to €22.86, indicating that the market has been quite optimistic about MasMovil's financial performance since the stock was trading at €22.50 at the time of the deal announcement.



VALUATION ANALYSIS

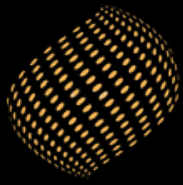
MERGER MODEL ANALYSIS

*all monetary information is expressed in € thousands (except share price and market cap)

Net income	16,813,717.00
Outstanding Diluted shares of combined company	2,789,370
EPS of combined company	6.0278
EPS of acquirer standalone	5.4929
Accretive/Dilutive	Accretive
Accretive/Dilutive	0.5349
Accretive/Dilutive (%)	10%

[Please click on the table to access full model.](#)

The merger model overall suggests a 10% **accretion** in the case of a merger since the combined company **EPS** appears to be greater than the standalone EPS of the acquirer.



CONCLUSION

IMPACT ON INDUSTRY

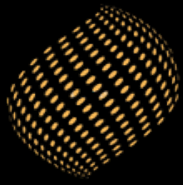
The merger of Orange and Mas Movil will continue the consolidation trend across the fragmented European telecoms market. The merger would increase market share and speed up the growth of the combined entity, creating a solid rival to market leader Telefonica.

In addition, the combined group would significantly improve Mas Movil's financial position and risk profile, allowing it to refinance portions of its significant debt burden and lower its cost of capital for future projects. Moreover, this deal would bring substantial **synergies** to Orange's operations, with due diligence showing potential synergies worth more than €450m per year by the fourth year post-closing. The deal includes a right to trigger an IPO under certain conditions for both parties and a path-to-control right for Orange to consolidate the combined entity further in the event of an IPO.

Ultimately, while the merger creates a more challenging operating environment for competitors such as Telefonica and Vodaphone, it is essential to note that if approved by the European Commission, the merger would open the market up to more M&A activity. Telefonica and other operators in Spain have argued for consolidation for years, viewing the fierce industry competition as a significant barrier to expansion and investment, making them strong supporters of this deal.



Source: Pixabay



GLOSSARY

Accretive: *Accretive in finance refers to the positive change in value after a transaction.*

EPS: *Earnings per share is a measure of a company's profitability, calculated by dividing quarterly or annual income by the number of outstanding stock shares.*

IPO: *Initial public offerings are a stock launch where the shares of a company becomes publicly available for investors*

Joint Venture: *An agreement where two businesses decide to combine their resources for a specific goal*

Leverage: *Leverage in finance refers to the debt used to undertake a project*

Synergies: *Synergies is a concept where the expected value of a combined company will be greater than the sum of the individual parts in each company.*

TGR: *Terminal Growth Rate is the rate that a company is expected to grow at forever based on the market and industry conditions.*

WACC: *Weighted average of cost of capital represents the cost of capital used to represent a firm's after-tax costs from all resources.*



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