A tale of three telcos

Decline and fall

By Nigel Hawkins, Hardman & Co Infrastructure and Renewables Specialist

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Note: All prices are quoted at close of business on 23 April 2021

Executive summary

- For investors, the UK telecoms sector has presented immense challenges. Having boomed in the 1990s, mainly on the back of mobile telephony growth rates, telecom shares subsequently fell back sharply, as major debt concerns predominated. With Cable & Wireless (C & W) having exited, the UK sector now consists of little more than British Telecom (BT), privatised in 1984, and Vodafone, which was founded in the early 1980s.

- In 2000, the sector was riding high, with not just BT and Vodafone at its forefront, but also C & W – the child of empire – which was effectively dissolved almost a decade later. Record valuations at the turn of the century were achieved not least by Vodafone, which had been powered by phenomenal growth throughout the 1990s.

- The end of the C & W era, which had lasted for ca.150 years, was driven by the controversial decision in 2000 to sell its 54% stake in Hong Kong Telecom (HKT), which had accounted for around a third of its operating profits (after stripping out minorities), in 1998. Thereafter, on the back of some dreadful acquisitions, C & W went downhill quite quickly.

- BT, the poster-boy of privatisation, continues to struggle. Its share price is currently just 19% above its 130p fully paid launch price in 1984, while its underlying EBITDA, once adjustments are made for the £12.5bn EE mobile telephony deal in 2016, has remained seemingly becalmed, at ca.£6bn p.a. Moreover, there was an emergency £5.9bn rights issue in 2001, while the current net debt figure of £18bn raises fears that another such issue may be on the cards.

- Vodafone was founded in the early 1980s. By 2000, it had become the fourth most valuable company in global history, fuelled by its growth throughout the 1990s – the decade of the massive £112bn Mannesmann acquisition. In recent years, Vodafone's strategy has been to rein in some of its overseas businesses, to focus more on cable deals, to grow its EBITDA and to cut its net debt, currently £38.4bn.

- In recent decades, other UK telcos have come to the stock market – and then have gone; they include Atlantic Telecom, COLT, Energis, Ionica, Kingston Communications (now KCOM), Telewest and Thus. Most of these stocks were one-time FTSE-100 members. Currently, there are no obvious pure telecoms companies set to take their places in the FTSE-100.

- Within the EU, many telecoms companies are also suffering, with only Deutsche Telekom, capitalised at €76bn, being an exception, despite a flat share price since 2002. Orange now dominates France Telecom and its growth prospects, while the formerly highly rated Telefónica has been adversely affected by declining earnings. Telecom Italia has suffered many reverses, both commercially and at the corporate level, including dissenting shareholders.

- The new telecoms environment is adjusting to the dominance of Apple's iPhones, with its many apps, and other similar devices. In the telecoms sector, investors need to move smartly. An investment in Nokia in mid-1996 and a well-timed switch into Apple in December 2007, for example, would have yielded returns of ca.300x over a 25-year period. The gain on Nokia shares in the 11 years would have been almost 16x and, over the past 14 years, during which time Nokia's shares have fallen by 87%, Apple's shares have risen by 19x.

Background

Privatisation took off in 1980s

The privatisation policy of the 1980s began shortly after the election of the Conservative Government in 1979. One of the earlier disposals was the sale of the government's residual stake in C & W.

Sale of BT in 1984 was pivotal

However, it was the far more high-profile majority stake sale of BT in 1984 that really attracted attention, since it was slanted specifically towards private investors. As such, it was the first major sale of the privatisation era – which stretched broadly from the early 1980s to the mid-1990s.

Undoubtedly, this initiative attracted serious competition – but in an unexpected way. While Mercury Communications, a C & W subsidiary, had been lined up to take on BT, the real threat only became evident some years later. While BT had its own mobile telephony business – Cellnet, later to become O2 – the advance of Vodafone in its successful quest to become the world's number one mobile phone company cost BT dear.

