Case Study 1

1.1.1 Victor Group plc Background Information

Unit:	Study Unit 3 – Strategic Treasury Solutions
Case:	Case study 1 – Treasury opportunities
Date:	1 September 2016
Summary:	Background information on Victor Group Plc, the subject company for Study Unit 3, Case Study 1. Includes a wide range of detailed data on the company's strategy, structure and financial condition in addition to summary financial data, including primary financial statements.
Key words:	strategy, acquisitions, financial structure

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1 Company background

It is January 2017. Victor is one of the global leaders in the mobile and fixed line telecommunications industry providing services for individuals, enterprises and communities, with nearly 450 million mobile customers across 4 continents. Its wider market place is in telecommunications with mobile, fixed line and unified communication providing, voice, messaging and data services with a view to keeping its customers connected wherever they are. It seeks competitive advantage by being one of the world's largest operators with leading technology and market positions while adding first class customer service. It offers mobile, fixed line, Cloud and Hosting services as well as M2M business solutions.

Around 2/3rd of revenue comes from European markets and 1/3rd from emerging markets, notably India. Its market share of mobile in each market is typically 20-50% but lower in fixed line offerings. While most revenue is in controlled subsidiaries, in places where it does not use subsidiaries, it uses associates and joint ventures and in some cases "Partner Markets", in additional territories, without the need for equity investment. Mobile service is offered in 24 countries, fixed line in 17 of these and 57 other markets are accessed through non subsidiary routes.

More detailed information on Victor is shown in the Appendix.

2 Business strategy notes[1]

Victor has maintained a strategy of adopting both organic and acquisitive growth to provide enhanced network coverage (both fixed and mobile) to provide customers with the best mobile and data services. Improved services leads to increased volume usage and income. Data volume nearly doubled in the most recent financial year to nearly 1 exabyte across the mobile network. A disposal of the holding in a large associate company in 2015 has allowed several acquisitions to infill mostly fixed line services, embark on a £19 billion investment programme (Project Bounce) as well as return some money to shareholders.

The demand for data is accelerating and Victor sees the future as improved infrastructure, growth in emerging markets and further products such as mobile money management and M2M services, the Internet of Things.

Whilst the customer base continues to grow, Victor's strategy is increasingly focused on revenue growth and margin improvement from growing usage and providing enhanced services to the customer base.

There is a large degree of competition, from both other mobile operators (and virtual mobile operators) and fixed line operators, each of whom try and bundle services. However, some consolidation recently might improve this background. Regulation is also a key limiter on growth, especially in the more mature markets of Europe.

[1] Victor's year end is 31 March. Financial information is derived from the financial statements for the year ended 31 March 2016. For working purposes, assume that all quoted amounts are materially the same as at today.

To tap the vast global potential, it has controlled operations in 24 markets and also associate, jv partnership participations in 57 other markets. It seeks to grow markets where it can.

Victor is dedicated to embracing shareholder value. It sees the forces impacting on its business as customers, technology, competition and regulation.

The priorities for the 2017 financial year are:

1	Increase commercial commercial momentum in 4G and NGN (Next Generation Networks).	Many networks are 3G only, penetration of 4G in European markets is only 72% (although doubled in 2016). 5G is currently under discussion and is a possibility for the early 2020s
2	Complete Project Bounce investment and significantly improve customer service.	Project Bounce is a capital investment programme with many aims, such as European 90% 4G coverage and Indian 95% 3G coverage.
3	Launch unified communications products in remaining markets & continue with Enterprise expansion.	Unified communications is the mix of mobile and fixed line services. Enterprise is complete communication / data storage for businesses.
4	Return to EBITDA growth and achieve cost synergies of acquisitions.	
5	Extend to all markets.	Provide the Victor culture, products and customer service worldwide.
6	Continue to grow dividend per share.	Dividends have grown strongly in recent years, around 7% until 2016 where the growth was 2%.

