Vodafone-Three merger
Consumer Dossier

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Summary: the Three-Vodafone merger is a bad deal for consumers

Three (11 per cent market share) and Vodafone (19 per cent market share)\(^1\) have agreed a deal to merge their UK operations. Before the deal can go ahead, the companies must win the approval of the UK regulator, the Competition and Markets Authority (CMA). The CMA’s mission is to “promote competitive markets” so that “people can be confident they are getting great choices and fair deals”.\(^2\)

The UK currently has four mobile network operators (MNOs): EE (owned by BT Group); O2 (owned by Liberty Global and Telefonica); Vodafone (owned by the multinational Vodafone Group); and Three (owned by CK Hutchison, part of CK Group). MNOs own or control the means of connecting mobile phone calls and data services, including radio spectrum and mobile phone masts.

Vodafone and Three’s owner, CK Group, claim that the current market of four MNOs is unsustainable. They argue a merger would increase investment in 5G networks and be “great for customers, great for the country and great for competition”\(^3\).

However, through research on the impact of mergers in other countries, plus analysis from economists, forensic accountants and data analysts, Unite has found:

- **Evidence from around the world shows the merger will likely lead to higher prices.**

  Around the world, less competition in the mobile market means higher prices. Unite’s research shows telecoms prices in European countries with three MNOs were 20% higher than in countries with four. A 2020 merger involved Vodafone and CK Hutchison in Australia was followed by sharp price rises and problems with service quality were reported. Research by the former Chief Competition Economist of the European Commission, backed up by evidence from other countries, concludes that the reduction from four to three MNOs would likely lead to prices being 15-50% higher than they would otherwise.

- **There is no evidence that mergers lead to greater investment. A similar merger in Australia saw investment fall by 45%.**

  Academic studies have found no evidence for an increase in overall investment after a reduction in MNOs. The European Commission ruled against a previous
merger involving Three, finding that, in some studies, mergers actually led to less investment. In Australia, the merger involving Vodafone UK and Three UK’s parent companies saw investment fall by 45% between 2018 (two years before the merger) and 2022.

- **The merger is really concerned with higher profits and dividends.**
  Vodafone owners have been clear about their desire to use the merger to increase returns and the Australian merger has led to significantly stronger profit margins. Vodafone’s then-Chief Executive said in 2022 that “the UK needs to consolidate to give [us] industrial scale so we can improve returns”. After a recent Australian merger involving Three and Vodafone, dividend pay outs rose by 2700%.

- **Far from being unsustainable, both Three and Vodafone are making healthy profits from their customers.**
  There has been no shortage of profit for investment in the UK’s four-MNO environment. Three UK had a turnover of £2.3 billion in 2021 and recorded a healthy operating profit margin of 28%, and the company has made over £2 billion in after-tax profits in the last five years. Of its 2021 earnings, 44% was reinvested in an attempt to grow market share, but there are signs that Three’s owners now want the firm to focus on dividends. Vodafone made adjusted operating profits of £115.7m in 2021.

Unfortunately for consumers, there are signs that the government and regulators may be preparing to row back on their long-standing opposition to MNO mergers.

A proposed merger between Three and O2 was opposed by the CMA in 2016 but CK and Vodafone are using their power and influence to move government towards their position. CK Group Chair Victor Li – son of billionaire founder Li Ka-shing – and Managing Director Canning Fok reportedly met with Rishi Sunak in April 2023 to pave the way for the merger. Li and Fok also met UK Investment Minister Dominic Johnson when he visited Hong Kong in May.4

In the same April week Sunak met Li and Fok, the government published its Wireless Infrastructure Strategy, which repeated claims about MNOs’ supposed unprofitability. It stated the Government’s “openness to market consolidation”. CK Group has form when it comes to lobbying and threatening the UK Government: in 2012, regular Downing Street visitor Canning Fok threatened to pull Three’s
operations out of the UK unless the company was given special treatment and guaranteed a generous allocation at an upcoming spectrum auction.\textsuperscript{5}
**Australia case study: a 2018 merger involving Three and Vodafone led to higher prices, reduced investment but bumper profits**

