



Telecom Italia Breaks Into Three Units, Abandons Convergence

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By Aude Lagorce

LONDON (Dow Jones) -- Barely a year after completing the \$26.6 billion purchase of its mobile-phone unit, Telecom Italia is changing tack and unraveling plans for an integrated phone, Internet and wireless company.

Marco Tronchetti Provera, the chairman of Europe's fifth-largest phone company, late Monday unveiled plans to split the company into a "utility business," which will own the actual fixed-line network, a retail business that will own both the fixed-client base and the content division, and a mobile arm.

Each company will have its own balance sheet and board, said Telecom Italia.

Telecom Italia (TI) shares slipped 0.7% in Milan. They were suspended on Monday.

Management said the strategic about-face was due to regulatory hurdles that made unattractive the integration of its fixed and mobile operations. Telecom Italia shares have fallen 24% since Dec. 7, 2004, the day it announced the mobile buyout.

Tronchetti Provera argued that the split of the group into three units would ease regulatory pressures and help the company gain market share by increasing its commercial focus. The better focus would make up for the loss of some synergies that were generated by having a single company, he said.

But Analysts for Exane BNP Paribas were not convinced, saying they believe the company is actually dressing up for a sale, even though management claimed it had received no offers and had no asset sale mandate. It added, however, that it would naturally consider any offer.

Dresdner Kleinwort believes Telecom Italia could sell its mobile operations for about 35 billion euros (\$44.5 billion) and that the proceeds would allow the group to pay off some of its 44 billion euros in debt and give back some money to shareholders.

The Italian government, too, was reluctant to applaud the move.

Prime Minister Romano Prodi said he was "surprised" and "worried" about Telecom Italia's spin-off, and that he would review the proposal as soon as details were available.

A risky transformation

Selling its mobile operations, however, would likely mean Telecom Italia's transformation into a media distributor rather than a phone company.

The potentially deeper thrust into the media business has caused concerns. Christopher Kummer, director of the Vienna-based Institute of Mergers, Acquisitions and Alliances, is particularly worried that management doesn't seem to have a clear strategy in place.

"They seem to change their mind about what they want to do quite often. There's no clear strategy about how they're going to transform into a media company. It's difficult to understand what they want to be," he said.

Kummer also questioned whether News Corp. (NWS) alone would suffice as a content provider. Telecom Italia recently signed an agreement with Rupert Murdoch's group to provide films through its high-speed Internet service.

Analysts for Goldman Sachs also warned that the sale of its mobile assets would restrict Telecom Italia's options in the future and that the group would lose any upside should 3G become popular in its later incarnations or should the industry consolidate.

They said shareholders had no ground to rejoice.

"From the current price it is not clear that there is a great deal of upside for equity shareholders in TI from breaking up the group up, but that will obviously depend upon any forthcoming offers."

Such offers could come from private-equity groups or industry players such as France Telecom (FTE) and Deutsche Telekom AG.

M&A expert Kummer said he believes private-equity outfits may ultimately bag the deal because they tend to have more money at their disposal. A purchase by a large industry player such as Deutsche Telekom (DT) would also pose anti-trust concerns, he said.

The abrupt change of strategy by Italy's largest phone company took place against the backdrop of a 15% decline in Telecom Italia's profit in the first half of 2006.

Revenue rose 2.6% to 15.3 billion euros, adjusted for recent acquisitions. Mobile revenue rose 1.1% to 4.98 billion euros and fixed-wireline sales edged 1.3% higher to 8.98 billion euros.

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