3 Company operations

Summary of Victor worldwide presence at 31 March 2016:

Market (approx. ownership)	**Mobile customers (m)**	**Turnover (£bn)**	**Organic growth in 2015 (%)**	**Mobile market share (%)**	**Fixed line market share (%)**
Germany, 100%	**31**	**8.5**	**(3.2)**	**33**	**20**
UK, 100%	**18**	**6.4**	**(1.2)**	**24**	**4**
Italy, 100%	**25**	**4.6**	**(9.3)**	**32**	**6**
Spain, 100%	**14**	**3.7**	**(9.3)**	**30**	**11**
India, 100%	**184**	**4.3**	**13.0**	**23**	

Victorcom (Africa), 65%	**69**	**4.3**	**2.4**	**53**	
Other	**105**	**10.4**			
Total	**446**	**42.2**	**(0.8)**	**6.2**	**c1.7%**

This is an overview of spectrum licence expiry dates:

	800MHz	900 MHz	1800MHz	2100MHz	2600MHz
Germany	2026	2017	2017	2021	2026
Italy	2030	2019	2019	2022	2030
UK	2034	notice	notice	notice	2034
Spain	2031	2029	2031	2031	2031
Netherlands	2030	2031	2031	2017	2031
Ireland	2031	2031	2016	2023	
Portugal	2028	2022	2022	2017	2028
Romania	2030	2030	2030	2021	2030
Greece	2031	2028	2027	2022	2031
Czech Republic	2030	2022	2022	2026	2030
Hungary	2030	2023	2023	2020	2030
Albania		2017	2017	2026	
Malta		2027	2027	2021	
India		various	various	2031	
South Africa		2029	2029	2029	
Turkey		2024		2030	
Australia	2029	2029	annual	2017	
Egypt		2023	2023	2023	
New Zealand	2032	2032	2022	2022	2029
Kenya		2025	2025	2023	
Ghana		2020	2020	2024	
Qatar	2030	2029	2029	2029	

The Group's businesses are principally:

Service	Revenue (£bn)	% of revenue
Mobile telecommunications services	29.3	69
Fixed line telecommunications	7.7	18
Other	1.5	4
Equipment sales	3.7	9
Total	**42.2**	**100**

Segmental analysis

Year ended 31 March 2016					
£m		Revenue	EBITDA	Non current assets	Capex
Germany		8,426	2,670	19,521	2,003
Italy		4,627	1,537	6,938	1,105
UK		6,356	1,360	7,759	980
Spain		3,639	783	8,154	858
Other Europe		4,976	1,574	8,189	1,083
Europe		**28,024**	**7,924**	**50,561**	**6,029**
India		4,298	1,281	8,599	882
Africa		4,341	1,527	4,712	745
Other		5,564	1,183	6,221	1,541
Group		**42,227**	**11,915**	**70,093**	**9,197**

4 Group risks

Victor has identified 10 major risks, as follows:

Operational risks	**External risks**	**Strategic risk**	**Reputational risk**
Malicious attack on network or IT infrastructure	Adverse political pressure	Competition by convergence	Customer health
Customer data misuse or leakage	Economic conditions	Competition by product substitution (e.g. internet messaging / voice)	
Contract risk with large corporates and governments			
Product competition on pricing and service			
Network / IT failure			

5 Group net debt

An analysis of net debt is as follows:

£m	**2015**	**2016**
Cash at bank and in hand	1,498	2,379
Money market funds	3,648	2,402
Repurchase agreemnts	4,799	2,000
Commercial paper		101
Securitised investments	189	
Cash at bank and in hand	**10,134**	**6,882**
Bank loans	(1,263)	(1,876)
Bank overdrafts	(22)	(21)
Commercial paper	(950)	(5,077)
Bonds	(1,783)	(1,786)
Other	(3,729)	(3,863)
Short term borrowings	**(7,747)**	**(12,623)**
Bank loans	(4,647)	(5,128)
Bonds	(16,697)	(17,174)
Other	(110)	(133)
Long term borrowings	**(21,454)**	**(22,435)**
Other financial instruments	**5,367**	**5,905**
Net debt	**(13,700)**	**(22,271)**

The commercial paper programme is structured as follows:

Location	**Programme size**	**Drawings 2016**	**Support by syndicated bank facility**
US	USD 15 billion	USD 3,321 million	USD 3.9 billion maturing 27 February 2021
Euro	GBP 5 billion	EUR 3,928 million	EUR 3.9 billion facility maturing 28 March 2021

Victor has a EUR 30 billion euro medium-term note programme and a US shelf programme. Drawings at 31 March 2016 were USD 14.6 billion, GBP 1.7 billion and EUR 7.8 billion.