In 2018 the Australian state approved a telecoms merger between Vodafone Hutchison Australia (VHA), which was owned by Vodafone and CK Group, and TPG. As would be the case in the UK if the Three-Vodafone merger goes through, this reduced the market from four to three MNOs.⁶

**The results have been terrible for Australian consumers:**

- The three remaining MNOs all significantly raised prices in the 12 months after the merger was completed in July 2020.⁷ **Vodafone/TPG** increased post-paid plans by between AUD$5 and $40 per month and reduced the expiration period of its pre-paid plans from 35 to 28 days, effectively meaning a 25% increase in costs for consumers over the course of a year. Meanwhile, **Telstra**, increased post-paid plans by between $5 and $15 per month, along with an effective increase of between 25% and 50% on pre-paid plans.

**And reduced investment:**

- Unite analysis of company accounts shows Australian MNOs have invested less and less every year since 2018. **Overall investment levels are now 45% lower than five years ago.**⁸

**But shareholders are lining their pockets:**

- Unite analysis also shows that, prior to the merger, VHA and TPG had a combined net profit margin of 4%. Since the merger, this has more than doubled.⁹

- Rather than being used for investment, these profits are being swallowed up by wealthy shareholders:¹⁰ **Dividend payments have increased by 2700%, up to £340 million since 2020.** An additional £12 million has been handed to shareholders in share buybacks.

The message from Australia is clear: **a three MNO market is great for profiteering but terrible for consumers and investment.**
1 What effect would a merger have on competition and prices in the UK?

1.1 Mobile prices could rise by £300 a year on average following a merger

Fewer MNOs generally mean higher prices. An in-depth study of the potential Three-Vodafone merger, published in 2022 by the Balanced Economy Project (BEP), looked at the evidence from several existing pieces of research on the effect of MNO consolidation on prices. All cited studies estimated higher prices resulting from fewer MNOs, disagreeing only on the scale.\(^\text{11}\) In total BEP estimated a £4 billion - £20 billion annual transfer from customers to mobile companies resulting from a merger.\(^\text{12}\)

The research considered a number of studies, all of which agreed that prices are likely to rise as a result of the merger.

- Research by Genakos, Valletti & Verboven (2017), cited in the BEP report but also by the Government’s Wireless Infrastructure Review, found a best estimate of an average 16.3% price rise relative to the case of no merger. This was a peer-reviewed academic study looking at 33 countries over 13 years, using a “difference in difference” approach which compares price changes in countries experiencing mergers with those that do not, allowing for the fact that the countries’ mobile network markets may differ in other respects. Instrumental variable estimation is used to account for two-way causality between market concentration and prices.\(^\text{13}\)

- Other academic research (Aguzzoni et al (2017)) cited also uses a difference-in-difference approach, and finds that a 2007 four-to-three merger in the Netherlands saw prices rising 10-15 per cent higher than they would have been if there had been no merger. In other words, during a period when prices were generally falling across Europe due to technological advance, they fell a lot less in the Netherlands.\(^\text{14}\)

- Analysis from consultancy Rewheel (2022) found that fewer MNOs means higher prices. Rewheel plot the correlation between median monthly price for each country against that country’s Herfindahl-Hirschman Index (HHI), a measure of market concentration.\(^\text{15}\) BEP estimate that, using Rewheel’s analysis, the Vodafone-Three merger would raise prices by 38%.\(^\text{16}\)
Other research suggests even larger rises, with prices potentially even doubling. Rewheel estimated in 2020 that mobile costs are on average roughly twice as high in 3-MNO countries than in 4-MNO countries.\textsuperscript{17}

1.2 In Europe, fewer operators tends to mean mobile prices remain higher

CK Hutchison Co-Managing Director Canning Fok stated in a March earnings call that a merger would be good for competition as it “will enable us to build a network that can compete with number one, number two [players in the market, i.e. EE and O2]”.\textsuperscript{18}

Unite analysis of Eurostat data found that, during the period between 2015 and 2021 (the last year for which there is data), prices for wireless telephone services have generally fallen, thanks to greater efficiency from increased take-up of mobile services.\textsuperscript{19,20} However, in countries with four MNOs, prices fell on average by 15% during that period, while in countries with three MNOs they fell by just 3%. This suggests that gains from efficiencies are passed on to consumers to a much greater degree in markets with more competition.

