European Telecoms

STRATEGY

The outlook for 2015

Figure 1: European telecom revenues are inflecting

Source: Company data, Credit Suisse

- We remain positive on European telecom stocks, expecting European revenues to continue to recover. We expect rising demand for high speed data to continue to drive demand for higher ARPU fixed lines and bigger mobile data bundles, whilst cannibalisation of out-of-bundle revenues is diminishing. Berec’s recent recommendation to scrap Roam Like at Home reduces the probability of one of the downside risks to this view. Sector M&A is also likely to continue to focus on in-market scale, generally value-creating. This is the best outlook for the sector in 15 years, in our view.

- **Stock Calls:** We prefer stocks with a high degree of exposure to Europe (rather than international markets), rating BT, DT, KPN, Liberty Global, TEFD, Telekom Austria and Vodafone all Outperform. We are less positive on Swisscom and Elisa (both Underperform) where this revenue inflection has already happened and been priced in, in our view. We remain less positive on the domestic wireline outlook for TI and Orange (both rated Neutral), whilst remaining Restricted on Telefonica. Telenor and Telia’s high international exposure also makes them less attractive (both Neutral).

- We have also upgraded our view on European satellite (rating Eutelsat, SES and Inmarsat Outperform), as rising demand for 4k (higher definition video) coincides with an improving outlook for US defence spend (see our Ideas Engine note published yesterday).
## Summary of our stock recommendations

