

AP CAPITAL RESEARCH

M&A Deal of The Week

Verizon & Frontier



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Executive Summary

M&A DEAL OF THE WEEK

Deal Summary

- On September 5, 2024, Verizon Communications (NYSE: VZ) announced its acquisition of Frontier Communications (NYSE: FYBR) in a \$20 billion all-cash deal. This transaction is a significant strategic move for Verizon as it expands its fiber network and bolsters its position in the U.S. telecommunications market. The acquisition will add 2.2 million fiber subscribers from Frontier, increasing Verizon's total fiber customer base to 10 million across 31 states including Washington, D.C.
- The deal, valued at \$38.50 per share, represents a 43.7% premium over Frontier's 90-day volume-weighted average share price before the announcement. Verizon aims to seamlessly integrate Frontier's fiber network with its existing Fios (Fiber Optic Subscribers) infrastructure, enhancing broadband and mobility offerings nationwide.
- This move builds upon Verizon's longstanding strategy to grow its fiber network, especially in rural and underserved areas, where Frontier has a strong presence.
- With this acquisition, Verizon extends its fiber-optic footprint to more than 25 million premises, further strengthening its competitive position against AT&T and Comcast.
- The deal enhances Verizon's ability to provide bundled services (fiber, broadband, and mobile), offering greater choice to Frontier's consumer and small business customers. This expansion is expected to improve customer retention rates, with combined fiber and mobile services reducing post-paid mobility churn by nearly 50%.
- Centerview Partners LLC and Morgan Stanley & Co. LLC acted as financial advisors to Verizon and Debevoise & Plimpton LLP acted as legal counsel. PJT Partners served as financial advisor to the Strategic Review Committee of the Board of Directors of Frontier, and Barclays served as financial advisor to Frontier. Cravath, Swaine & Moore LLP served as legal advisor to Frontier, and Paul, Weiss, Rifkind, Wharton & Garrison LLP served as legal advisor to the Strategic Review Committee of the Board of Directors of Frontier.

Key Figures

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|--------------------------------------|--------------------------------------|
| • Deal Value: \$20 billion | • Deal premium: 43.7% |
| • Verizon EV/EBITDA: 7.5x | • Frontier EV/EBITDA: 8.4x |
| • Verizon EV: 352.36 B | • Frontier EV: 18.83 B |
| • Verizon P/E: 16.4x | • Frontier P/E: -92.65 |
| • Verizon D/E: 185.4% | • Frontier D/E: 219.0% |
| • Verizon P/S: 1.4x | • Frontier P/S: 1.5x |
| • Verizon Market Cap: 181.8 B | • Frontier Market Cap: 8.77 B |



Company Information

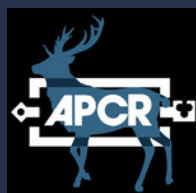
M&A DEAL OF THE WEEK

Verizon (NYSE:VZ)

- Verizon Communications Inc., a leading global telecommunications provider, is headquartered in New York City and predominantly serves the U.S. market. The company was established in 2000 following the merger of Bell Atlantic and GTE, forming Verizon Communications. It operates through two principal divisions: Verizon Consumer Group and Verizon Business Group.
- Over the past five years, Verizon's revenue has experienced volatility, reaching a peak of \$143.6 billion in 2022. However, subsequent declines can be attributed to intensifying competition within the telecommunications sector. This trend has been mirrored in both net income and EBITDA. Conversely, the company's long-term debt reached a high of \$143.4 billion in 2021 but has been gradually declining since that period.
- Focusing on the financial performance for 2023, Verizon reported a total revenue of \$136.8 billion, with 76% of this derived from its Consumer Group, particularly its wireless services, broadband offerings, and the expansion of its 5G network. The company's net income for 2023 stood at \$19.1 billion, reflecting a robust financial position despite significant capital expenditure on 5G infrastructure.
- However, Verizon's substantial investments in 5G infrastructure, spectrum acquisitions, and prior M&A activities have contributed to a debt burden of approximately \$128 billion as of 2024. While this places Verizon among the most indebted companies in the telecoms industry, the debt is considered manageable, supported by strong and consistent cash flows.