In 2021, the average telecommunication price level index for European countries with 3 MNOs was 115, compared to 95 in countries with 4 MNOs. In other words, in European countries with fewer MNOs, prices are 20% higher.\textsuperscript{21}
1.3 A similar merger involving Vodafone and CK Hutchison in Australia led to rising prices and worse service quality

In 2018, Vodafone Hutchison Australia (a company formed from a merger between Vodafone and Three’s Australia businesses in 2009\textsuperscript{22}) agreed a merger with TPG, which was a new competitor in the market. This reduced the numbers of MNOs in the market from four to three.\textsuperscript{23}

The Australian Competition and Consumer Commission (ACCC) opposed the merger, but it was overruled by a Federal Court.\textsuperscript{24}

After completion of the merger, there were subsequently significant price hikes across the board. The ACCC attributed this to diminished competition:

“Our analysis shows that consumers will now be left paying significantly more for a range of mobile phone plans at Telstra, Optus and Vodafone ... The ACCC opposed the merger of TPG and
Vodafone because we were concerned it would lead to higher mobile prices, and result in three similar providers with little incentive to compete strongly … When markets end up with a smaller group of large look-alike players with stable positions, competition is muted and consumers pay more.”

Following the merger, prices for Australian consumers rose sharply and there were issues with service quality. For example:

- The three dominant market players in the Australian market all significantly raised their prices in the 12 months after the merger was completed.²⁶
  - **Vodafone/TPG** increased post-paid plans by between AUD$5 and $40 per month. They also reduced the expiration period of their pre-paid plans from 35 to 28 days, effectively meaning a 25% increase in costs for consumers over the course of a year.
  - **Telstra** increased post-paid plans by between $5 and $15 per month, along with an effective increase of between 25% and 50% on pre-paid plans.

- All three major Australian telecoms companies were hit with fines by the Australian Competition and Consumer Commission in 2022, after admitting to making false or misleading representations to consumers when promoting certain internet plans.²⁷

- In December 2022, the ACCC blocked attempts by TPG and Telstra to enter into agreements to share infrastructure. The ACCC believed that the agreement would result in significant harmful consequences for the welfare of customers in the longer-run, in the form of lower quality service, less coverage, higher prices and less innovation in Australian markets.²⁸

### 1.4 The UK Government is misreporting research on MNO consolidation

The Government’s Wireless Infrastructure Strategy says that “some – though not all – studies of mergers in other counties show a reduction in the number of mobile operators leading to increased consumer prices”.²⁹ This is not supported even by the evidence cited in their report. The reference notes only that “There are several studies that look at the effects of consolidation in mobile markets and conclude that post-merger prices increased”.³⁰ The Government’s report also goes against all of the evidence outlined in Section 1.1 of this report.
The Australian federal court which approved the Vodafone-Hutchison/TPG MNO merger also seemed to ignore the evidence. It argued, despite evidence to the contrary from the Australian Competition and Consumer Commission, that fewer MNOs would result in increased competition:

“Despite evidence showing the three mobile network owners reacted strongly to the potential competitive threat of a new TPG network, the Court considered that the merger would be pro-competitive, allowing Vodafone to compete more effectively against Telstra and Optus. When markets end up with a smaller group of large look-alike players with stable positions, competition is muted and consumers pay more.”31

The UK Government’s misreading of crucial evidence could lead to a similar hike in prices for UK consumers.
2 What impact are mobile phone prices already having on the cost of living?

2.1 Mobile bills are increasingly part of the cost-of-living crisis for British households

Rising telecoms prices are becoming a major issue for UK consumers. According to September 2022 research by Ofcom, nearly 1-in-3 households were experiencing problems paying for their phone or internet service – the highest level the regulator has ever recorded.32

Polling suggests that by far the most important factor for customers when choosing a mobile network is price, with 55% of respondents in Survation polling for Unite ranking price first. The public are also concerned about ensuring telecoms bills are affordable, with three-quarters of people agreeing that “Mobile network operators need do more to ensure affordable mobile and data services for working people and those on low incomes”.33

2.2 Pay monthly customers saw “inflation plus” price rises of up to 14.4% in April 2023

Mobile phone companies often link customer bills to inflation when it is convenient for them, protecting themselves against rises in costs.

