

Combining Regional Carriers Is Becoming More Common

Asset sales and mergers are increasing, even as federal money is about to pour into new and improved broadband deployments. Policy has yet to keep up. More guidance and rulemaking may be needed, not less.

By Steven S. Ross / *Editor-at-Large*

The broadband industry's shape is shifting. Wall Street follows mainly the existing major carriers plus SpaceX and maybe AST SpaceMobile, the company launching massive prototype BlueWalker satellites for 5G cellular-to-space communications. But the real news for vendors, consultants and a constellation of about 2,000 existing broadband deployers is that they all may be in play for mergers, acquisitions and joint operating agreements.

Over the past year, requests for help modifying the **BROADBAND COMMUNITIES** financial models have increased from two or three a month during the pandemic to four or five. They are almost back to levels I have not seen since 2010 to 2019 after the disruption by the Great Recession. That's despite the growth in general user ability to understand the models without my free (and confidential) hands-on help.

The size of the shift, relative to the broadband industry's current corporate structure, is not easy to determine. I estimate 2,000 distinct "telecom" organizations, but there are more than 4,000 such entities in regulatory databases. Many competitive local exchange carriers (CLECs) are established and owned by carriers outside their regular franchise areas. Some are run by real estate developers or condominium

homeowner associations or by third parties operating only in a defined building or group of buildings without the need to establish a local franchise.

Over the past decade, I have encouraged broadband operators to cooperate in various joint planning and operating agreements. They save money in the long run. One form, the public-private partnership, continues to grow in popularity.

But now the trend includes a significant increase in outright acquisitions – one entity (typically a local exchange carrier, a small LEC) acquiring some or all of another carrier's LEC or CLEC footprint and customers. As I have noted, this is often tricky because of the structure of existing financing that may be in place. Federal and state loans, for instance, typically have priority over other loans for repayment or asset takeover.

Even when lienholders are willing and flexible, valuing assets for sale and predicting costs and risks of the planned expansions that typically trigger the deals in the first place is tricky. Accounting for equipment inflation is easy ... plug in a new number. But carriers usually contact me when the biggest modeling issue might include the cost of delays because of supplier hiccups and construction labor shortages. I addressed this last year (bbcmag.com/community-broadband/bandwidth-hawk-financing-just-got-extra-complicated-broadband-communities-has-your-back) and at last year's Summit. I will address it at this year's Summit May 1–4 as well. (See the box at left for details.)

What is new, however, is a growing desire on the part of deployers and financiers to "value" existing networks for possible equity deals or – as I have noted in the past – as a new standard of value to backstop loans in an age of higher interest rates and less "easy money." Right now, these equity deals – often innovative and uncommon even 18 months ago – are beginning to displace loan and lease financing.

Do the parties value by revenue? Operating margin? Replacement cost? Original cost? What about competitive threats? Improved positioning for federal grant or loan funds, now that the federal government alone has placed about \$50 billion, is on the table. Possible new players range from owners



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Presented by Steve Ross

and managers of significant real estate portfolios to new tribal and public entities. Tribal operators and investment funds can and do own broadband assets outside tribal lands.

Wall Street and significant carriers still worry about the possibility, increasingly unlikely, that the FCC will once again try to regulate operators of pure internet broadband services under Title II of the Telecommunications Act to guard against anti-competitive pressures on the trunk and middle mile.

Again, the pressures pushing the industry toward mergers are indeed

many, and most start with labor, fiber and equipment shortages, wage inflation and, of course, the Federal Reserve Bank's raising short-term interest rates. We know that. But the devil is in the details (see box below).

It is hardly news to those already in the industry, but it *is* news to many financial and regulatory folks that the vendor universe has changed. The changes go beyond the "buy American" clauses in the infrastructure law. There are security issues as well. Chinese Huawei and ZTE, whose combined sales to carriers have grown to be

almost as large as all other broadband equipment and software suppliers combined (Huawei alone sells more than \$100 billion a year), have essentially been banned from the U.S. market and sharply restricted in Europe. The stated reason is that Huawei and ZTE present serious network security issues.