Frontier Communications Inc (NYSE: FYBR)

- Frontier Communications is a U.S.-based telecommunications provider, established in 1935 in Connecticut. The company offers internet, television, and telephone services, along with business solutions, across six key segments: residential, business, wholesale, government, rural and underserved regions, as well as smart home solutions.
- Prior to 2022, the company's strategic priorities were centred around expanding its fibre network, enhancing customer service, and pursuing growth through expansion and acquisitions. However, escalating costs hindered Frontier's ability to compete with larger industry players such as AT&T and Comcast. As a result, the company filed for Chapter 11 bankruptcy protection in 2020, citing approximately \$14 billion in debt.
- In response, Frontier implemented a restructuring plan, successfully reducing its debt to \$4 billion by 2021. Since emerging from bankruptcy, the company has focused on further deleveraging while making significant investments in its fibre infrastructure and improving customer service.
- In terms of financial performance, Frontier's revenue has steadily increased post-bankruptcy. The company achieved year-on-year revenue growth of 2.90% in 2022, followed by a growth rate of 2.82% in 2023.



Deal Rationale and Risk

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Rationale – Building Subscriber Base and Competitive Advantage

Expansion

With this deal, Verizon is expanding its fibre footprint, with Frontier operating the largest pure-play fibre internet network in the US with 2.2 million subscribers, who will add to Verizon's 7.4 million connections in their Fios bundle. This will allow them to stay more competitive in the telecom industry with competitors such as AT&T.

Reintegration

Verizon had previously sold assets to Frontier in 2009 and 2016. In 2009 Verizon sold landline businesses in 14 states in more rural areas, and in 2016 they additionally sold TV and internet landline businesses across California, Texas, and Florida. This totalled 19.1 billion across both deals at the time. This will again help Verizon expand their subscriber base, and be more competitive.

Revenue and Synergy Gains

Verizon expects this deal to be accretive to revenue and adjusted earnings growth rates. Verizon expects at least \$500 million in cost synergies by the third year of the deal, due to increased scale, distribution, and network integration.

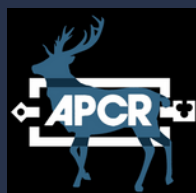
Risk

High cost and debt

This deal is an all-cash acquisition that cost Verizon \$20 billion. This will set Verizon back in terms of debt reduction and other operations, especially with Frontier being a cash-burning business at the moment due to high capital expenditures which will require ongoing investment. This is in addition to Frontier having a high debt of \$11.25 billion which will need to be refinanced by Verizon. Verizon does have high free cash flow at the moment, though the additional capital demands could place pressure on the company's balance sheet and harm the company's ability to reduce debt or other operations. Therefore, potentially affecting the company's ability to remain competitive.

Synergy concerns

Although the deal is expected to bring \$500 million in cost synergies within three years, the synergies represent 2.5% of the transaction value. This raises concerns over whether Verizon has overpaid in this deal, particularly given the 43.7% premium offered. Verizon clearly feels it can unlock a lot from Frontier; however, the lack of cost synergies could undermine the financial rationale of this deal.



Precedent Transactions Analysis

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EV/EBITDA Analysis

First, the EV/EBITDA multiples in these deals range from 7.5x (T-Mobile-Sprint) to 48.5x (Microsoft-Nuance), highlighting the difference in growth potential. Microsoft-Nuance commanded a higher multiple due to its cutting-edge technology, while traditional telecom infrastructure deals like T-Mobile-Sprint (7.5x) and AT&T-Discovery (9.1x) were more conservative, reflecting the sector's maturity. For Verizon-Frontier, a multiple in the 7x to 9x range is expected, aligning with Frontier's growth opportunities in 5G and fibre.