For example: Three used to link annual increases to the Retail Prices Index (RPI), but changed this to a flat rate increase of 4.5% at a time when RPI was below 4.5%. Then in 2022, when inflation rose, they raised the annual increase again to “an amount up to the December CPI Rate, published in January of that year, plus 3.9%” – i.e. 14.4%.34

‘Inflation plus’ increases are an example of so-called second-round inflation, where high inflation one year feeds high inflation the following year. While the Bank of England and others have warned workers against ‘embedding’ inflation by linking their pay demands to high inflation, mobile companies are doing exactly this by linking their own price increases to last year’s CPI.
2.3 Pay-as-you-go consumers – usually older or on lower-incomes – faced price rises of up to 250% in 2022

This rise for pay monthly customers follows an up-to-250% increase in prices for pay-as-you-go customers – who are disproportionately of retirement age and on lower incomes – that Three announced in 2022.35

All these rises have come despite Ofcom, who have an advisory role in telecoms merger cases, pleading with telecoms firms in September to halt price hikes.36

Vodafone and Three also both recently reintroduced roaming fees for customers, despite previously saying they had no plans to do so.37
3 Will the merger increase investment in mobile infrastructure?

Behind the argument that a merger is necessary to make money available for investment lies an implicit argument that prices will rise. However, companies assert that this is necessary for investment – which, it is claimed, is financially unviable in a market with four MNOs.

The Department for Science, Innovation and Technology chose to title the finance section of its recent Wireless Infrastructure Strategy, ‘Strengthening the investment environment’, which at least one commentator regarded as a ‘nudge-nudge, wink-wink’ signal to allow the merger.\(^{38}\)

3.1 Previous mergers in other countries have not driven more overall investment, as firms can simply distribute additional profits

However, there is nothing to say that additional profits will necessarily be used for investment. Three themselves have previously said that the one-off gains from the sale of assets to TowerCo would at least partially be used for a share buy-back.\(^ {39}\)

The BEP report referenced in Section 1.1 found that MNOs in the US, which has an extremely concentrated mobile market, are more profitable than European firms. However, European firms are as profitable as US firms \textit{before deducting investment} – in other words the rate of investment out of profits is higher when there is a lesser degree of monopoly.\(^ {40}\)

When ruling against a similar merger between Three and O2 in 2016, the European Commission (EC) considered the evidence on the question of whether decreasing the number of MNOs leads to an increase in the total level of infrastructure investment:

\begin{quote}
“Research seems to suggest that a reduction of the number of mobile network operators from four to three in a national mobile market in the EU can lead to higher prices for consumers - but not that it leads to more investment per subscriber. In other words, it does not seem to lead to significantly higher overall investment in the market...”\(^ {41}\)
\end{quote}

\begin{quote}
“The Commission notes that the conceptually sounder studies in this respect indicate that mergers tend to have no effect on industry level investments (as measured by CAPEX). As, by definition, mergers involving MNOs reduce
\end{quote}
the number of MNOs in a given market, this finding implies that CAPEX per MNO increases (but not CAPEX per subscriber). The Commission does not however consider at this stage that the studies would allow inferences that an increase in the CAPEX per MNO increases the quality of networks or that consumers (who tend to pay higher prices for the same usage) would be overall better off as a result of mergers in the mobile telecommunication industry."\(^{42}\)

Indeed, the EC found that some studies indicated less overall investment following mergers:

“The report mentions that … for the subsample of European countries the point estimate indicates that concentration would be associated with a decrease in industry CAPEX. The estimate is statistically significant in one of the two specifications reported for this subsample”.\(^{43}\)

A major academic study (referenced in Section 1.1) also found no conclusive evidence of overall investment being higher as a result of MNO mergers.\(^{44}\)

### 3.2 Australian MNOs are investing 45 per cent less since the 2020 merger involving both Three’s parent company and Vodafone