**Figure 2: Summary of recommendations**

<table>
<thead>
<tr>
<th>Company</th>
<th>Ticker</th>
<th>FX</th>
<th>Price Target</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Outperform</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BT</td>
<td>BT.L</td>
<td>GBP</td>
<td>4.40</td>
<td>Significant upside from RPL growth and cost cutting (both underestimated by consensus). Potential EE acquisition likely to create material synergies</td>
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<tr>
<td>Deutsche Telekom</td>
<td>DTEGn.F</td>
<td>Eu</td>
<td>13.0</td>
<td>German EBITDA inflecting. Likely to continue to take share in US mobile</td>
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<tr>
<td>Eutelsat</td>
<td>ETL.PA</td>
<td>Eu</td>
<td>32.0</td>
<td>Improving outlook for Ultra HD and a potential rebound in US defence spend</td>
</tr>
<tr>
<td>Inmarsat</td>
<td>ISAT.L</td>
<td>GBP</td>
<td>8.5</td>
<td>Structural competitive advantage reinforced by Global Express</td>
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<tr>
<td>KPN</td>
<td>KPN.AS</td>
<td>Eu</td>
<td>3.40</td>
<td>Worth eu3.40 on sale of TEFD stake/buyback</td>
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<tr>
<td>Liberty Global</td>
<td>LBTYA.O</td>
<td>US$</td>
<td>55.0</td>
<td>Still benefiting from pricing power with price increases in several of its key markets</td>
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<tr>
<td>NOS</td>
<td>NOS.LS</td>
<td>Eu</td>
<td>5.20</td>
<td>Price competition improving and strong potential for opex synergies with Optimus</td>
</tr>
<tr>
<td>Rai Way</td>
<td>RWAY.MI</td>
<td>Eu</td>
<td>3.5</td>
<td>Defensive business model with growing dividends</td>
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<td>SES</td>
<td>SESFd.PA</td>
<td>Eu</td>
<td>33.0</td>
<td>Improving outlook for Ultra HD and a potential rebound in US defence demand</td>
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<tr>
<td>TalkTalk</td>
<td>TALK.L</td>
<td>GBP</td>
<td>3.0</td>
<td>On course to hit medium-term growth and margin targets</td>
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<td>TEF Deutschland</td>
<td>O2Dn.DE</td>
<td>Eu</td>
<td>4.8</td>
<td>EBITDA to beat consensus due to competition reducing, a cut back in eplus SAC and from merger synergies</td>
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<tr>
<td>Tele2</td>
<td>TEL2b.ST</td>
<td>SEK</td>
<td>85.0</td>
<td>Swedish mobile competition remains benign</td>
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<tr>
<td>Telekom Austria</td>
<td>TELA.VI</td>
<td>Eu</td>
<td>9.6</td>
<td>Approaching the inflection point in mobile and upside potential in fixed line</td>
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<tr>
<td>Telenet</td>
<td>TNET.BR</td>
<td>Eu</td>
<td>42.0</td>
<td>Regulation impact expected to be low</td>
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<tr>
<td>Vodafone</td>
<td>VOD.L</td>
<td>GBP</td>
<td>2.50</td>
<td>Further upside from an inflection in European revenue y/y trends, driven by 4G data</td>
</tr>
<tr>
<td><strong>Underperform</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Swisscom</td>
<td>SCMN.VX</td>
<td>CHF</td>
<td>560.0</td>
<td>Revenue growth already priced-in and now at risk from Xavier Neil buying Orange CH</td>
</tr>
<tr>
<td>Elisa</td>
<td>EL1V.HE</td>
<td>Eu</td>
<td>24.0</td>
<td>Revenue growth already priced-in</td>
</tr>
<tr>
<td><strong>Neutral</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Belgacom</td>
<td>BCOM.BR</td>
<td>Eu</td>
<td>28.0</td>
<td>Wireline duopoly. Mobile improving post price-war</td>
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<td>Bouygues</td>
<td>BOUY.PA</td>
<td>Eu</td>
<td>30.0</td>
<td>Mobile inflecting but macro still a pressure on the rest of the Bouygues Group</td>
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<td>Iliad</td>
<td>ILD.PA</td>
<td>Eu</td>
<td>140</td>
<td>Binary, dependent on outcome of mobile consolidation</td>
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<td>Mobistar</td>
<td>MSTAR.BR</td>
<td>Eu</td>
<td>14.0</td>
<td>Pressure on mobile diminishing. Potential target for Telenet.</td>
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<td>Orange</td>
<td>ORA.PA</td>
<td>Eu</td>
<td>16.0</td>
<td>Mobile bottoming out and EBITDA stabilisation during 2015 looks credible</td>
</tr>
<tr>
<td>TDC</td>
<td>TDC.CO</td>
<td>DKK</td>
<td>53.0</td>
<td>Mobile market now consolidating. Regional footprint expansion unlikely to create value.</td>
</tr>
<tr>
<td>Telecom Italia</td>
<td>TLIT.MI</td>
<td>Eu</td>
<td>1.0</td>
<td>Mobile outlook improving but wireline remains a drag. Brasil sale unlikely.</td>
</tr>
<tr>
<td>Telenor</td>
<td>TEL.OL</td>
<td>NOK</td>
<td>142</td>
<td>EM exposure no longer as attractive vs Europe</td>
</tr>
<tr>
<td>TeliaSonera</td>
<td>TLSN.ST</td>
<td>SEK</td>
<td>49.0</td>
<td>Sweden remains strong but increased pressure in EM assets (Eurasia+Russia)</td>
</tr>
<tr>
<td><strong>Restricted</strong></td>
<td></td>
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<tr>
<td>Altice</td>
<td>ATCE.AS</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telefonica</td>
<td>TEF.MC</td>
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</table>

*Source: Credit Suisse estimates*
European mobile to continue to recover

Figure 3: We forecast European mobile to return to stable revenues by 2016-2017E

Source: CS estimates

We expect European mobile revenues to continue to recover, approaching stability in 2016. We expect mobile price erosion to continue to slow, driven by the prices of an increasing number of the challengers approaching a marginal cost floor, as we have previously argued. Equally, we expect a fast adoption of 4G during 2015, with 50% of smartphones being 4G by end 2015, driving demand for bigger data bundles. Taken together, this is likely to bring a continued improvement in y/y trends for European mobile revenues. Roam Like at Home (RLaH) is, in our view, the biggest threat to this turn-around, but the EU proposal now looks less likely following Berec's advice to drop the whole idea. Meanwhile a return to actual growth depends on how much 4G data usage expands beyond initial adoption – early figures are encouraging but not conclusive.