Three differing fates

In the intervening decades, BT has faced a raft of challenges, many of which – even today – remain unresolved, while Vodafone's pedestal, like its share price, has undoubtably slipped in recent years. Plus, C & W has been dismantled at a fraction of its former value.

Cable and Wireless – a tale of woe

CABLE & WIRELESS

C & W was established via various companies involved in laying the transatlantic cable in the 1860s, using the famous Great Eastern steam ship, designed by the legendary engineer, I.K. Brunel. Subsequently, C & W established itself throughout much of the fifth of the world's land mass that comprised the British Empire, including Hong Kong, whose core telecoms business sustained the group until its sale in 2000.

The child of empire

Mercury lined up to compete with BT

Having sold off its residual C & W stake in the early 1980s, C & W's Mercury business was restructured, with the aim of it becoming a credible competitive force to BT – a role that was eventually assumed by Vodafone and other mobile players.

Hong Kong Telecom drove C & W's numbers

Prior to the HKT sale to PCCW, C & W's operating profits summary for 1997/98, which is reproduced below, highlighted its financial dependence on HKT, although the 46% minorities stake (not deducted below) materially reduces this exposure.

Cable and Wireless – operating profit, 1997/98

Year-end March	£m	% of op. profit
Hong Kong	1,052	64%
Other Asia	14	1%
United Kingdom	238	14%
Other Europe	-15	-1%
Caribbean	278	17%
North America	48	3%
Rest of the world	36	2%
Total	**1,651**	**100%**

Source: Hardman & Co Research

Vindicated by subsequent political events?

While the sale of HKT may have looked like the beginning of the end for C & W, the reality was that the political environment in Hong Kong, following the UK's exit agreement with mainland China, meant that any long-term investment – as subsequent events have proved – was laden with risk.

Dire acquisitions record destroyed value

The real problem for C & W thereafter was its dreadful acquisitions record of buying mainly US-based technology businesses; a considerable part of the HKT proceeds was invested in these failing businesses, which included Digital Island and Exodus.

C & W's messy fate

It became clear, subsequently, that C & W's days as a thriving global telecoms business, valued at ca.£38bn in 2000 and just ca.£4bn nine years later, were drawing to a close. Eventually, the company was split up, with C & W Worldwide being acquired by Vodafone for ca.£1bn in 2012, while the Caribbean-based C & W Communications was eventually bought for ca.$7.4bn by Liberty Capital in 2016. A sad end to a company with a long, proud and distinguished history.

British Telecom – privatisation's poster-boy struggles

BT had to face the Vodafone upstart

Like Deutsche Telekom, France Telecom, Telefónica and Telecom Italia, BT was privatised – the first in the queue in 1984 – as the effective monopoly owner of the national telecoms network. The one salient difference was that BT had to face competition in its expanding mobile market from sector upstart, Vodafone. By contrast, the four leading EU telecoms companies had all established their own very strong mobile brands before any competitor was able to mount a serious challenge.

BT's gold-plated inheritance…

As such, for much of its 37 years as a quoted telecoms company, BT has faced challenge after challenge – and, often, has not responded well. After all, it inherited most of the UK telecoms network at privatisation in 1984 – its absence from Hull and the presence of privately owned networks being notable exceptions.

…but a raft of challenges

The most serious of the challenges faced by BT have included:

- **Mobile telephony:** The seemingly inexorable rise of Vodafone – effectively from a standing start in the early 1980s – in the rapidly expanding mobile telecoms market inflicted real damage on BT's growth prospects, something that Deutsche Telekom, for example, did not face in Germany.

- **The emergence of Apple's iPhones:** The massive demand for these and related products has dramatically changed the nature of the communications market and seriously impaired BT's growth prospects.

- **Lack of EBITDA growth:** For around a generation, BT's adjusted EBITDA has been seemingly becalmed at ca.£6bn p.a., once allowance is made for the additional debt taken on to finance the EE deal.

- **Cashflow deficits:** BT has faced various cashflow issues, not least in 2001, when it had to launch a record-breaking £5.9bn rights issue; even today, with net debt of £18bn – more than its current market capitalisation – and a formidable broadband investment programme to finance, this issue has resurfaced.