Huawei and ZTE responded by focusing on markets outside North America and Europe and cutting prices. Nokia and Ericsson, which combine for about a third of the worldwide carrier equipment and software market, lost business in China and suffered modest

BEYOND TECHNOLOGY: THE CHANGING BROADBAND ENVIRONMENT

- Grants and loans come with rules. As I noted last year (www.bbcmag.com/community-broadband/bandwidth-hawk-financing-just-got-extra-complicated-broadband-communities-has-your-back), new federal funding programs tend to favor rural and low-income areas. They also avoid multiple recipients for the same funding application, whether grant or loan. That can put operating partnerships and consortia at a disadvantage.
- State rule details under Infrastructure Act funding govern a state's existing pattern of accommodations for public-anchor tenants such as libraries, city halls, emergency responders and schools.
- Regarding combining cellular, P2P wireless and fiber, the FCC is operating with only four commissioners, and the two-year-old Biden Administration effort to appoint Gigi Sohn as the fifth commissioner collapsed. Details of how the FCC might allow adjustments in spectrum ownership, licensing and responsibilities are still not firmly established. Ideally, carriers would trade or jointly use the spectrum to combine for seamless wireless services using new fiber backhaul. But in exchange, they generally erase some uniqueness and thus some competitive advantage. Delicate rulemaking is required, but significant carriers naturally lean instead toward having the FCC gridlocked with no new rulemaking possible.
- The scale of new uses (agriculture, cell-site leasing, telemedicine, remote working and education, driverless vehicles, more nimble first responses) is still unpredictable, at least in detail, for a given location.
- Potential lenders and equity partners like the "sure" money of the family \$30/month low-income subsidy, extended in the infrastructure act from pandemic days. The funds are paid directly to carriers. They don't always like the idea of guaranteeing the availability of good two-way internet access at that low price. The cost-per-megabyte of providing the service decreased, but the definition of "good access" could change. And what happens when the existing pool of money, about \$15 billion to start, with some already spent, runs out? Some look to the FCC to hand out much of its Universal Service Fund money that way rather than by reverse auction and formal carrier application for 10-year subsidies. Some expect an "inflation adjustment" in the \$30. At the moment, though, with only four commissioners, that's all wishful thinking.
- As technology changes, so do roles of software versus hardware and ways to value software, IRUs, and investments at the network edge, closest to customers.
- Small family businesses are subject to a wide range of inheritance taxes, but generally are treated more leniently than larger businesses. Low capital gains taxes (in theory) reward long-term investments and compensate for inflation. Inflation is suddenly high again after a 20-year holiday, and the far left is attacking the whole idea of preferential taxes on capital gains and inheritances as an unwarranted reward for the wealthy who have capital gains in the first place.

employee layoffs even though their market share in Europe and the U.S. has increased.

What does Wall Street think? Well, Cisco and Motorola had more than 80 percent of the \$300 billion total stock market capitalization of the top 25 broadband equipment and software suppliers last year. Cisco has twice the sales of Huawei, but sells mainly to enterprise customers, not carriers.

None of this, of course, includes companies whose stocks are not publicly

traded. Nor does it include suppliers of fiber optic cable, which is a vast market but now tends to be a one-time purchase for deployers. Equipment is typically renewed on a typically 7-to-10-year schedule. Fiber, once deployed, has only to be maintained, and a 40-year lifetime is usually assumed. Newer electronic equipment and software carry more and more traffic over the same fiber.

We know this. Regulators generally know this. Wall Street, not so much. But Wall Street attitudes trickle down

to regional lenders that help fund these broadband mergers, acquisitions and deployments. The pressure on regional lenders increased recently with recent bank failures.

More guidance and even rulemaking from regulators is often anathema to national carriers but would be a blessing, not a curse, for the smaller deployers who, combined, provide half of all new premises connections. 🙌



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Fun Industry Facts From The 50s

- The most common phone used in the 1950s was the rotary phone.
- First 345 Kilovolt transmission line.
- First nuclear power station ordered.
- 90% of U.S. farms had electricity .
- In 1953, Mark R. Sullivan, with Pacific Telephone & Telegraph Company, predicted the cell phone.
- Bell filed a patent for a wireless telephone in the 1800s.
- Home electrification specialists were all the rage teaching people how to use electric appliances.

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