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The road to year-end

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With a global pandemic, major geopolitical developments, bankruptcies, landmark legal events in europe and a global recession, the first half of 2020 packed in more than the last decade... And there's still another half to complete. Melanie Mingas explores the outlook to year end and the factors that could shape the industry.

Could Europe become a hotspot for M&A activity?

Mergers and acquisitions (M&A) are a natural part of recession and, with many major economies across the world now in one, the likelihood of M&As will only increase.

"Absolutely! In traditional industries, the corona-crisis will have a major negative impact on EBITDA," says Anders Borg, senior adviser to IPsoft and Sweden's former minister for finance.

"This may force companies to undertake urgent strategic reviews. In many sectors, not least financial and telecoms, competition from both start-ups and tech giants is pushing new thinking and breaking down barriers. Therefore, incumbent companies may look to merge and revitalise their businesses via closer ties with digital leaders," he adds.

Yet, events in Europe in H1 could see a global trend take a local angle, after the European Commission u-turned on its decision to block Hutchison's Three from merging with Telefónica's O2.

"The clear overall takeaway is that this u-turn makes it easier to get deals past merger watchdogs, making the EU more attractive for global telco deal-making," says Virna Rizzo, from law firm Cohen

Amir-Aslani, Globalaw. The result, she adds, is that it could be harder for the commission to block transactions on competition grounds, even in cases where the market is already “relatively concentrated”.

She continues: “The judgment will have significant implications regarding the circumstances in which the Commission can decide to prohibit transactions that do not create or strengthen a ‘dominant’ player. However, given the implications for merger control policy, and the legal test to be applied, we expect the Commission to appeal this judgment before the Court of Justice.”

There are further concerns the UK could become a hotspot for IP dispute cases, following the Supreme Court’s decision in the Unwired Planet vs Huawei and Conversant vs Huawei and ZTE cases.

Dr Roya Ghafele, from OxFirst, acted as an economic advisor in the decision and said: “What impact such a rise in patent litigation could have on consumers remains to be seen.

“For sure, many technology companies will be carefully considering whether to maintain their market position in the UK.”

After all, she adds, in future those who do maintain a presence in the country could end up being faced with the choice of either “exposing their international licensing practices to the English Courts or risk being shut down in the UK”.

China, Hong Kong and the US

Geopolitical tensions took a turn in H1, as China passed its “security law” in Hong Kong, granting police, among other things, the power to intercept communications.

While France, Germany, the US and others have made their feelings known through their various extradition treaties, in industry terms the fallout echoed throughout and the impact on telcos is still trickling down.

Telstra, which invested in the Hong Kong America’s cable in 2018, has pledged its allegiance while committing to protect customer data, but the EU will limit technology exports that could be used for “repression or surveillance”.

It was the Union’s first response to the new law and the “sanctions” as Reuters termed it, include trade curbs and a “review of visa arrangements”.

According to further reports in August, the latest twist is that even Hong Kong’s exports will now be labelled “made in China” when sold to and within the US, with tariffs a prospect at the time of writing.

On the Huawei front, the US and UK will be on the market for new equipment from alternative vendors, with India and Brazil also now considering bans and strip-out projects on national security grounds.

Bullish outlook for data centre investment

The data centre space has surpassed expectations year to date, with the value of related M&A deals in the first 16 weeks of this year reaching an aggregated deal value of US$15 billion — higher than the 2019 full year total.

Granted the number was inflated by Digital Realty's $8.4 billion acquisition of Interxion, the largest ever data centre transaction, sentiment among developers and investors remains bullish. Christian Mouchbahani, managing partner at M Capital Group, says: "The data centre industry is one immediate bright spot within and post Covid-19, in a world of challenges and short-term dim outlooks." Giving a five-year outlook, he expects sector growth to reach 10 to 15% CAGR as cloud services remain centre stage, data traffic continues to grow, and more data practices are outsourced. As many others have witnessed, global Covid-induced lockdowns have also helped in driving demand. Geographically speaking, North American markets, including major US and Canadian cities, will continue to lead with European markets close behind. Emerging markets in APAC, Latin America, and Africa are "quickly catching up with strong growth potential and investor interest". Traditional retail colocation and wholesale markets are expected to experience "considerable growth across all regions".

Satellites

Despite a July report by NSR predicting satellite industry revenues will decline 7% this year before taking "more than three years" to recover, the outlook is surprisingly bright. The first half of 2020 saw GEO satellite orders reach the same level as full year 2019, which is "pretty remarkable" according to Jeff Crusey, investment manager at Seraphim Capital. One factor, he says, is that the cost of a bit has decreased, even though satellites themselves remain expensive. On the small sat side, SpaceX had its Covid-19 related setbacks but has still dominated launches year to date and Crusey says the firm will "continue to take the lead", despite others facing delays. This could also pave the way for launch market consolidation to year end. The launches scheduled for H2 are predominantly led by Synthetic Aperture Radar (SAR) satellites and very low earth orbit (LEO) sats — second Covid waves permitting. On the investor side of things, Crusey says space tech and satellites are too far upstream to see the immediate impact of recent months, however, there has been consolidation with larger cheques focused on fewer companies. Looking ahead, delays will make things even trickier for the start-ups as investors adapt to a new global economic environment. "If they were proactive enough to have gone into hibernation mode — cut headcount and cash burn — then they might make it through, but we're going to see lots more fall out," Crusey says. On a positive note, in lieu of VC dollars governments are stepping up, changing the economics of the marketplace. Crusey says: "OneWeb was bought out of bankruptcy, then you have things like the rural fund in the US driving companies that traditionally wouldn't enter into LEO sat communications. A notable one is Viasat, which has normally been very bearish on GEO sats, but is now working to put up a LEO constellation."

Global 5G progress

According to Guillermo Pedraja, head of networks, 5G and IoT consulting at NTT DATA UK, H1 saw two distinct trends emerge.

Pre-Covid, early 5G adopters like South Korea accelerated deployment and rollout with similar drive witnessed from the US. However, China is tipped to lead the world in terms of volume. Guillermo says: “My forecast is that China will, by the end of the year, have probably 10 times the 5G deployments of anywhere else in the world in terms of volume.” As the Covid-19 pandemic continued, other trends started to emerge. In LATAM, Guillermo says “Covid completely killed the pace” for 5G, while on Europe and the UK, he adds: “They believe in it, they are betting on it, and they are putting money behind it.” However, the supply chain is likely to be a primary concern in H2. On Huawei, Guillermo says the UK’s July decision “is undoubtedly going to mean a delay”, but it could also democratise the supply chain in H2. With no other vendor providing an end-to-end portfolio, Guillermo sees two supply alternatives for the west: Japan’s NEC, or players from the ecosystem of smaller, more innovative suppliers. “They are more niche but it’s an opportunity for the industry to help them mature and be competitive in certain areas. I see [them] playing a strategic and important role over the coming years,” he adds. Despite all the apparent progress, there is one final twist. “It’s not real 5G. They are deploying base stations to cover as much as they can,” Guillermo says and here, China will take the lead again. “China will deploy massively to show the world that, with the help of their vendors, they can have true 5G. There are dynamics that will be very interesting. I don’t expect China and Huawei to sit still but I’m fairly certain they will channel their feelings into their own market to show how powerful they are. It’s a different kind of cold war.”