

Equities

9 December 2010 | 220 pages

The Phone Book

Telecoms in 2011 – delivering the dividend promise

- **Strong economies and data growth** — For 2011 we favour strong economic exposure, data growth and dividend momentum - our top picks are BT Group, KPN, Telenor and Vodafone where we upgrade the target price to 195p (185p). We expect improving growth rates which are now apparent for many European operators to go further, although mobile may stutter in 1H11 due to MTR cuts. We see potential for better pricing dynamics generally and new monetisation options in fixed line. At 10.0x 2011E earnings (market ex financials is on 11.4x), 10.9% equity FCF yield and a 6.9% dividend yield we remain positively biased.
- **Smartphone growth and wholesale pricing supportive** — The arrival of smartphones at lower price points should allow mobile data growth to be sustained in Europe and accelerated in emerging markets while over the top TV is set to drive demand for fixed broadband. In many markets wholesale prices are rising and a new pricing model for internet peering could be a material positive for fixed line access players (see p11).
- **Dividend momentum from falling leverage and better growth** — We expect credit metrics to improve faster yoy in 2011 with FCF up 4% yoy, lower spectrum payments and falling capex in emerging markets boosting confidence in dividend sustainability (we expect only a 61% payout). We expect better revenue growth to prompt companies to be less parsimonious with capex in developed markets with emerging markets largely making up the difference.
- **Not yet time to head South** — We see peripheral EU sovereign credit risk as far from resolved and downgrade OTE to Hold from Buy following its rally, remaining holders of TEF, TI and PT. We downgrade Belgacom to Sell from Hold. Mobistar and Elisa remain Sell rated. See page 2 for a list of our estimate and target price changes (which are discussed more fully in the company writeup pages) and analyst transfers of coverage.

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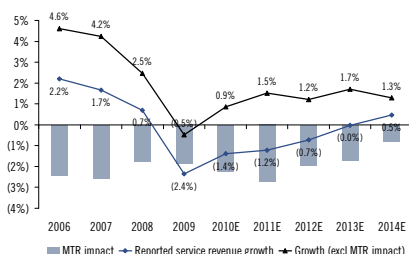
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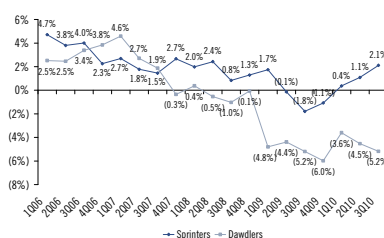
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European mobile service revenue growth, %



Source: Citi Investment Research and Analysis

Sprinters accelerating, Dawdlers getting worse



Source: Company Reports and CIRA Estimates

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Data Summary

Ticker	Rating		Target Price		Current Year Earnings Estimates		Next Year Earnings Estimates	
	Old	New	Old	New	Old	New	Old	New
BCOM.BR	2L	3L	€27.00	€24.00	€2.45	€2.45	€2.52	€2.43
BOUY.PA	1H	1H	€40.00	€40.00	€3.14	€3.14	€3.74	€3.74
BT.L	1M	1M	£2.10	£2.10	p18.5	p18.4	p19.7	p20.1
DTEGn.DE	1L	1L	€11.00	€11.00	€0.78	€0.75	€0.78	€0.78
ELI1V.HE	3L	3L	€12.07	€13.00	€0.99	€1.22	€1.27	€1.21
FTE.PA	2L	2L	€17.00	€17.00	€1.71	€1.68	€1.82	€1.76
KPN.AS	1L	1L	€13.50	€13.50	€1.13	€1.13	€1.31	€1.30
MSTAR.BR	3L	3L	€39.00	€39.00	€4.10	€4.10	€3.78	€3.78
OTEr.AT	1H	2H	€8.00	€8.00	€0.50	€0.50	€0.63	€0.62
PTC.LS	2M	2M	€8.50	€8.50	€0.53	€0.53	€0.89	€0.89
SCMN.VX	1L	1L	SFr410.00	SFr440.00	SFr34.86	SFr34.86	SFr37.55	SFr37.55
TEF.MC	2L	2L	€17.50	€17.50	€1.90	€1.90	€1.96	€1.85
TEL.OL	1M	1M	NKr120.00	NKr120.00	NKr5.92	NKr5.94	NKr7.95	NKr8.15
TEL2b.ST	2M	2M	SKr150.00	SKr150.00	SKr14.89	SKr15.03	SKr11.88	SKr11.71
TELA.VI	2M	2M	€10.50	€10.50	€0.73	€0.69	€0.92	€0.73
TLIT.MI	2M	2M	€1.10	€1.10	EU¢14	EU¢14	EU¢13	EU¢13
TLSN.ST	2M	2M	SKr55.00	SKr55.00	SKr4.62	SKr4.63	SKr4.63	SKr4.68
VOD.L	1L	1L	£1.85	£1.95	p15.7	p15.7	p17.2	p17.2

We are making the following coverage transfers:

- Swisscom to Georgios Ierodionou from Simon Weeden
- Tele2 to Laurie Fitzjohn Sykes from Simon Weeden
- Telecom Italia ordinary shares to Georgios Ierodionou from Simon Weeden
- Telecom Italia savings shares to Georgios Ierodionou from Simon Weeden
- Telefónica to Georgios Ierodionou from Simon Weeden
- Telekom Austria to Georgios Ierodionou from Dimitri Kallianiotis
- Telenor to Laurie Fitzjohn Sykes from Simon Weeden
- TeliaSonera to Laurie Fitzjohn Sykes from Simon Weeden

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Rerating - a job only half done

We see the sector rerating that began in 2010 as a job half done. Year to date the European telcos nearly matched a rallying market, more than all in a characteristically strong second half when it delivered an absolute total return of 13.9%. Revenue growth has recovered but remains negative in developed Europe and should continue to improve in 2011 in our view, although 1H will see some bumps from MTR cuts. Smartphones have gained strong traction in the market and we expect their arrival at attractive price points in the emerging markets to be a key theme in 2011. Apple's near instant capitulation on tentative plans for soft SIMs for the iPhone and Google's earlier failure with online-only sales of the Nexus 1 indicate that the operators' capabilities, notably in distribution and post sales support, still position them as key partners for the Over The Top players. On our 2011 estimates the major European names trade on only an average PE of 10.0x, an equity FCF yield of 10.9% and offer a dividend yield of 6.9%.

Growth in demand for mobile data (likely to start to see a new leg in the emerging markets), government promotion of rural broadband, signs of renewed capital discipline re M&A, potential movement on internet peering pricing and, in places, dividend momentum should be favourable for the sector in 2011. Less positive could be the harsher MTR outcome vs 2010 (-270bp from mobile growth vs -220bp), the European Commission's concerns about upward movements in ULL pricing and possible margin pressure from subsidies as smartphones fill out mid-range handset options. Our top picks are BT Group, KPN, Telenor and Vodafone. We downgrade OTE to Hold from Buy and Belgacom to Sell from Hold while reiterating our Sell ratings on Mobistar and Elisa.

This report looks at recent industry trends and at what we expect to see coming in 2011. It breaks down into three sections:

- **Industry Trends:** this introductory section covers industry trends and their implications for investment in 2011, see Page 6.
- **Company Section:** looks at pertinent drivers, estimates, valuation and ratings for each incumbent and wireless operator, see Page 27.
- **Country Section:** examines the mobile and fixed line trends in individual European markets, see Page 144.

Stock picking: seek data growth, avoid austerity

We are seeking to bias our stock calls in favour of strong economic exposure, data growth and dividend momentum. We expect that in 2011 the sector will continue to benefit from the economic strength of the emerging markets as well as falls in the unit costs of smartphones which should make them a practical proposition for far more customers in both the developed and emerging worlds. We expect the growing popularity of alternative handset operating systems to reduce the power of Apple in the market and remain watchful for evidence that the operators' pricing power is improving, after modest progress in 2010.

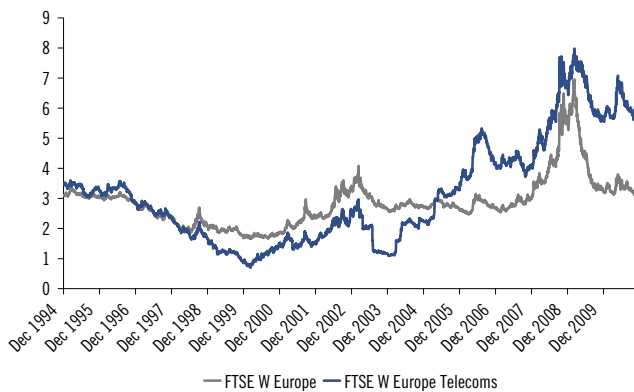
Our analysis shows that difficult mobile markets tend to remain difficult. This is illustrated by Figure 17 which shows that countries with the lowest voice yields are also often the ones where yields are still falling the fastest. On the other hand, margin risk remains a concern as smartphones fill out the mid market handset choices, but improving revenue trends are helpful and we think the operators can justify a modest increase in capital intensity yoy as well.

Our stock picks are biased to Buys reflecting our positive stance on the sector and absolute return rating framework, exposure to attractive developed world and emerging markets and prospects for dividend momentum:

- **Buys:** Our top picks are BT Group, KPN, Telenor and Vodafone. We reiterate Buy ratings on Deutsche Telekom, Bouygues, Swisscom and Freenet, cable plays Virgin Media, and KDG, and satellite operator Eutelsat.

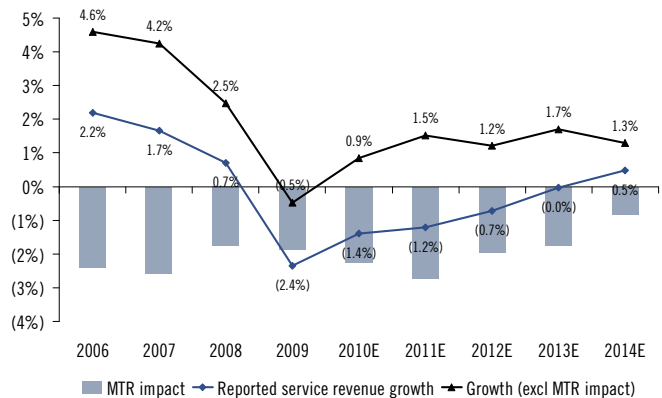
- **Downgrade to Hold:** We downgrade OTE to Hold from Buy following its recent rally which we ascribe largely to the arrival of a new CEO, as we feel the stock will struggle to run much further given the macro environment.
- **Sells:** We downgrade Belgacom to Sell from Hold and reiterate our Sell ratings on Mobistar and Elisa.

Figure 1. Sector dividend yields remain well above the market average
%



Source: DataStream

Figure 2. Forecast European mobile service revenue growth
%, yoy



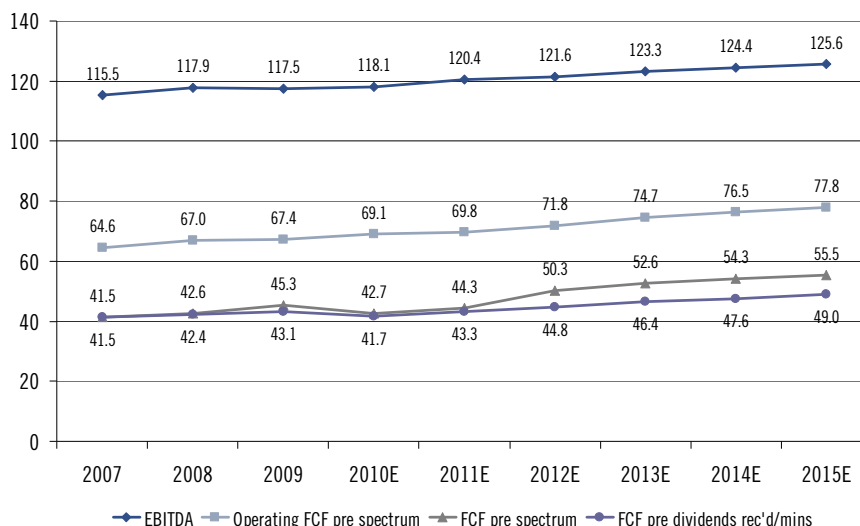
Source: DataStream

Earnings outlook justifies higher rating

The sector's performance in 2010 YTD – a 10.2% total return in Euros – was due partly to earnings (Figure 4) and partly to rerating, which we think has further to go. We expect to see growth in FCF and EBITDA in 2011, aided by increased scope of consolidation through M&A including Telemar, Telecom Argentina and FT's changed consolidation of Orange Egypt.

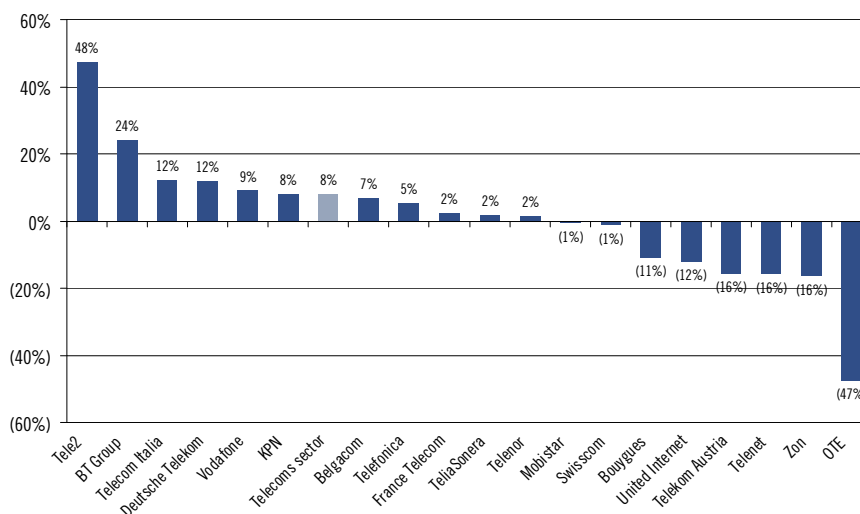
Figure 3. Incumbent and wireless forecast EBITDA, OpFCF and FCF

€bn, constant exchange rates, year to Dec or subsequent March



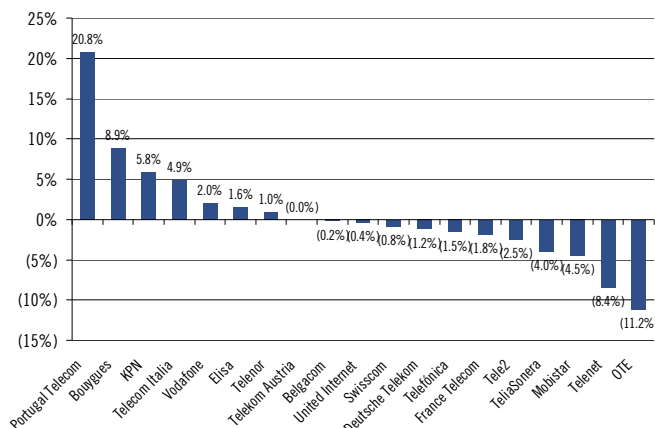
Source: Company Reports and CIRA Estimates

Figure 4. Consensus EPS revisions 2010 year to date



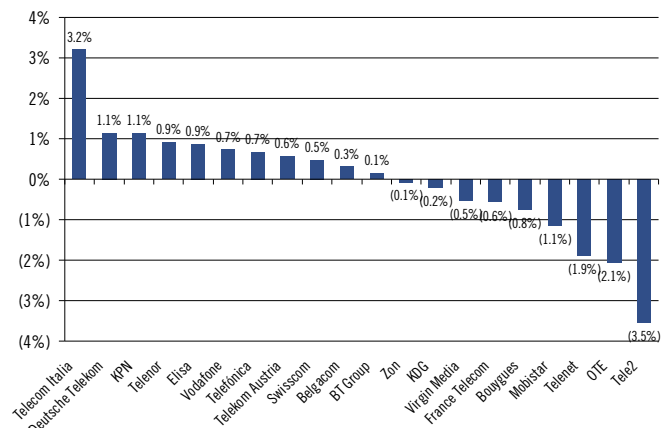
Source: Bloomberg

Figure 5. Citi estimates vs consensus for EPS, 2011



Source: Bloomberg, Citi Investment Research and Analysis

Figure 6. Citi estimates vs consensus for EBITDA, 2011



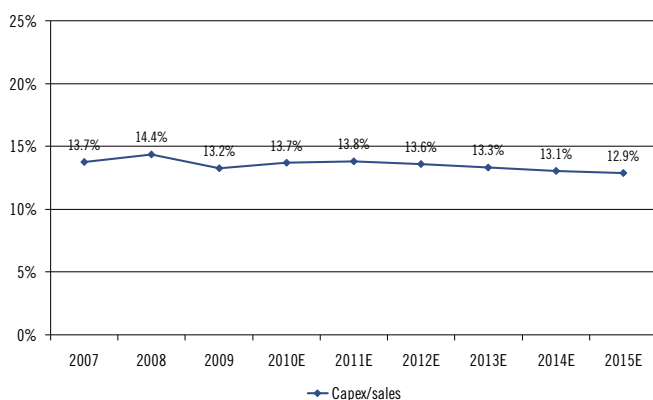
Source: Bloomberg, Citi Investment Research and Analysis

Capital intensity to shift back somewhat to developed world

We expect falling capex to sales in emerging markets to largely compensate for a rise in the developed world reflecting greater confidence in mobile growth.

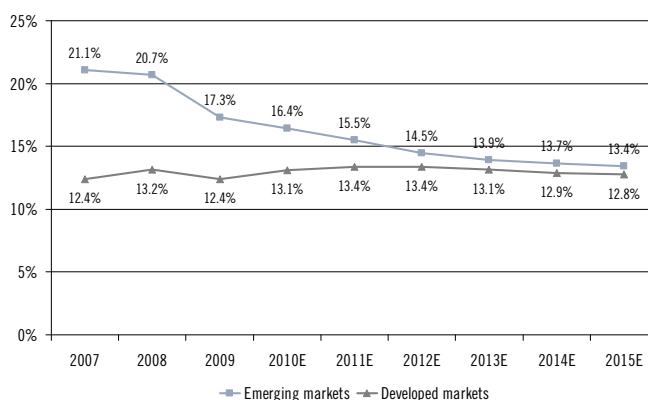
We expect improving top line growth in Europe to give operators the confidence to adopt a marginally more pro-growth stance towards developed market capex. However, given that overall capex to sales already rose 50bp yoy in 2010 to 13.7% we expect only a modest further increase in the average in 2011 (Figure 7). Within the mix we expect a stronger rise yoy in developed Europe (Figure 8) to offset a fall in emerging markets and (for DT) the US. Beyond 2011 we see declines in emerging markets due to maturing infrastructure and rising revenue which are enough to start to see the sector average on a declining trend.

Figure 7. Incumbents and wireless capex/sales % (excl Bouygues)



Source: Company Reports and CIRA Estimates

Figure 8. Developed and emerging capex to sales converging % (excl Bouygues)



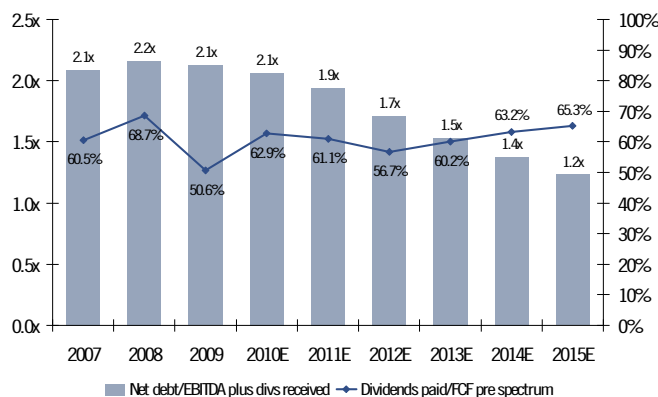
Source: Company Reports and CIRA Estimates

FCF growth and capital discipline leave room for dividend surprises

We expect industry net debt/EBITDA (Figure 9) to be down slightly yoy at 2.1x at the end of 2010, but from there to fall faster to 1.7x by end 2012. The slow rate of deleveraging in 2010, despite a dividend payout ratio of only 63% of FCF, was largely due to the high burden of spectrum costs which came to €7.9bn (Figure 38) and by year end accounted for nearly 0.1x of the 2.1x net debt/EBITDA multiple on its own. By contrast, the change in ownership at Vivo was internal to the group and other M&A was relatively modest.

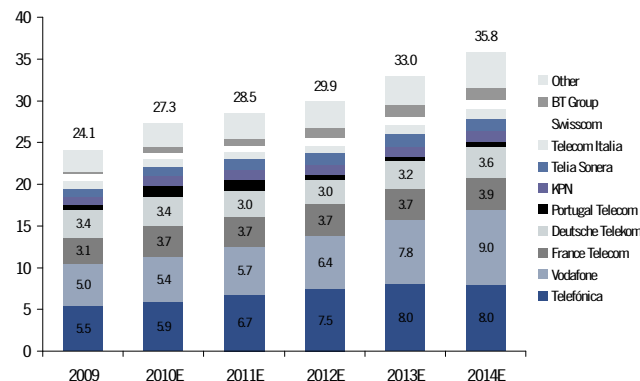
The dip in the payout of FCF forecast for 2012 is mainly due to the start of dividend flow from Verizon Wireless to Vodafone, raising FCF, which we assume is set aside in year one in case there is a transaction involving Verizon's minority in Vodafone Italy. Beyond that the payout ratio starts to rise on our estimates although the improving credit metrics suggest there could be more to come. By end-11 capacity for buybacks or higher dividends should be evident.

Figure 9. We forecast an accelerating rate of decline in industry leverage
x, %



Source: Company Reports and CIRA Estimates

Figure 10. Dividends paid to shareholders
€bn, constant exchange rates, year to Dec or subsequent March



Source: Company Reports and CIRA Estimates

Austerity to drag for some time

The impacts of austerity measures have only just begun and for that reason we expect sovereign risk and weak macro environments to continue to be an important factor for investors in the sector. National budgetary conditions are shown in Figure 11 and unsurprisingly Greece, Ireland, Portugal and Spain stand out as markets where we can expect significant fiscal tightening to continue in 2011 in our view. Some countries have introduced special tax measures and more may follow:

- **Hungary:** revenue tax on telco for three years starting in 2010 which is being challenged in court. Annual revenue of less than 500 mn forints (€1.8 million) taxed at 2%. 500m to 5bn at 4%, and above 5bn forints at 6.5%.
- **Croatia:** Excise duty on mobile communications: 6% of the income realized from SMS, MMS and mobile voice services. In force since 1 August 2009.
- **Greece:** Temporary "crisis levies" are not sector specific - 10% on previous year's profits on highly profitable firms and 40% corporate tax on distributed profits (cash dividends or shares).