The maturity of debt is as follows:

Maturity of net debt	Bank loans	Commercial paper	Bonds	Other	Total
Within one year	1,928	5,092	2,461	3,885	13,366
In one to two years	831		1,866	18	2,715
In two to three years	1,090		3,481	11	4,582
In three to four years	920		1,817	12	2,749
In four to five years	862		1,236	12	2,110
In more than five years	1,660		13,076	115	14,851
Discounting effects	(287)	(15)	(4,977)	(36)	(5,315)
Total	**7,004**	**5,077**	**18,960**	**4,017**	**35,058**

Note that in the table above, commercial paper could be considered to be maturing in up to five years' time because of its support from syndicated bank facilities.

In aggregate, Victor has committed bank facilities of approximately £11 billion, of which £6.6 billion was undrawn at 31 March 2016. All bond finance is raised centrally but the majority of bank finance is used to support local operations, the largest of which is a INR 457 billion (£4.9 billion) loan to Victor India. Such facilities are a mix of recourse and non-recourse financing.

Foreign exchange and interest rate analysis of debt and net debt:

2016	Floating rate	Fixed rate	Other	Total	Fixed rate average rate (%)	Fixed rate average maturity (years)
Sterling	55	2,046	7	2,108	6.3	8.1
Euro	4,252	13,972	1,307	19,531	3.4	7.5
US Dollar	7,782	180		7,962	2.8	3.5
Other	2,898	2,559		5,457	9.6	0.6
Total	**14,987**	**18,757**	**1,314**	**35,058**		
2015	**Floating rate**	**Fixed rate**	**Other**	**Total**	**Fixed rate average rate (%)**	**Fixed rate average maturity (years)**
Sterling	885	1,910	6	2,801	5.7	2.5
Euro	4,557	10,220	1,448	16,225	4.4	2.6
US Dollar	4,330	207		4,537	2.9	5.7
Other	2,768	1,988	882	5,638	10.2	1.4
Total	**12,540**	**14,325**	**2,336**	**29,201**		

An analysis of Victor net debt by currency and interest rate, post derivatives, is as follows:

Currency	Percentage of net debt	Forecast interest rate
Euro	86	2.6%
US Dollar	10	1.0%
Sterling	(30)	0.5%
Indian Rupee	25	10.0%
South African Rand	5	7.0%
Other	4	4.0%

6 Treasury policy

Victor's treasury function provides a centralised service to the Group for funding, foreign exchange, interest rate management and counterparty risk management. Treasury operations are conducted within a framework of policies and guidelines authorised and reviewed annually by the Board. A Treasury Risk Committee, comprising of the Group's Financial Officer, Group Treasury Director and Director of Financial Reporting, meets three times a year to review treasury activities and its members receive management information relating to treasury activities on a quarterly basis. Victor's accounting function, which does not report to the Group Treasury Director, provides regular update reports of treasury activity to the Board. Victor's internal auditor reviews the internal control environment regularly.

Victor uses a number of derivative instruments for currency and interest rate risk management purposes only that are transacted by specialist treasury personnel. Victor mitigates banking sector credit risk by the use of collateral support agreements.

Funding and liquidity

Victor's policy is to borrow centrally, using a mixture of long term and short term capital market issues and borrowing facilities, to meet anticipated funding requirements. These borrowings, together with cash generated from operations, are on-lent or contributed as equity to certain subsidiaries.

Victor manages liquidity risk on long-term borrowings by maintaining a varied maturity profile with a cap on the level of debt maturing in any one calendar year, therefore minimising refinancing risk. Long-term borrowings mature between one and 28 years. Liquidity is reviewed daily on at least a 12 month rolling basis and stress tested on the assumption that all commercial paper outstanding matures and is not reissued.