Figure 4: CS forecasts for Vodafone Europe 4G penetration
% of Vodafone smartphone users that are using 4G (CS forecasts)

Source: Credit Suisse estimates
Figure 5: CS forecasts for European mobile – by main revenue segment

- Mobile service revenue growth
- Impact from data growth
- Impact from MTRs
- Impact from roaming

Source: Credit Suisse estimates

Figure 6: Best price in each market* vs cost to deliver

Price (ex VAT) vs Cost to deliver*

Source: Credit Suisse estimates * including enough data for typical smartphone customer
Wireline revenues to continue to improve as well

We forecast demand for high speed broadband over fixed lines to continue to rise, as coverage is extended, as the availability of video-rich web content rises and as the number of internet devices per household continues to rise. Cable is positioned to continue to maintain its speed advantage over the telcos, with most telcos building FTTc (50-100Mbps) whilst cable operators are already testing 500Mbps+. However rising high speed broadband demand will also allow telcos to better monetise the higher wholesale prices allowed on such lines, under EU regulation – as a result, incumbent wireline revenues are likely to continue to benefit from slowing line loss and improving RPL trends, with incumbent wireline revenues potentially turning positive in aggregate at some point in 2015 – see Figure 8.

Source: Company data, Credit Suisse estimates

Figure 8: Incumbent wireline revenue trends on track to turn positive in 2015E

Source: Credit Suisse estimates
From challengers to challenged

Most European telecoms multi-millionaires have been made in the ULL/MVNO side of the industry in the last 10 years. However, the ‘free ride’ is increasingly over, with the outlook becoming tougher for such challengers.

- Unbundlers still have positive margins in reselling FTTc, but they are much lower than the 60% gross margins open to them on copper ULL. As demand for high speed broadband rises, life becomes less easy.

- In mobile, most 3rd/4th mobile operators are shrinking and have failed to achieve scale, despite operating for up to twenty years. They now face the cost of building 4G and further spectrum costs in the coming years. Many will continue to seek to exit, encouraging more consolidation. Some will be bought, others may be left to flounder (e.g. Yoigo, Tele2Neths).

- As the challengers fall behind in mobile coverage, MVNOs no longer have such an easy time, encouraging more fixed line operators to combine with mobile networks.

Incumbents (PTTs and Vodafone) should perform better in this environment vs challengers, at least relative to the last 15 years. Some challengers will benefit from take-out premia, but picking such winners comes partly down to chance. We therefore focus on the incumbents.

Figure 9: The mobile challengers are still shrinking (on average) and most lack scale. The incumbents are also starting to close the gap in market share momentum

Vodafone Europe growth, growth of PTT mobile operations and also the growth of the challengers in the same market sample

Source: Credit Suisse estimates
Spectrum unlikely to break the mobile story in 2015

The US AWS auction has broken the record books, now at usd44bn vs the FCC reserve price of usd10.5bn. The current price of usd2.5Mhz/pop compares to usd1.0/Mhz/pop in the previous 700Mhz auction and prices below the usd1/Mhz/pop level in previous AWS rounds. As demand for data continues to rise and starts to fill US mobile network capacity (particularly in key metropolitan areas), US mobile networks are competing increasingly on speed. The US industry is moving from sunk cost to marginal cost economics and the value of spectrum is therefore rising, with c. 2Ghz capacity spectrum becoming much more important than before.

European mobile data network economics is likely to follow the same trend, although running 1-2 years behind the US in terms of 4G network utilisation, given our later start. EU Member States also remain budget-constrained and have rejected the EC’s proposal for more balanced spectrum licensing regime in Europe. This altogether suggests the risk of much greater spectrum payments coming than investors currently expect, and the risk that another EU mobile boom turns to bust. Indeed, a German spectrum auction (2G refarming + 700Mhz) is around the corner, and France auctions 700Mhz in December.

However:

- Against this rising capacity demand, we should weigh the deteriorating economics of the 3rd/4th bidders. Most long-standing #4 operators are struggling to generate positive Operating FCF (EBITDA-CAPEX) whilst the cashflow of #3 operators has deteriorated (-22%) in recent years, including Wind, Bouygues and Base. The ability and willingness of challengers to fund new spectrum payments has never been smaller, whilst interest from new entrants in recent auctions has been minimal, the result of years of falling ARPUs.

- In Germany specifically, the merger of TEFD and e-plus, combined with balanced spectrum rules (no new entrant preference, Simultaneous Round rather than Combinatorial Clock auction structure) suggest a reasonable outcome.