Figure 11. National budgetary conditions, fiscal tightening, bail outs and austerity measures (% of GDP)

Country	Budget Deficit			Debt 2Q10 A	Rescue Package	Target cuts	Fiscal tightening			Headline Austerity measures
	2009	2010E	2011E				2010E	2011E	2012E	
Belgium	(5.8%)	(5.1%)	(4.4%)	100.8%			(1.3%)	(0.6%)	(0.5%)	
Denmark	(3.0%)	(5.4%)	(4.1%)	44.9%		DKr 24bn (€3.2bn) over next 3 years				1) Cuts in public investment 2) No more automatic adjustments to pensions & other benefits 3) Suspension of some planned tax reforms
Finland	(2.4%)	(4.1%)	(2.8%)	47.5%						
France	(7.9%)	(8.2%)	(7.0%)	82.8%		€45bn over next 3 years	(0.2%)	(1.1%)	(1.0%)	1) Closing tax loopholes; withdrawal of temporary economic stimulus measures 2) Aim is to raise the retirement age from 60 to 62 and the full state pension age from 65 to 67 3) Highest earners required to pay an extra 1% income tax
Germany	(3.3%)	(5.7%)	(5.1%)	74.6%		€80 bn (3% of GDP) by 2014	2.5%	(0.5%)	(0.4%)	1) Higher taxes on nuclear power 2) 10k gov't job cuts over 4 years 3) Cut in subsidies to parents
Greece	(13.6%)	(8.1%)	(7.6%)	132.9%	€ 110bn	€30bn over 3 years	(8.0%)	(3.7%)	(1.5%)	1) Measures against tax evasion & corruption in the tax and custom service 2) Average retirement age to rise from 61.4 to 63.5 3) Freeze in public sector salaries & pensions for at least 3 years; no bonus payments for civil servants 4) VAT increase from 19% to 23% 5) Increase in taxes on fuel, alcohol & tobacco by 10%
Ireland	(11.4%)	(12.2%)	(11.0%)	79.6%	€ 85bn	€6bn in 2011, €15bn by 2014	(1.7%)	(3.5%)	(1.0%)	1) Gov't spending cuts by € 4bn > all public servants' pay cut by at least 5% and social welfare reduced 2) Reduction of 242k public sector jobs 3) € 2.8bn savings in social welfare spending 4) € 1.9bn to be raised from income tax changes 5) €1 cut in min wage to €7.65/hour 6) VAT rise from 21% to 22% in 2013 and 24% in 2014 7) Child benefits cut by €16/mth 8) Carbon tax brought in & set at €15/CO2 tonne
Italy	(5.3%)	(5.2%)	(4.9%)	119.1%		€24bn over 2011, 2012	(0.1%)	(0.8%)	(0.8%)	1) Cuts in public sector pay (up to 10%) and hiring freeze (replacing only 1 employee in 5 who leave) 2) Cuts in public sector pensions and local gov't spending (target is € 13bn "local" cuts) 3) Retirement delayed by up to 6 mths for those who reach retirement age in 2011 4) Provincial gov'ts serving < 220k inhabitants will be scrapped 5) Limit tax evasion
Netherlands	(4.9%)	(5.9%)	(5.1%)	63.3%		€3.2bn for 2011, €18bn by 2015	1.5%	(0.8%)	(0.7%)	1) Increasing patient healthcare payments 2) Slowing pay raises for government employees to below the inflation rate 3) Reduction of the tax break for childcare 4) Cuts to funding for mandatory language and citizenship classes for immigrants (immigrants expected to cover the gap)
Norway	9.7%	10.8%	11.1%	45.8%						
Portugal	(9.4%)	(8.8%)	(7.6%)	80.6%		target deficit is -4.6% in 2011	(1.8%)	(4.0%)	(1.5%)	1) 5% pay cut for top earners in the public sector 2) VAT increase by 1% 3) Tax hikes for > €150k earnings. By 2013 personal income tax to reach 45% 4) 40% military spending cut by 2013
Spain	(11.4%)	(10.4%)	(9.6%)	56.7%		target deficit is -6% in 2011	(2.5%)	(3.0%)	(2.0%)	1) Tax rise for highest earners: +1% tax for personal income > €120k 2) 8% spending cuts 3) 5% pay cut for public workers from June10, salary freeze for 2011 4) End of "baby cheques" of €2,500 for new mothers
UK	(10.9%)	(11.4%)	(9.4%)	73.2%		£83bn (€95bn) over 4 years	(0.5%)	(1.5%)	(1.5%)	1) 490k public sector jobs cut over 4 years 2) Most Whitehall departments: 19% budget cuts, Defence budget cut by 8% 3) Retirement age to rise from 65 to 66 by 2020 4) Changes to tax credits & housing benefits 5) New bank levy brought in
Euro Area				82.0%	195		0.1%	(1.2%)	(0.9%)	

Source: Citi Investment Research and Analysis

A new price model for Internet peering?

Wholesale pricing for the exchange of internet traffic could become a new focus for the industry after a dispute between Level 3 and Comcast in the US. Level 3 says that it is approaching regulators and policy makers after being told it would be charged by Comcast for delivery of internet traffic into the Comcast network. This strikes a chord in Europe where industry executives have been lobbying for political support for a value recovery mechanism that will enable those profiting from the expansion of capital intensive access networks to help contribute to their cost. France Telecom's CEO was recently quoted saying that "Service providers are flooding the networks with no incentive" to be efficient. While we don't expect a huge shift in the economic terms we believe that the market may be too sceptical about the potential benefits from this for the operators.

Level 3 says that it has started to be charged by Comcast for delivery of internet traffic.

Level 3 disclosed on Nov 29 that it is now being charged by Comcast for delivery of internet traffic. It previously qualified for settlement-free peering under which internet traffic is exchanged between ISPs on a sender keeps all basis. However, Comcast says the traffic coming from Level 3 is set to double and will leave Comcast receiving 5x more data volume than it returns, requiring an adjustment to the terms of trade.

Level 3 responds that it is delivering content which is requested by Comcast's own customers, and compares this to a traditional voice interconnect dispute. Access carriers have market power to prevent voice calls being completed, and this aspect of operator life is regulated as a result. However, Comcast's customers can access the all of the web's content anyway via other routes and voice call termination is not settlement-free.

Comcast says it is prepared to net to nil the in-balance traffic but not the rest and, in our view, is likely to use the same approach as it already applies to content delivery networks (such as Akamai) which do not qualify for settlement-free peering. We do not expect a meaningful change in costs for Level 3 in the near-term (less than \$5m in FY11E) given the low marginal cost that would likely be applied.

We expect to see a growing imbalance of traffic between access and backbone carriers as more video is directed to households and mobile devices from content sites on the internet. It seems quite likely that the access carriers will increasingly want to levy small wholesale charges depending on the quantity of traffic involved.

In Europe wholesale charging could help the economics of increasing broadband availability and speeds by sharing some of the cost.

In Europe this could help the economics of increasing broadband availability and speeds by sharing some of the cost where the network is most capital intensive with businesses set to benefit from it, a normal enough practice in other industry pricing structures or where the public sector is involved. European regulators, already concerned that over the top players from outside the continent threaten the business models of some of the local players, may be prepared to let this develop, within a reasonable pricing framework.

Mobile recovery only for some

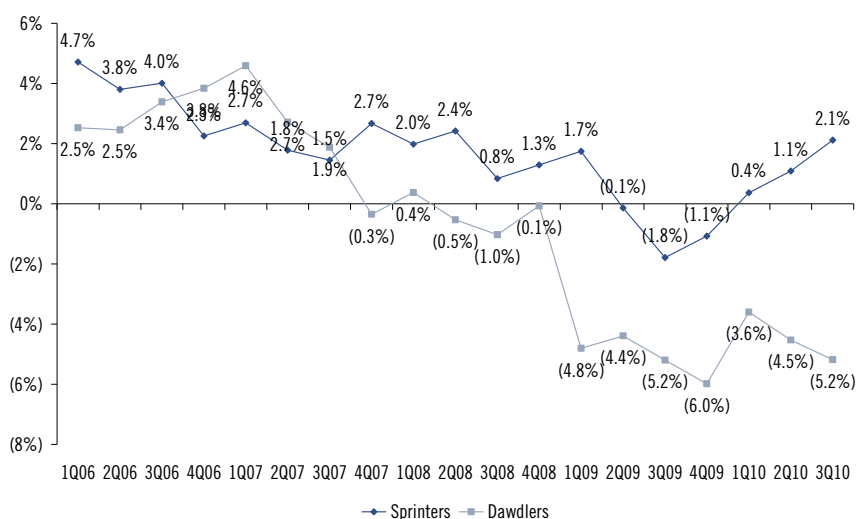
The divergence in mobile performance increased in 3Q10 with the delta between sprinters and dawdlers mobile service revenue growth widening to 7.3ppt from 5.6ppt 2Q10. This divergence is due to both macro weakness and higher competitive intensity. We argue that competitive intensity remains the key driver of voice revenue growth. We do not see a reason for the divergence in performance to narrow 1H11, notably due to continued macro weakness and price competition in Spain and Italy. In addition we highlight the risk to France, Belgium and Norway from new mobile entrants.

We have updated our Sprinter/Dawdler country analysis to highlight the underlying trends which distinguish markets in recovery from those that are still struggling. With this report we move France into the Sprinter category as its service revenue growth was positive in 3Q10 and has prospects of improving further once it laps severe termination rate reductions due in 2011.

Sprinters		Dawdlers
Belgium	Norway	Austria
Finland	Sweden	Denmark
France	Switzerland	Greece
Germany	UK	Italy
Netherlands		Portugal
		Spain

In 3Q10 the gap has widened between the two groups, with the Sprinters reporting service revenue growth of +2.1% vs. a decline of -5.2% in the Dawdler markets. Growth is also accelerating for the Sprinters (+1.0ppts qoq) while decline is slowing at the dawdlers (-0.7ppts) suggesting that a point of inflection may be approaching.

Figure 12. Mobile service revenue growth split by 'Sprinter' and 'Dawdler' countries

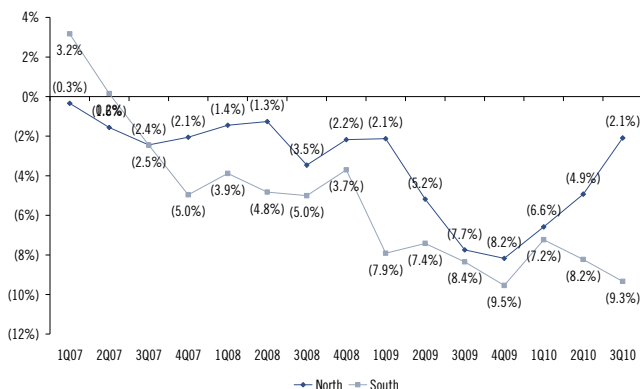


Source: Company data, Citi Investment Research and Analysis

Voice and non-voice trends diverging but Sprinter's superior growth profile remains built on solid foundations

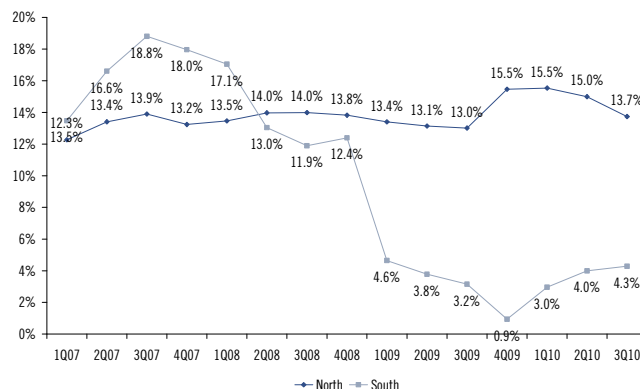
Figure 13 shows once again that the material driver in revenue growth is the improvement in voice revenues. The Sprinter countries recorded a +2.8ppt improvement qoq taking the growth to -2.1% with a stellar trajectory. In contrast large declines, particularly at Telefónica Spain and Telecom Italia, continue to pressure the Dawdler's voice growth.

Figure 13. Voice revenue growth (Sprinters vs. Dawdlers)



Source: Company data, Citi Investment Research and Analysis

Figure 14. Non-voice revenue growth (Sprinters vs. Dawdlers)

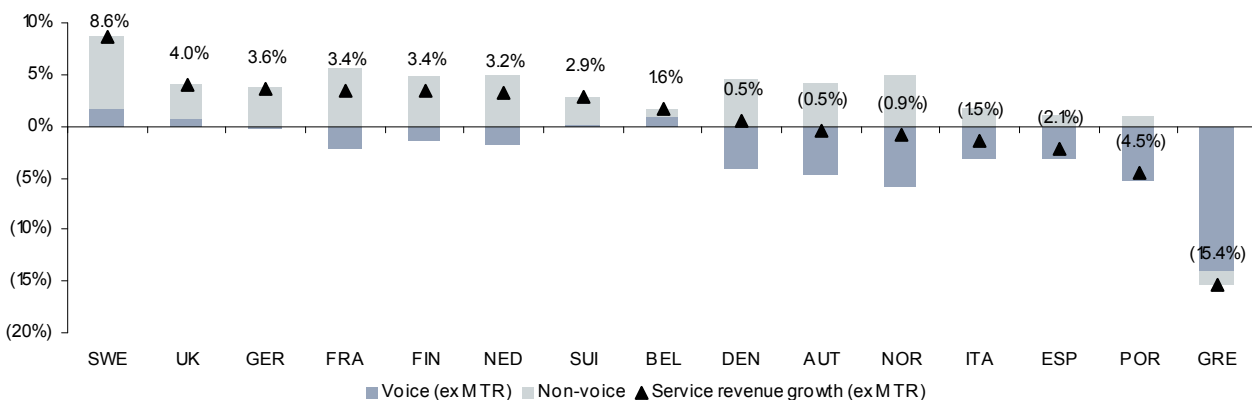


Source: Company data, Citi Investment Research and Analysis

What is driving the divergence?

We now look at what is driving the difference in growth rates country by country. Figure 15 shows the growth rate excluding the impact of MTR cuts by country and how this is broken down between voice and non-voice. In general voice has shown a greater variation over time and between countries.

Figure 15. Mobile service revenue growth (excl MTR impact) voice vs non-voice contribution



Source: Company Reports and CIRA Estimates

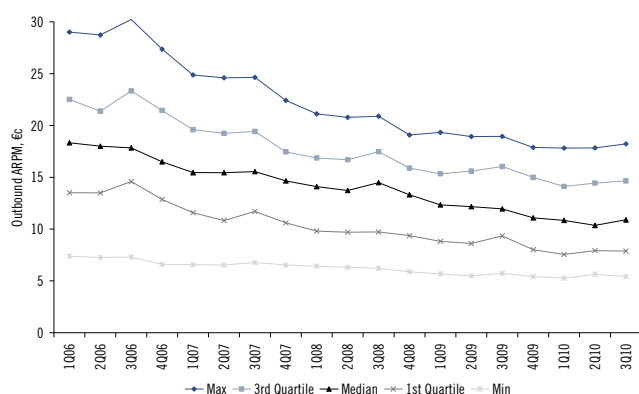
Outbound voice yields - No convergence, No Floor

We analyse outbound voice yields to judge the pricing trends within markets. In general voice revenue growth trends show little relation to the general price level. Markets with high pricing appear to be no more at risk of voice declines than markets where prices have already fallen.

In Figure 17 we show the decline in voice revenue excluding the impact of MTRs from 2007-2009 vs the outbound voice yield in 2007. We calculate the outbound yield by taking voice revenue, then stripping out revenue from MTRs and calculating the number of outbound minutes. These calculations require a number of assumptions, we therefore present the chart below with the necessary caveats. However the clear lack of any correlation we believe is robust to the assumptions we have made.

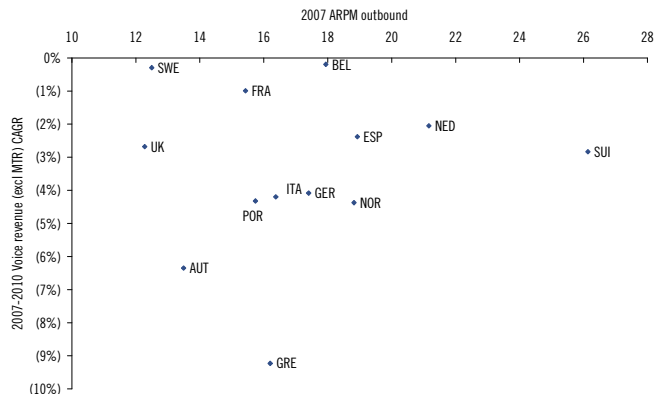
In addition there does not appear to be a floor to voice yields. The lowest price voice yields can still fall as fast in percentage terms as some of the highest, as shown in Figure 16. This result is supported by the fact that the marginal cost of a voice minute is negligible. Current MTR glide paths which go to €1-3c across countries are based on incremental cost analysis by regulators.

Figure 16. Outbound voice yield vs voice revenue growth



Source: Company Reports and CIRA Estimates

Figure 17. Outbound voice yield (2007) vs voice revenue growth (2007-10)



Source: Company Reports and CIRA Estimates

Competitive intensity drives voice revenue

The lack of any simple convergence in outbound voice yields does not come as a surprise since telecoms markets have sustained high prices despite low marginal costs through their oligopolistic market structures. This fits with the fact that a successful smaller operator is gaining share in both Spain and Italy where voice is seeing some of the largest declines. Because the poor performance in Spain and Italy is not purely macro driven we argue it will continue for longer. We therefore focus on where the level of competitive intensity could change during 2011.

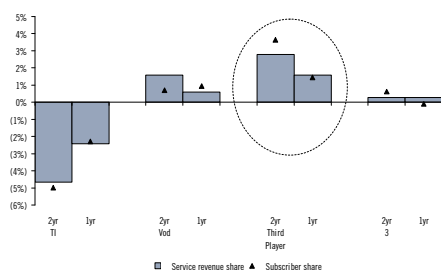
Threat of a new entrant

In **Belgium** Telenet operates an MVNO and depending on its success may bid for a 4th license. In **France** there is the upcoming entry of Illiad. In **Norway** in Sept 2003 3 Hutch was awarded a 3G license, however 3 Hutch has not yet launched services. In March 2009 the Norwegian authorities extended the deadline to March 19th 2012 to achieve a 40% population coverage. 3 Sweden states in its 2009 annual report that this business is in planning. However we remain skeptical that 3 would chose to enter a market with increasing competition in data.

Successful smaller player currently taking share

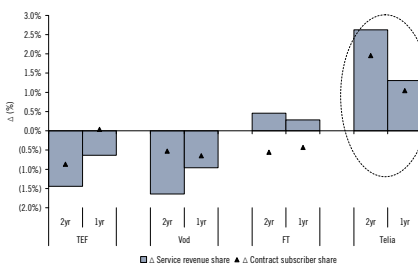
In **Spain** Yoigo (Telia) has reached 4.3% revenue market share in 3Q10 a 2ppt yoy increase, as shown in Figure 19. Yoigo is positioned in the discount voice segment. In **Finland** DNA has been gaining market share for some time, as shown in Figure 20.

Figure 18. Italy Δ mobile service revenue share



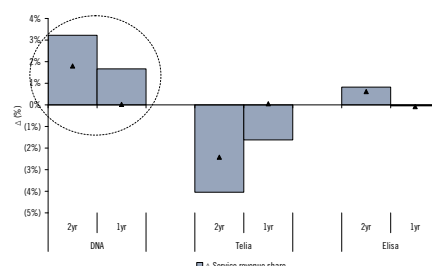
Source: Company Reports and CIRA Estimates

Figure 19. Spain Δ mobile service revenue share



Source: Company Reports and CIRA Estimates

Figure 20. Finland Δ mobile service revenue share



Source: Company Reports and CIRA Estimates

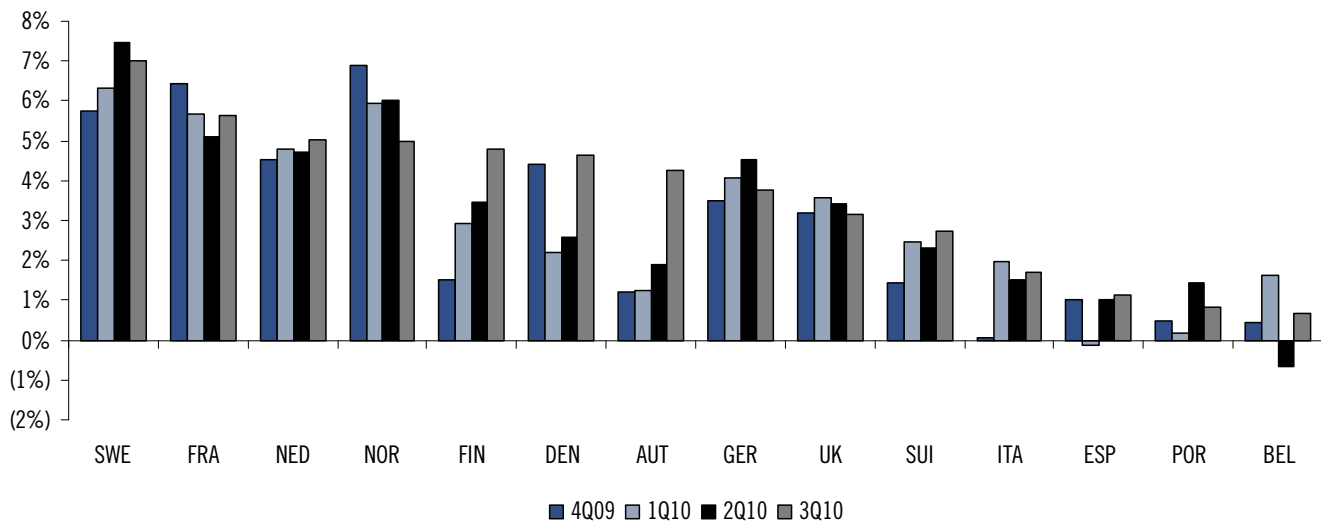
Smartphones and Data Growth

We are positive on prospects for mobile revenue growth due to the beneficial impact of Smartphones. Smartphone penetration has seen a noticeable increase during 2010, network operators have emphasised the ARPU uplift this generates. In addition we highlight a minimal impact from increased subsidies in margins, however this may change as smartphones become mass market. Lastly we argue that the falling price of smartphones will lead to faster than expected mobile data growth in emerging markets.

(1) Data growth stronger in Northern Europe

Across Europe non-voice revenue is contributing c.3ppt to growth, partially offsetting the decline in voice. On average the current breakdown of revenue is 70% voice, 15% messaging and 15% pure data. It is the 15% pure data proportion of revenue which is driving the 3ppt contribution to growth, with messaging revenue broadly flat. As Figure 21 shows data growth has been stronger in Northern European countries.

Figure 21. Non-voice ppt contribution to service revenue growth

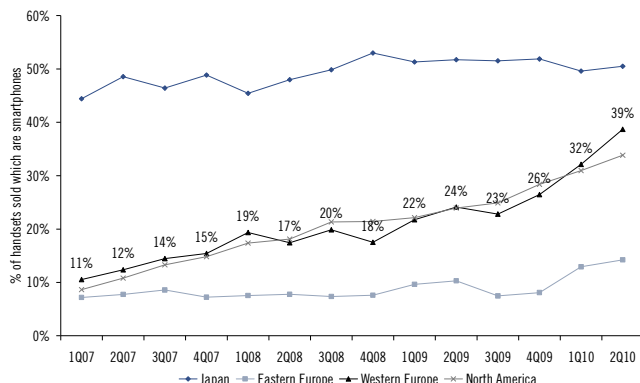


Source: Company Reports and CIRA Estimates

(2) Smartphones driving data growth

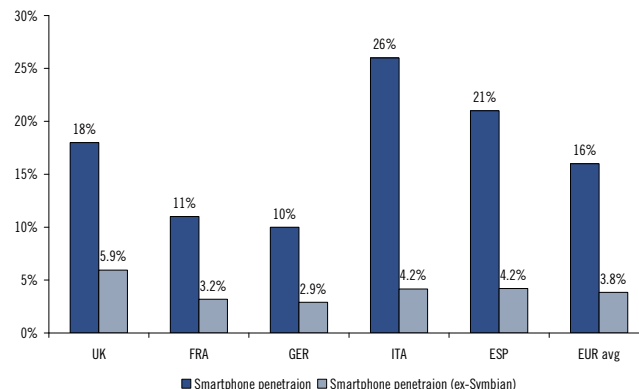
Smartphone take up has been increasing substantially in the last few quarters partly driven by the falling price of smartphones. Figure 22 shows the percentage of handsets sold which are smartphones increasing noticeably from 3Q09 onwards. Figure 23 shows smartphone penetration including and excluding Symbian phones. We highlight the fact ex-Symbian penetration in Jan 2010 was only c.4% showing the space for significant upside in our view.