As shown in the following chart, Australian MNOs have invested less and less in recent years despite the 2020 merger between Vodafone Hutchison Australia (itself owned by both Vodafone and Three’s parent, CK Hutchison) and TPG Mobile. In fact, all three MNOs are investing less in 2022 than they did in 2018 and 2019. Indeed, investment fell by 45 per cent between 2018 and 2022.\(^{45}\)

**Overall Investment by Australia’s MNOs: Telstra; Optus; TPG & VHA** \(^{46}\)
Implicit in references to topics like the ‘investment environment’ is a claim that Three and Vodafone are not currently making sufficient profits to be able to invest the necessary amount for the country’s future network.

However, there is no evidence that the UK’s 5G roll-out is suffering as a result of there being too many MNOs in the UK market. As noted by Ofcom:

“While MNOs have said that their financial performance in recent years has not been supportive of investment, they have all undertaken significant investment: a total of £2.7bn a year on average over the last five years. In addition, their business plans show that they plan further significant investment over the next few years, to deliver increased capacity and widespread rollout of 5G, with some looking to launch 5G standalone (5G SA) shortly.”

Moreover, because investment is paid for up-front but the benefits are realised over time, MNOs do not see the full returns from their large-scale outlays immediately in the form of a return on capital employed.

In other words, ‘low returns’ in the present – due to relatively high levels of investment – may well be foreshadowing high returns in the future. The claim that low returns are deterring investment, and that investment will be unlocked if profits are boosted, simply doesn’t stack up.
4 What will the merger mean for Three and Vodafone’s owners and staff?

Evidence from other countries indicates that the merger is likely to lead to be good for the companies’ owners and bad for their staff: with increased returns for the former, and job losses for the latter.

4.1 In Australia, the recent merger of Vodafone Hutchison Australia with TPG boosted profits, dividends and share buybacks

Since the 2020 merger taking the Australian market from four to three MNOs, money has flowed into shareholders’ pockets. In 2018 the combined net profit margin for TPG and VHA was 4%, and in 2019 it was -8%. Since the merger, the average profit margin has been 10%. The net profit margin in 2020 was 17%, which was partly down to tax benefits that arose as a result of the merger.

VHA and TPG Combined Profit Margins have risen since 2019

In addition, these profits appear to be going into shareholders’ pockets, rather than towards investment. The graph below shows the net cash invested by TPG and VHA before and after the merger. Investment has fallen every year since 2018, especially in 2022, when it fell to just 6% of its 2018 level.
Meanwhile, dividends and share buybacks have increased. Between 2018 and 2019, total dividends paid were £12 million. By contrast, the dividends paid out since the merger took place in 2020 amount to £340 million, a 2700% increase. Similarly, there were no share buybacks in 2018 or 2019, however following the merger there was a £4 million buyback in 2020 and an £8 million buyback in 2022.\(^5\)

**Dividends Paid Before and After the Merger\(^5\)**
4.2 A 2014 merger in Norway saw corporate earnings double

Most countries in Europe that have seen MNOs reduce from 4 to 3 do not have sufficiently disaggregated data to establish changes in overall sector profits before and after the merger.\textsuperscript{55} Norway, however, is an exception to this.\textsuperscript{56}

In 2015, Telia Norge and Tele2 Norge merged under the Telia Brand.\textsuperscript{57} The chart below demonstrates the combined revenue and profit of Telia Norge and Tele2 Norge before the merger, and Telia in Norway since the merger.\textsuperscript{58}

Revenue, EBITDA and Net Income

As evidenced above, revenue and both profit measures were declining before the merger, but revenue and EBITDA (earnings before interest, taxes, depreciation and amortisation) have increased steadily since. EBITDA was almost three times higher in 2022 than 2014. Net income was higher on average between 2016 and 2021 than before the merger, although this was cancelled out by a loss in 2022, which the company attributed to impairments.\textsuperscript{59,60}

Additionally, earnings margins have increased substantially since the merger, reaching a maximum of just over 45% in 2021 – a doubling since 2014.\textsuperscript{61}
4.3 Three & Vodafone are likely to use redundancies to increase profits: 1,600 jobs could go in the UK after the merger

There are around 13,500 employees of Vodafone and Three in the UK. According to their annual statements, Vodafone had 9,010 UK employees in 2021-22: 2,160 in sales and distribution, and 6,850 in administration. Three had 4,487 (3,591 in ‘operations’ and 896 in administration).