- **Regulation by Ofcom:** Having been allocated an RPI-3 pricing formula (for most of its core services) at flotation, regulatory involvement in BT's affairs has become more invasive; the current – as yet, not fully agreed – rate of return debate for its planned nationwide fibre-optic broadband ramp-up is a case in point.

- **Pension deficits:** The perennial theme of BT's burgeoning pension deficit deters potential shareholders. Despite periodic cash injections from BT, the pension deficit issue seldom seems to go away.

- **A bloated cost base:** At flotation, BT had a high cost base; despite various cost-cutting initiatives, this issue persists and regularly offsets any revenue growth benefits.

- **Global division shortcomings:** BT has sought to expand overseas, with few obvious benefits and many shortcomings; its global division has undertaken various writedowns, including the £530m losses sustained by BT Italia in 2017.

- **Demand for broadband investment:** Politicians – perhaps unsurprisingly – are virtually unanimous that a speedy rollout nationwide of fibre-optic cable to modernise the UK's broadband network is urgently required. BT has invested heavily in this area but, to complete, it will require very substantial financial resources in coming years.

- **Poor acquisitions:** BT's acquisition record is a poor one, so much so that investors generally expect BT to focus almost exclusively on the UK – deals, such as buying Germany's Viag Interkom, for example, benefited neither BT's finances nor its shareholders.

Lamentable return

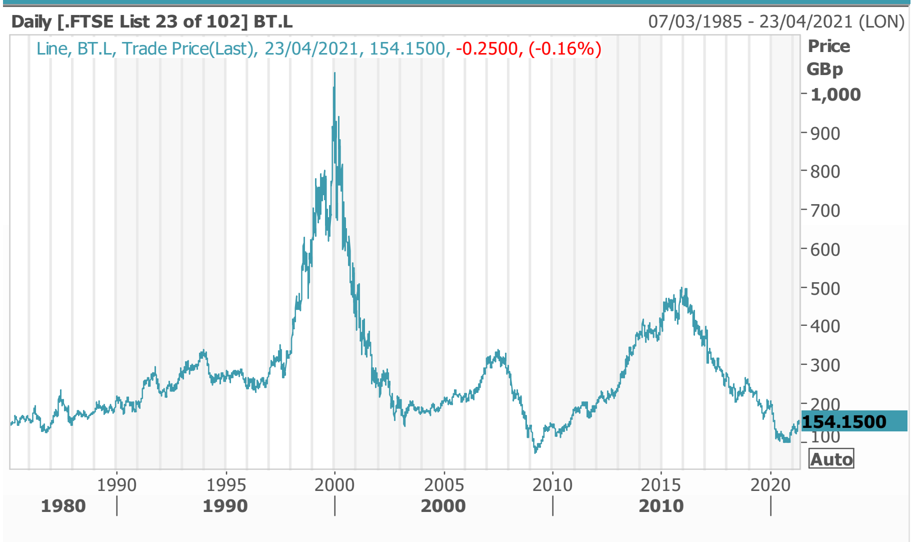
Even before adjusting for the £5.9bn emergency rights in 2001, BT's share price today, at 155p, is little above the 130p fully paid issue price in 1984 – a lamentable return for long-term equity investors.

While BT has paid decent dividends until quite recently, the overall verdict is that investing in BT will not have been very profitable, unless such investment was made during the boom period between 1997 and 1999, when its shares soared. There were also mini share price rallies for BT in 2007 and 2015.

Dreadful share price performance over past five years

Since their peak in 2000, BT shares have lost ca.85% of their value, as the share price graph below shows.

BT – share price performance, March 1985 to April 2021



Source: Refinitiv

KPIs going in wrong direction

The recent weakness in BT's share price is broadly explained by its five-year record since 2015/16, which shows that all the key financial variables have been going in the wrong direction – most notably, dividend per share, which has been cut sharply, due partly to COVID-19.