Figure 22. Smartphone % of handsets sold



Source: Gartner and CIRA Estimates

Figure 23. Smartphone penetration including and excluding Symbian phones



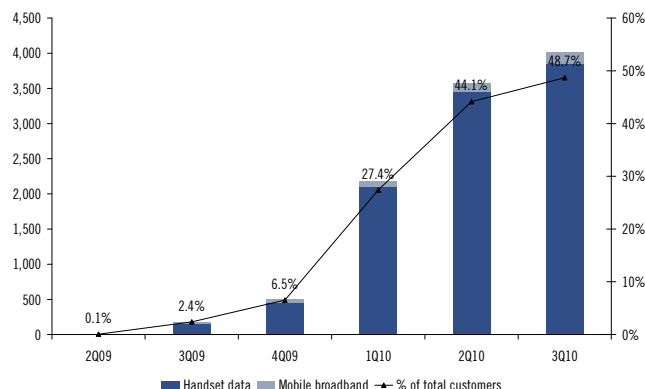
Source: comScore MobiLens/Ofcom

(3) Smartphone growth in Emerging Markets

The falling price of 3G handsets should make mobile data an increasingly important revenue driver in emerging markets.

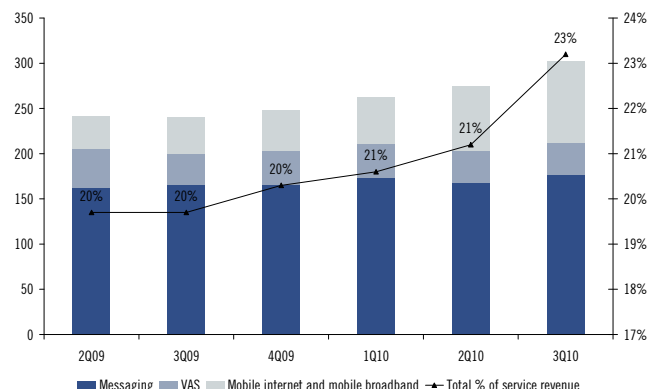
The majority of Telenor's emerging market assets are yet to have a 3G auction (Pakistan, Bangladesh, Thailand). The exception is Malaysia where despite Digi (Telenor Malaysia) having a delay securing a 3G license it is now benefiting from mobile data growth, as shown in Figure 24 and Figure 25. While being just one example we argue that as the price of 3G handsets falls, mobile data should start to drive emerging market revenue growth.

Figure 24. Digi (Telenor Malaysia) handset data and mobile broadband customers



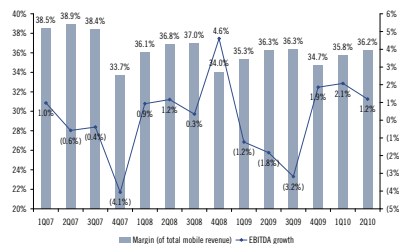
Source: Company Reports and CIRA Estimates

Figure 25. Digi (Telenor Malaysia) non-voice revenue breakdown and % of service revenue



Source: Company Reports and CIRA Estimates

Figure 26. European mobile margin and EBITDA growth



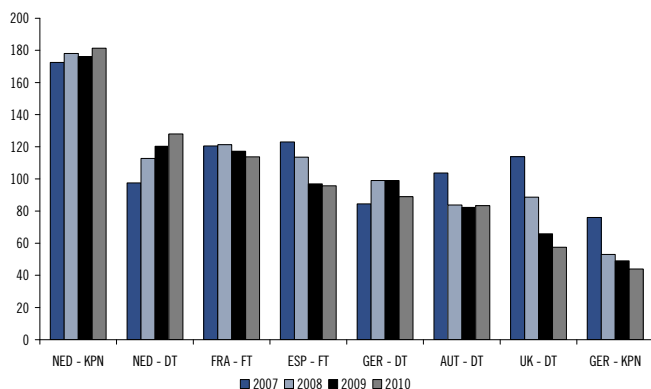
Source: Company Reports and CIRA Estimates

(4) Smartphone impact on margins

The rise in smartphone penetration has so far not impacted margins, as shown by Figure 26. This has been achieved by the falling price of handsets as well as operators reducing SAC spent on mid-range phones to allow for an increase in SACs on smartphones. We highlight there is a risk that as smartphones are sold to the entire customer base margins may begin to come under pressure.

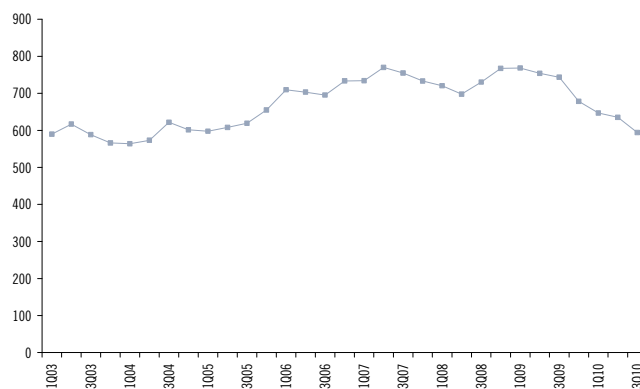
The minimal impact on margins is further supported by Figure 27 where we show the trends in SAC and blended SAC/SRC where reported. We note that there is no upward trend, if anything the trend is downwards with the exception of the Netherlands. In Figure 28 we calculate the total SAC expenditure by T-Mobile Germany, it is interesting to note the significant reversal in trend following the onset of the recession.

Figure 27. SAC and SAC/SRC blended trends – If anything SAC shows a falling trend, despite increase smartphone penetration



Source: Company Reports and CIRA Estimates

Figure 28. T-Mobile Germany total expenditure on SAC, recent downward trend



Source: Company Reports and CIRA Estimates

Country-by-country variation in fixed is far greater than in mobile

Fixed revenue recovery taking longer than mobile, but from deeper depths

Fixed pressure still easing only slowly

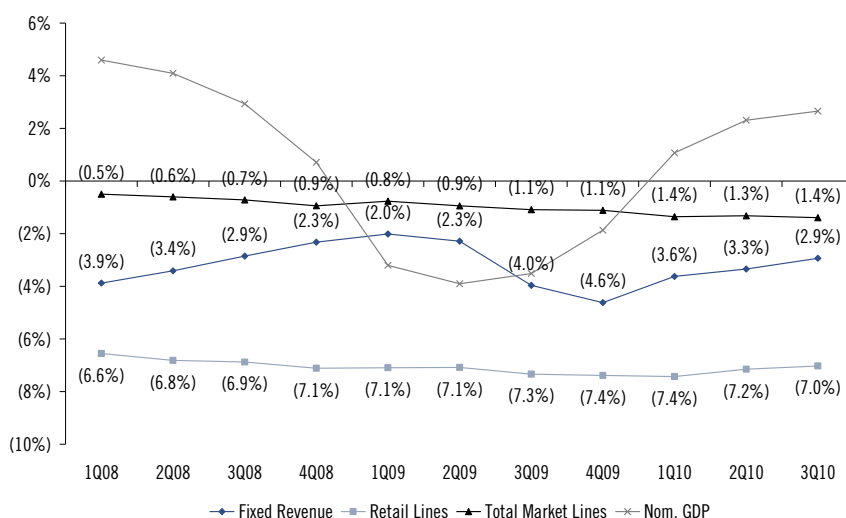
Operationally, we have seen the second successive quarter of slightly improving line loss trends at the incumbent players in aggregate. However retail line loss remains at -7% yoy on average, with a spread from flat (Austria) to -11% (Sweden). Market specific factors dominate and generalisations are difficult.

It is worth noting that while incumbent retail losses are slowing, the broader market is not showing improvement which should be of longer-term concern. The balance in many countries through 2011 and 2012 will be convincing consumers that higher-speed fixed services are still required despite an increasing range of mobile-only alternatives. A similar challenge to the last 5 years perhaps, but with a greater mobile threat.

In terms of a broader link to the macro environment, we see that incumbent fixed revenue growth is improving. The rate of decline (-2.9% in 3Q10) is 170bps better than the nadir (4Q09). Comparing fixed revenue growth with that of mobile where there has been 250 bps of improvement from the 3Q09 trough, the slower improvement in fixed probably reflects a more negative start point as well as more severe structural issues.

Looking forward, broadband penetration is slowing significantly while line loss is not. We believe the incumbents must raise ARPU by continuing to incentivise customers into flat rate call plans, and higher tier broadband packages. If they are unable to do this in 2011, the weight of line loss, coupled with a continued slowdown in broadband market growth, means continued improvement in fixed line revenue trends may be short-lived in our view.

Figure 29. European incumbent fixed revenue growth vs. total market line loss, retail line loss and growth in nominal GDP
(all yoy %)



Source: Citi Investment Research and Analysis, Company reports and Datastream

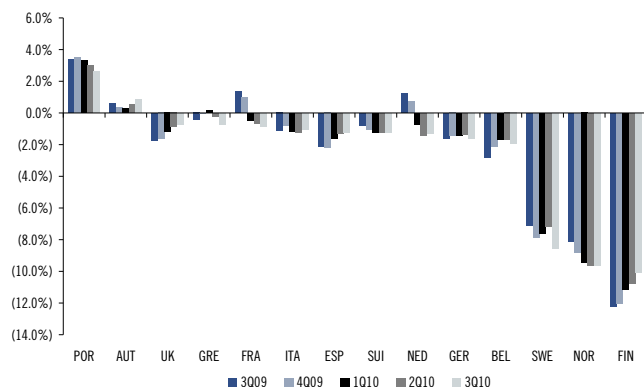
Access Lines

Figure 30 - Figure 33 present the underlying line trends across most European markets. The total line count is broadly stable across most markets with the notable exceptions of: **Finland** where losses are slowing albeit from the worst position in Europe; both the **UK** and **Spain** are improving steadily toward a neutral position; **Sweden** with a noticeable step down after a couple of quarters of improvement.

Figure 33 shows broadly three clusters with one outlier:

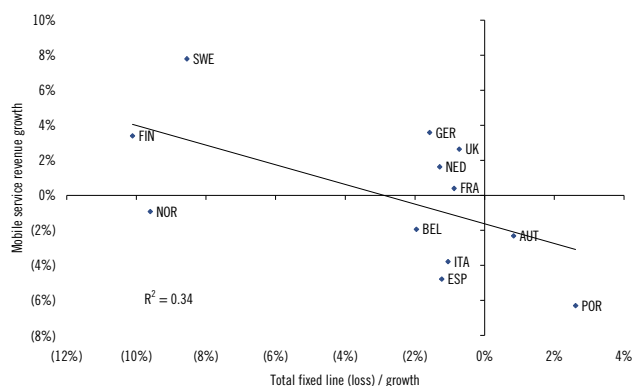
- **Scandinavian** countries where incumbent line loss is high in markets where total losses are high
- **Austria** and **Portugal** where incumbent losses are low in a growing market
- The **UK** where incumbent retail line loss of c.10% is at odds with market growth which is almost nil. This is driven by BSkyB's push into full ULL.
- **The rest** – minimal total loss (<2%); the incumbent slightly underperforming.

Figure 30. Market by market access line growth/loss



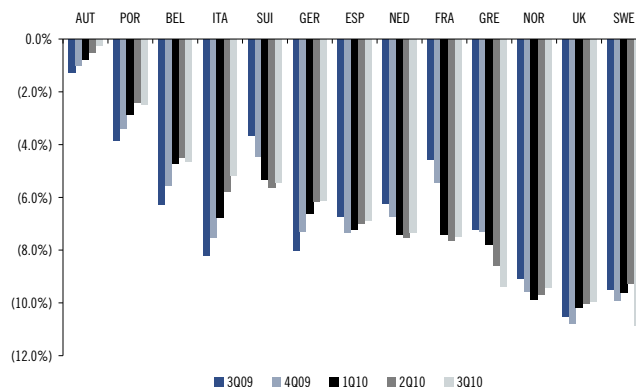
Source: Citi Investment Research and Analysis, Company Reports

Figure 32. Market access line (loss)/growth vs. the market mobile service revenue growth



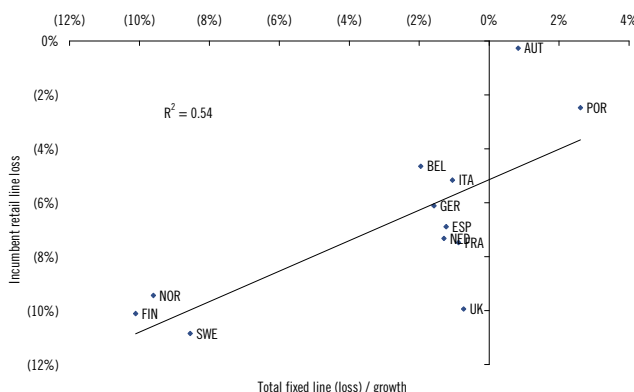
Source: Citi Investment Research and Analysis, Company Reports

Figure 31. Incumbent retail access line loss



Source: Citi Investment Research and Analysis, Company Reports

Figure 33. Incumbent retail line loss in the context of market fixed line (loss)/growth



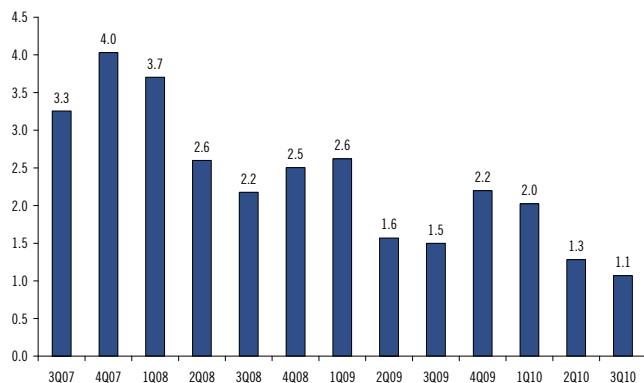
Source: Citi Investment Research and Analysis, Company Reports

Broadband

The third quarter is seasonally weak for broadband net additions and in aggregate 2010 has been no exception (Figure 34). Within the mix we note:

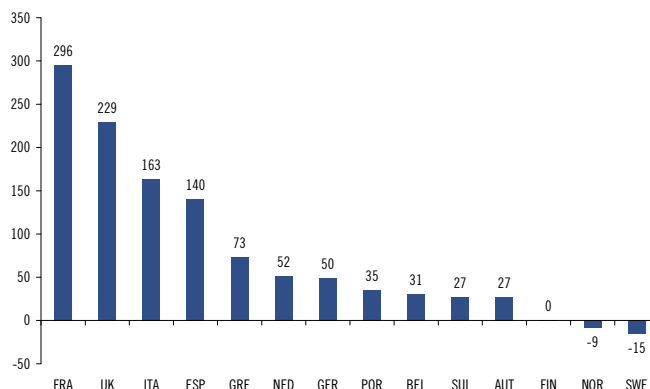
- The **UK** saw an 11% yoy increase in broadband net adds as competition was stimulated by triple-play bundle sales ahead of the start of the Premier League football season. **Austria** also saw increased adds yoy (+43%) with TKA continuing to offer free TVs with its fixed line bundles.
- Despite **France** recording the largest number of net additions in Europe in the quarter it also saw the greatest yoy fall in absolute yoy (-160k). **Germany** is the largest broadband market in Europe (24.8m connections) but reported only 50k net additions.

Figure 34. Aggregate European broadband net additions



Source: Company Reports and CIRA Estimates

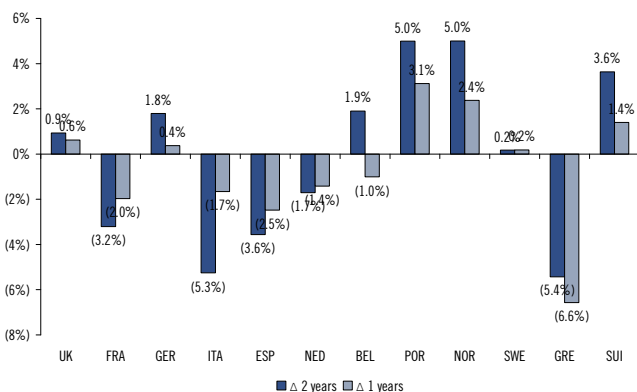
Figure 35. 3Q10 market-by-market broadband net additions



Source: Company Reports and CIRA Estimates

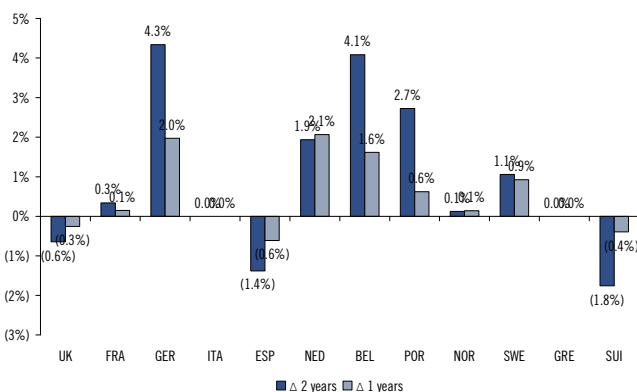
- OTE and Telefónica are the incumbents losing the greatest retail broadband market share, both to altnets rather than cable operators.
- Cable continues to make the biggest strides in Germany and Holland.

Figure 36. Change in incumbent broadband market share



Source: Citi Investment Research and Analysis, company reports

Figure 37. Change in cable broadband market share



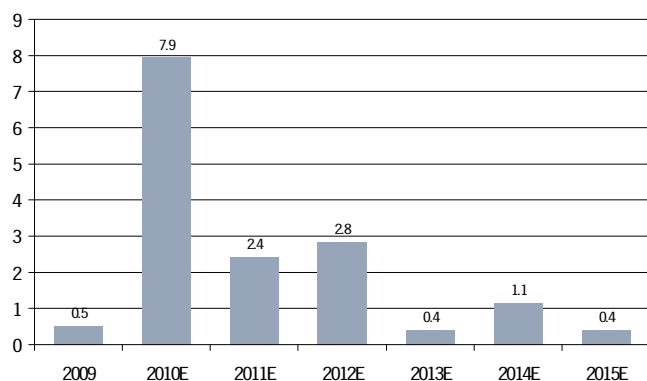
Source: Citi Investment Research and Analysis, company reports

Spectrum auctions set to moderate

Spectrum payments should fall yoy in 2011 to €2.4bn from €7.9bn (Figure 38) with France, Spain and a number of emerging markets to watch, plus the UK's preparations for 2012.

The French industry minister expects 4 lots (2 of 2x10MHz and 2 of 2x5MHz) of 800MHz range spectrum to be sold before summer 2011. The government is targeting minimum receipts of €2bn (\$0.72 per MHz per pop) which looks somewhat ambitious to us although the government did achieve a surprisingly high per MHz per pop price for its 2009 2GHz sale (Figure 40). There is still uncertainty as to which form the offering will take.

Figure 38. Spectrum costs – 2010 peak due to Germany, India and Mexico
€bn, year to Dec (for Mar-end reporters, year to subsequent Mar)



Source: Company Reports and CIRA Estimates

Figure 39. Spectrum licence costs by operator
€bn, year to Dec (for Mar-end reporters, year to subsequent Mar)

	2009	2010E	2011E	2012E	2013E	2014E
Deutsche Telekom	0	1,301	143	144	144	144
France Telecom	58	400	800	500	250	250
KPN	0	285	0	0	0	0
Portugal Telecom	0	0	0	64	0	0
Telecom Italia	0	0	0	450	0	0
Telefónica	0	2,389	527	400	0	0
Telenor	(0)	41	263	359	0	0
Vodafone	450	3,514	690	909	0	776
Total	507	7,929	2,423	2,826	394	1,170

Source: Company Reports and CIRA Estimates

Emerging market spectrum auctions

We expect a series of smaller auctions rather than the two large auctions we saw in 2010.

During 2010 there were a number of significant 3G spectrum auctions in emerging markets India and Mexico. In 2011 and 2012 we expect a number of smaller auctions in emerging markets.

- **Thailand** – 3G auction, we expect this to happen in 2010, however the auction keeps being delayed by legal disputes.
- **Pakistan** – We expect a 3G auction in 1H11.
- **Bangladesh** – 3G auction, however not imminent we forecast in 2012.
- **South Africa** – Upcoming auction for 2.5Ghz and 2.6Ghz spectrum. Timing uncertain - it was postponed in June 2010.
- **Brazil** – An additional 3G license is due to be auctioned, the terms currently restrict this to a new entrant. The most likely acquirer would be the Nextel. We also expect a LTE/WiMax auction (2.6Ghz and 3.5Ghz in 2011 or 2012).
- **Argentina** – Argentina are yet to hold a 3G auction, however we believe this will most likely be held in 2012.
- **Chile** – Chile plan to hold a LTE 2.6Ghz auction in 2011.
- **Columbia** – We expect Columbia to hold a 2.6Ghz auction in 2011 or 2012.

Indian 3G spectrum was the most expensive ever sold

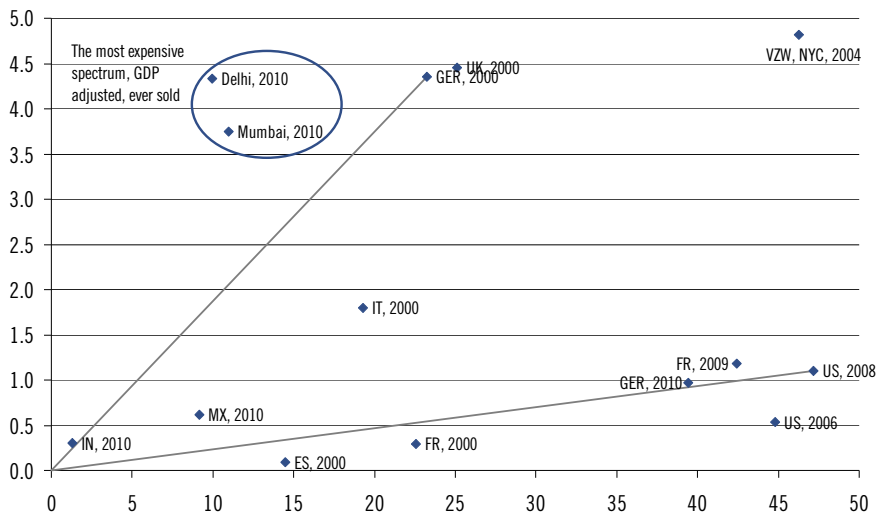
We believe investors could feel concerned that some among the Indian authorities want to rebase past spectrum sales to the very high level of the 3G auction which was brutally priced, and set to be so by the authorities themselves.

As Figure 40 shows, adjusted for GDP, the 2010 3G auction in the Indian cities of Delhi and Mumbai was the most expensive spectrum ever sold. Even ignoring the GDP differences, the cost in Delhi rivaled the very high, internet bubble fueled prices for 3G spectrum in Germany and the UK in 2000 at close to \$4.5 per MHz per pop. The reason for the high pricing in India was an acute shortage of spectrum for 3G and the need of the established players to retain their high spending customers, who are both concentrated in the cities and key to the economics of emerging market carriers. In many licence circles there were only 3 available licences each of a single 3G carrier bandwidth (2x5MHz) meaning that the offer was equal to a single operator's licence in many European countries.