In the EU, spectrum payments gradually push the marginal player out of the game. So in general we do not expect an industry spectrum bust in the coming 12 months. Indeed, the European industry’s history of paying more per MHz/pop for 20 year licences than US operators paid for perpetual spectrum rights looks over, another sign of the diverging fortunes of the two industries.

Figure 10: Development of OpFCF (EBITDA-CAPEX) of challenger mobile operators (#3 and #4) since 2011* (eu’m)

Source: Credit Suisse estimates  * sample excludes iliad, which launched post 2011. 2014 (LTM) includes last 4 quarters up to and including Q3 2014. #3 sample includes Sunrise (main challenger in Switz) and #4 includes Orange (second challenger)
Convergence the main test to our thesis

The main operational threat to our bullish thesis in 2015 is convergence, in particular the bundling of fixed with mobile. Could telcos cross-subsidise further price cuts in mobile from more profitable operations in fixed line?

Such competition from F-M bundles has been a discussion point for many years – going back ten years Tele2 was launching F-M bundles across its EU ULL/MVNO operations. The industry has shown repeatedly that demand for such bundles is weak, unless there is a considerable discount to be had. Telefonica Fusion has been a success in Spain (>50% of Telefonica fixed line customers subscribe to Fusion) but this offered a 40% discount to prevailing stand-alone pricing from Telefonica, worth a saving of around eu40-48/m inc VAT to the customer. No bundles are offering such savings today, with only TI’s TIM Smart bundle offering a decent saving in % terms (30%, worth eu17/m) relative to TI’s stand-alone pricing. Most incumbents are unlikely to offer large discounts at a time when their line loss is slowing, given the likely impact to back-book fixed line revenues. Fusion is likely to remain the exception, not the rule, in our view.

Figure 11: Savings from bundles vs stand-alone pricing (local currency, per month)*

* CHF per month for Swisscom, euros for all others

Figure 12: 2012: Fusion bundle vs unbundled price for same services (for single customer with one mobile device) at the time Fusion was first launched (saving has reduced significantly since)

*including same F2M minute bundle as Fusion  ** Imagenio Familiar

†Habla y Navegar 50, including eu5 discount for taking Movistar xDSL as well

<table>
<thead>
<tr>
<th>Fusion bundle (inc 1GB mobile data)</th>
<th>Fusion</th>
<th>Fusion Fibra</th>
<th>Fusion TV</th>
<th>Fusion Fibra TV</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price (ex VAT)</td>
<td>49.9</td>
<td>59.9</td>
<td>79.9</td>
<td>89.9</td>
</tr>
<tr>
<td>Non-bundled price (ex VAT)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Voice line</td>
<td>13.97</td>
<td>13.97</td>
<td>13.97</td>
<td>13.97</td>
</tr>
<tr>
<td>Broadband (DSL or Fibra)</td>
<td>24.9</td>
<td>39.9</td>
<td>24.9</td>
<td>39.9</td>
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<tr>
<td>TV bundle **</td>
<td></td>
<td></td>
<td>29.9</td>
<td>29.9</td>
</tr>
<tr>
<td>Mobile bundle - 500mins + 500GB + free SMS ***</td>
<td>45</td>
<td>45</td>
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<tr>
<td>Total non-bundled price</td>
<td>83.87</td>
<td>98.87</td>
<td>113.77</td>
<td>128.77</td>
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<tr>
<td>Saving (ex VAT of 21%)</td>
<td>33.97</td>
<td>38.97</td>
<td>33.87</td>
<td>38.87</td>
</tr>
</tbody>
</table>

Source: Credit Suisse estimates

* including same F2M minute bundle as Fusion  ** Imagenio Familiar

†Habla y Navegar 50, including eu5 discount for taking Movistar xDSL as well
Domestic telco EBITDA to continue to inflect

**Figure 13:** CS forecasts for European incumbent telecoms domestic EBITDA* (eu’m) – includes Vodafone

As revenues inflect, we also expect cost cutting to continue, driven by:

- Ageing of workforce – led by Orange and DT
- Virtualisation – as legacy network systems are replaced by IP and virtualisation
- Mobile SACs may reduce as markets become less competitive, with challengers some way behind incumbents on 4G coverage

So we continue to expect incumbent telco domestic EBITDA to inflect and start growing, our core sector view.