Interest rate management

Victor's main interest rate exposures are to euro and Indian rupee and, to a lesser extent sterling interest rates.

Under Victor's interest rate management policy, interest rates on monetary assets and liabilities denominated in euros, US dollars and sterling are maintained on a floating rate basis except for periods up to six years where interest rate fixing has to be undertaken in accordance with treasury policy. Where assets and liabilities are denominated in other currencies interest rates may also be fixed. In addition, fixing is undertaken for longer periods when interest rates are statistically low.

Foreign exchange translation exposure management

Victor's primary listing is on the London Stock Exchange and so its share price is quoted in sterling. Since the sterling share price represents the value of its future multi-currency cash flows, principally in euro, South African rand, Indian rupee and sterling, Victor maintains the currency of debt and interest charges in proportion to its expected future principal multi-currency cash flows. As Victor's future cash flows are increasingly likely to be derived from emerging markets it is likely that a greater proportion of debt in emerging market currencies will be drawn.

At 31 March 2016, 129% of net debt was denominated in currencies other than sterling (86% euro, 23% India rupee 11% US dollar and 9% other) while 29% of net debt had been purchased forward in sterling in anticipation of sterling denominated shareholder returns via dividends. This allows euro, US dollar and other debt to be serviced in proportion to expected future cash flows and therefore provides a partial hedge against income statement translation exposure, as interest costs will be denominated in foreign currencies.

Foreign exchange transaction exposure management
Victor has a policy to hedge external foreign exchange risks on transactions denominated in non-base currencies above certain de minimis levels. Under this policy, foreign exchange transaction exposure in Group companies is generally maintained at the lower of €5 million per currency per month or €15 million per currency over a six month period.

Counterparty risk management
Cash deposits and other financial instrument transactions give rise to credit risks on the amounts due from counterparties. Victor regularly monitors these risks and the credit ratings of its counterparties and, by policy, limits the aggregate credit and settlement risk it may have with any one counterparty.

Victor invests in UK index linked government bonds on the basis that they generated a floating rate return in excess of £ LIBOR and are amongst the most creditworthy of investments available. Victor has two managed investment funds. These funds hold fixed income sterling securities and the average credit quality is high double A. Money market investments are in accordance with established internal treasury policies which dictate that an investment's long-term credit rating is no lower than mid BBB. Additionally, Victor invests in AAA unsecured money market mutual funds where the investment is limited to 7.5% of each fund. Victor has investments in repurchase agreements which are fully collateralised investments. The collateral is sovereign and supranational debt of major EU countries with at least one AAA rating denominated in euros, sterling and US dollars and can be readily converted to cash. In the event of any default, ownership of the collateral would revert to Victor.

In respect of financial instruments used by Victor's treasury function, the aggregate credit risk Victor may have with one counterparty is limited by (i) reference to the long-term credit ratings assigned for that counterparty by Moody's, Fitch Ratings and Standard & Poor's; (ii) that counterparty's five-year credit default swap ('CDS') spread; and (iii) the sovereign credit rating of that counterparty's principal operating jurisdiction. Furthermore, collateral support agreements were introduced from the fourth quarter of 2008.

Corporate finance and investment appraisal policies
Victor does not pursue the idea of an optimum capital structure. Instead it aims to align its policies to achieve the equivalent of a single A rating. It puts a high value on the real option value of having spare debt capacity to facilitate the pursuit of sizeable acquisitions.

Group borrowing and tax efficiency are managed centrally making use of intra group transactions and operating company opportunities.

Victor uses the APV method for evaluating projects, based on the un-geared equity value but making allowance for the value of the tax shelter on debt as appropriate. For further details see 4th edition of Damodaran (pages 376-381). It does, however, exclude the cost of its own bankruptcy from the valuation.

Evaluation is based on local currency cash flows and local currency discount rates.

Victor's current ratings are as follows:

Agency	Long term	Short term
Standard & Poor's	BBB+	A2
Moody's	Baa1	P2

7 Appendix – Detailed company information

7.1 How Victor makes money

Victor invests in superior telecommunications networks so that it can sustain high levels of cash generation, reward shareholders and reinvest in the business – thus creating a virtuous circle of investment, revenue, strong cash conversion and reinvestment.