On Figure 40 we have added what we consider to be an approximately normalised line for developed countries, the lower of the two, which joins the origin to the US 2008 700MHz auction. This passes close to the latest German 700MHz auction and France's 2GHz sale in 2009, all at around "the industry standard" of \$1 per MHz per pop. The line joining the origin to the German 2GHz auction in 2000 shows the highest price paid in a significant issuance prior to the 3G auction in the Indian cities this year. The national average for India's 3G is close to this "left boundary" line but is likely to see stronger GDP growth from here, albeit this is a market where a risk discount would most certainly appear warranted in our view. The 2010 Mexican auction, though not as egregious as India, also sits in the expensive part of the matrix, although the higher growth potential from GDP may be enough to justify that.

Figure 40. Spectrum costs compared to local GDP

\$ spectrum costs per MHz per pop, \$k GDP per pop



Source: DataStream, National authorities, European Commission, Company Reports and CIRA Estimates

Neelie Kroes is ready to investigate national regulators which set ULL wholesale rates above levels implied by EU recommendations.

Regulatory focus broadband & MTRs

We expect regulatory interest to remain high in broadband and particularly on bringing faster access speeds to rural areas. This should in principle be positive for the incumbents which could legitimately expect some incentive to upgrade their networks where the economic case for doing so is weak or non-existent. Indeed the state aid supervisors at the European Commission have been approving schemes sponsored by governments and local authorities such as in Cornwall, UK.

Regulation is also likely to be active in 2011 in applying further MTR reductions, most of which have been set, looking again at international roaming and preparing for further spectrum issuance. The review of the international roaming price regime is due by the spring and will probably extend the duration of the price cap for voice and could expand the breadth of the controls on data.

Regulators not lavish with rural broadband incentives

The incumbents are not being showered with largesse by governments. Recent comments by Information Society Commissioner Neelie Kroes seem to us to be inconsistent with the objective of expanding fast broadband availability. She says she is ready to investigate national regulators which set ULL wholesale rates above levels implied by EU recommendations. The Commission may well be worried by the precedent set by the Italian regulator which is allowing TI to increase its ULL prices by 9% over two years. Ofcom has also permitted BT to raise ULL wholesale prices, now cleared, with minor adjustments, by the Competition Appeals Tribunal.

Key is customers' preparedness to pay a material premium for fibre grade access speeds which currently seems to be confined to a narrow segment. A low reference price provided by lower ULL rates would outweigh the incentive to invest in a higher return asset mix by the operator in our view. As a result slightly higher prices for basic service should give a more favourable investment environment, and help justify the cost of shortening loop lengths in rural areas.

Separately the UK government is committing £830m to expansion of fibre local network into regions uneconomic for the carriers to reach on their own, and BT says that with this would enable it to reach up to 90% of homes, beyond its current two thirds target, if it were given access to these funds.

Satellite options

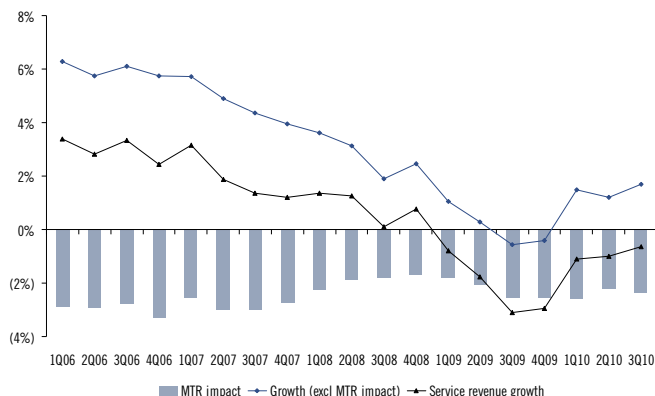
Avanti's successful launch of its Ka satellite on the 26th of November this year gets some potential rural broadband capacity into space. Their commercial service launch is expected after Christmas; customer capacity of 350k on Hylas 1 if we assume a 100% fill rate for consumer broadband. Eutelsat is scheduled for its Ka satellite launch on the 20 of December 2010. If successful, this will be a larger satellite capable of supporting 1.5m customers with a footprint of 15m potential customers (currently outside of any fixed rollout plans) across Europe and the Mediterranean basin.

Mobile termination rate cuts heavier in 2011

As Figure 43 and Figure 44 show, we expect the impact of mandated reductions in mobile termination rates (MTRs) to toughen in most markets in 2011 vs 2010. We estimate the net impact across Europe to be -270bp in 2011 vs around -220bp in 2010. The main drivers of this adverse swing are Germany and the UK which enjoyed periods of no cuts during 2010. The UK cut is scheduled for 1 April but might be delayed if, as we expect, the operators challenge Ofcom's ruling. After heavy hits in 2010, Spain and, especially, France should see improvement in 2011.

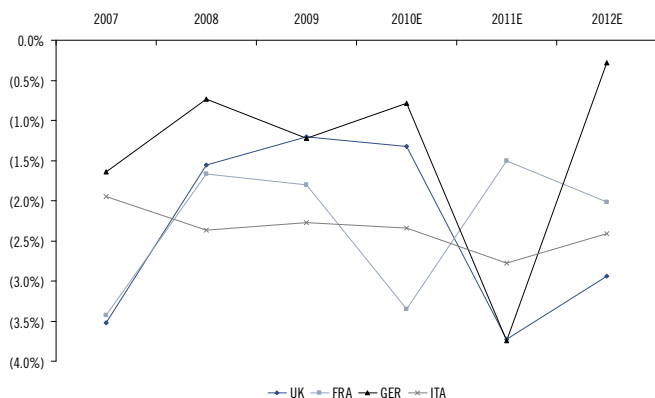
Figure 42 sets out our expectations for the impact of MTR cuts across Europe quarter by quarter. This shows that we expect MTR pressures to increase in 4Q10 and further in the first two quarters of 2011 to peak in 2Q11 at around 320bp impact including the UK cut. Longer term as incoming call revenues fall in the mix and rates start to reach the regulators' desired levels these pressures should steadily ease.

Figure 41. Ex MTRs mobile service revenue growth has been positive for 3Qs
% growth yoy



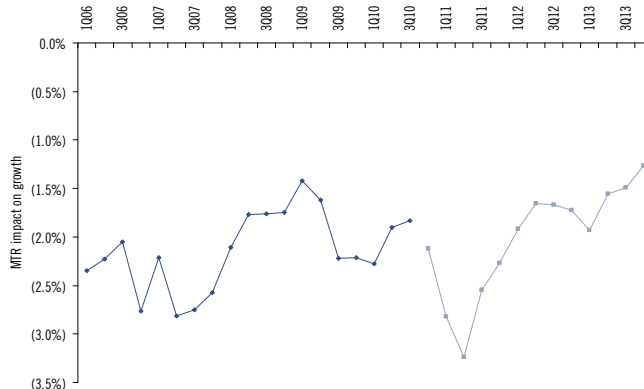
Source: Company Reports and CIRA Estimates

Figure 43. The impact on service revenue of MTR reductions in 2011 is set to ease in France but toughen in Germany and the UK



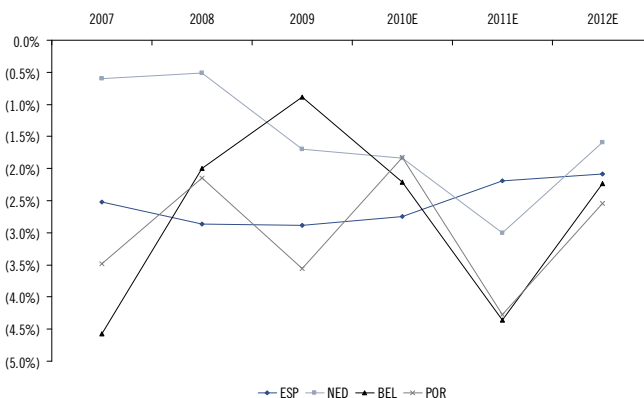
Source: Company Reports and CIRA Estimates

Figure 42. We expect MTR pressures to peak in 2Q11
% impact on yoy European mobile service revenue growth



Source: Company Reports and CIRA Estimates

Figure 44. The impact on service revenue of MTR reductions in 2011 is set to ease in Spain but toughen significantly in Portugal & Belgium



Source: Company Reports and CIRA Estimates

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Company section

Company Focus

- Company Update
- Rating Change
- Target Price Change
- Estimate Change

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Sell/Low Risk	3L
<i>from Hold/Low Risk</i>	
Price (09 Dec 10)	€26.39
Target price	€24.00
<i>from €27.00</i>	
Expected share price return	-9.1%
Expected dividend yield	6.4%
Expected total return	-2.7%
Market Cap	€8,920M
	US\$11,828M

Price Performance (RIC: BCOM.BR, BB: BELG BB)



Belgacom SA (BCOM.BR)

Underweight mobile data, overweight tax and subsidies risk

- **Cut to Sell** — We are turning underweight on Belgacom and reduce our target price to €24. We feel that risks are on the downside from: 1) Mobile subsidies, 2) increased tax rate, 3) Market share loss.
- **Easy target for the tax man** — Belgium has the third highest debt/GDP ratio in Europe. Telcos are easy targets as the unexpected renewal fees for 2G spectrum have shown. Belgacom's effective tax rate is 25% vs 34% standard corporate tax rate. We estimate we would have to cut our EPS 11€ by 13% if Belgacom's tax rate were to rise to the standard corporate tax rate.
- **Status quo on mobile subsidies might not last** — So far only Telenet has pushed mobile subsidies. Base has launched limited offers including mobile subsidies. We see a risk that the peace could be broken especially if Telenet becomes more aggressive with its Full MVNO or Base tries to catch up in mobile data having launched its mobile data network in Q4.
- **Limited benefit from mobile data** — Belgacom grew mobile data revenues by 11% yoy in Q3 vs. 20% for most European operators. We believe that the main reason for Belgacom's underperformance is the lack of subsidies and distribution agreement to sell the iPhone. Without subsidies the take up of mobile data for Belgacom is likely to continue lagging peers.
- **More risk of price competition in mobile** — Service revenue growth has turned negative. There is a risk that with much lower termination rates, Mobistar and Base could more aggressively target business subscribers. Belgacom's on-net pricing advantage could disappear.
- **Fixed still declining** — Fixed revenues accelerated their decline to 3% pa in Q3. Belgacom increased prices on broadband and telephony over the summer but it might be more difficult to do the same next year as Telenet has not followed. Costs in the meantime will be impacted by a €12m increase in salaries due to salary indexation with inflation.
- **Undeserved valuation** — Stock trades on a small premium at 5.4x EV/EBITDA 11€ (sector on 5.1x) and 10.8x PE 11€ (sector on 10x). We think this premium is underserved considering declining top-line and risks highlighted above. Belgacom could announce a small share buyback of €100m.

Belgacom SA (EUR)

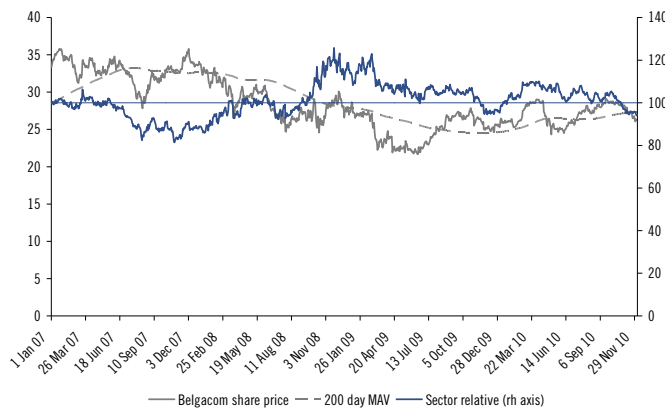
Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	5,978.0	5,990.0	6,631.2	6,603.7	6,591.7
Net Income (€M)	884.0	892.0	786.1	775.8	780.3
Diluted EPS (€)	2.71	2.78	2.45	2.43	2.46
Diluted EPS (Old) (€)	2.71	2.78	2.45	2.52	2.56
PE (x)	9.7	9.5	10.8	10.9	10.7
EV/EBITDA (x)	5.4	5.6	5.5	5.5	5.5
DPS (€)	2.18	2.08	2.18	2.18	2.20
Net Div Yield (%)	8.3	7.9	8.3	8.3	8.3

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	9.5	9.3	10.5	10.6	10.5
EV/EBITDA adjusted (x)	5.3	5.5	5.4	5.4	5.4
P/BV (x)	3.7	3.3	2.7	2.6	2.5
Dividend yield (%)	8.4	8.1	8.4	8.4	8.5
Per Share Data (€)					
EPS adjusted	2.71	2.78	2.45	2.43	2.46
EPS reported	2.45	2.82	3.81	2.43	2.46
BVPS	6.96	7.86	9.57	9.94	10.27
DPS	2.18	2.08	2.18	2.18	2.20
Profit & Loss (€M)					
Net sales	5,978	5,990	6,631	6,604	6,592
Operating expenses	-4,817	-4,729	-5,043	-5,459	-5,445
EBIT	1,161	1,261	1,588	1,145	1,147
Net interest expense	-108	-117	-99	-92	-82
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	1,053	1,144	1,490	1,053	1,065
Tax	-254	-241	-253	-263	-266
Extraord./Min.Int./Pref.div.	0	1	-14	-14	-18
Reported net income	799	904	1,223	776	780
Adjusted earnings	884	892	786	776	780
Adjusted EBITDA	1,990	1,955	1,959	1,934	1,926
Growth Rates (%)					
Sales	-1.4	0.2	10.7	-0.4	-0.2
EBIT adjusted	-4.4	0.2	-7.8	-0.6	0.2
EBITDA adjusted	-4.2	-1.8	0.2	-1.3	-0.4
EPS adjusted	-9.8	2.6	-11.9	-0.8	1.1
Cash Flow (€M)					
Operating cash flow	1,552	1,406	1,615	1,529	1,530
Depreciation/amortization	744	706	808	789	779
Net working capital	-79	-187	-70	-50	-50
Investing cash flow	-1,143	-609	-689	-740	-665
Capital expenditure	-764	-597	-711	-740	-649
Acquisitions/disposals	-379	-12	22	0	-16
Financing cash flow	-570	-1,030	-753	-699	-696
Borrowings	478	-330	0	0	0
Dividends paid	-711	-684	-701	-699	-696
Change in cash	-161	-233	173	89	168
Balance Sheet (€M)					
Total assets	7,784	7,452	8,353	8,405	8,464
Cash & cash equivalent	565	332	475	550	698
Accounts receivable	1,205	1,089	1,232	1,252	1,272
Net fixed assets	2,501	2,420	2,335	2,287	2,173
Total liabilities	5,505	4,923	5,055	5,016	4,973
Accounts payable	1,238	1,123	1,317	1,292	1,267
Total Debt	2,521	2,187	1,958	1,944	1,926
Shareholders' funds	2,276	2,527	3,297	3,387	3,490
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	33.3	32.6	29.5	29.3	29.2
ROE adjusted	36.9	37.2	28.1	24.9	24.3
ROIC adjusted	19.8	19.2	16.4	15.5	15.5
Net debt to equity	85.9	73.4	45.0	41.2	35.2
Total debt to capital	52.6	46.4	37.3	36.5	35.6

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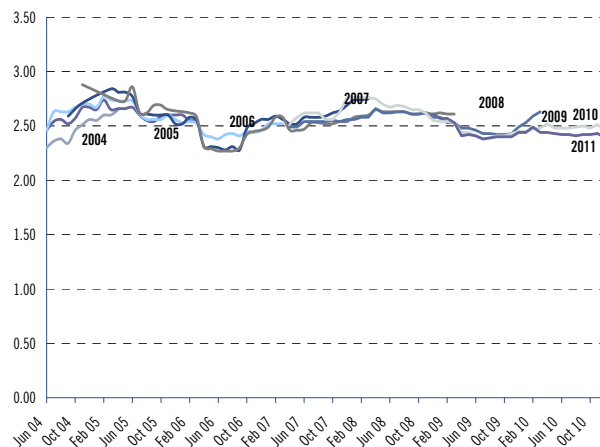
Performance and Outlook

Figure 45. Belgacom has lately underperformed the sector (left axis €/share; right axis index: end-2006=100)



Source: DataStream

Figure 47. Consensus EPS has lately drifted off a little (€)



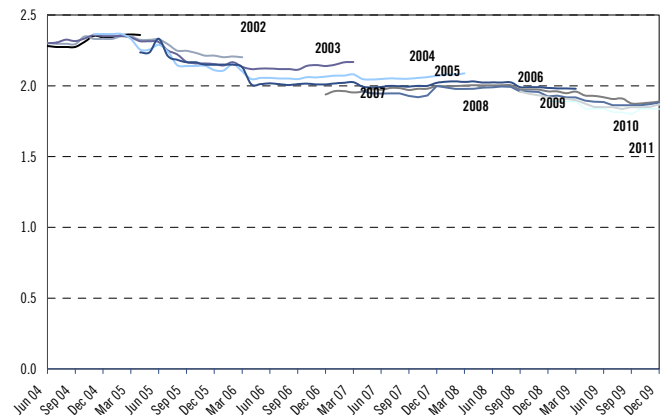
Source: DataStream

Figure 46. Belgacom trades in line with the sector average on PE (1 year forward)



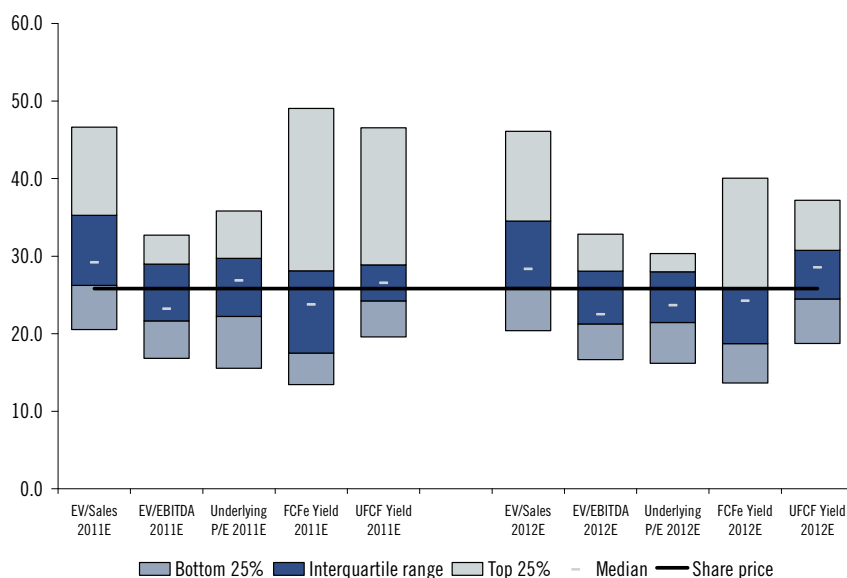
Source: DataStream

Figure 48. EBITDA consensus has consistently fallen (€bn)



Source: DataStream

Figure 49. Compared to its incumbent and wireless peers in Europe Belgacom trades below the median on our 2011 estimates and roughly at the median on 2012 estimates
€/share

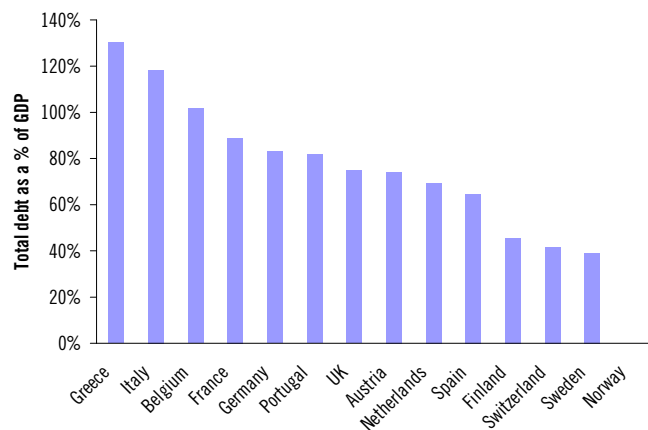


Source: Powered by dataCentral

Easy target for the tax man

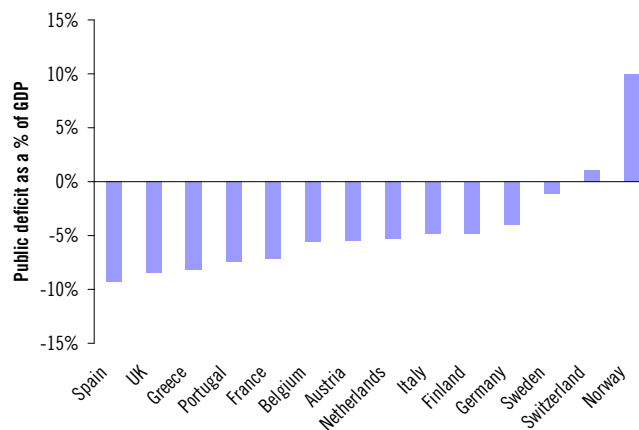
3 reasons to worry that Belgium might go after Belgacom for extra cash: 1) Belgium has the third largest public debt relative to GDP in Europe (see Figure 48). 2) Fiscal balance is expected to remain in negative territory (see Figure 49). 3) There is no government in place to make structural reforms and reduce spending so increasing taxes might be the only option to reduce the deficit¹.

Figure 50. Belgium 3rd most indebted country in Europe



Source: Citi Investment Research and Analysis and Eurostat

Figure 51. Belgium in the middle of the pack in terms of fiscal deficit

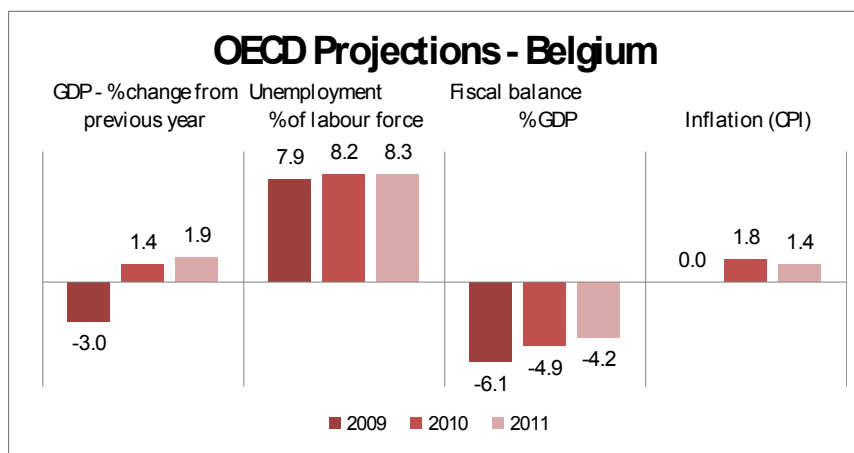


Source: Citi Investment Research and Analysis and Eurostat

¹ See our report called *Belgium – Not Just A Sovereign Debt Crisis Looming* published on 6 September 2010 by Jürgen Michels for more details on the current political crisis in Belgium following the resignation of Elio Di Rupo - leader of the French-speaking Socialist Party – as chairman of a meditation committee to build a new government.

Fundamentally Belgium is in a far better position than countries such as Greece or Portugal in our view. In order to reduce the deficit-to-GDP ratio from 6.0% in 2009 to 3.0% in 2012, the government had planned a tightening of fiscal policy by 0.6% of GDP in 2011 and 0.8% of GDP in 2012. The current political crisis calls this pace into question. Our rate strategists believe that Belgium is in good shape medium term but that short term there is too much uncertainty to be long Belgian debt². In the absence of a strong government, the telecoms sector could become a target for the extra cash needed to balance the budget especially as the telecoms sector pay a lower effective tax rate than the standard Belgian corporate tax rate.