When Orange and T-Mobile merged to form EE, it was reported that the new company was to cut 7.5% of their 16,000-strong workforce “to strip out duplicated roles following the tie-up”. The recent merger between T-Mobile and Sprint in the US was followed by losses of 12% of workforce (a reduction from 80,500 to 71,000 since 2018, while revenue per employee rose from $849,000 (2019) to $1.12m).

On the basis of a 7.5-12% cut in jobs across the merged company, we could see 1,000-1,600 redundancies for Vodafone and Three staff. This is in addition to any job losses resulting from plans announced by Vodafone in May 2023 to axe 11,000 positions globally.
4.4 Vodafone have been clear that the proposed merger is about increasing profits

Those in charge of Vodafone have been clear about the real rationale for the merger: that it is about boosting profits. In February 2022, Vodafone’s then-CEO, Nick Read, was quoted as saying:

“We feel the UK needs to consolidate to give [us] industrial scale so we can improve returns ... We are approaching consolidation with speed and resolve.”66
5 Are mobile companies really struggling at the moment?

Robert Finnegan, chief executive of Three UK, claimed in March 2023 that the network’s investment plans would be unsustainable without a Vodafone merger. The basis for this was supposedly that, “Very simply, we’re spending more than we’re earning”. However, the image of a company which is struggling to stay afloat is not borne out by the figures. Meanwhile, Vodafone’s apparent unprofitability appears to be at least partly a result of accounting choices designed to minimise tax payments by transferring money to other Vodafone arms abroad.

5.1 Between 2017 and 2021, Three made after tax profits of more than £2 billion

Three UK is a profitable company. Between 2017 and 2021, it made combined after tax profits of more than £2 billion. This figure was boosted by bumper profits in 2021, but Three was still making an average of £200 million in annual net profits in the four years before that.

In 2021, EBITDA\(^1\) was £647m in 2021 on revenues of £2.31 billion: a healthy margin of 28%.

This figure also excludes the one-off gain from the sale of non-current assets e.g. the sale of physical tower assets to TowerCo/Cellnex.

5.2 In recent years, Three has chosen to concentrate on building future market share through investing its earnings rather than paying dividends

Of the company’s £647m of EBITDA in 2021, 44% was reinvested, predominantly in 5G capability. Recent company financial statements report that Three’s “market-leading 5G spectrum portfolio ... gives the company a competitive edge ... and the continuous 5G rollout plan differentiates Three compared from rest of the market [sic]”.

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\(^1\) EBITDA is Earnings Before Interest, Tax, Depreciation and Amortisation.
Investment has been high in recent years due to the roll-out of 5G. This has been made possible because EBITDA margins have also been high (between 28 per cent and 32 per cent since 2018).

**Hutchison 3, EBITDA as a percentage of revenue**

<table>
<thead>
<tr>
<th>Year</th>
<th>EBITDA Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>31.8%</td>
</tr>
<tr>
<td>2019</td>
<td>29.2%</td>
</tr>
<tr>
<td>2020</td>
<td>29.2%</td>
</tr>
<tr>
<td>2021</td>
<td>28.0%</td>
</tr>
</tbody>
</table>

Compared with their operations in other countries, 2022 figures from group accounts show higher rates of re-investment in the UK than in Hutchison’s other European subsidiaries (with the exception of Denmark, which also has four MNOs). This could indicate that, in countries with more MNOs, smaller companies in particular are incentivised to invest more for the future in their physical networks – an incentive which ultimately benefits future consumers.

Despite this, Three’s owner has pointed to a need to merge due to their low return on capital employed (ROCE); this alternative measure of profitability fell sharply in 2019 and has remained comparatively low since.71

ROCE is defined as operating income divided by assets. A company which is in a growth phase has a rapidly expanding asset base. According to Ofcom, Three’s fixed assets rose sharply from £2 billion to £3 billion between 2018 and 2020, and their ROCE fell as a result.72 Greater capital also results in greater depreciation of assets, pushing ROCE down further.
A recent Ofcom report highlighted the apparently low ROCE for Three (and Vodafone) since 2019, claiming that it is below the ‘cost of capital’.\textsuperscript{73} If a firm’s ROCE stays low for a long time, the argument is that it would struggle to attract external investment.