BT – financial summary over past five years

Year-end Mar (£bn)	2015/16	2016/17	2018/19	2018/19	2019/20
Revenues (adj.)	18.9	24.1	23.7	23.5	22.8
Operating costs (adj.)	15.1	19.9	19.8	19.6	19.2
Operating profit (adj.)	3.8	4.1	4.0	3.8	3.6
Profit before tax (adj.)	3.4	3.5	3.4	3.2	2.9
EPS (p per share, adj.)	31.8	28.9	27.9	26.3	23.5
DPS (p per share, adj.)	14.0	15.4	15.4	15.4	4.62

Source: BT plc

The broadband rollout programme

In terms of broadband investment, and following prolonged negotiations with Ofcom, BT will be undertaking a massive rollout of fibre-optic installations under its Fibre to the Premises (FTTP) programme. BT recently confirmed "its plan to build FTTP to 20m premises by mid to late 2020s". Nevertheless, the precise financial arrangements of this proposed investment remain unclear.

A long haul to recovery

More generally, to rediscover its growth profile, let alone to approach its share price rating in 2000, will require a prodigious effort, especially on behalf of BT's core business, Openreach – it will be a long haul, unless a potential bidder intervenes.

vodafone

Vodafone – the glamour fades

Bred in the Racal stable in 1982

Vodafone's origins date back to the early 1980s, when it emerged as Racal Telecom, a subsidiary of Racal, a leading electronics company of the day; the former's founding slightly pre-dated the privatisation of BT. In 1991, it was demerged from Racal and separately quoted on the London market as Vodafone. During the 1990s, its year-on-year growth was phenomenal as mobile telephony boomed.

To Germany and to Mannesmann

In 1998, Vodafone undertook one of the largest acquisitions in corporate history, when it acquired the German-based Mannesmann for £112bn – a deal that, in retrospect, looks to have been severely over-priced. However, Vodafone's share price – at least initially – reacted positively.

To fourth most valuable company in history within a generation – quite remarkable

By 2000, and within just ca.18 years of its founding, Vodafone had become the fourth most valuable company in global history; only Microsoft, Cisco and General Electric (GE), all US-based, commanded a higher market value at the time than Vodafone.

GE shares have plummeted too

In the intervening period, Vodafone has lost around two-thirds of its share price value, although the plunge of the venerable GE – the company co-founded by Thomas Edison and, for decades, the bellwether of US industry – has seen its shares fall by more than 75% since 2000. Indeed, the latter figure incorporates the doubling of GE's share price over the past year.

£84bn Verizon Wireless sale

In recent years, Vodafone has cut back its near global footprint, most notably in 2013, when it sold its 45% stake in the US-based Verizon Wireless for £84bn. Instead, it has re-focused on the developing cable sector and on increasing its stalled EBITDA.

EBITDA is flat-lining

Unquestionably, growth in recent years has been elusive, with adjusted EBITDA being comparatively flat, at ca.€14bn, between 2015/16 and 2019/20; nor have revenues increased markedly.

The table below shows Vodafone's key financial data since 2015/16, although due allowance needs to be made for the exit from the Indian businesses since 31 August 2018 and for the Liberty Global acquisition, which had a material impact on the accounts as from 31 July 2019.

Key financial data for Vodafone, 2015/16 to 2019/20

€bn	2015/16	2016/17	2017/18	2018/19	2019/20
Revenues	49.8	47.6	46.6	43.7	45.0
EBITDA	14.2	14.1	14.7	13.9	14.9
Operating profit (loss)	1.3	3.7	4.3	-0.9	4.1
Profit before tax (continuing operations)	-5.1	-2.0	4.8	-4.1	-0.5
EPS (continuing operations, € per share)	-20.3	-7.9	15.9	-16.3	-3.1
DPS (€ per share)	14.48	14.77	15.07	9.00	9.00
Net debt	36.9	31.2	31.5	27.0	38.4

Source: Vodafone plc

Germany and the Mannesmann legacy

Vodafone's revenues and adjusted EBITDA for its core markets in 2019/20 are shown below. It is noticeable that Germany – accounting for 34% of adjusted EBITDA – is the key market; this is a legacy of the Mannesmann deal.