Figure 52. Little growth and more deficit expected in Belgium



Source: OECD

Belgacom benefits from tax breaks such as the “deduction for risk capital” introduced in 2006. This allows for the deduction of a notional interest charge equivalent to the cost of capital³. In practice this means that Belgacom’s effective tax rate is currently at 25% vs. the standard corporate tax rate of 33.99%. We fear that such tax breaks may come to an end as the government tries to get more cash where it can. There are two reasons to think that the government might look at telecoms as a target: 1) Government has disputed the claims from Belgacom and Mobistar that 2G licences were renewed automatically and instead forced Belgacom to pay €75m for it of which €28m were paid this year. 2) Telecoms in Belgium are very profitable (EBITDA margins >40% for mobile for all three players), pay big dividends but little taxes (Belgacom on 24% tax rate, Base and Telenet pay almost no cash tax, Mobistar is the exception with an effective tax rate of 33%).

² See our report called *Belgium – Fizz or Bang?* Published on 7 September by Robert Crossley.

³ This break was introduced to stimulate equity funding and is calculated by using the amount of net equity multiplied by a the yield on Belgian government bonds (used as a proxy for notional interest).

Figure 53. Belgacom the second most exposed operator if its tax rate normalizes



Source: Company reports, Citi Investment Research and Analysis

Note: Group effective tax rate is compared to standard corporate tax rate in domestic country

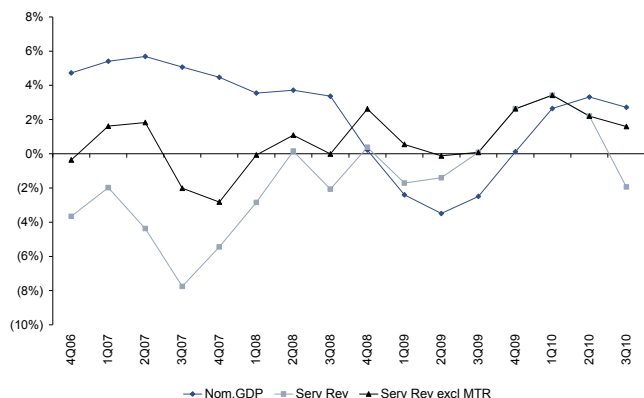
We estimate that we would have to cut our EPS 11E estimate by 13% if Belgacom's effective tax rate were to rise to the standard corporate tax rate in Belgium.

Second guessing the timing and extent of increased taxes on telecoms stocks is hard but we have seen negative precedents in more distressed countries (e.g. Greece, Hungary, Croatia and Serbia).

Underweight mobile data

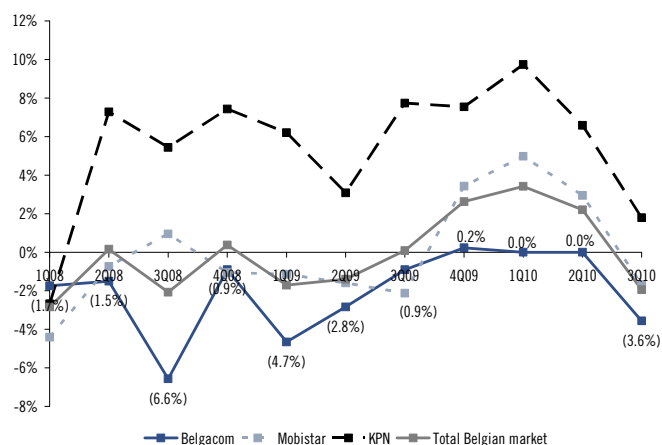
Belgacom is underperforming in mobile data due to the lack of subsidies and iPhone distribution agreement. Belgacom only grew mobile data (excluding SMS) by 11% in 3Q10 which is around half the growth rate observed for most other European mobile operators. We fear that Belgacom is unlikely to gain significant mobile data growth until it starts subsidizing handsets which could provoke a negative market reaction with all operators pushing handset subsidies. Base will also now be in a better position to compete as it has just launched its mobile data network. As illustrated in Figure 53, Belgacom is underperforming its competitors and probably needs to spend more on commercial costs and eventually lower its tariffs since competition didn't follow its latest price increase in August.

Figure 54. Belgian mobile market turning negative due to termination cut



Source: Citi Investment Research and Analysis and company data

Figure 55. Belgacom underperforming in mobile service revenue growth

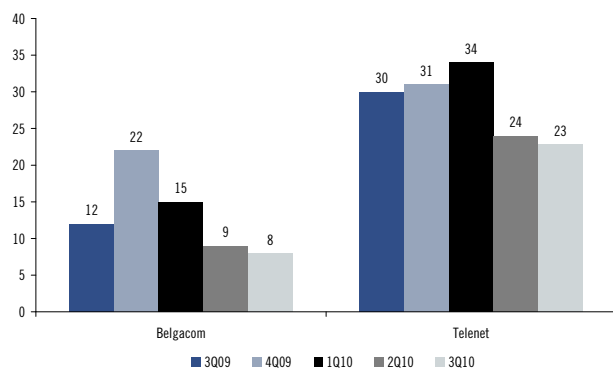


Source: Citi Investment Research and Analysis and company data

Lagging behind cable

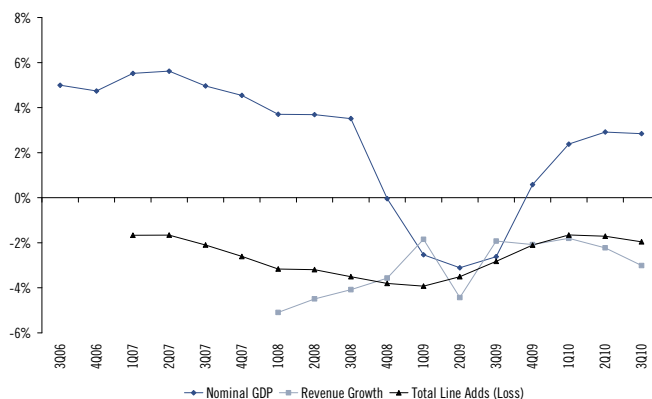
The main issue in fixed for Belgacom is that cable continues to gain market share and Belgacom is hardly adding any new subscribers on DSL (see Figure 54). Fixed line revenues which had shown improvement have started to worsen again and are currently declining by around 3% pa. We feel that the only way for Belgacom to grow revenues is to increase prices but this is becoming harder since prices are already high in Belgium (see our *Tariff Tracker* for details) and Telenet hasn't followed the latest price increase applied by Belgacom. The main growth area in Fixed has been TV which has been remarkably successful but we expect this growth to start slowing down now as we estimate that over 50% of Belgacom's broadband subscribers have IPTV.

Figure 56. Belgacom hardly adding any new broadband subscribers



Source: Citi Investment Research and Analysis, Company reports

Figure 57. Belgacom's fixed revenues getting worse not better



Source: Citi Investment Research and Analysis, Company reports

The main disadvantage for Belgacom is network speed. Telenet which uses DOCSIS 3.0 can provide much higher speeds at lower marginal cost than DSL. Telenet already offers 100Mbit/s packages vs. 30Mbps on Belgacom's VDSL. In addition, there are further technologies in the pipeline beyond DOCSIS 3.0 such as DVB-C2. Belgacom could regain a network advantage if it were to rollout FTTH but that would require significant capital investment. The main advantage for Belgacom vs. cable is that Belgacom offers point-to-point bandwidth so its 30Mbps is not shared. The 100Mbps on Telenet is shared which means that if 500 homes are passed on the same cable segment and assuming 60% market share and internet penetration of 80% then $500 \times 0.6 \times 0.8 = 240$ homes compete for this bandwidth.

Figure 58. Upgrade cost DOCSIS 3.0 vs FTTx

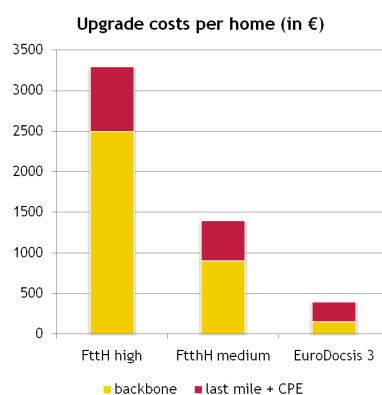
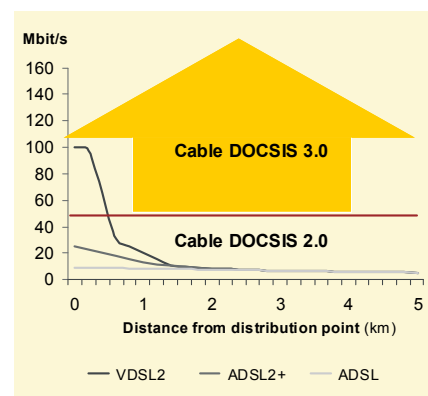


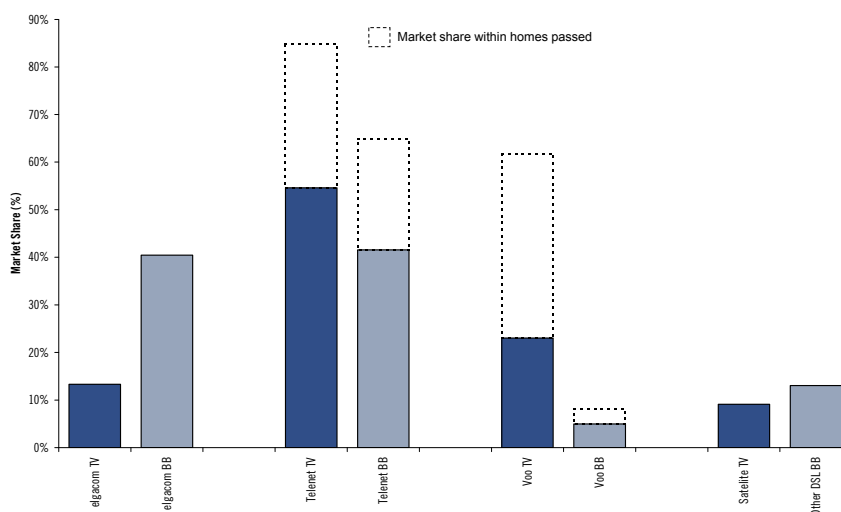
Figure 59. Speed cable vs DSL



Source: Telenet March 2010

Source: KDG presentation

Figure 60. Broadband and TV Market Shares as of 2009



Source: Company reports and Citi Investment Research and Analysis

Telenet remains Belgacom's main competitor. We do not expect Telenet to raise its market share in broadband significantly despite its network advantage. Telenet's market share of broadband in its footprint is already above 60% (see Figure 58) and raising it much more could attract unwanted regulatory attention. One company to watch is Voo the main cable operator in the South of Belgium. So far Voo has made few inroads with its triple play strategy but an upgraded cable network could make Voo more competitive. We are less worried about the risk from Mobistar's move in triple play with a TV offer based on satellite. We see this move as defensive and do not think that this offer will be particularly attractive to customers despite the price discount, due to lower technical capabilities.

Forecast Changes

We have lowered our revenues and EBITDA estimates to reflect lower market share for Belgacom predominantly in mobile. We have cut our EPS estimates by respectively 4.2% and 5.2% for 2011E and 2012E.

We also lower our target price to €24 from €27 due to the estimate cut and higher risks of tax increase and subsidies.

Figure 61. Forecast Changes for Belgacom (In €m except per share data)

	New Forecast			Old forecast			Delta		
	2010E	2011E	2012E	2010E	2011E	2012E	2010	2011	2012
Net Revenues	6,631	6,604	6,592	6,591	6,654	6,696	0.6%	-0.8%	-1.6%
EBITDA	2,396	1,934	1,926	2,397	1,982	1,981	0.0%	-2.4%	-2.8%
EBIT	1,588	1,145	1,147	1,597	1,201	1,206	-0.5%	-4.6%	-4.9%
Profit before tax	1,490	1,053	1,065	1,488	1,102	1,124	0.1%	-4.5%	-5.3%
Taxation	-253	-263	-266	-252	-276	-281	0.2%	-4.5%	-5.3%
Reported net income	1,223	776	780	1,224	810	821	-0.1%	-4.2%	-4.9%
Reported EPS	3.81	2.43	2.46	3.82	2.52	2.56	-0.1%	-3.7%	-4.0%
Underlying EPS	2.45	2.43	2.46	2.45	2.52	2.56	-0.1%	-3.7%	-4.0%
Net debt	1,437	1,348	1,182	1,501	1,391	1,132	-4.3%	-3.1%	4.4%
FCF	904	788	878	853	809	964	5.9%	-2.6%	-8.9%

Source: Citi Investment Research and Analysis

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Company Focus

■ Company Update

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Buy/High Risk	1H
Price (09 Dec 10)	€32.03
Target price	€40.00
Expected share price return	24.9%
Expected dividend yield	5.0%
Expected total return	29.9%
Market Cap	€11,391M US\$15,104M

Price Performance (RIC: BOUY.PA, BB: EN FP)



Bouygues SA (BOUY.PA)

Undervalued and geared up for any signs of recovery

- **Retain Buy rating** — We retain our Buy (1H) recommendation on Bouygues which remains the most geared stock in the sector to early signs of an economic recovery. Next year growth in construction should pick up (we have +8.6% yoy) while margins at Colas should recover following this year's profit warning (we forecast +60bps yoy). We recently raised our revenue forecasts by 1.2% for FY10E and 2.4% in FY11E.
- **Stock is undervalued** — We argue the stock currently trades at an undeserved discount vs. the market. At 8.5x FY11E P/E vs. the market above 10x, the stock feels un-rewarded for the 11% 10E-13E EPS CAGR in our view. There might be some upside to the 5.1% 11E dividend yield if the macro environment stabilizes.
- **Solid B/S could favour "flight to quality"** — Bouygues' Net Debt to EBITDA ratio stood at c.1x at the end of Sept. 2010. This leaves the company with significant scope to buyback shares or do M&A (note that Bouygues stated that it would not invest directly in Areva). So far management wants to keep its powder dry in case the environment deteriorates. The company will be in a good position to pick-up interesting assets if opportunities arise.
- **Construction to drive the top-line recovery** — The order book is at historically high levels for the business at €14.3bn +24% yoy. Bouygues benefits from the structural shift to PPP projects which favour large group with strong technical capabilities and solid balance sheet. We argue this will be one of the key factors in margin stabilization through 2011E.
- **Costs under control at Colas** — Restructuring plans at Colas should reverse the declining top-line trend. We expect Colas' revenues to decline by a moderate 1.1% yoy in FY11E but margins should grow from current depressed level by 60bps to 3.4%. A harsh winter and municipal elections coming in 2013 may push local municipalities to invest more in road maintenance.
- **Strong momentum in Telecoms despite worsening market** — Bouygues mentions that commercial momentum remains very strong. We expect a strong Q4 in terms of top-line but margins are likely to continue being under pressure as Bouygues gets ready to welcome the new mobile entrant by locking in its subscribers on 2-year quadruple play plan. We expect Bouygues to spend €300m on 4G auction.

Bouygues SA (EUR)

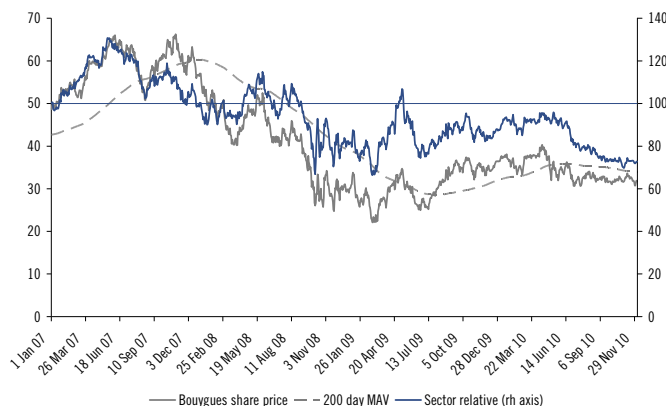
Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	32,713.0	31,353.0	30,929.5	31,671.3	31,797.1
Net Income (€M)	1,501.0	1,319.0	1,113.8	1,323.5	1,460.8
Diluted EPS (€)	4.36	3.80	3.14	3.74	4.12
Diluted EPS (Old) (€)	4.36	3.80	3.14	3.74	4.12
PE (x)	7.3	8.4	10.2	8.6	7.8
EV/EBITDA (x)	3.0	3.0	3.2	2.7	2.4
DPS (€)	1.60	1.60	1.60	1.60	1.65
Net Div Yield (%)	5.0	5.0	5.0	5.0	5.1

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	7.2	8.3	10.0	8.5	7.7
EV/EBITDA adjusted (x)	2.9	2.9	3.1	2.7	2.4
P/BV (x)	1.4	1.3	1.3	1.2	1.1
Dividend yield (%)	5.1	5.1	5.1	5.1	5.2
Per Share Data (€)					
EPS adjusted	4.36	3.80	3.14	3.74	4.12
EPS reported	4.36	3.80	3.14	3.74	4.12
BVPS	22.04	24.09	25.21	27.35	29.87
DPS	1.60	1.60	1.60	1.60	1.65
Profit & Loss (€M)					
Net sales	32,713	31,353	30,929	31,671	31,797
Operating expenses	-30,483	-29,498	-29,157	-29,770	-29,784
EBIT	2,230	1,855	1,773	1,901	2,013
Net interest expense	-277	-344	-335	-306	-261
Non-operating/exceptionals	338	432	326	405	453
Pre-tax profit	2,291	1,943	1,764	2,001	2,205
Tax	-605	-487	-468	-511	-561
Extraord./Min.Int./Pref.div.	-185	-137	-183	-167	-184
Reported net income	1,501	1,319	1,114	1,323	1,461
Adjusted earnings	1,501	1,319	1,114	1,323	1,461
Adjusted EBITDA	3,827	3,616	3,142	3,517	3,590
Growth Rates (%)					
Sales	10.5	-4.2	-1.4	2.4	0.4
EBIT adjusted	3.1	-16.8	-8.2	11.7	5.9
EBITDA adjusted	5.4	-5.5	-13.1	11.9	2.1
EPS adjusted	8.8	-12.8	-17.3	18.8	10.4
Cash Flow (€M)					
Operating cash flow	2,654	3,396	2,403	3,140	3,180
Depreciation/amortization	1,597	1,761	1,369	1,616	1,577
Net working capital	-182	459	-400	0	0
Investing cash flow	-2,220	-529	-1,603	-1,729	-1,410
Capital expenditure	-1,892	-1,362	-1,352	-1,729	-1,410
Acquisitions/disposals	-230	677	-251	0	0
Financing cash flow	-137	-1,877	-1,389	-1,825	-1,052
Borrowings	0	0	0	0	0
Dividends paid	-687	-671	-679	-671	-699
Change in cash	252	1,025	-589	-413	717
Balance Sheet (€M)					
Total assets	35,488	33,935	34,176	34,147	34,999
Cash & cash equivalent	3,840	4,713	4,187	3,774	4,491
Accounts receivable	7,097	6,132	7,185	7,185	7,185
Net fixed assets	7,216	6,915	6,827	6,941	6,774
Total liabilities	26,723	24,209	23,982	23,134	23,041
Accounts payable	7,577	6,479	6,479	6,479	6,479
Total Debt	8,780	7,438	7,212	6,364	6,271
Shareholders' funds	8,765	9,726	10,194	11,013	11,958
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	11.7	11.5	10.2	11.1	11.3
ROE adjusted	20.6	16.4	12.8	14.2	14.4
ROIC adjusted	18.2	14.9	13.6	14.9	15.6
Net debt to equity	56.4	28.0	29.7	23.5	14.9
Total debt to capital	50.0	43.3	41.4	36.6	34.4

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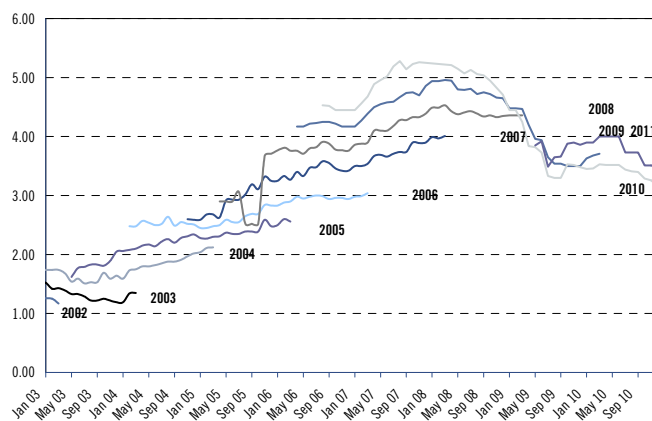
Bouygues performance and outlook

Figure 62. Bouygues has underperformed the sector recently (left axis €/share; right axis index: end-2006=100)



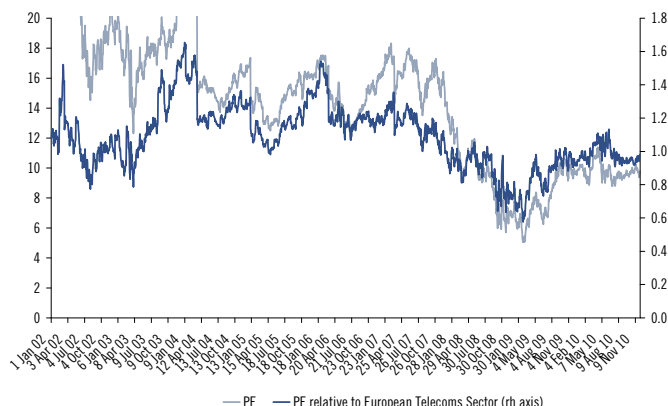
Source: DataStream

Figure 64. Consensus EPS has been falling since 2009 driven by the construction divisions (€)



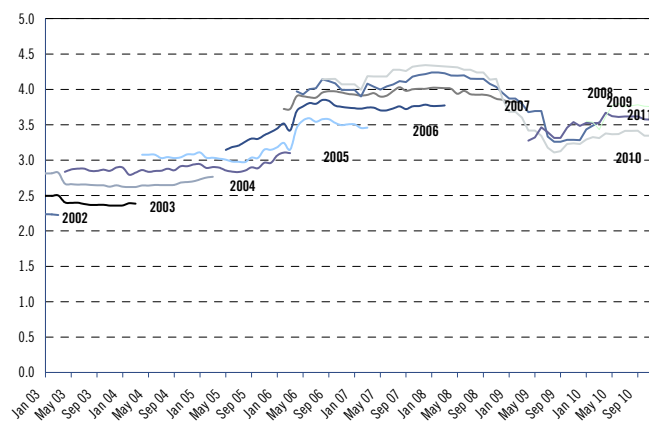
Source: DataStream

Figure 63. Bouygues trades slightly below the sector average on PE (1 year forward), however it has historically traded at a premium



Source: DataStream

Figure 65. EBITDA consensus has risen recently following downgrades during 2009 (€bn)



Source: DataStream

Sum of the Parts

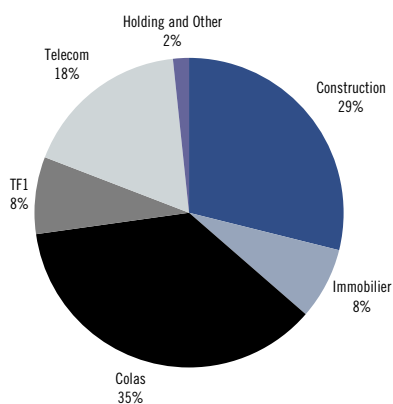
Our €40 price target on Bouygues is based on our DCF valuation (9% WACC and terminal growth rate of 2%). Below we provide the details of our Sum of the Parts for Bouygues which includes a conglomerate discount of 15%.

