TELECOMMUNICATIONS

Sectorial Note

Consolidation process in the industry continues

- **In the short run, Axtel might sell assets that include mass market operations and a long distance back-bone with several metropolitan loops and optic fibers**
- **Grupo Televisa is still analyzing strategic options, especially the strengthening of content and distribution as it happens in other regions, along with assets sale**
- **While, Megacable remains a potential consolidation target due to its extensive network, solid cash flow generation and a debt-free balance sheet**

Factors that will change Mexico's telecomm environment. Mexico's telecommunications sector is led by *América Móvil*; nonetheless, its competitors have found niche markets both in the business segment and residential segment, where competitors have managed to obtain a relevant customer base. Despite this, AMX continues to be treated as a preponderant economic agent by the Federal Institute of Telecommunications (IFT by its Spanish acronym), a regulatory entity; due to its high market share in both the land-line and mobile segments. In our view, medium-term factors that could cause a layout change in the telecommunications sector in Mexico are: (1) pressure on profitability due to competition and regulation; (2) obtaining of economies of scale and services convergence; (3) deployment of the Shared Network; and (4) unbundling of the preponderant operator's local network.

Meanwhile, in the short term, *Axtel* and *Grupo Televisa* stand as companies whose news could refashion the telecomm sector's map. On the other hand, *Megacable* remains an acquisition target.

IFT seeks to create an environment of greater convergence with the unbundling of Telmex's local network. IFT's main target is to foster convergence of services in order to increase competition and reduce prices in all segments of the telecommunications market. In that sense, the most relevant actions of the IFT are: (1) unbundling of Telmex' local network y (2) development of a Shared Network. The unbundling of local networks seeks to allow the resale of land-line services at the national level, by using Telmex' local networks. Thus, some companies would be able to complete their service offerings. From our point of view, companies such as SKY and Dish would be the most benefited from the unbundling as they could offer a triple-play package service while other companies could extend their networks' coverage. In recent days, the public consultation period of the reference unbundling offer (RUO) 2019 concluded with several comments from operators in regards to

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Axtel	**Buy**
Current Price	$3.81
TP 2018	$5.30
Potential Return	+39.1%
FV/EBITDA LTM	5.5x
FV/EBITDA 2018e	5.4x

Mega	**Buy**
Current Price	$87.30
TP 2018	$92.00
Potential Return	+5.4%
FV/EBITDA LTM	8.9x
FV/EBITDA 2018e	8.2x

Tlevisa	**Buy**
Current Price	$69.53
TP 2018	$81.00
Potential Return	+16.5%
FV/EBITDA LTM	8.2x
FV/EBITDA 2018e	7.7x

the Electronic Management System and the rates proposed by *América Móvil.*

The Shared Network would boost the coverage of mobile services. *Altán Redes*, a group of private investors along with minority interests of Axtel and Megacable, was the successful candidate of the bidding process to develop, manage and operate the Shared Network for a period of 20 years. The concession specifies that the Shared Network must have a 92.2% coverage in terms of the population with telephony and mobile broadband services with 4G technology, to be used by other operators. The government granted *Altán* the right to use 90MHz of the 700MHz spectrum and a pair of fiber optic wires in the CFE network with an approximate extension of 36,000 km.

This Shared Network will allow the launch of mobile telephony services by some companies under the figure of Mobile Virtual Network Operator (MVNO) and for existing mobile operators is an alternative to increase the scope and capacity of their 4G networks at lower prices. At the moment, *Altán* has coverage of 30% in terms of population; the next goal is to cover of 50% by 2019, to gradually reach the goal of 92.2% by 2023.

We consider that AT&T and *Telefónica* could be the main customers of the Shared Network as this will be an alternative to extend the coverage and capacity of their mobile networks. Additionally, land-line service operators such as *Axtel*, *Megacable* and *Izzi* and the satellite TV companies, Dish and SKY, could become *Altán* customers, under the Mobile Virtual Network Operator figure.

Consolidation in the telecommunications sector seems likely, especially amidst a more competitive environment, as companies would seek to generate synergies and economies of scale to maintain profitability. As we previously, *Axtel* and *Grupo Televisa* could provide news in this regard very soon.

***Axtel* is undergoing an assets detachment process for sale.** Prior to the merger between *Alestra* and *Axtel*, both companies operated independent networks. The integration of these companies increased the coverage and redundancy of the networks, which is why *Axtel* recently focused its efforts on optimizing traffic by unbinding several segments of the network. Moreover, *Axtel* detached mass-market-focused operations, which include fiber optic networks in 10 cities with an approximate extension of 6,200 km. These initiatives give *Axtel* the possibility of monetizing a parallel Long Distance network with an approximate extension of 9,300 km coupled with 6,000 km of metropolitan loops and 4 fiber optic cables.

