

Private Equity Snaps Up European Telecom Assets: KKR Sells Deutsche Glasfaser to EQT and OMERS for €2.8bn

Introduction

KKR, the massive American private equity (PE) fund, has agreed on the 10th of February, 2020, to sell the ultrafast German fiber internet business Deutsche Glasfaser in a €2.8bn deal to EQT and Omers, respectively a private equity firm and a Canadian pension fund. According to what has been revealed so far on the deal, EQT plans to merge the company with Inexio, the German fiber optic network operator which the PE firm bought last year. KKR, which acquired a 70% stake in the German company in 2015, for a total valuation of €200m, has decided to sell Deutsche Glasfaser last year. Reggeborgh, the Dutch investment company which owns the remaining 30% of Deutsche Glasfaser, will also sell its stake in Glasfaser to EQT and Omers. The deal, and the future intentions of EQT for Deutsche Glasfaser, will likely create a unique presence in Germany's high-speed internet market, and this choice will perfectly contribute to the German government's goal to improve the digital infrastructure of the country.

About Deutsche Glasfaser

Deutsche Glasfaser, founded in 2011, is a telecommunication company based in Germany. The company's main business is related to the expansion of the fiber optic networks in the rural areas of the country, with the aim of a broader telecommunication services coverage.

As an internet service provider, Deutsche Glasfaser markets internet, TV and telephone services for private customers. In May 2019, the company reports, being the latest certified data, observe 300,000 customers and about 500,000 homes to have signed under their contracts. With regard to broadband coverage in the country, Deutsche Glasfaser is now seen as an important opponent of Deutsche Telekom.

Deutsche Glasfaser was founded by the Dutch private investment company Reggeborgh, already known at that time in the Netherlands due to the subsidiary Reggefiber, founded a few years earlier and which created around 2.5 million fiber optic connections (covering 30% of Dutch households).

Since 2015, the American private equity fund KKR had represented the major shareholder of the group. In 2016 the company has started pursuing extensive expansion plans of fiber optic networks nationwide.

Deutsche Glasfaser is also a member of the Federal Association for Broadband Communication, which is committed to the nationwide expansion of fiber optic networks, supporting the cause of fair competitive conditions in the telecommunications market.

In July 2017, Deutsche Glasfaser announced the takeover of Unser Ortsnetz GmbH, which business lays down the fiber optic networks to the individual apartments.

About KKR

KKR is a leading global investment firm, headquartered in New York, with \$148bn AUM, managing multiple alternative asset classes, including private equity, energy, infrastructure, real estate and credit, with strategic

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partners that manage hedge funds. KKR aims to generate attractive investment returns for its fund investors by following a patient and disciplined investment approach, employing world-class people, and driving growth and value creation.

About EQT and Omers

EQT is a differentiated global investment organization, with €7bn AUM and a 25-year history of investing in, developing and owning companies. EQT manages and advises a range of specialized investment funds and other investment vehicles that invest across the world with the mission to generate attractive returns and future-proof companies.

Founded in 1962, Omers is one of Canada's largest defined benefit pension plans, with \$97bn in net assets (as of December 2018). Omers invests and administers pensions for almost half a million active, deferred and retired employees of 1,000 municipalities, school boards, libraries, police and fire departments, and other local agencies.

Industry Overview

The telecom world is preparing itself for the 5G era, which is expected to take the consumer market by storm. According to Deloitte reports, the transition to 5G is expected to generate a windfall for network, infrastructure and equipment vendors. Leading research and advisory group Gartner predicts that worldwide 5G network infrastructure revenues will touch \$4.2bn in 2020, recording year-over-year growth of 89%. To support this growth, countries worldwide are gearing for next-gen 5G mobile networks through 5G spectrum auctions (a process through which a government sells the rights to transmit signals in 5G as a way to allocate the government's resources efficiently) and the strengthening of their technology, media and telecom (TMT) sector, preempting a major growth in infrastructure costs in the sector.

This inevitable growth in costs comes at a time of general liquidity overhang, a phenomenon of excess liquidity in the market - a consequence of world's extremely low interest rates for years. This has also affected private equity, which, consequently is amid a retake of its business transformation. PE groups hunt for assets in an attempt to put some of their roughly \$1.5tn of dry powder to work. The PE mega-funds (those with over \$5bn), like those managed by Blackstone and KKR, are making up the largest proportion of capital raised, at levels not seen since 2007 just before the housing crisis hit, according to PitchBook.

