VENTURE Insights

Consumers lose while the market wins: TPG and Vodafone merger

TPG and Vodafone announced the merging of the two companies to form a third major telco which will challenge leaders Telstra and Optus.

This move is positive news for the market as the likelihood of a mobile price war is expected to be reduced, stabilising ARPUs and margins.

However, consumers are going to miss out on what would have been aggressive mobile pricing from TPG to win market share.

Key takeaways

/ **TPG and Vodafone will merge to form a third full service telco provider in Australia with a combined enterprise value of A$15bn**

/ **The merged group will have 50.1% of its shares owned by Vodafone and Hutchison, and 49.9% by TPG shareholders.** Current TPG executive chairman David Teoh will be a non-executive chairman, while current Vodafone CEO Iñaki Berroeta will be the new CEO and managing director

/ **A combined Vodafone-TPG entity will be a stronger competitor to Telstra in the upcoming 3.6 GHz spectrum auctions,** and will accelerate both companies' plans for 5G deployment since TPG also brings small cell assets to the entity

/ **Whilst we expect market ARPU and margins to stabilise due to reduced competitive pressure,** we still expect the merged group to compete heavily with Optus and Telstra for mobile market share

/ **Our early market research is indicating 40% of respondents were aware of the TPG build with 18% of those wanting to move and another 30% waiting for TPG's plans.** Consumers will undoubtedly miss out on what would have been aggressive mobile pricing from TPG – however, they may benefit from a range of converged fixed and mobile products

TPG – Vodafone announce merger

TPG and Vodafone have formally announced that they are merging just a week after confirming to the media their intentions to combine in a "proposed merger of equals". This is a strategic complementary move by both companies to better challenge market leaders Telstra and Optus as a full-service telecommunications company. The merging of products and services from both TPG and Vodafone will create a stronger portfolio of solutions for consumers, SMBs and enterprises.

Key highlights

- New merged entity to be listed on the ASX as "TPG Telecom Limited"
- Combined enterprise value of A$15bn, with pro forma revenue of A$6bn and EBIDTA A$1.9bn
- 50.1% of shares owned by VHA, 49.9% by TPG
- David Teoh to be a non-executive chairman, while Vodafone's current CEO Iñaki Berroeta will be chief executive and managing director
- Board of directors will include David Teoh, Iñaki Berroeta and two directors each from TPG, Hutchinson Australia, Vodafone Group and independents

Figure 1. Comparison of key metrics

	Telstra	Singtel Optus	TPG / Vodafone
Enterprise value (A$bn)	51.0	58.5	15.0
Mobile market share (%)	~41%	~29%	~20%
Fixed line market share (%)	~51%	~17%	~22%

Source: ASX announcement

Our take

Merged Group

Market reaction to this announcement has been positive, with share prices of TPG and Hutchison Australia rising 21% and 50% respectively in the hours after the announcement. The general telco market also reacted positively with Telstra also experiencing a 4% increase in its share price. Overall, this merger of complementary companies will create a more stable competitive market, bringing together scale and efficiencies from both companies, including the leverage of complementary network assets, cross sell of products and services, rationalisation of duplicated costs and benefits from increased economies of scale.

A 50.1%-49.9% split between Vodafone and TPG suggests that this deal is driven by Vodafone and is a way of Vodafone acquiring the fixed broadband and enterprise service capabilities from TPG to become a strong challenger to Telstra and Optus. This view is supported by the agreement that Vodafone will continue to use their brand for 10 years on their products. The merged group will continue to trade on the ASX as TPG Telecom Limited.

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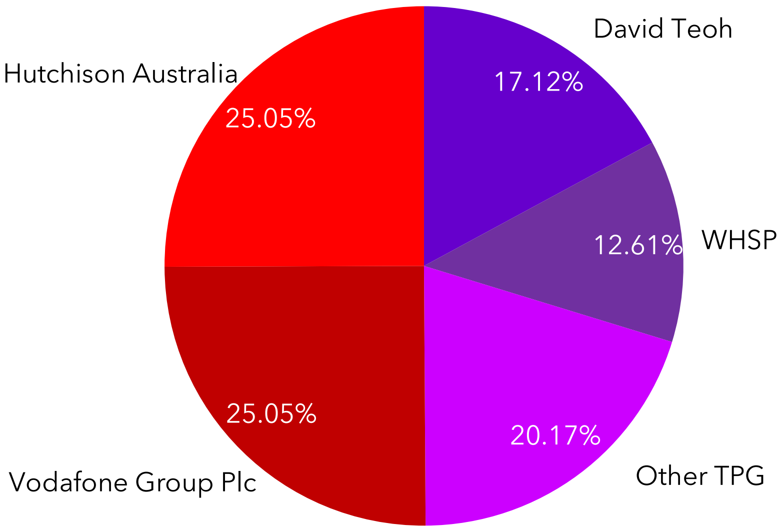
David Teoh handing the executive responsibilities to Iñaki Berroeta suggests that Vodafone's operations and public image may be key to sustaining customer numbers and delivering growth, while signalling the possibility that Mr Teoh may want to focus on the Singapore business as it rolls out its outdoor mobile network by the end of 2018.