Vodafone – key figures (2019/20)

Year-end March (€bn)	Revenues	Adj. EBITDA	EBITDA share
Germany	10.7	5.1	34%
Italy	4.8	2.1	14%
United Kingdom	5.0	1.5	10%
Spain	3.9	1.0	7%
Other Europe	4.9	1.7	12%
Vodacom (data)	4.5	2.1	14%
Others	4.1	1.4	9%
Total	**37.9**	**14.9**	**100%**

Source: Vodafone

2020/21 EBITDA projections

Looking forward, Vodafone will be focusing on the cashflow from its key markets. It is projecting EBITDA for 2020/21 at a slightly lower level – between €14.4 bn and €14.6bn – than the €14.9bn for 2019/20, mainly because roaming revenues, due to COVID-19 travel constraints, have been severely affected.

(Ad)vantage Vodafone

Vodafone's cashflow profile should also be boosted by the recent IPO in Germany of Vantage Towers, which operates ca.68,000 macro towers across nine countries. Following its recent minority stake sale, Vodafone's retained stake still exceeds 80%; part of the proceeds from this IPO will go to paying down Vodafone's high net debt.

Other UK telcos – the "disappeared"

Vanishing FTSE-100 stocks of old

A generation ago, there were many quoted UK telcos. Apart from BT and Vodafone, they included Atlantic Telecom, COLT, Energis, Ionica, Kingston Communications (now KCOM), Telewest and Thus. Most of these companies were one-time FTSE-100 members.

Excess net debt did for many of them

Most of the "disappeared" were absorbed by other telcos, often because their finances had become too stretched; both Energis and Thus, for example, were absorbed by C & W. At one time, most had grandiose expansion plans, with COLT building out in a raft of leading EU cities, Energis expanding aggressively into Germany, and Telewest cabling large chunks of the UK. In the latter's case, its debt mountain effectively meant its end as a quoted independent company.

Ionica, too, which deployed innovative wireless "local loop" technology, had high hopes – these were dashed as it failed to secure sufficient financial backing.

BT/Vodafone aside, a very thin sector representation nowadays

This scenario leaves just three mainstream telecoms companies – the third is the relatively small Telecom Plus – that are quoted on the main Stock Exchange. There are, though, some telecoms/technology companies on AIM that may, in time, be promoted to the main market.

EU telcos

Growing EBITDA pushed bull case in 1990s…

In the 1990s, many EU telecoms were privatised and, as the mobile telecoms sector took off, achieved very aggressive valuations, based on a rapidly expanding customer base, growing EBITDA numbers and impressive rollouts of mobile networks.

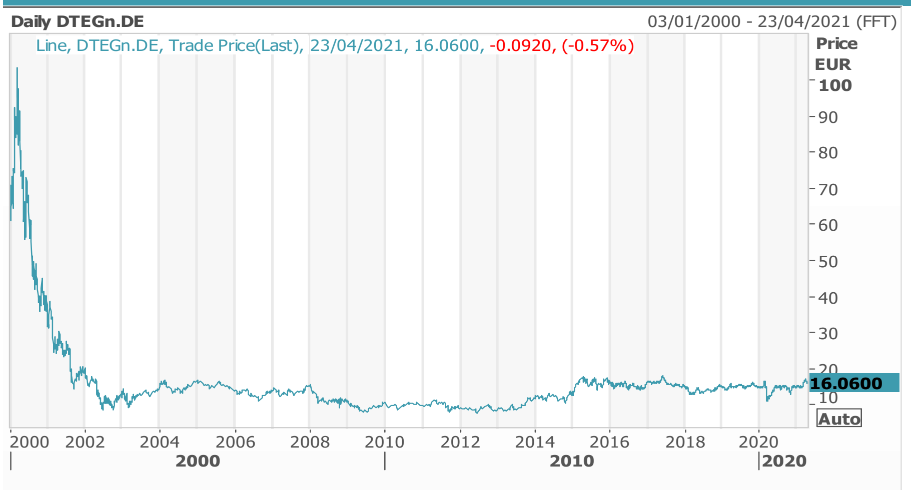
…while growing net debt pushed bear case in 2000s

However, from 2000 onwards, the worm turned. Debt levels soared – to the consternation of many investors – and valuations fell.