With rising private company multiples that make public company valuations more attractive for PE, public-to-private transactions are finding favor once more with PE firms. Furthermore, fiber internet deals, according to a PE infrastructure specialist at Linklaters, are underpinned as an infrastructure-type investment with more stable long-term cash flows. European private equity telecom transactions disclosed in the first six months of the year hit €9.24 billion, compared to €1.92 billion in deals a year earlier, according to data from S&P Global Market Intelligence. The \$14.3bn Zayo deal, in which fiber network owner Zayo was acquired by EQT and PE firm Digital Colony Partners, in 2019 helped boost the value totals for TMT buyouts for the last year to \$73.8bn, although volumes were also high, with 380 deals recorded, to make the sector the most active for PE firms. At a time when demand for reliable connectivity has become critical for increasingly data-driven companies such as Netflix, Google and Apple, an increased investment in fiber, the wider asset class and related technologies can be expected to be seen.

Deal Structure

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The Swedish fund will own 51% of the combined group, while Omers Infrastructure (acting on behalf of OMERS) will own the remaining 49%. The deal will see KKR and the Dutch investor Reggerborgh exit the business, in which they hold 70% and 30% respectively.

The sale of the Deutsche Glasfaser represents a 13.0% return for KKR, the US buyout valued the business at around €200m when they acquired a 70% stake in 2015 from Reggerborgh.

With this transaction, EQT Infrastructure IV is expected to be 70-75% invested.

Deal Rationale

Deutsche Glasfaser is expected to be combined with Inexio to form a leading Fiber to the Home (FTTH) player in rural Germany, as well as one of the leading telecom companies in Germany. German fiber operators Inexio and Glasfaser have been 'de facto local monopolies' in the market. Inexio was acquired by EQT in September 2019 into its Infrastructure IV portfolio.

The deal comes also at a time when roll-up strategies, that basically follow a pattern where a PE firm buys a sub-scale business and bolts on smaller companies at a lower multiple to roll it up into a business of scale, are trending in the private equity space as an opportunity for value creation, and a relatively easy and successful exit strategy. Also known as leveraged build-up, roll-up has become an attractive vehicle for the consolidation of leadership within a fragmented industry. Some roll-up candidates, titillated by the surging tide of capital drenching the public markets, choose to go public simultaneously with their business combination - in what's known as a roll-up IPO.

Germany is among the countries in Europe with the lowest penetration of FTTH connectivity and will require significant investments over the coming years. The combined group of Inexio and Deutsche Glasfaser is committed to invest over €7bn into the rollout of fast-speed internet infrastructure in Germany, thereby contributing significantly to the German government's plan to provide nation-wide gigabit convergent internet infrastructure by 2025. With a medium-term target of more than 6 million fiber optic connections for the new group of companies, Deutsche Glasfaser has set a very high number for the expansion. The combined business will likely dominate the telecom market with solid and stable cash flows and pose market entry barriers to existing as well as potential competition. It is also interesting to note that Vodafone Germany and Deutsche Glasfaser have announced an agreement in December 2019 to cooperate on the expansion of fibre-optic networks for residential customers. Under the wholesale partnership, Deutsche Glasfaser will deploy fibre-to-the-home (FTTH) networks which will be leased to and operated by Vodafone on a long-term basis.

Looking ahead, the management team of Deutsche Glasfaser plans to continue the rapid growth of the Company by pursuing a large-scale deployment of FTTH internet access in rural Germany. FTTH is the fastest, most reliable and future-proof internet connectivity solution available and the only technology that will be able to handle the strongly growing internet bandwidth demands of the future.

Market Reaction

The day the deal has been announced EQT slightly declined with a -0.84% decline intraday. As of 20th February 2020, share price is up 20%. KKR & Co. Inc. shares rose 1.8% intraday and are up 2.0% since the announcement. The deal, in which EQT beat rival investment firms Antin and Brookfield, values Deutsche Glasfaser at more than \$2.74bn, including debt.

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Financial Advisors

Morgan Stanley acted as financial advisor to KKR, Clifford Chance served as legal counsel on the transaction. The closing of the transaction is expected in Q2 2020.

TAGS: Telecom, 5G, Germany, Private Equity, Fiber Optic, TMT

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