We can’t be sure what the specific cost of capital is for Three as it is privately owned and financed out of earnings. One indication, however, is the loans Three has made to other firms in the Hutchison group in recent years – which had interest rates of 0.74 per cent and 0.85 per cent.\textsuperscript{74} The cost of capital assumed by Ofcom, by contrast, is based on the ‘Other UK Telecoms’ part of BT Group and is around 8 per cent.\textsuperscript{75} If Three receives loans from other Hutchison group companies at a similar cost to the loans it provides, then its cost of capital would be significantly lower than that assumed by Ofcom – indicating that the basis on which it is claimed that Three’s ROCE is insufficient may be flawed.

Thus, not only do Three’s temporarily lower profits since 2019 suggest a firm in a growth phase, well-placed to take advantage of 5G in future, but their current ROCE may nevertheless be far higher than the company’s cost of capital. In short, claims about the company needing to merge in order to survive are not supported by the available evidence.

\section*{5.3 Three’s latest accounts suggest the company’s owners are looking to start paying out dividends}

In December 2021 Three’s share premium was reduced from £11.7 billion to £1 billion, raising the company’s accumulated profits from minus £4.6 billion to positive £7.5 billion. This represents money which can be distributed to shareholders in dividends, and suggests that the company may be looking to reward shareholders after years of reinvestment.\textsuperscript{76}

\section*{5.4 Three’s owners have a history of making threats to get their way}

Aside from their own accounts, there are good reasons to be suspicious of Three’s claims that their network is unsustainable.

The Sunday Times reported in May 2012 that CK Hutchison Co-Managing Director Canning Fok threatened to abandon Hutchison’s UK telecoms business unless it was given special treatment and guaranteed a generous allocation at an upcoming spectrum auction. The ultimatum was delivered at a meeting in Downing Street in
April 2012 with then-Prime Minister David Cameron, Culture Secretary Jeremy Hunt, and Ed Vaizey, at that time a minister in Hunt’s department. The article describes both Fok and Li Ka-shing as frequent visitors to 10 Downing Street due to their significant British business interests.\textsuperscript{77}

In 2021, Three said that their 5G investment would be threatened if they were not allowed to sell their phone masts to Cellnex.\textsuperscript{78} In 2022 the sale was investigated by the Competition and Markets Authority and approved subject to Cellnex divesting itself of a number of assets.\textsuperscript{79}

5.5 Three’s owners made pre-tax profits of £6.8 billion on its UK assets in the last five years

Three’s owners, the CK Group, have been highly profitable in the last five years. Over that period, the group has amassed £6.8 billion in pre-tax profits on their UK assets, and returned £2.6 billion in dividends to shareholders.\textsuperscript{80}

Huge profits have been accumulated from its other UK assets, including:\textsuperscript{81}

- £3.5 billion from its distribution and network operators, such as UK Power Networks
- £255 million from Northumbrian Water
- £304 million from its UK ports
- £335 million from Superdrug

In short, the CK Group is already extracting enormous profits from UK consumers. Any claim that the group’s investment plans are being held back due to insufficient profitability should be taken with a substantial pinch of salt.

5.6 Vodafone reported an operating loss of £318 million in 2021, but the company’s accounting tricks mask its true profitability

Vodafone UK appears to have made an operating loss for the past four years. In 2021, its operating loss was £318 million, which, despite being a decline from the operating profit of £187m reported for 2020, nonetheless constitutes an improvement in underlying business. 2020’s figure was flattered by a one-off “net gain on disposal of joint arrangement” of £679m, excluding which Vodafone made
a £492 million operating loss in 2020. In short, things were improving in 2021, but the recent headline picture is one of large operating losses.\textsuperscript{82}

Vodafone UK’s operating profit margin is also by far the lowest of the four UK MNOs; its operating margin in 2021 was -5.7\%, compared with an average of +21.1\% for all the MNOs.\textsuperscript{83} Unlike Three, lower profitability for Vodafone does not appear to be due to higher capital expenditure; Vodafone’s capex as a percentage of revenue averaged 13.2\% between 2018 and 2021, compared with an average of 17.5\% for the other three MNOs.\textsuperscript{84}

On the face of it, then, Vodafone’s claim that they are struggling with profitability in an excessively competitive market seems plausible.