Deutsche Telekom's share price been flat as a pancake for a generation

An obvious case in point was Deutsche Telekom, now by far the most valuable of the privatised EU telcos. Until 2000, its share price had soared. Subsequently, it has been as flat as the proverbial pancake; the graph below illustrates this point.

Deutsche Telekom – share price performance, January 2000 to April 2021



Source: Refinitiv

This very pronounced downward trend has been emblematic of the sector: Orange, the owner of France Telecom, and Telefónica – once a high-riding stock – have suffered similarly. In Telecom Italia's case, it has been riven by major shareholder disagreements for years.

EU telcos – market capitalisations at 23 April 2021

	(£bn)
Deutsche Telekom	66.3
Vodafone	37.5
Orange (France Telecom)	23.8
Swisscom	19.4
Telenor	18.6
Telefónica	17.7
British Telecom	15.2
Telia	12.2
KPN	10.7

Source: Bloomberg

Nokia's collapse, despite 40% market share of mobile phone sales

One of the most dramatic telecoms collapses in recent years has been that of Nokia, the much-lauded mobile phone company from rural Finland that, by 2007, had secured a 40% global market share in handsets. Thereafter, it has been downhill all the way, with Nokia's current share price being 95% off its peak in 2007.

A fund manager's dream – into Nokia in mid-1996 and then a switch into Apple in 2007

Indeed, one of the great investor coups would have been to buy Nokia shares in mid-1996 and then to switch into Apple shares in mid-2007. The Nokia investment would have delivered a return of almost 16x over 11 years. Since mid-2007, shares in Nokia have fallen by 87%, while those in Apple have risen by 19x. Compounding the near 16x rise in Nokia's shares with a 19x rise in Apple's shares over a 25-year period would have generated a ca.300x return – and would have been an ambitious fund manager's investment dream.

Conclusion

A roller coaster ride

Long-term telecoms investors are likely to have experienced a roller coaster ride, with shares soaring in the lead-up to the new millennium. Then the boom times came to an end, although there was a pronounced rally in some telecom stocks before the financial crash in 2008/09.

Thereafter, a combination of iPhone sales, falling mobile telecoms growth, tighter regulation and high debt levels has curtailed the sector's expansion.

Reversing this trend will be a long haul. Even shares in the EU's most valuable telecoms business, Deutsche Telekom, have flatlined since 2002.

Apple and others in new financial league

Since 2000, each of C & W, BT and even Vodafone have really struggled, while shares in major US tech stocks, such as Apple, have moved into another trillion-pound financial league altogether.

About the author

Nigel Hawkins is the Infrastructure and Renewables Specialist at Hardman & Co.

Nigel specialises in the energy sector, with a particular focus on the expanding renewable generation market, both in the UK and overseas, about which he has written several reports assessing the sector's finances. He has been involved in analysing the utilities sector since the 1980s. He covered the privatisation of the water and electricity companies for Hoare Govett between 1989 and 1995. Subsequently, he researched the UK and EU telecoms sector for Williams de Broe. He has also written many feature articles for Utility Week magazine since the mid-1990s. Between 1984 and 1987, Nigel was the Political Correspondence Secretary to Lady Thatcher at 10 Downing Street. Nigel joined Hardman & Co in February 2016. He holds a BA (Hons) in Law, Economics and Politics from the University of Buckingham and is a senior fellow of the Adam Smith Institute.

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research@hardmanandco.com

1 Frederick's Place
London
EC2R 8AE

+44(0)20 3693 7075

www.hardmanandco.com