Recently, *Axtel* sold 154 telecommunications towers to a subsidiary of American Tower Corp for an approximate amount of USD $61m. These resources were used to reduce leverage. At the end of 2Q18, Net debt to EBITDA ratio stood at 3.6x, it is worth remembering that the company aims to reduce its leverage to a 2.5x level, in line with the policies of *Alfa's*, its main shareholder. From all Mexico-based companies, we believe that AT&T

could be interested in the parallel network and to a lesser extent in the mass market customer base, although *Telefónica* could not be ruled out.

Our Axtel projections model does not incorporate resources from the sale of the parallel network nor from the mass segment business, thus, some news in this regard would be supplemental for our estimates and positive for the share price. For 2018, we expect consolidated revenues of MXN $15.5bn which would represent a marginal decrease vs. 2017 while at the EBITDA level, we forecast MXN $5.5bn equivalent to a margin of 35.3% (+20bp vs. 2017). At the current price of MXN $3.81, Axtel trades at 5.4x FV / EBITDA 2018e, and with our target price of MXN $5.30 the multiple would be placed at 6.2x. We hold our BUY recommendation stemmed from the attractive appreciation potential.

Grupo Televisa* is studying several strategic alternatives to create value for its shareholders.** *Televisa* is the company that could most influence the reshape of Mexico's telecommunications sector since it has operations in the land-line segment through *Izzi* and in satellite TV with SKY, being one the leading companies in these segments. During the 2Q18 conference call, Alfonso de Angoitia, co-CEO of *Grupo Televisa*, mentioned that the company is analyzing various strategic alternatives derived from the latest transactions among content and distribution companies in the US. **This could be a transcendental decision for *Televisa as it could opt for a spin-off of assets if they believe that parties have a greater value vs. holding operations with the current structure. Management is expected to make a decision before the end of 2018; this could be a driver for the share price if accomplished.

***Televisa's* options aimed to reshape the telecommunications sector.** Several market participants have speculated about the likelihood that *Televisa* will sell its 58.7% stake in SKY to AT&T, who owns the remaining 41.3%. Should *Televisa* were to sell its stake, the company would be in a better financial position to make relevant acquisitions and consolidate the cable segment without opposition from the regulatory authorities of the sector. At the end of 2Q18, SKY had 7.96 million subscribers, LTM revenues of MXN $22.1bn and EBITDA of MXN $9.9bn, which is equivalent to a margin of 45% (we have to remember that the company recorded additional expenses for the Soccer World Cup broadcasting during such period).

We believe that ***Megacable*** is the only company that could give *Televisa* a national scale, since they have highly complementary networks. A joint venture would represent a more efficient competition vs. *América Móvil* on the business and residential segments. Additionally, *Televisa* could improve the resulting company's profitability by generating economies of scale as well as costs and expenses synergies.

As of 2Q18, the Revenue Generating Units (RGU) base of *Televisa's* cable operations closed at 10.7 million, generating LTM revenues of MXN $34.4bn and an EBITDA of MXN $14.6bn with a margin of 42.4%. On the other hand, *Megacable* wrapped the quarter up with a RGU base of 7.6 million, LTM revenue of MXN $18.5bn and a MXN $8.7bn EBITDA, to a margin of 46.9%. The combination of these companies could generate value to its shareholders although everything will depend on the valuation at which the transaction would be carried out. According to Bloomberg's consensus, the average of comparable peers is a LTM FV / EBITDA of 9.2x vs 8.9x of *Megacable* and 8.2x of *Televisa*. A composite company would have 18.3 million RGU, revenues of MXN $ 52.9bn and an EBITDA (prior synergies) of MXN $23.3bn equivalent to a margin of 43.9%.

***Televisa's* financial position could ameliorate in the short term with the sale of non-relevant assets.** At the beginning of 2018, *Televisa* announced the sale of its 19% equity stake in *Imagina* for an amount of €284m in addition to its 50% stake in CJ Grand, a TV shopping channel. During the 2Q18 conference call, management mentioned that were examining a possible sale of other businesses such as Games and Raffles, Radio, Publishing and Distribution of publications. After the latest quarterly figures, *Televisa's* ND / EBITDA ratio is at 2.4x and with our 2018 estimates this ratio could decrease to 2.1x. However, our model does not consider sales of additional assets.

As for *Televisa's* shares, we hold a BUY rating and a TP2018 of MXN $81. This target price implies that the stock would trade with a FV / EBITDA multiple 2018e of 8.6x.

***Megacable* shows a favorable outlook.** *Megacable* is a best-liked for us within the telecomm sector. Our team has it under coverage due to its attractive organic growth and healthy financial structure. The generation of cash flow, the extension of its network and a debt-free balance sheet produce an attractive consolidation target.

For *Megacable* shares, we hold a BUY recommendation with a TP2018 of MXN $92; this price would imply a FV / EBITDA multiple 2018e of 8.6x.

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HOLD	*When the share expected performance is similar to the MEXBOL estimated performance.*
SELL	*When the share expected performance is lower than the MEXBOL estimated performance.*

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