Figure 66. Bouygues Sum of the Parts

	Stake (%)	MV	Net (debt)	EV	Equity p/share	As a % of Group EV	As a % of Group MV	2011E EV/EBITDA	Metric
Construction	100%	6,079	3,120	2,959	17.2	18%	26%	5.0x	Same multiple as for Vinci and Eiffage construction
Immobilier (property development)	100%	1,398	29	1,369	3.9	8%	6%	6.0x	In-line with Nexity
Colas (road building)	96.4%	4,841	101	4,740	13.7	29%	21%	5.5x	Road building division average
TF1 (broadcasting)	42.8%	1,117	31	1,086	3.2	7%	5%	8.4x	Market value
Telecoms	89.6%	5,942	-263	6,205	16.8	38%	26%	5.0x	In line with sector and FT
Total Consolidated Assets		19,377	3,018	16,359	54.7	100%	83%		
Cofiroute (concession)	17.6%	898			2.5		4%		Vinci's estimate for Cofiroute
Alstom	30.7%	2,951			8.3		13%		Market value
Total Associates		3,848			10.9		17%		
Less Net Debt 2011 at holding level		-5,591			-15.8				
Group		17,634			49.8				
Less conglomerate discount of 15%		-2,645			-7.5				
Group - Post Conglomerate Discount		14,989			42.3				
Shares outstanding (m)		354.3							
Per share valuation		42.31							

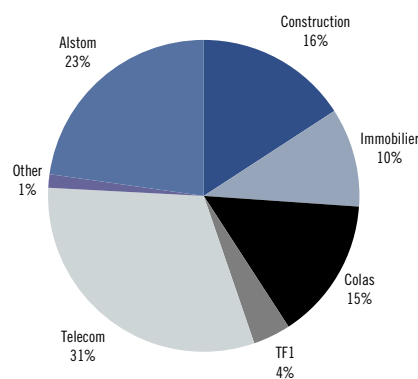
Source: Citi Investment Research and Analysis

Figure 67. 2010E Sales Breakdown per Division



Source: Citi Investment Research and Analysis

Figure 68. 2010E Earnings Breakdown per Division



Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change

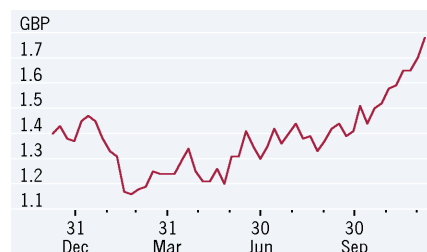
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Buy/Medium Risk	1M
Price (09 Dec 10)	£1.81
Target price	£2.10
Expected share price return	16.2%
Expected dividend yield	4.6%
Expected total return	20.8%
Market Cap	£14,029M
	US\$22,173M

Price Performance (RIC: BT.L, BB: BT/A LN)

BT Group PLC (BT.L)
Prospect of dividend momentum

- **BT remains a top pick, target price 210p** — BT will, in our view, continue to deleverage rapidly and is well placed to raise its payout to shareholders once its credit rating catches up with its improving fundamentals. Our dividend forecasts to show a doubling of the payout between 2010/11 and 2012/13 with net debt and the pension deficit continuing to be reduced. We increase 2011/12E EBITDA by 1.7% due to Global Services. At the earnings level this is offset by higher D&A and lower share of associate net income.
- **FCF upgrades, pension risk moderating** — BT again raised its FCF guidance at its latest quarterly results on the back of better than expected cost savings and working capital improvements. In our valuation we allow £3.6bn for the pension deficit net of tax which incorporates £1.6bn to be paid into the scheme by end 2011 and the change to CPI for inflation indexation. It does not include benefits from fund performance, changes to employee terms or the government guarantee and we have added £1bn net of tax to allow for an adverse move in other assumptions. We expect the IAS19 pension deficit to have improved materially since end-Sep (by roughly £3bn from £5.2bn reported) mainly due to higher AA bond yields.
- **Revenue weakness prior to 2Q partly leased line related** — the decline in revenue moderated in fiscal 2Q (Figure 74) as weakness in Wholesale's private circuits from 1Q09/10 passed its anniversary. We expect revenue growth to improve gradually, boosting confidence in the resilience of earnings, and investors to increasingly focus on fibre and triple play adds.
- **Interest costs set to fall** — In 2009/10 BT's average interest rate was 9.1%, rising on our ests to 9.7% in 2010/11, elevated by the carry cost on its cash balance and high yields on historic issuance. Its 2017, 6.625% sterling bonds currently yield 4.7% and we expect its interest rate to fall with bond retirement, and as its cash balance is reduced. The company has £2.5bn of debt maturing by March 2011, no need for new issuance until Jan 2013 and we expect a ~£200m fall in cash interest costs yoy in 2011/12.
- **Fibre and positioning for OTT TV** — BT is aiming to pass 4m homes with fibre local network by end-10, mainly thus far fibre to the cabinet, and encouragingly take up is accelerating. In TV progress has been slower. BT Vision will support the iPlayer from December 2010 and YouView from Summer 2011.

BT Group PLC (GBP)

Year to 31 Mar	2009A	2010A	2011E	2012E	2013E
Sales (£M)	21,390.0	20,911.0	20,156.5	19,888.3	20,022.7
Profit Before Tax (£M)	1,829.0	1,510.0	1,901.9	2,114.1	2,269.5
Diluted EPS (p)	17.7	14.9	18.4	20.1	21.3
Diluted EPS (Old) (p)	17.7	14.9	18.5	19.7	21.9
PE (x)	10.2	12.2	9.9	9.0	8.5
EV/EBITDA (x)	4.6	4.2	3.9	3.7	3.5
DPS (p)	6.5	6.9	7.2	10.8	14.4
Net Div Yield (%)	3.6	3.8	4.0	6.0	8.0

Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	10.2	12.2	9.9	9.0	8.5
EV/EBITDA adjusted (x)	4.6	4.2	3.9	3.7	3.5
P/BV (x)	98.7	-5.3	-7.2	-13.3	nm
Dividend yield (%)	3.6	3.8	4.0	6.0	8.0
Per Share Data (p)					
EPS adjusted	17.7	14.9	18.4	20.1	21.3
EPS reported	-2.5	12.9	16.6	19.2	21.2
BVPS	1.8	-34.2	-25.2	-13.6	-3.5
DPS	6.5	6.9	7.2	10.8	14.4
Profit & Loss (£M)					
Net sales	21,390	20,911	20,157	19,888	20,023
Operating expenses	-19,042	-18,311	-17,370	-16,977	-17,051
EBIT	2,348	2,600	2,787	2,911	2,972
Net interest expense	-933	-890	-862	-759	-661
Non-operating/exceptionals	-1,659	-703	-315	-142	-55
Pre-tax profit	-244	1,007	1,610	2,011	2,256
Tax	53	22	-284	-477	-561
Extraord./Min.Int./Pref.div.	-2	-1	0	0	0
Reported net income	-193	1,028	1,326	1,534	1,695
Adjusted earnings	1,378	1,189	1,469	1,612	1,708
Adjusted EBITDA	5,238	5,639	5,778	5,871	5,923
Growth Rates (%)					
Sales	3.3	-2.2	-3.6	-1.3	0.7
EBIT adjusted	-18.9	10.7	7.2	4.5	2.1
EBITDA adjusted	-9.4	7.7	2.5	1.6	0.9
EPS adjusted	-25.9	-16.1	23.3	9.7	6.0
Cash Flow (£M)					
Operating cash flow	3,769	3,885	3,880	4,012	4,210
Depreciation/amortization	2,890	3,039	2,991	2,960	2,951
Net working capital	-462	-170	-68	-135	-75
Investing cash flow	-3,259	-2,545	-2,576	-2,526	-2,530
Capital expenditure	-3,038	-2,480	-2,579	-2,530	-2,536
Acquisitions/disposals	-227	-68	0	0	0
Financing cash flow	-909	-758	-1,542	-1,651	-1,930
Borrowings	522	-497	-1,000	-1,000	-1,000
Dividends paid	-1,222	-265	-542	-651	-930
Change in cash	-399	575	-238	-166	-250
Balance Sheet (£M)					
Total assets	27,191	28,680	27,594	26,722	25,925
Cash & cash equivalent	1,463	1,858	1,620	1,454	1,204
Accounts receivable	4,185	3,696	3,634	3,550	3,538
Net fixed assets	17,330	16,808	16,423	16,007	15,604
Total liabilities	27,022	31,306	29,527	27,753	26,174
Accounts payable	8,009	7,335	7,205	7,006	6,940
Total Debt	11,824	11,141	10,141	9,141	8,141
Shareholders' funds	169	-2,626	-1,933	-1,031	-248
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	24.5	27.0	28.7	29.5	29.6
ROE adjusted	49.7	na	na	na	na
ROIC adjusted	14.2	16.5	16.6	16.8	17.3
Net debt to equity	nm	na	na	na	na
Total debt to capital	98.6	130.8	123.5	112.7	103.1

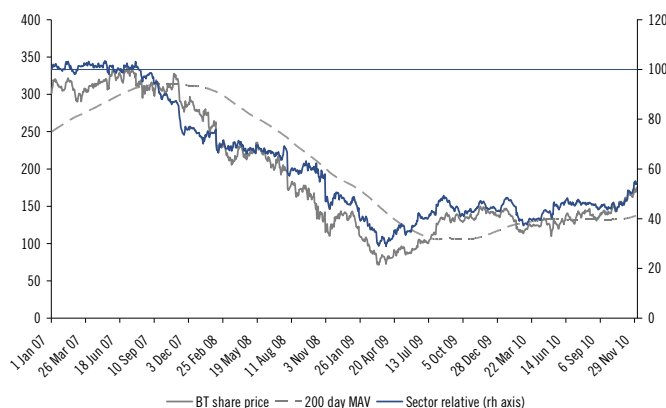
For further data queries on Citi's full coverage universe
please contact CIRA Data Services Europe at
CIRADatServicesEMEA@citi.com or +44-207-986-4050

Prospect of dividend momentum

BT's latest results provided another increase in guidance, visibility on further improvements in the pension scheme and a moderation in revenue declines as a fall in wholesale private circuit revenue in 2009/10 passed its anniversary. There was a strong increase in order entry at Global Services (even excluding one large re-sign) and an encouraging start for its retail fibre broadband offer. This we expect to set the tone for 2011 when we expect to see moderation of the revenue decline, continued solid cost control and further progress with Global, fibre broadband and the IT services offers for smaller businesses where BT has indicated signs of economic recovery.

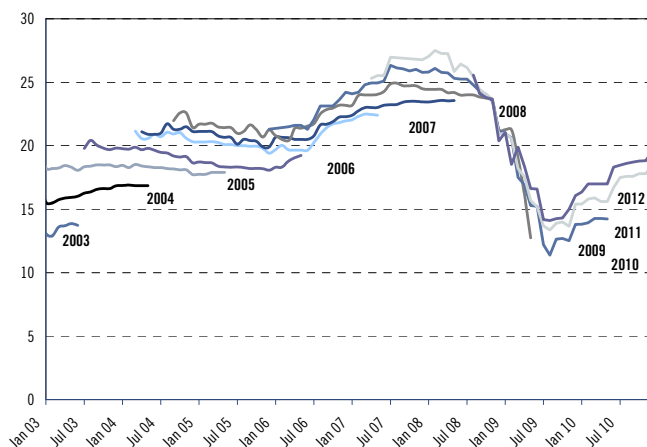
When BT cut its dividend nearly 60% in 2008/09 it needed to stabilise Global Services, put its pension scheme financing onto a solid footing and reduce debt. It has done all three and from here we anticipate an upward rebasing of the dividend and forecast it to double in the two years to 2012/13 and be back to its 2007/08 level in 2013/14. By that time we expect net debt to be back down to only 1.0x EBITDA. We reiterate our Buy rating and 210p target price, ex the next 12 months' dividends.

Figure 69. BT has outperformed the sector since recently driven after significant underperformance prior to April 2009 (left axis p/share; right axis index: end-2006=100)



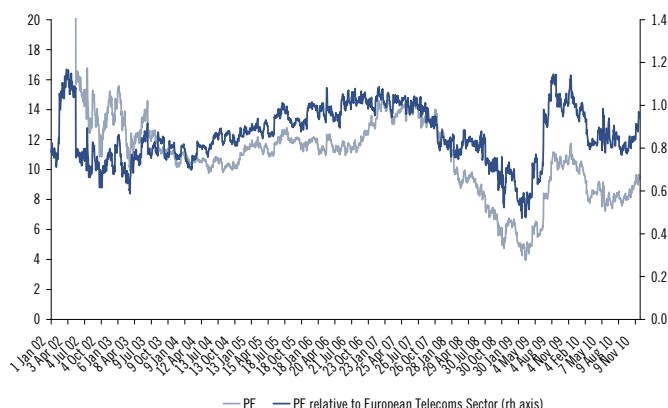
Source: DataStream

Figure 71. Consensus EPS has been rising since Jan-09 (p)



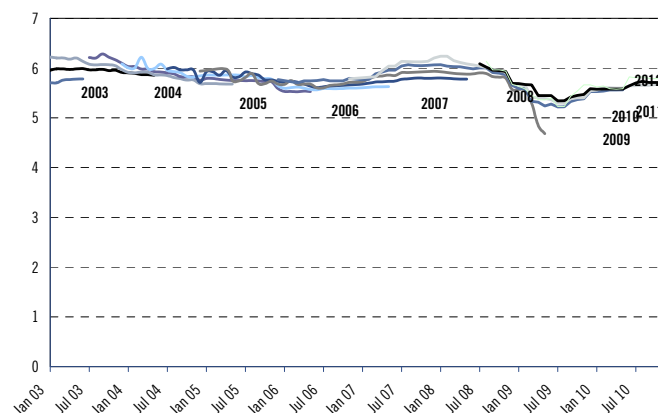
Source: DataStream

Figure 70. BT trades slightly below the sector average on PE (1 year forward)



Source: DataStream

Figure 72. EBITDA consensus has been broadly flat (£bn)

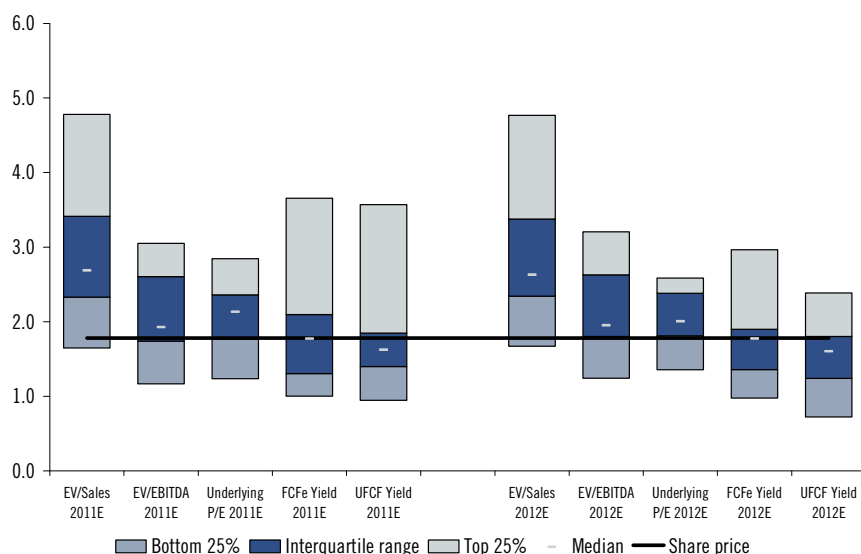


Source: DataStream

Full ULL migration, which has been running at high levels, should start to slow as TalkTalk and Sky programmes complete. We may find BT takes OFCOM to court if it does not change its mind and allow pension deficit recovery to be included in regulated costs. The company has announced that given the £830m set aside by the government for broadband expansion it could expand its local fibre build out from the current plan of two thirds of the country to up to 90 per cent of UK premises.

Figure 73. Compared to its incumbent and wireless peers in Europe BT trades slightly below the median on our 2011 estimates and 2012 estimates.

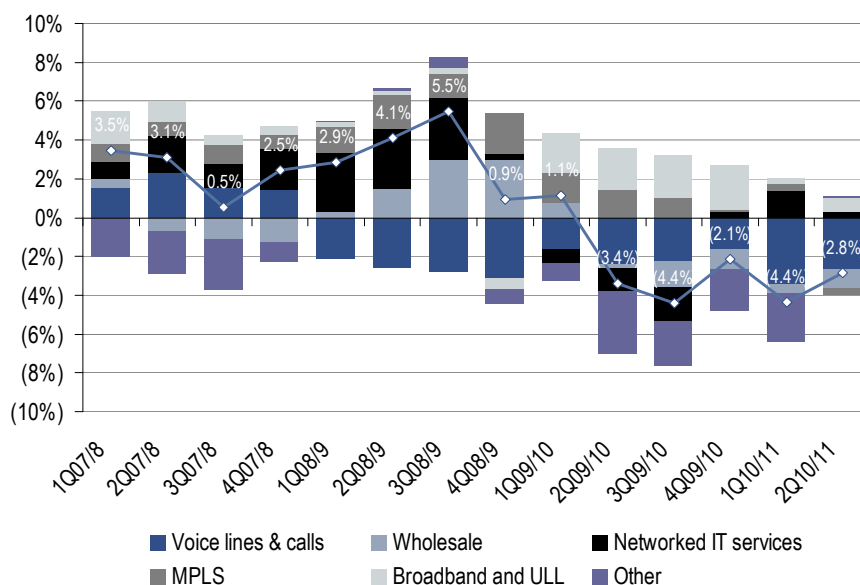
p/share



Source: Powered by dataCentral

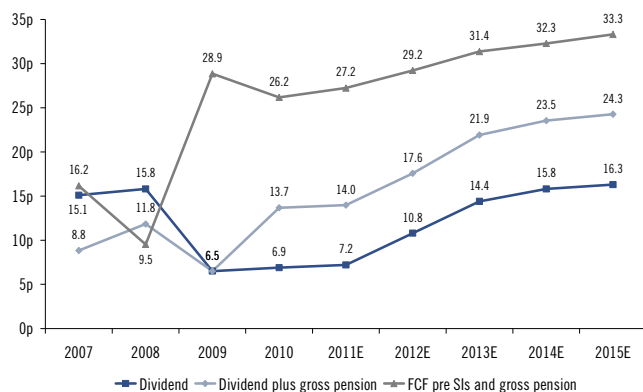
Figure 74. Contribution to growth shows weak voice and calls, broadband and ULL nearly flat and an improvement in networked IT services

% contribution to group revenue growth, yoy



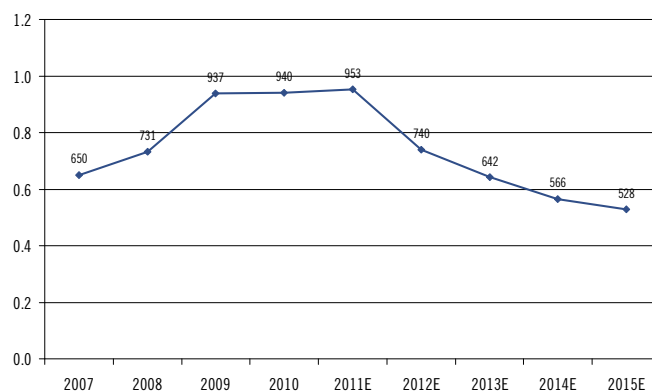
Source: Company Reports

Figure 75. Per share cost of dividends and pensions vs FCF
p/share, year to March



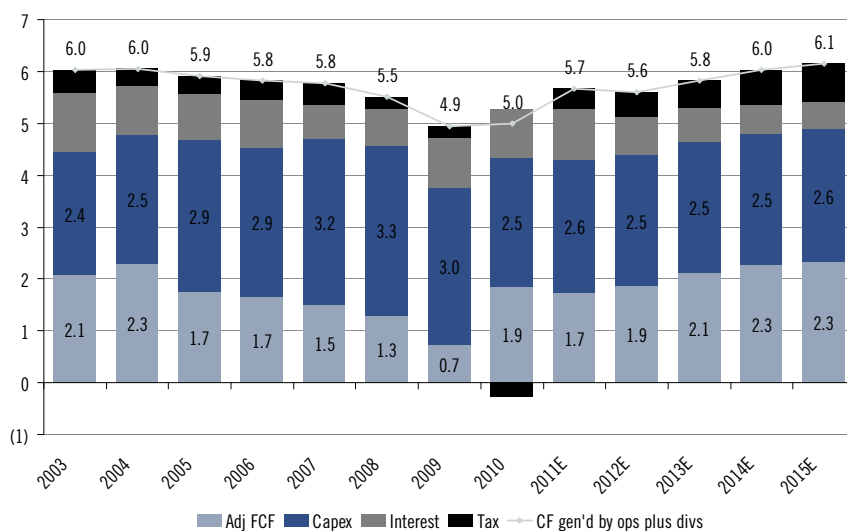
Source: Company Reports and CIRA Estimates

Figure 76. Cash interest cost is set to fall sharply
£bn (labels £m), year to March



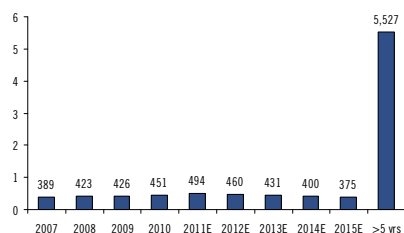
Source: Company Reports and CIRA Estimates

Figure 77. Reconciliation of cash generated by operations and FCF shows interest burden falling
£bn, year to March



Source: Datastream, Citi Investment Research and Analysis

Figure 78. Operating lease payments/obligations
£bn (labels £m)



Source: Company Reports

Lease accounting change could increase EBITDA

The IASB is proposing a change to lease accounting which will require capitalising all leases on companies' balance sheets and abolishing the current distinction between finance and operating leases. The resulting IFRS is scheduled for H1 2011. The final IFRS is due in Q2 2011, with the new standard planned to take effect no earlier than 2013.

We estimate the impacts on BT's accounts if this is adopted would be quite extensive, and among the largest of the European telcos:

- **EBITDA** would rise by 8.0% for 2009/10 and 8.5% on our estimate for 2010/11. The EBITDA margin would rise to 29.1% from 27.0% in 2009/10 and to 31.1% from 29.1% in 2009/10.
- **Depreciation and amortisation, and net financial costs** would increase to approximately match the rise in EBITDA.
- **Financial liabilities** would increase by the present value of the committed future payments (Figure 78) discounted at the lessee's incremental borrowing rate (or the rate the lessor charges the lessee if it can be readily determined). At a discount rate of 6.0% we estimate BT's operating lease liability at around £4.2bn at end-March 11 (0.7x EBITDA), slightly higher than the adjustment currently used by S&P (which, as it applies to March 2010, makes the difference appear narrower than were they co-incident). There is a matching asset which is amortised over the life of the lease and will not generally equal the value of the underlying asset.
- **The cash flow statement** would see a rise in operating cash flow approximately offset by a rise in net financial costs.
- **EV/EBITDA impact is dilutive** – with EV 14% and EBITDA 8% higher the impact on EV/EBITDA of capitalising the operating leases is to make it 7% higher.

BT reported £451m in rental costs relating to operating leases in 2009/10, due mainly to its property outsourcing to Telereal in 2001. S&P adjusted BT's debt upward by £3,928m for its operating leases at end-March 2010.