**Figure 14:** European large cap telecoms domestic EBITDA growth y/y

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*Source: Credit Suisse estimates  * includes domestic operations of Belgacom, BT, DT, KPN, Orange, SCMN, TDC, Ti, TEF, TKA, TNOR, TLSN and Vodafone. For Vodafone we include Vodafone Europe.

For Vodafone we include Vodafone Europe, not AMAP
More dividends to rise

Figure 15: Cash dividend as a % of FCF* based on CS forecasts

Source: Credit Suisse estimates  * dividend cover calculated as cash dividend paid vs Free Cash Flow pre dividend and pre one-off spectrum payments

This improving domestic EBITDA outlook should translate into more dividend growth in some cases. For example:

- Belgacom – with EBITDA expected to stabilise and CAPEX likely to fall over time, there is scope for a rise in the dividend on a 2-3 year view
- BT – likely to continue to pay a rising dividend, even after a potential mobile acquisition
- DT – DT’s current eu50c dividend falls to 50% of FCF in 2015E as TMUS cashflow grows. Management is to give an update on dividend policy at the CMD on the 26 February.
- KPN – significant scope to raise its dividend from the €7c in respect of 2014 given Eplus cash proceeds of €5bn
- NOS – we forecast a 20% DPS growth in 2015E to €0.17 per share for NOS, in line with consensus. There could be room for NOS to grow dividends beyond these forecasts.
- Swisscom if capex starts to come down already in 2015. High capex is the main reason Swisscom took a break from growing dps a few years ago
- Tele2 - A completion of the sale of Tele2’s Norwegian business could lead to a special dividend.
- TEF – Telefonica is currently paying a significant element of its dividend in scrip. Management has been suggesting a return to a full cash dividend at some point.
- Vodafone – dividend likely to rise modestly in the coming years, with FCF recovering in FYMar17E
Most M&A to continue to focus on value-creating in-market scale, rather than footprint expansion

Figure 16: The shift in industry M&A away from footprint-expansion towards in-market scale remains another big driver of the improved sector outlook

<table>
<thead>
<tr>
<th>Year</th>
<th>Footprint expansion</th>
<th>In-market consolidation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Target</td>
<td>Acquiror</td>
</tr>
<tr>
<td>1999</td>
<td>One2One</td>
<td>Vodafone Airtouch PLC</td>
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<tr>
<td>2000</td>
<td>Mannesmann AG</td>
<td>France Telecom</td>
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<tr>
<td></td>
<td>Orange</td>
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<td>VoiceStream Wireless</td>
<td>Deutsche Telekom</td>
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<td></td>
<td>Sonera</td>
<td>Telia AB</td>
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<td>2004</td>
<td>Mobilitel (Bulgaria)</td>
<td>Telekom Austria</td>
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<td>2005</td>
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<td></td>
<td>O2</td>
<td>Telefonica</td>
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<td>2007</td>
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<td>Vodafone</td>
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<td>2008</td>
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<td>Telenor</td>
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<td>2009</td>
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<td>2011</td>
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<td>Portugal Telecom</td>
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<td>2012</td>
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<td>2014</td>
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<tr>
<td>TOTAL</td>
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</tbody>
</table>

Source: Company data, Credit Suisse estimates  Note: we compare price paid to the value of asset acquired today, based on current EV/EBITDA multiples and estimated current EBITDA contribution of the asset acquired  * Vodafone then sold Airtouch US to Verizon to create VZW, consolidating the US market  ** based on increase in BT share price following news of its interest in acquiring either EE or O2 (from 380p)

When recently revisiting the sector with PMs who had been away from telcos for the past several years, the biggest change they saw was in the M&A activity, a rather subtle shift that has happened over several years but key to the sector’s on-going performance. Operators that were chasing global footprints since the 1990’s have gradually shifted instead towards rationalising footprints and pursuing in-market scale, either through fixed-mobile integration or mobile-mobile consolidation. An industry that managed to destroy at least eu147bn in footprint M&A over 2000-2010 (see Figure 16) has instead created eu12.9bn of value since 2009 from in-market deals.