7.1.1 Spectrum, network and IT infrastructure

Victor uses its spectrum licences to provide the radio frequencies needed to deliver communications services. Victor combines base station sites and expertise in network management to transmit signals for mobile services. Through fixed broadband assets (cable, fibre and copper) and wholesale agreements with other operators, Victor provides broadband, voice and TV services. Its IT estate provides data centres, customer relationship capability, customer billing services and online resources.

7.1.2 Revenue

The majority of revenue comes from selling mobile voice, text and data. Mobile users pay either monthly via fixed term contracts (typically up to two years in length) or prepay by topping up their airtime in advance of usage. Enterprise customers are typically on contracts that last between two to three years. Over 90% of mobile customers are individual consumers and the rest are enterprise customers. A growing share of mobile revenue arises from monthly fees rather than metered access, which is much more vulnerable to competitive and economic pressures. Fixed customers typically pay via one to two year contracts, and as a result fixed revenue streams are more stable than mobile.

7.1.3 Cash flow

The track record of converting revenue into cash flow is strong – with some £11.2 billion generated over the last three years. Victor achieves this by operating efficient networks where it seeks to minimise costs, thus supporting gross margin. Victor also has strong local market share positions – typically the first or second largest mobile operator in each market with a share of more than 20%. This provides in-market scale efficiencies to support EBITDA margin, which in turn provides healthy cash flow.

7.1.4 Reinvestment

Cash flow helps to maintain a high level of investment to give customers a superior network experience, which over time should enable Victor to secure a premium positioning in most markets. Victor also continues to participate in spectrum auctions to secure a strong portfolio of spectrum. Over the last three years Victor has committed £21 billion in capital investment in networks, IT and distribution, a further £4 billion on the renewal and acquisition of spectrum and £13 billion on acquiring new fixed line businesses.

7.1.5 Shareholder returns

The cash generated from operations allows Victor to sustain generous shareholder returns while also investing in the future prosperity of the business. In the 2015 calendar year Victor was the fifth largest dividend payer in the FTSE 100. Over the last three years Victor has returned almost £13 billion to shareholders, in the form of ordinary dividends, excluding share buy backs and the VeriVizion Return of Value (disposal of an associate). In addition, Victor has increased the dividend per share every year for more than 15 years.

7.2 How Victor sets itself apart

Victor aims to differentiate itself from competitors by offering a leading network, leveraging the benefits of large scale, global reach and international brand; by its leading position in enterprise; and by training and developing the best people.

7.2.1 Network quality

Victor aims to have the best mobile network in each of its markets, combined with competitive fixed networks in main markets. This means giving customers broad coverage, a reliable connection, and increasing speeds and data capacity.

Key differentiators:
Victor is one of the world’s largest mobile operators with 283,000 base station sites. Victor has the best or co-best mobile data networks in 16 out of 20 markets. Victor has a leading holding of spectrum in most of its key markets and Victor own the largest cable companies in Germany and Spain. Project Bounce, the £19 billion investment programme, aims to strengthen further network and service differentiation.

7.2.2 Service design

The mobile services Victor provides are carefully designed to meet the needs of targeted customer segments. For example, SIM-only plans which do not include a handset for customers focused on value, shared data plans for families, and bundles including generous data allowances, content, roaming, cloud storage and internet security for those wanting worry-free solutions. Victor can also design bespoke solutions to meet the needs of its business customers, whatever their size. The majority of fixed revenue is from home and office broadband solutions, including TV and calls over a landline. The remainder arises from carrying other operators’ international traffic across sub-sea cable systems.

Key differentiators:
Victor is typically either number one or number two in mobile enterprise in most of its markets. Victor has a comprehensive portfolio of total communication services including mobile, fixed, Cloud and Hosting, and M2M business solutions

7.2.3 Branding and marketing

Victor communicates its services to customers through clear and effective branding and marketing. The strength of the brand is a major driver of purchasing decisions for consumers and enterprise customers alike. For example, in only 30 months, Victor Red, the globally branded pricing plan (providing bundles of unlimited voice, text and generous data allowances) has over 20 million customers.