Valuation

Figure 79. BT discounted cash flow valuation comes to 209p/share
£m. year to March

Free cash flow	2010	2011E	2012E	2013E	2014E	2015E	2016E
EBITDA	5,639	5,778	5,771	5,922	6,062	6,155	6,255
Movements in working cap	(170)	(68)	(91)	(119)	(59)	(37)	(37)
Restructuring/other	(920)	29	(76)	(28)	14	6	4
Capex inc spectrum	(2,480)	(2,579)	(2,530)	(2,536)	(2,531)	(2,555)	(2,580)
Tax paid	276	(405)	(473)	(543)	(669)	(730)	(769)
Interest paid	(940)	(953)	(740)	(642)	(566)	(528)	(490)
Divs received	3	3	4	5	7	9	11
Divs paid to minorities	0	0	0	0	0	0	0
FCF pre net pension top ups	1,408	1,806	1,865	2,061	2,260	2,320	2,394
Interest/divs added back	937	950	736	636	558	519	480
Tax shield on interest	0	(267)	(207)	(180)	(158)	(148)	(137)
Unlevered FCF	2,345	2,489	2,393	2,517	2,660	2,691	2,736
Value of yrs 1-8 cash flows	15,427			Market gearing (D/E)			33.0%
Fade period value	9,622			Tax rate			28.0%
Terminal value	1,719			Risk free rate			3.5%
Other	0			Bond spread			3.0%
Enterprise value	26,768			Equity market premium			5.0%
Post BS events	0			Asset beta			1.10
Minority equity value	(14)			WACC			8.9%
Associate equity value	427						
Net debt @ end 2012E	(7,635)						
Net pension deficit	(3,378)			Capex growth during fade period			0.0%
Equity value	16,168			TY ROCE spread over WACC			0.0%
Number of shares (mn)	7,753			Perpetuity growth (post yr 25)			1.5%
Implied share price (£)	2.09			Implied perp growth post year 4			(2.0%)

Source: Datastream, Citi Investment Research and Analysis

Figure 80. BT sum of the parts at 210p/share implies a PE of 10.5x for 2011/12E on our forecasts
£m, priced at Dec 2011, ex dividend

	£m	£/share	EV/RAV	EV/EBITDA		EV/EBIT		UFCF Yield	
				2010/11E	2011/12E	2010/11E	2011/12E	2010/11E	2011/12E
Core BT	14,738	1.90		4.1x	4.1x	7.3x	6.8x	12.4%	13.1%
Global Services	2,848	0.37		5.0x	5.2x	n/a	n/a	0.7%	0.1%
Openreach ULL	9,550	1.23	1.0x	5.8x	6.0x	9.2x	10.2x	4.5%	3.9%
Total consolidated	27,136	3.50		4.7x	4.7x	9.6x	9.5x	8.4%	8.5%
Tech Mahindra Ltd	304	0.04							
Tax shield (NPV)	82	0.01							
Minorities	(14)	(0.00)							
EV	27,509	3.55							
Net debt (Mar 12)	(7,635)	(0.98)							
Dividend to come	0	0.00							
Pension deficit, net (Mar 12)	(3,589)	(0.46)							
Equity value	16,285	2.10							
				11.3	10.5				

Source: Datastream, Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change

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Buy/Low Risk	1L
Price (09 Dec 10)	€9.91
Target price	€11.00
Expected share price return	11.0%
Expected dividend yield	7.1%
Expected total return	18.1%
Market Cap	€43,225M
	US\$57,312M

Price Performance (RIC: DTEGn.DE, BB: DTE GR)

Deutsche Telekom AG (DTEGn.DE)
Looking to the US to pull through

- **Strong yield and domestic market key advantages** — DT trades on 4.8x 2011E EBITDA, a 12.7% FCF yield and an attractive and well covered 7.1% dividend yield. We retain our Buy rating and €11.00 ex-div price target. Our forecast revisions see EBITDA lower by 1% for 2010-12E due to weaker Eastern Europe partly offset by the stronger US\$/€.
- **Potential guidance for 2011** — DT may change the metrics that it chooses to guide to in 2011 but we expect an outlook statement at the 4Q results. Our forecasts show 2011 FCF of €6.2bn, EBITDA of €19.3bn (at US\$1.32/€). In Germany we expect a slow down in both line loss (at 1.1m in 2011) and retail broadband adds (at 0.52m). In the US we expect 1% growth in service revenue in US dollars and a small improvement in the EBITDA margin.
- **Germany sees end of iPhone exclusivity** — The experience of France and the UK suggests that the ending of T-Mobile's exclusivity over the iPhone need not be traumatic. However, this combined with a 49% MTR cut likely to be applied from 1 December 2010 leads us to expect revenue growth from mobile to slow in 2011. The impact on the group will depend on pass through to fixed line customers.
- **US risks continue** — While we expect T-Mobile US's HSPA+ device range to continue to fill out and the network performance to become more widely recognised, the outlook in the US is still challenging. If Verizon Wireless launches the iPhone, ending AT&T's exclusivity early in 2011 as many industry commentators expect, we would expect it to push aggressively for share and note that even the pentaband iPhone filed with the FCC does not support T-Mobile's AWS frequencies.
- **Guidance, save for service scale** — The company is targeting €4.2bn in operating cost savings group wide by 2012 and reported €1.7bn gross had been achieved by 3Q10 year to date. This turned into €0.74bn in net cost reductions as progress in Germany and the rest of Europe was, to some extent, deployed in marketing in the US. We expect the save for service efforts to accelerate in 4Q10 and into 2011.
- **Eastern Europe remains economically vulnerable** — Eastern Europe makes up only 13% of DT's EV on our SOTP valuation but 26% of EBITDA and remains under economic pressure which does not look like easing near term.

Deutsche Telekom AG (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	61,666.0	64,639.0	62,351.4	61,572.9	61,887.1
Net Income (€M)	3,426.0	3,390.0	3,223.5	3,344.6	3,456.6
Diluted EPS (€)	0.79	0.78	0.75	0.78	0.81
Diluted EPS (Old) (€)	0.79	0.78	0.78	0.78	0.82
PE (x)	12.6	12.7	13.3	12.7	12.2
EV/EBITDA (x)	4.8	4.6	5.1	5.1	5.0
DPS (€)	0.78	0.78	0.70	0.70	0.75
Net Div Yield (%)	7.9	7.9	7.1	7.1	7.6

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	12.6	12.7	13.3	12.7	12.2
EV/EBITDA adjusted (x)	4.8	4.6	5.1	5.1	5.0
P/BV (x)	1.1	1.2	1.2	1.2	1.2
Dividend yield (%)	7.9	7.9	7.1	7.1	7.6
Per Share Data (€)					
EPS adjusted	0.79	0.78	0.75	0.78	0.81
EPS reported	0.34	0.08	0.63	0.71	0.77
BVPS	9.17	8.34	8.03	8.01	8.05
DPS	0.78	0.78	0.70	0.70	0.75
Profit & Loss (€M)					
Net sales	61,666	64,639	62,351	61,573	61,887
Operating expenses	-52,846	-55,481	-53,885	-53,279	-53,456
EBIT	8,820	9,158	8,466	8,294	8,432
Net interest expense	-2,548	-3,149	-2,643	-2,720	-2,685
Non-operating/exceptionals	-2,820	-3,354	-934	41	223
Pre-tax profit	3,452	2,655	4,890	5,614	5,969
Tax	-1,428	-1,782	-1,700	-2,024	-2,081
Extraord./Min.Int./Pref.div.	-541	-520	-464	-545	-631
Reported net income	1,483	353	2,726	3,045	3,257
Adjusted earnings	3,426	3,390	3,224	3,345	3,457
Adjusted EBITDA	19,459	20,668	19,556	19,294	19,422
Growth Rates (%)					
Sales	-1.4	4.8	-3.5	-1.2	0.5
EBIT adjusted	9.1	3.8	-7.6	-2.0	1.7
EBITDA adjusted	0.7	6.2	-5.4	-1.3	0.7
EPS adjusted	14.0	-1.1	-4.5	4.7	4.3
Cash Flow (€M)					
Operating cash flow	15,355	15,766	15,091	14,973	15,021
Depreciation/amortization	10,639	11,510	11,090	11,000	10,990
Net working capital	156	118	-156	-185	-248
Investing cash flow	-8,823	-8,620	-10,713	-10,161	-8,573
Capital expenditure	-8,335	-8,826	-10,336	-9,019	-9,111
Acquisitions/disposals	-252	-1,067	-750	-1,500	0
Financing cash flow	-3,097	-5,123	-3,996	-3,600	-5,575
Borrowings	863	-838	0	0	-2,000
Dividends paid	-3,963	-4,287	-3,996	-3,600	-3,575
Change in cash	3,374	2,081	-181	1,188	873
Balance Sheet (€M)					
Total assets	123,140	127,774	127,019	127,240	125,932
Cash & cash equivalent	5,289	7,206	6,625	7,413	7,885
Accounts receivable	7,393	6,757	6,648	6,697	6,865
Net fixed assets	41,559	45,468	46,382	47,256	48,273
Total liabilities	80,028	85,837	86,851	87,507	86,286
Accounts payable	7,073	6,304	6,083	6,112	6,259
Total Debt	43,447	48,117	49,517	49,517	47,517
Shareholders' funds	43,112	41,937	40,168	39,733	39,645
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	31.6	32.0	31.4	31.3	31.4
ROE adjusted	8.3	8.9	9.1	9.7	10.1
ROIC adjusted	7.4	7.3	6.6	6.2	6.4
Net debt to equity	88.5	97.6	106.8	106.0	100.0
Total debt to capital	50.2	53.4	55.2	55.5	54.5

For further data queries on Citi's full coverage universe
please contact CIRA Data Services Europe at
CIRADatServicesEMEA@citi.com or +44-207-986-4050

Looking to the US to pull through

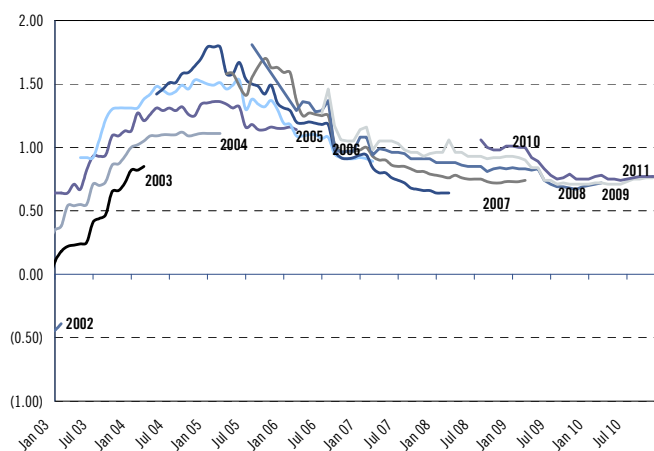
Deutsche Telekom is set to start 2011 with its German exposure (54% of EV and slightly over 100% of equity value on our SOTP valuation) again an advantage in a world worried about sovereign credit risk and the economic impact of austerity measures elsewhere. The modest improvement in trends in the US in 2010 was hard won and mainly down to rising data ARPU while contract churn remains elevated. We expect further marketing spend and Android device launches to deliver some recovery in churn later in 2011 but only once the probable "Verizon iPhone" hiatus passes. Everything Everywhere is set to pay a £0.6bn dividend to its two parents in 4Q10 and should show progress on cost savings with 3G roaming between T-Mobile and Orange networks starting in 2Q11. Although the end of the iPhone exclusivity and, nearly co-incidental, cut to MTRs should slow growth the MTR reduction should be largely internalised at the group EBITDA level and the fixed business is still showing itself to be in better shape than most incumbents. At 27 November €309m had been used out of the stock repurchase commitment of €0.4bn to buy 0.7% of the share capital.

Figure 81. DT has performed in line with the sector (left axis €/share; right axis index: end-2006=100)



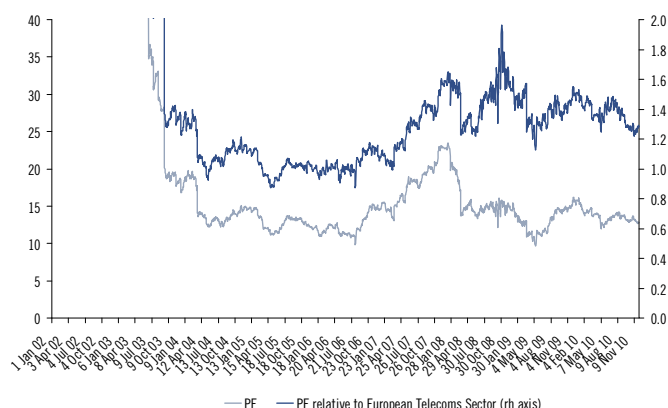
Source: DataStream

Figure 83. Consensus EPS has been broadly flat (€)



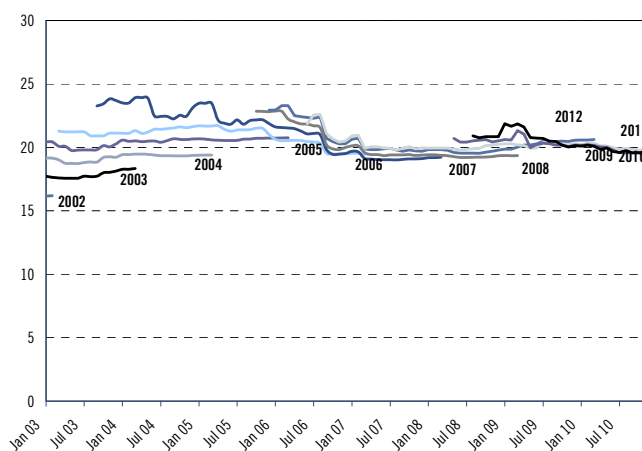
Source: DataStream

Figure 82. DT trades above the sector average on PE (1 year forward)



Source: DataStream

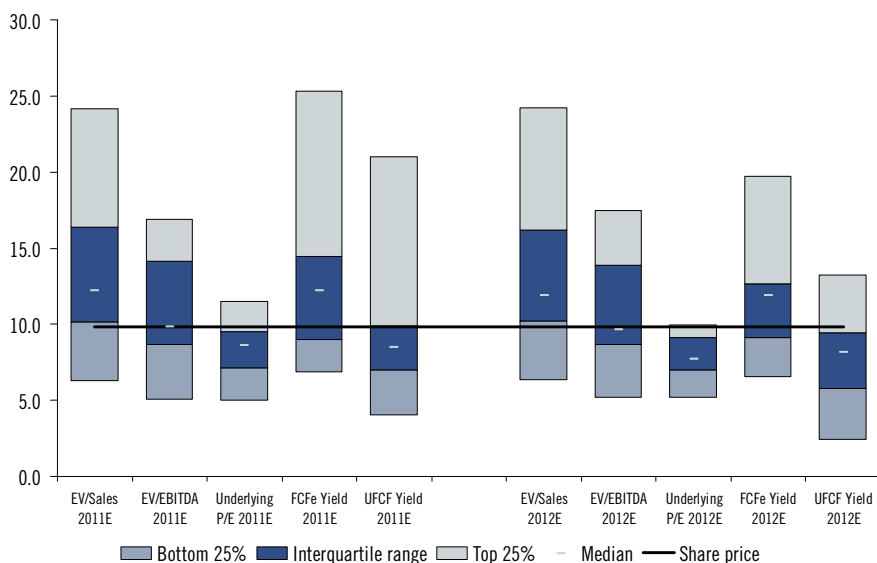
Figure 84. EBITDA consensus has been stable with a slight decline recently (€bn)



Source: DataStream

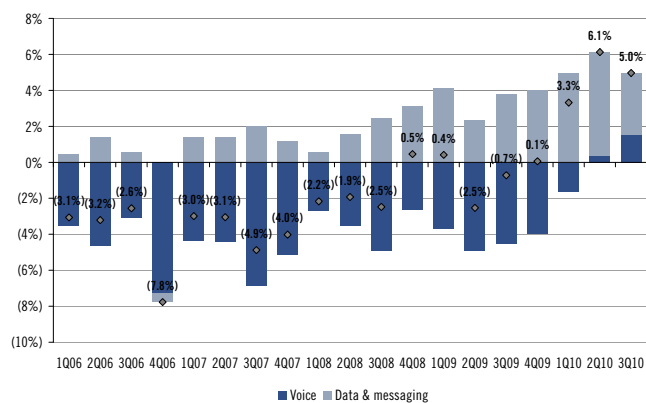
Figure 85. Compared to its incumbent and wireless peers in Europe DT trades below the median on our 2010 estimates and on 2011 estimates

€/share



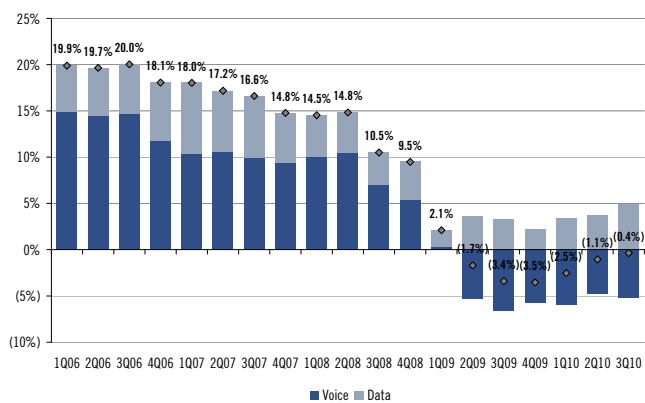
Source: Powered by dataCentral

Figure 86. German mobile service revenue growth, voice and data contribution



Source: Company reports and Citi Investment Research and Analysis

Figure 87. T-Mobile USA service revenue growth, voice and data contribution



Source: Company reports and Citi Investment Research and Analysis

iPhone 4 omits T-Mobile US frequency range

According to the FCC device filing from Apple the iPhone 4 is a pentaband phone, only the second such 3G phone launched, supporting five different 3G frequency combinations (Figure 88). T-Mobile's AWS range (UMTS Band IV) is unfortunately not one of them.

The multiband support in the iPhone delivers on Apple's desire to build and ship a single hardware model globally, part of its commercial approach for the iPhone from inception. While launch of a CDMA unit will, if it comes, require a change in that policy we do not take that to mean that Apple will accept more than two variants, e.g. by splitting the WCDMA model between North America and the rest of the World for example.

The iPhone 4 supports in Europe and Asia the standard 3G ranges around 2000MHz (Band I) and the lower of the prospective ranges for refarming from GSM at 900MHz (Band VIII); for North America the PCS ranges around 1900MHz (Band II) and long established 800MHz slots (Band V) which also cover Telstra and Telecom New Zealand, as well as supporting a range on which DoCoMo is deploying 3G, lower in the 800MHz vicinity (Band VI).

Apple's choice of frequencies for the iPhone allow it to work with the largest carriers in the major economies all over the World giving it the largest possible addressable market without conceding a regional variant. T-Mobile's hopes of seeing a compatible model in the US rest for now on further expansion of the number of frequency bands. T-Mobile's 34m US customers give it some heft but not an unserved market and the other users of AWS are small (the Canadian new entrants for example). There are other candidates for inclusion if the iPhone adds more frequency ranges in time, such as Europe and Asia's 1800MHz GSM ranges (DCS, Band III) and the 700MHz ranges in the US (SMH, Band XII is the most significant).

Figure 88. UMTS bands supported by iPhone 4

UMTS band	Known as	Uplink MHz	Downlink MHz	Main regions
I	IMT	1920-1980	2110-2170	Europe, Asia, Brazil, Australasia, Africa
II	PCS	1850-1910	1930-1990	US, Canada
V	CLR	824-849	869-894	US, Canada, Australasia
VI		830-840	875-885	Japan
VIII	GSM	880-915	925-960	Europe, Asia, Australasia

Source: engadget.com, Wikipedia

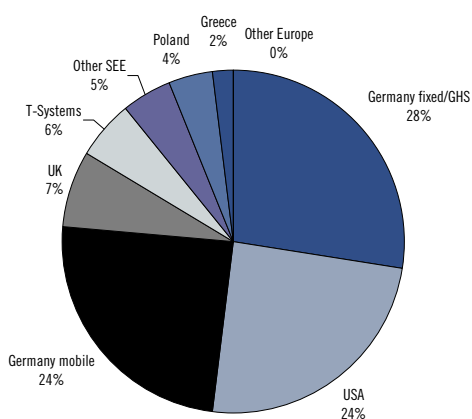
Valuation

Figure 89. Deutsche Telekom DCF valuation comes to €11.0/share

Free cash flow	2008	2009	2010E	2011E	2012E	2013E	2014E
EBITDA	19,459	20,668	19,556	19,294	19,422	19,705	19,755
Movements in working cap	156	118	(156)	(185)	(248)	(249)	(252)
Restructuring/other	(1,483)	(1,616)	(400)	(250)	(250)	(250)	(250)
Capex inc spectrum	(8,335)	(8,826)	(10,336)	(9,019)	(9,111)	(8,903)	(8,586)
Tax paid	(520)	(928)	(1,943)	(1,843)	(1,895)	(2,202)	(2,310)
Interest paid	(2,257)	(2,476)	(1,966)	(2,043)	(2,008)	(1,866)	(1,705)
Divs received	13	29	373	358	538	622	715
Divs paid to minorities	(561)	(885)	(595)	(575)	(578)	(592)	(702)
Free cash flow	6,472	6,084	4,533	5,737	5,870	6,264	6,665
Interest/divs added back	2,805	3,332	2,188	2,260	2,049	1,836	1,692
Tax shield on interest	(755)	(828)	(658)	(684)	(672)	(624)	(571)
Unlevered FCF	8,522	8,588	6,063	7,314	7,247	7,476	7,787
Value of yrs 1-8 cash flows	47,437						
Fade period value	34,629						
Terminal value	15,861						
Other	0						
Enterprise value	97,926						
Post BS events	0						
Minority equity value	(8,429)						
Associate equity value	6,037						
Net debt @ end 2011E	(48,283)						
Equity value	47,251						
Number of shares (mn)	4,281						
Implied share price (€)	11.0						
Market gearing (D/E)							33.0%
Tax rate							33.5%
Risk free rate							2.6%
Bond spread							1.5%
Equity market premium							4.5%
Asset beta							1.10
WACC							7.2%
Capex growth during fade period							2.3%
TY ROCE spread over WACC							2.0%
Perpetuity growth (post yr 25)							1.5%
Implied perp growth post year 4							(1.4%)

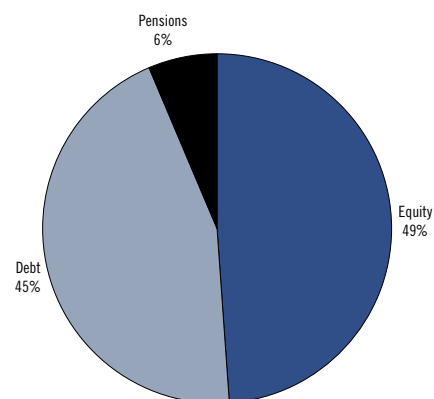
Source: Datastream, Company Reports and CIRA Estimates