We expect this trend to continue. Widely discussed candidates for 2015 include VOD-LBTY, 3Italia-Wind, BT-EE, TIM-Oi, Telenet-Mobistar and Vod/Wind Hellas - Forthnet as well as the completion of pending deals (ORA-JAZZTEL, TELIA-TNOR Denmark). Whilst the most money is made from buying the target co, some of this comes down to chance, while the fact such in-market deals are generally value creating (in our view) supports our focus on the incumbents.
We find out how dovish the new EC really is

The idea of a more dovish regulation of telcos in Brussels was over-hyped last year, with Neelie Kroes’ more constructive proposals rejected by the EU Parliament. Whilst the new EC has also been widely described as ‘dovish’ on telco regulation, there is little hard evidence to support this as yet. VP Ansip has already come out in favour of net neutrality whilst Commissioner Oettinger has made protecting copyright his early focus. During 2015 we will find out a lot more about where the Commission stands. Key decisions include:

- **TSM.** Despite Neelie Kroes’ stated wish to deregulate the industry to improve investment incentives, the Telecoms Single market has ended up including a regulation of the internet (enforcing net neutrality) and of European mobile prices (Roam Like at Home). A decision to enforce Roam Like at Home could have a significant negative effect on European mobile in 2016, and impact earnings forecast momentum this year. We think that Oettinger’s best move would be discard the proposal – as Berec has proposed - and start again with his own agenda.

- **A new 2020 Agenda.** Mr Oettinger and Ansip are likely to frame their own agenda for their 5 year term rather than just administrate Neelie’s. With a lot of FTTc being built, the question is whether the EC’s targets for broadband now change, e.g. to focus more on the digital divide (areas with slow broadband) or for speeds in metro areas be increased beyond FTTc (by encouraging FTTH rather than FTTc). Any decision that tightened regulation of FTTc could be significantly negative for European wireline and our sector view.

- **The EC anti-trust** will continue to make key decisions in 2015, including Orange-Jazttel and Telia – Telenor in Denmark. A key issue is whether the MBA-MVNO remedy loses credibility in the same way the Austrian remedies did. In a downside case, the EC might decide it can’t find any remedy that stops a 4-to-3 mobile consolidation being anti-competitive. Equally, a more enlightened EC might decide that mobile and WiFi are sufficient substitutes to allow 4-to-3 mobile consolidation with lighter remedies in any case.
International exposure will affect relative performance

Figure 17: Regional exposure of the revenues of key European telco stocks

Source: Company data, Credit Suisse estimates *TeliaSonera EBITDA adjusted to include TLSN's proportional stake in Megafon (25%) EBITDA and Turkcell (37%), **Telenor EBITDA adjusted to include its proportional stake in VIP (36%) EBITDA

We see the European telco story as likely to be the best risk/reward across the different regions of the global Telco industry in 2015. So generally the more European a European telco is, the better its likely performance in 2015. By region:

- The US is likely to see a negative impact on ARPU, EBITDA and FCF from the big increase in price competition in H2 2014. TMUS has been a winner from the US price war up to now but whether this remains so is a critical factor for the DT share price outlook in 2015.
- Exposure to Russia/CIS is likely to remain a drag, with a worsening economy likely to have a knock-on effect on telcos (lagging 3-6m typically). Consumers are likely to become more price sensitive, impacting churn and competition, and business closures are likely to impact fixed line and mobile demand.
- LatAm exposure may also drag on performance, as economies continue adjust to lower oil prices and low BRIC growth.
- In Asia bottom-up market dynamics and macro exposure vary market-by-market. In general though, the region is becoming gradually more competitive at a time when Europe is recovering, in our view.
Cable to retain pricing power

OTT (Netflix et al) is clearly impacting DVD demand in the US, but has still yet to impact cable TV ARPU or cord-cutting, despite the relatively high (and rising) price of TV in the US. This suggests European cable will also remain relatively immune to OTT, given the much lower price of cable TV in Europe. This is already supported by trends in markets like UK and Sweden where Netflix is 25%+ penetrated but has not impacted the cable operator. OTT remains a long term threat, but is unlikely to impact cable performance in 2015, in our view.