P/E Ratios

The P/E ratios further show how investors view growth. Microsoft-Nuance had a high P/E of 41.3x, while AT&T-Discovery's 9.7x reflects more stable, established earnings. Verizon's acquisition of Frontier likely falls on the lower end of the range, given Frontier's steady, utility-like earnings profile.

Deal Premium

Deal premiums and EV/sales multiples, ranging from 3x to 6x in these deals, emphasise that revenue generation remains a key value driver in telecom mergers. Verizon will likely seek similar value metrics, balancing synergies with industry-standard multiples.

In summary, these precedent transactions help frame the Verizon-Frontier deal, suggesting an emphasis on synergies, strategic growth, and adherence to valuation norms seen in large telecom mergers.

Date	Aquirer	Target	Target Ticker	Target EV	Premium	EV/Sales	EV/EBIT	EV/EBITDA	P/E
Sep-24	Verizon	Frontier Communications	FYBR	\$20.0Bn	43.70%	3.25	25.46	8.20	-92.65
Apr-20	T-Mobile	Sprint	S	\$26.0Bn	25%	2.10	5.40	7.50	29.20
Jul-20	Liberty Global	Vodafone Group	VOD	\$24.0Bn	14%	2.00	12.30	10.10	15.70
Mar-22	Microsoft	Nuance Communications	NUAN	\$19.7Bn	23%	23.60	56.60	48.50	41.30
Jun-19	L3 Technologies	Harris Corporation	HRS	\$33.0Bn	16%	3.70	14.70	12.30	17.80
Apr-22	AT&T	Discovery, Inc	DISCK	\$6.25Bn	25%	3.00	7.40	9.10	9.70

Max	\$33.0Bn	25%	23.60	56.60	48.50	41.30
75th Percentile	\$26.0Bn	25%	3.70	14.70	12.30	29.20
Average	\$21.79Bn	21%	6.88	19.28	17.50	22.74
Median	\$24.0Bn	23%	3.00	12.30	10.10	17.80
25th Percentile	\$19.7Bn	16%	2.10	7.40	9.10	15.70
Min	\$6.25Bn	14%	2.00	5.40	7.50	9.70



Industry Analysis

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The Telecommunications Industry

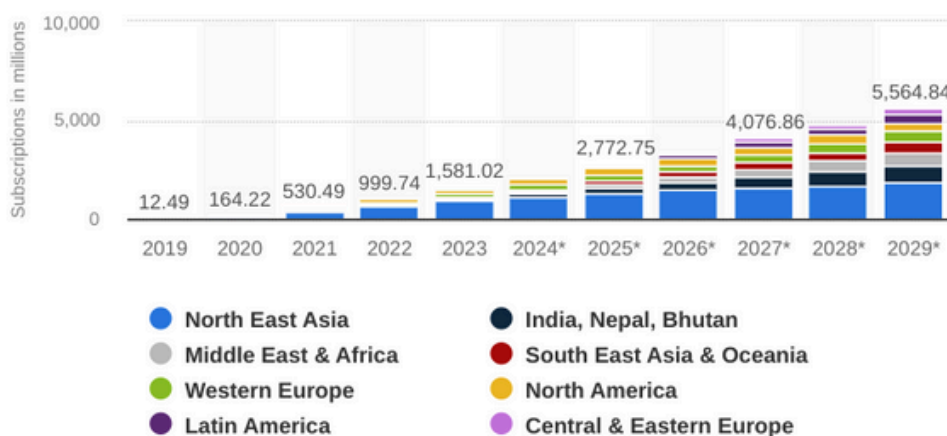
The Telecommunications industry plays an essential role in how we communicate on a global scale. Offering services such as voice communication, internet access, and data transmission through the use of several technologies. Among others, it incorporates wired and wireless networks, fibre-optic infrastructure, and satellite systems to allow us to exchange ideas, converse and do business with nearly anyone, regardless of where in the world they might be.