Figure 2. Shareholder split for new merged group



Source: ASX announcement

The timing of this merger is interesting given the upcoming 3.6 GHz spectrum auctions, where both and TPG would have been participating in to acquire valuable spectrum for their upcoming 5G projects. There is no doubt the timing is driven largely by the intention of bidding as a single participant, which has been deemed the spectrum Joint Venture.

Market competition and impact on customers

ARPUs and margins have been declining in the telco market, but this merger between the two-leading challenger telcos may reduce ongoing pricing pressure. A reduction in churn is also likely as both Vodafone and TPG focussed on the value conscious market segments. This merging of value product providers will reduce the likelihood of a price war initially expected due to TPG's aggressive mobile entry and should stabilise key performance metrics, benefiting Telstra and Optus. Our early market research is showing about 40% of respondents are aware of the TPG network build with 18% wanting to move (predominately from Telstra and Optus) and another 30% waiting to see the plans. Unfortunately, it's consumers who will miss out on what would have been aggressive mobile pricing by TPG in order for it to win market share. However, we still expect strong competition from the merged group for mobile market share led by a value driven

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approach. Ultimately, this could then lead to an acceleration of innovation with the arrival of 5G and emergence of IoT as more capital will be available for investment.

For business and enterprise customers, this merger should also be seen as positive news as it means the arrival of another major telco offering business solutions and services. However, this move could potentially hurt smaller business telco providers who cannot offer as wide a range of products and services such as mobile or IoT solutions.

There has been no indication that current TPG and Vodafone products and plans will change, though overtime we expect plans from both brands to consolidate and remain innovative. Vodafone's licence to continue to use their brand for 10 years indicates that in the short to medium term, the merged group will continue to focus on targeting middle and budget customers.

Strategy

A merged group will lead to lower capex and operations costs, while also delivering more flexibility in consumer choice and possibly generating higher revenues through packaged products. The sharing of infrastructure assets will benefit both parties given Vodafone's relative strength in mobile and TPG's in fixed and fibre networks.

TPG's focus on building their $600m dense metro network is highly complementary of Vodafone's wider coverage. Given TPG's small cell focused metro network and that Vodafone has never announced significant small cell deployments, this merger also gives Vodafone swift access to small cell network capabilities. This will enhance their ability to complete with Telstra and Optus in metro areas where dense networks and high data usage are expected to accelerate with the arrival of 5G. TPG's Singapore division will be spun out as an independent business. With TPG Singapore rolling out a national outdoor mobile network to be completed by the end of 2018, an independent Singapore business will allow the rollout to progress as planned without interference.

Spectrum

The merged group will have a total of approximately 196 MHz of spectrum for the main metro areas of Sydney and Melbourne, which is the third most among the telcos, just behind Telstra. A spectrum Joint Venture (JVCo) will be formed which will register as a bidder for the upcoming 3.6 GHz spectrum auction in November this year. This has competitive implications, and as such the ACCC has stated that it will conduct a 12-week inquiry into the merger and the consequences for the spectrum auction. Originally designed under the assumption that TPG and Vodafone would bid separately, a joint participant changes auction dynamics and can affect pricing and the allocation of bands.

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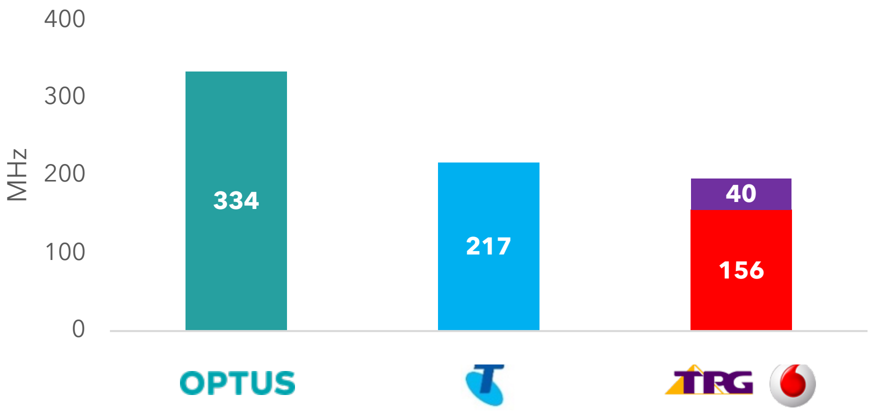
Figure 3. Estimated spectrum holdings in Sydney and Melbourne



Source: ASX announcement, Venture Insights

Currently, TPG and Vodafone do not have spectrum in the 3.6 GHz range, and together can be more competitive in the bidding process than if they were to bid separately. With their pooled resources, the JVCo should be able to acquire more of the priority bands up for auction than as individual bidders. For metro areas, Telstra is expected to be the main competitive bidder against the JVCo for 3.6 GHz in metro areas as Optus has already access to the maximum allowed limit of spectrum in that band. A stronger bidding competitor may also lead to increased spectrum prices which can set precedence for future spectrum auctions.

With their combined spectrum holdings, plus any additional spectrum they may acquire in the upcoming auctions, this merger will speed up both companies' roadmaps for 5G by allowing them to target customers in both metro and regional areas effectively and in a timely manner. This has the potential to bridge the gap between the leaders and challengers in the market, reducing the benefits of a first-to-market play by Telstra and Optus.

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