Key differentiators:
Victor is the UK's most valuable brand with an attributed worth of US$27 billion.

7.2.4 Sales

Victor sells mobile services through a variety of distribution channels. Shops comprise exclusive branded stores, distribution partners and third party retailers. Branded stores enable customers to test products and services before they buy, obtain advice from sales advisors, and top-up their price plans. Online channels, whether accessed through a mobile device or PC, are becoming much more important and Victor is upgrading IT estate to meet this growing demand. Branded channels (including online and telesales) account for around 60% of new consumer contract customers and around 90% of contract renewals in Europe. Third party channels account for around 40% of acquisitions. Large corporate customers are served by a direct sales team; small and medium-sized companies are managed through a network of around 2,000 indirect partners, and sole traders are serviced via retail stores and telesales capabilities. The transition towards unified communications is changing how Victor reaches customers. The fixed line businesses use door-to-door selling and more telesales than our other services. Mobile money service M-Pesa, enables users to top up their airtime as well as providing access to financial services.

Key differentiators:
Victor has over 16,000 exclusive branded shops across the globe. In India, Victor supplements the branded stores with 1.8 million small-scale outlets for top-ups, significantly more than any competitor. In the established M-Pesa markets of Kenya and Tanzania, Victor is the market leader for mobile money services

7.2.5 Customer service

Victor has over 17,000 employees dedicated to providing customer service, supported by contractors and third parties. All call centres are available 24 hours a day, seven days a week in all European markets, and this is now being rolled out across remaining markets outside Europe. In an increasingly digital age Victor also offer live webchat capability, and selfcare, either via a handset, tablet or laptop, to enable customers to self-diagnose and resolve their own queries.

Key differentiators:

Victor is both a multinational and a multicultural company, and the diverse workforce helps to better understand and meet the needs of customers. Victor employs people from over 130 countries, with 24 nationalities among the Senior Leadership Team.

7.3 The focus for expansion

An area identified for investment by Victor is in the fixed line market, with mobile and fixed line services bundled into one package for customers. The acquisitions in 2016 were mostly around increasing fixed line capability and is a focus for future expansion.

7.3.1 Background

- Customers increasingly want access to their content – photos, videos, music, internet – wherever they are, and on whatever device they are using – phone, tablet, laptop or TV screen
- Customers are agnostic about using fixed or mobile networks – the most important requirement is a reliable connection
- The market sees a growing demand for both combined fixed and mobile bundles and pay TV and broadband packages
- The growing demand for data requires a strong backhaul network with high speed fixed fibre or microwave capability linked to the mobile radio network

7.3.2 What is unified communications?

More and more customers are consuming bundled fixed and mobile services which often provide better value for money, and increasingly, one single bill and one single point of contact. To meet this evolving demand requires seamless high speed connectivity through the integration of multiple technologies such as 3G, 4G, WiFi, cable and fibre. Victor calls this "unified communications".

7.3.3 The market opportunity

Victor is well established in mobile, with a market share in Europe of over 20%. In the fixed market, where Victor is building presence, the market share is currently around 10%, giving a real opportunity to grow in this space.

The bundling of fixed and mobile services has been a feature of the enterprise (business) market for several years and it is becoming increasingly important for consumers too. In a number of key European markets, a large share of households already take combined fixed and mobile bundles – including 50% in Spain and 25% in Portugal – and Victor sees clear signs of this expanding to other countries. During the year competitors of Victor launched new convergent offers in several key European markets and Victor responded with offers of its own. Therefore, it is critical for Victor to continue to develop fixed broadband services alongside established mobile assets so that it can compete in this growing segment.

7.3.4 Victor's strategy

Victor's goal is to secure access to high speed fixed broadband infrastructure in all its major European markets. It will continue to do this either through building its own fibre, wholesaling (renting) from incumbent fixed operators or acquisitions. Victor decides which approach to adopt on a market by market basis, taking into account the cost of building own fibre, the economics of the wholesale terms on offer, the speed of market development, and the availability of good quality businesses to acquire.