The global telecommunications market was valued at \$1.8 trillion in 2022 with projections indicating steady growth. With demand increasing for high-speed internet services the sector is expected to reach around \$2.8 billion by 2030. This may be due to the rise of streaming, cloud computing and smart devices as different technologies become more accessible and new products are introduced to the market.

Key Trends

- Growth is expected in the telecommunications market in 2024 with a forecast 1.6 trillion us dollars to be spent worldwide, a 4,3 percent increase on the estimated spend for 2023.
- Strong focus on the roll out of 5G with the number of subscriptions forecast to reach over 5.5 billion by 2029.

Forecast number of 5G mobile subscriptions worldwide from 2019 to 2029, by region (in millions)



Threats

Cyber-security Risks

Cyber attacks are a growing concern. As the infrastructure of this industry becomes more digital, risks of data breaches, ransomware and denial of service attacks rise significantly. This can result in the disruption of services and the compromise of user data and damage to companies' reputations. In turn financial losses, legal consequences, and loss of customer trust may follow. To combat this telecom companies like Verizon must invest in security technologies to protect their networks and customer data.

Regulatory and Compliance Pressures

This is a highly regulated industry, and changes to such regulations can create uncertainty and additional costs. Governments and official bodies frequently update privacy laws and data protection requirements. Non-compliance with these regulations can result in substantial fines and legal pursuits. Additionally, navigating multiple regulatory frameworks across different regions adds complexity.

Final Thoughts

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Dev Basak.

In my view, the acquisition of Frontier Communications is a significant opportunity for Verizon. By adding 2.2 million fiber subscribers, this deal allows us to expand our footprint in both rural and urban areas, strengthening our market position. However, I recognize that integrating Frontier's operations will be a challenge, especially with its current debt burden. The expected \$500 million in synergies could be a game-changer if realized, but it's clear that careful management will be required to ensure that this acquisition truly delivers long-term value for Verizon. Despite these risks, I believe the deal positions Verizon well for future growth and competitiveness in the evolving telecommunications landscape.

Fatima Rafia.

From an optimistic standpoint, the acquisition of Frontier Communications, particularly its extensive fibre network in rural areas, could provide Verizon with a first-mover advantage in a niche market. This move has the potential to significantly enhance Verizon's market share by bolstering its core customer base in the Northeast and Mid-Atlantic regions. However, Verizon must carefully consider the additional capital required to facilitate a smooth transition of Frontier's customers and to support ongoing infrastructure development. Verizon's prior experience with the acquisitions of Yahoo and AOL should serve as a valuable guide in executing this transaction effectively.

Max Hanson.

With this deal, Verizon is expanding its fibre footprint by adding Frontier's 2.2 million fibre subscribers to its existing base, helping the company remain competitive. However, Frontier is a cash-burning business and with the deal being worth \$20 billion in an all-cash transaction reducing the company's ability to pay off debt, the long-term value of the deal is uncertain. The expected synergies are modest, and if they fail to materialize, the impact of this acquisition may be limited in the long run.

Adithya Praveen.

I believe this acquisition will enable Verizon to expand into new markets, particularly in rural areas where it currently has less presence. Frontier's established infrastructure in these regions will provide Verizon with a strategic advantage, allowing it to enhance its market penetration. Additionally, this deal opens the door for Verizon to offer bundled services such as 5G, broadband, and satellite TV, further increasing its customer base and reinforcing its competitiveness in these underdeveloped areas. This expansion could play a key role in strengthening Verizon's position in the telecommunications landscape.

Noah Benger-Pereira.

I think this is a significant deal for the telecommunications industry, with Verizon already being the second-largest company within the market and Frontier being a notable player in the US. It is certainly an opportunity for growth, particularly in underserved markets. That being said, this acquisition will need to be carried out with care as they face a number of different challenges from navigating regulatory difficulties, to dealing with Frontier's financial struggles as well as maintaining customer satisfaction.



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