In the meantime, with cable operators continuing to upgrade network speeds, cable is likely to retain pricing power, as shown recently by LBTY which has started to increase prices in Germany, whilst repeating annual price increases in the UK, Neths, Belgium and Switzerland. We still remain positive on European cable, five years after our original Sept-2009 upgrade note.

Figure 18: In the US OTT is cannibalising DVDs, not traditional pay-TV revenues

Figure 19: Cable ARPUs* in Europe mostly much lower than in the US

Source: ADLittle analysis, Dec 2014

Source: Credit Suisse  * revenue per subscriber, including TV and broadband (excluding mobile)
Satellite – the 4K revolution

The Global satellite industry revenue outlook is also improving, in our view. We have greater confidence that the global satellite industry can sustain mid-single digit revenue growth over the next 10 years, with global satellite transponder demand exceeding supply over this period. We see potential to upgrade industry revenue forecasts further as 4K gains.

4k fast becoming a reality. 4k, the next generation of HD, will require twice as much transponder capacity per channel vs. current HD. The timetable for 4k adoption has accelerated over 2014, with prices for 4k TV sets falling significantly; we estimate 4k is now standard in over a third of new large-screen TV sets on sale in the US & Europe. Netflix is already streaming content in 4k and DirecTV has launched its first 4k satellite. In our Ideas Engine note released yesterday (click here for short version – full version available upon request), we raised our forecasts for 4k satellite transponder demand, an important growth driver for the global satellite industry.

Figure 20: 85% of Global Media Executives expect 4G to become mainstream within 10 years

Headwinds from US budgetary pressure set to fall as US Defence spending now likely to rise in 2016. We expect US budgetary pressure on global satellite operators to ease over 2015-16 as the US defence budget stabilises in 2015 and rises in 2016 as (1) a Republican-controlled Senate; and (2) continued US GDP strength will likely lead to a real increase in the year-on-year US Defence budget in 2016.

Figure 21: US Defence budget scenarios
Companies Mentioned (Price as of 02-Jan-2015)

BT Group (BT.L, 401.0p)
Belgacom (BCOM.BR, €30.02)
Bouygues (BOUY.PA, €30.02)
CHARTER COMMUNICATIONS INC (CHTR.OQ, $166.43)
COMCAST CORPORATION INC (CMCSA.OQ, $57.35)
Com Hem Holding (COMH.ST, Skr63.3)
Deutsche Telekom (DTEGn.F, €13.16)
Elisa Corporation (EL1V.HE, €22.68)
Eutelsat Communications (ETL.PA, €26.8)
Hutchison Whampoa (0013.HK, HK$89.8)
Iliad (ILD.PA, €197.4)
Imarsat PLC (ISA.L, 790.0p)
KPN (KPN.AS, €2.59)
Liberty Global (LBTYA.OQ, $50.1)
Mobistar (MSTAR.BR, €19.59)
NOS (NOS.LS, €6.24)
Netflix, Inc. (NFLX.OQ, $348.94)
Oi SA (OIBR4.SA, R$8.43)
Orange (ORAN.PA, €14.06)
Orange Polska (TPSAq.L, $1.95)
Portugal Telecom (PC.TLS, €0.86)
SES (SESFd.PA, €30.4)
Swisscom (SCMN.VX, SFr522.5)
TDC (TDC.CO, Dkr74.72)
TalkTalk (TALK.L, 306.3p)
Tele2 AB (TE2B.St, Skr95.05)
Telecom Italia (TLIT.Mi, €0.88)
Telefónica (TEF.MC, €11.88)
Telefónica Brasil (VIVT4.SA, R$46.26)
Telefónica Deutschland (O2Dn.DE, €4.41)
Telekom Austria (TELA.VI, €5.39)
Telenet (TNET.BR, €45.42)
Telenor (TEL.OL, Nkr152.2)
TeliaSonera (TLSN.ST, Skr50.25)
Time Warner Cable (TWC.N, $150.66)
Total Access Communication PCL (DTAC.BK, Bt96.5)
Verizon Communications Inc (VZ.N, $46.96)
Vivendi (VIV.PA, €20.56)
Vodafone Group (VOD.L, 221.9p)

Disclosure Appendix

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