However, in their annual report, Vodafone prefer to direct shareholders to their ‘adjusted’ accounts. According to this methodology, Vodafone UK’s results look far healthier: in 2021, Vodafone UK made ‘adjusted’ operating profits of £115.7 million (compared with the operating loss of £318 million referenced above).\textsuperscript{85}

According to notes accompanying the accounts, the difference between the adjusted and non-adjusted operating profit figures is due to the exclusion in the former of restructuring costs, interest on lease liabilities, and ‘group recharges deemed non-operational’ – with most of the difference between the two appearing to be made up of ‘group recharges’ (of the £433.4 million difference between adjusted and non-adjusted operating profits\textsuperscript{86}, restructuring and interest on leases appears to only account for £65.4 million\textsuperscript{87}).

\section*{5.7 MNO profitability is shielded from increased costs by ‘inflation plus’ contracts}

The Government’s Wireless Infrastructure Strategy claims that mobile operators are large consumers of energy and so are facing increased costs. They also “recognise that [the new telecoms security regulatory framework] represent[s] a significant cost”.\textsuperscript{88}

However, MNOs largely insulate themselves against input cost rises with ‘inflation plus’ clauses in customer contracts (see Section 2.2). These guarantee companies that when costs rise their income rises too. In addition, while it is unknown what additional costs the new regulatory framework imposes on MNOs, consumers should not be picking up the bill for companies meeting their legal requirements.
The Government’s Strategy also cites research from Deloitte showing that “mobile operators have experienced flat mobile revenues, and declining [overall] revenues since 2018 ... This is largely driven by falling average monthly revenue per user (ARPU) ... Even for upgraded services such as 5G, average prices have fallen in the last 5 year up to 2022 and overall UK prices for mobile services are some of the lowest in Europe.”

However, not only is the evidence provided for one specific form of contract only (including 5GB mobile data and 300 minutes), but falling data prices largely reflect the falling cost of providing data services due to technological advance: prices are calculated in terms of the cost of a terabyte of data, so progress from 3G to 4G then 5G leads to falling prices.

Furthermore, ARPU would be expected to fall as more people use mobile phones (due to population growth and/or greater take-up). Thus falling ARPU may be compatible with increasing revenue (and profits). Indeed, studies have found that EBITDA can rise at the same time as ARPU falls.

5.8 EE and O2 recorded combined operating profits of £2.4 billion in 2021

EE made operating profits of almost £1.6 billion in 2021, and combined operating profits of £6.1 billion between 2018 and 2021. The company has consistently had an operating margin over 20% in the last four years, and has paid out almost £1.7 billion in dividends.

Meanwhile, O2 made operating profits of just under £800 million in 2021, and combined profits of almost £3.2 billion between 2018 and 2021. Over the same time period, the company paid out dividends of almost £1.5 billion.

What this shows is that even in a supposedly excessively competitive market, well-run MNOs are capable of recording a profit – indicating that if Three and Vodafone’s owners want higher profits, it’s their management they should look to, rather than blaming the state of the market.

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Unite analysis of Telia, Tele2 Norge and Telia Norge Accounts

Telia Company, retrieved 19/04/2023

Unite analysis of Telia, Tele2 Norge and Telia Norge Accounts. Note that Telia Norge has a 2014 figure through projections by unite based on previous years. Note that data on Telia in Norway was missing in 2015, the year of the merger, but the other two companies ceased reporting in 2013 (Telia Norge) and 2014 (Tele2). Unite analysis of Telia, Tele2 Norge and Telia Norge Accounts. Note that Telia Norge has a 2014 figure through projections by unite based on previous years.

Telia Company Annual Report 2022, pg 26

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