Figure 90. Sum of the parts split by geography
% of EV



Source: Datastream, Company Reports and CIRA Estimates

Figure 91. Sum of the parts split by equity and liabilities
% of EV



Source: Datastream, Company Reports and CIRA Estimates

Figure 92. Deutsche Telekom sum of the parts comes to €11/share

€m, priced at Dec 2011, ex dividend

Division	Stake	Enterprise value	Net (debt) 2011	Valuation Method	DT equity	% of DT EV	Value/ share	EV/ Sales	EV/ EBITDA	EV/ OpFCF
Germany										
Fixed	100.0%	32,852	0	5.5x 2010 EV/EBITDA	32,852	36.2%	7.7	1.8x	5.5x	10.7x
Mobile	100.0%	20,644	0	6.0x 2010 EV/EBITDA	20,644	22.8%	4.8	2.5x	6.0x	7.9x
Total		53,496	0		53,496	59.0%	12.5			
T-Mobile USA										
	100.0%	20,757	0	5.0x 2010 EV/EBITDA	20,757	22.9%	4.8	1.3x	5.0x	11.0x
Europe										
Austria	100.0%	1,372	0	5.0x 2010 EV/EBITDA	1,372	1.5%	0.3	1.4x	5.0x	7.4x
Czech Republic	60.8%	3,003	0	5.0x 2010 EV/EBITDA	1,825	2.0%	0.4	2.4x	5.0x	6.0x
Netherlands	100.0%	2,745	0	5.5x 2010 EV/EBITDA	2,745	3.0%	0.6	1.6x	5.5x	8.1x
Poland	97.0%	3,638	0	5.5x 2010 EV/EBITDA	3,529	3.9%	0.8	2.0x	5.5x	8.4x
Total		10,758	0		9,471	10.4%	2.2			
SEE										
Hrvatski Telekom	51.0%	3,038	0	Market value	1,549	1.7%	0.4	2.7x	5.9x	9.0x
Magyar Telekom	59.3%	3,388	(860)	Market value + 25%	1,499	1.7%	0.3	1.7x	5.0x	8.8x
Slovak Telecom	51.0%	2,001	0	5.0x 2010 EV/EBITDA	1,020	1.1%	0.2	2.2x	5.0x	7.2x
OTE	30.0%	9,086	(3,881)	5.0x 2010 EV/EBITDA	1,562	1.7%	0.4	1.7x	5.0x	8.7x
Total		17,513	(4,741)		5,630	6.2%	1.3			
T-Systems										
	100.0%	4,682	0	5.0x 2010 EV/EBITDA	4,682	5.2%	1.1	0.5x	5.0x	14.3x
GHS										
	100.0%	(9,375)	0	German avg EV/OpFCF	(9,375)	(10.3%)	(2.2)		15.7x	9.4x
United Kingdom	50.0%	13,346	(1,272)	DDM-10% + loan	6,037	6.7%	1.4	1.6x	8.3x	13.4x
Total		111,177	(4,741)		90,698		21.2	1.8x	5.8x	10.7x
Net debt/pensions not inc above	100.0%	0	(43,543)		(43,543)	(48.0%)	(10.16)			
Equity value			Shares:	4,284m	47,156	52.0%	11.0			

Source: Datastream, Company Reports and CIRA Estimates

Forecast revisions

Figure 93. Forecast revisions see EBITDA forecasts come down 1% with financial costs offsetting that from 2011E

€m

Year to December	New			Prior			2010E			2011E		
	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
Net Revenue												
Germany	23,436	23,411	23,506	23,511	23,286	23,101	(75)	125	405	(0.3%)	0.5%	1.8%
USA	15,987	16,155	16,251	15,867	15,272	15,396	120	884	856	0.8%	5.8%	5.6%
Europe	7,035	6,178	6,199	7,060	6,258	6,279	(25)	(80)	(80)	(0.4%)	(1.3%)	(1.3%)
Southern and Eastern Europe	9,540	9,254	9,178	9,772	9,745	9,757	(231)	(492)	(580)	(2.4%)	(5.0%)	(5.9%)
Systems Solutions	6,117	6,264	6,397	6,110	6,278	6,416	7	(14)	(19)	0.1%	(0.2%)	(0.3%)
GHS	236	310	356	231	322	371	6	(11)	(16)	2.4%	(3.5%)	(4.2%)
Group Revenues	62,351	61,573	61,887	62,551	61,161	61,321	(199)	412	566	(0.3%)	0.7%	0.9%
EBITDA												
Germany	9,652	9,456	9,329	9,680	9,447	9,279	(28)	9	51	(0.3%)	0.1%	0.5%
USA	4,128	4,151	4,306	4,097	4,016	4,159	31	136	148	0.8%	3.4%	3.5%
Europe	2,157	2,036	2,056	2,171	2,067	2,087	(14)	(31)	(31)	(0.6%)	(1.5%)	(1.5%)
Southern and Eastern Europe	3,555	3,409	3,373	3,716	3,682	3,676	(161)	(273)	(303)	(4.3%)	(7.4%)	(8.2%)
Systems Solutions	893	936	943	893	936	943	0	0	0	0.0%	0.0%	0.0%
GHS	(730)	(596)	(486)	(730)	(596)	(486)	0	0	0	0.0%	0.0%	0.0%
Group EBITDA	19,556	19,294	19,422	19,728	19,454	19,559	(172)	(160)	(137)	(0.9%)	(0.8%)	(0.7%)
Depreciation & amort	(11,090)	(11,000)	(10,990)	(11,077)	(10,915)	(10,902)	(12)	(85)	(89)	0.1%	0.8%	0.8%
Financial income/(expense)	(2,643)	(2,720)	(2,685)	(2,630)	(3,004)	(2,910)	(13)	284	224	0.5%	(9.5%)	(7.7%)
Associates	216	341	423	215	330	409	1	11	13	0.6%	3.2%	3.2%
Tax payable, before SIs	(2,352)	(2,024)	(2,081)	(2,386)	(1,916)	(1,992)	34	(108)	(89)	(1.4%)	5.6%	4.5%
Minority interests, before SIs	(464)	(545)	(631)	(466)	(585)	(692)	2	40	61	(0.4%)	(6.9%)	(8.8%)
Specific items, post tax	(498)	(300)	(200)	(498)	(300)	(200)	0	0	0	0.0%	0.0%	0.0%
Net income	2,726	3,045	3,257	2,886	3,063	3,273	(160)	(18)	(16)	(5.5%)	(0.6%)	(0.5%)
Net income pre SIs & gw amort	3,980	4,101	4,213	4,140	4,119	4,229	(160)	(18)	(16)	(3.9%)	(0.4%)	(0.4%)
Stated EPS, diluted	0.63	0.71	0.77	0.67	0.71	0.77	(0.04)	(0.00)	(0.00)	(5.5%)	(0.4%)	(0.2%)
EPS, before SIs (diluted)	0.75	0.78	0.81	0.78	0.78	0.82	(0.04)	(0.00)	(0.00)	(4.7%)	(0.3%)	(0.2%)
DPS	0.70	0.70	0.75	0.70	0.70	0.75	0.00	0.00	0.00	0.0%	0.0%	0.0%
Net debt	(42,892)	(42,104)	(39,632)	(42,433)	(42,080)	(39,880)	(459)	(24)	249	1.1%	0.1%	(0.6%)
Net Debt / EBITDA	2.5x	2.5x	2.4x	2.5x	2.5x	2.4x	0.0x	0.0x	0.0x			
Net interest paid	(1,966)	(2,043)	(2,008)	(1,953)	(2,327)	(2,233)	(13)	284	224	0.6%	(12.2%)	(10.1%)
Dividends received	373	358	538	373	345	519	0	13	19	0.0%	3.8%	3.7%
Cash tax paid	(1,943)	(1,843)	(1,895)	(1,946)	(1,745)	(1,816)	3	(98)	(79)	(0.2%)	5.6%	4.3%
Change in working capital	(156)	(185)	(248)	(156)	(183)	(245)	0	(1)	(2)	(0.3%)	0.7%	0.9%
Change in provisions	(400)	(250)	(250)	(400)	(250)	(250)	0	0	0	0.0%	0.0%	0.0%
Capex excluding spectrum licences	(9,035)	(8,867)	(8,959)	(9,112)	(9,138)	(9,043)	77	271	84	(0.8%)	(3.0%)	(0.9%)
Capex on spectrum	(1,301)	(152)	(152)	(1,301)	(143)	(144)	0	(8)	(8)	0.0%	5.8%	5.6%
FCF pre min divs & spectrum	6,429	6,464	6,600	6,533	6,155	6,490	(104)	309	110	(1.6%)	5.0%	1.7%

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Target Price Change
- Estimate Change

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Sell/Low Risk	3L
Price (09 Dec 10)	€15.60
Target price	€13.00
from €12.07	
Expected share price return	-16.7%
Expected dividend yield	7.9%
Expected total return	-8.8%
Market Cap	€2,594M
	US\$3,440M

Price Performance (RIC: ELI1V.HE, BB: ELI1V
FH)Elisa Oyj (ELI1V.HE)
Attractive yield, but not enough

- **Premium valuation, rising competition** — Elisa trades on a premium to the sector, at 6.2x 2011 EV/EBITDA on our estimates, vs the sector on 5.0x, a 24% premium. We argue that this premium is unjustified due to operational risks. Over the last year strong growth in mobile has been offsetting declines in fixed, however now competition is rising within the mobile market. We do not see any specific upcoming negative catalysts, however on valuation grounds we maintain a Sell. Amongst the high dividend yield stocks we prefer KPN.
- **Rising mobile competition** — Competition has been rising in the Finnish mobile market. For example Elisa's churn increased to 18.1% in 3Q10 from 15.9% 2Q10, 14.5% 3Q09. Elisa's margins were impacted by higher SAC in 3Q10 and competitor DNA cited rising competition in its 3Q10 report.
- **Mobile Fixed cannibalisation** — Mobile data growth remains strong in Finland, however this is partly at the expense of Fixed. Elisa's retail line loss remains -10% yoy, with no growth in fixed broadband connections.
- **Attractive dividends, but not enough** — At the 3Q10 results Elisa announced a €0.5 special dividend, this means Elisa's cash dividends have provided a 7.7% dividend yield in 2010E. While this is an attractive yield, we prefer KPN amongst the high dividend yield companies due to its higher mobile exposure and attractive valuation.
- **Forecast changes and TP change** — We update our forecasts post 3Q10 results. No change to revenue and EBITDA. We cut EPS by -5.5% in 2010-12 due to higher depreciation and interest costs. We increase our TP to €13.0 from €12.07 due to a slight reduction in our WACC.

Elisa Oyj (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	1,485.0	1,430.0	1,447.6	1,441.2	1,450.1
Net Income (€M)	177.2	177.2	190.0	188.4	199.8
Diluted EPS (€)	1.12	1.14	1.22	1.21	1.28
Diluted EPS (Old) (€)	1.16	1.14	0.99	1.27	1.35
PE (x)	13.9	13.7	12.8	12.9	12.2
EV/EBITDA (x)	7.0	6.9	6.7	6.6	6.4
DPS (€)	1.00	0.92	1.23	1.28	1.37
Net Div Yield (%)	6.4	5.9	7.9	8.2	8.8

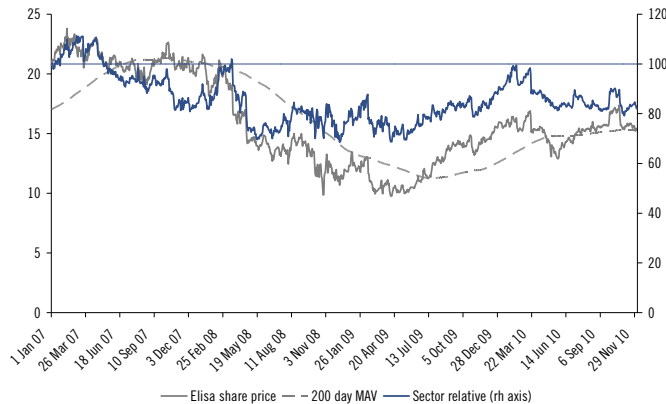
Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	13.7	13.5	12.5	12.7	11.9
EV/EBITDA adjusted (x)	6.9	6.8	6.6	6.5	6.3
P/BV (x)	2.8	2.7	2.9	2.9	3.0
Dividend yield (%)	6.5	6.0	8.0	8.3	8.9
Per Share Data (€)					
EPS adjusted	1.12	1.14	1.22	1.21	1.28
EPS reported	1.11	1.13	0.93	1.21	1.28
BVPS	5.52	5.78	5.29	5.22	5.17
DPS	1.00	0.92	1.23	1.28	1.37
Profit & Loss (€M)					
Net sales	1,485	1,430	1,448	1,441	1,450
Operating expenses	-1,221	-1,163	-1,175	-1,153	-1,151
EBIT	264	267	273	288	299
Net interest expense	-37	-33	-79	-36	-33
Non-operating/exceptionals	0	0	0	1	2
Pre-tax profit	227	234	193	253	268
Tax	-51	-58	-48	-64	-68
Extraord./Min.Int./Pref.div.	-1	-1	0	0	0
Reported net income	176	176	145	188	200
Adjusted earnings	177	177	190	188	200
Adjusted EBITDA	478	484	491	500	506
Growth Rates (%)					
Sales	-5.3	-3.7	1.2	-0.4	0.6
EBIT adjusted	-7.7	-1.5	2.2	5.5	3.9
EBITDA adjusted	-2.6	1.3	1.5	1.8	1.1
EPS adjusted	-9.5	1.6	7.2	-0.8	6.0
Cash Flow (€M)					
Operating cash flow	452	433	376	401	406
Depreciation/amortization	208	217	219	212	207
Net working capital	83	37	0	0	0
Investing cash flow	-190	-179	-160	-158	-159
Capital expenditure	-179	-170	-160	-158	-159
Acquisitions/disposals	-11	-9	0	0	0
Financing cash flow	-244	-254	-176	-199	-204
Borrowings	89	-93	45	0	0
Dividends paid	-285	-157	-221	-200	-206
Change in cash	18	-1	39	44	43
Balance Sheet (€M)					
Total assets	2,031	1,965	1,978	1,969	1,966
Cash & cash equivalent	33	31	70	114	157
Accounts receivable	319	278	278	278	278
Net fixed assets	631	618	560	506	458
Total liabilities	1,156	1,065	1,155	1,157	1,161
Accounts payable	259	270	270	270	270
Total Debt	845	750	795	795	795
Shareholders' funds	875	900	824	813	806
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	32.2	33.8	33.9	34.7	34.9
ROE adjusted	18.6	20.0	22.1	23.0	24.7
ROIC adjusted	12.8	12.9	14.4	14.9	15.9
Net debt to equity	92.8	79.8	87.9	83.8	79.1
Total debt to capital	49.1	45.4	49.1	49.4	49.6

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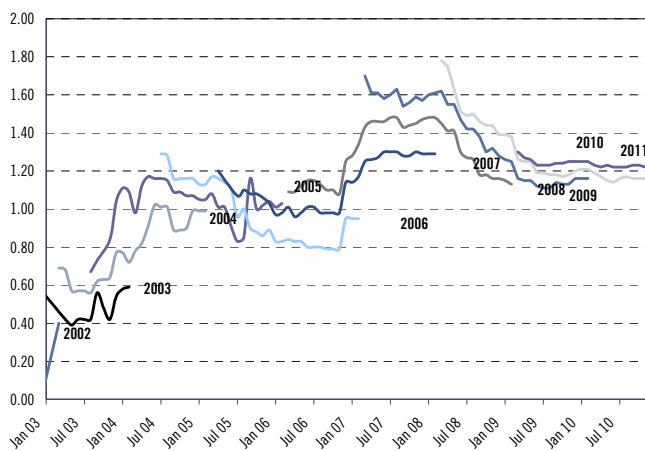
Elisa performance and outlook

Figure 94. Elisa has lately recovered somewhat after underperforming since end-09 (left axis €/share; right axis index: end-2006=100)



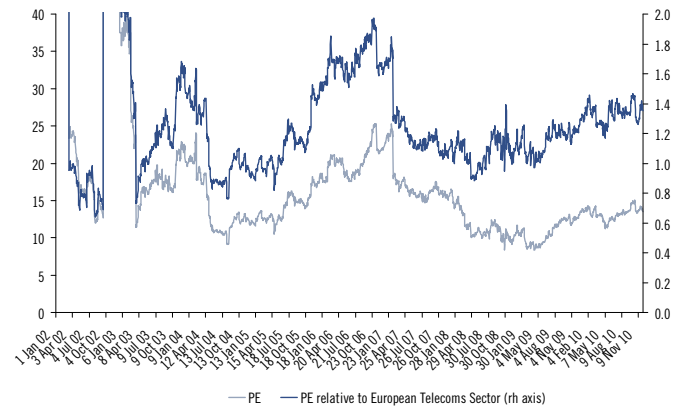
Source: DataStream

Figure 96. Consensus EPS has lately stabilised after declining in 08 (€)



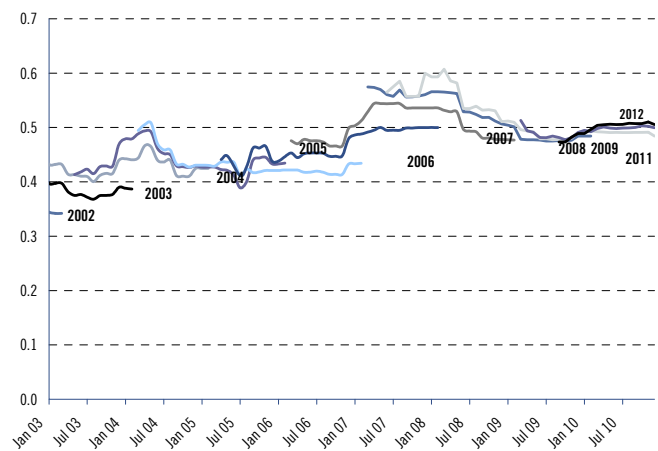
Source: DataStream

Figure 95. Elisa trades well above the sector average on PE (1 year forward)



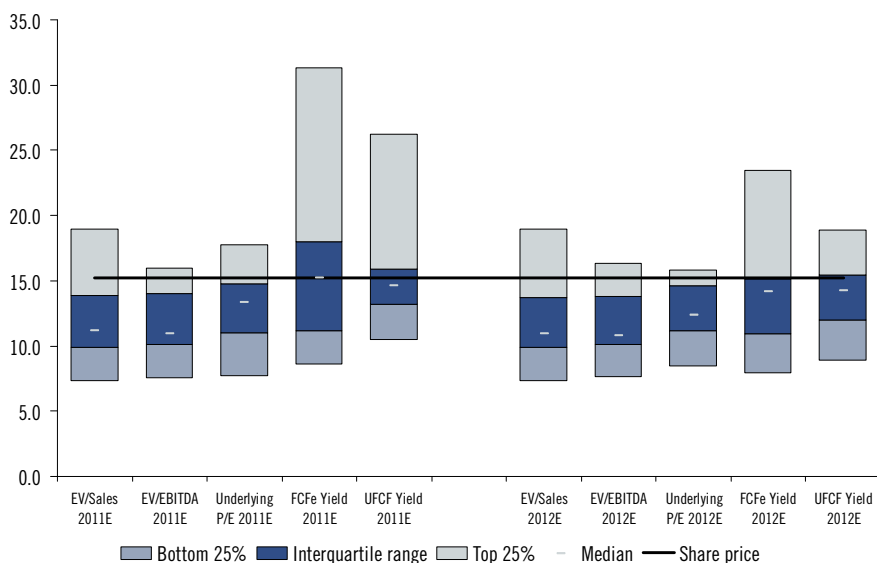
Source: DataStream

Figure 97. EBITDA consensus has lately been recovering (€bn)



Source: DataStream

Figure 98. Compared to its incumbent and wireless peers in Europe Elisa trades at or above the upper quartile on our 2011 estimates and roughly at the median on 2012 estimates
€/share

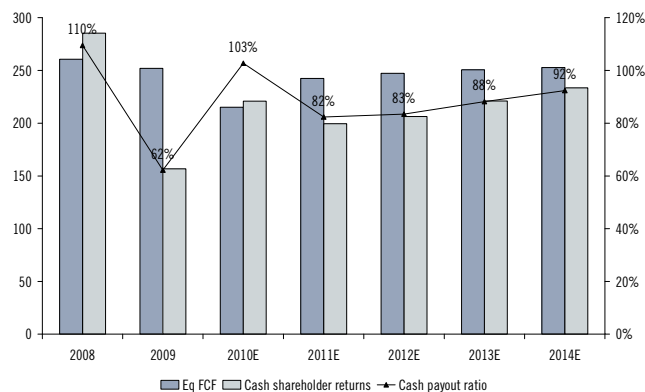


Source: Powered by dataCentral

Leverage and Dividends

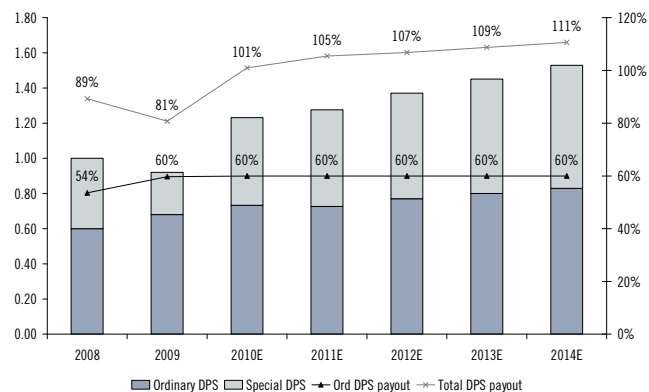
- **Dividend policy:** Ordinary dividend 40-60% of net income, surplus cash over leverage target may be paid out in a special dividend.
- **Leverage policy:** Target 1.5-2.0x net debt/EBITDA.

Figure 99. Dividend cash payout ratio – We forecast a cash payout of c.90% longer term



Source: Company reports, Citi Investment Research and Analysis

Figure 100. Dividend payout ratio – we forecast an ordinary dividend payout ratio at the upper end of the 40-60% range



Source: Company reports, Citi Investment Research and Analysis

Valuation

We increase our target price to €13.0 from €12.07. This is from reducing our WACC from 8.1% to 7.6%. We use a 25 year ROCE fade DCF.

Figure 101. DCF Valuation (€m)

Free cash flow	2008	2009	2010E	2011E	2012E	2013E	2014E
EBITDA	472	484	491	500	506	509	512
Movements in working cap	83	37	0	0	0	0	0
Restructuring/other	(5)	(2)	(67)	(35)	(31)	(29)	(27)
Capex inc spectrum	(179)	(170)	(160)	(158)	(159)	(159)	(160)
Tax paid	(60)	(57)	(48)	(64)	(68)	(71)	(74)
Interest paid	(39)	(30)	0	0	0	0	0
Free cash flow	272	262	215	242	247	251	253
Interest/divs added back	40	30	0	0	0	0	0
Tax shield on interest	(10)	(8)	0	0	0	0	0
Unlevered FCF	302	284	215	242	247	251	253
Value of yrs 1-8 cash flows	1,540			Market gearing (D/E)			33.0%
Fade period value	942			Tax rate			26.0%
Terminal value	258			Risk free rate			3.0%
Other	0			Bond spread			2.0%
Enterprise value	2,740			Equity market premium			4.5%
Post BS events	0			Asset beta			1.06
Minority equity value	(36)			WACC			7.6%
Associate equity value	0						
Net debt @ end 2011E	(681)			Capex growth during fade period			2.0%
Equity value	2,024			TY ROCE spread over WACC			2.0%
Number of shares (mn)	156			Perpetuity growth (post yr 25)			1.5%
Implied share price (€)	13.00			Implied perp growth post year 4			(2.7%)

Source: Citi Investment Research and Analysis

Forecast Changes

We update our forecasts post 3Q10 results. No change to revenue and EBITDA.
We cut EPS by -5.5% in 2010-12 due to higher depreciation and interest costs.

Figure 102. Forecast changes (€m)

	New forecasts			Diff			
	2010E	2011E	2012E		2010	2011	2012
Revenue	1,448	1,441	1,450		0.0%	0.0%	0.0%
EBITDA (clean)	491	500	506		0.0%	0.0%	0.0%
Margin	33.9%	34.7%	34.9%		0.0ppt	0.0ppt	0.0ppt
Non-recurring items	0	0	0		0.0%	0.0%	0.0%
Reported EBITDA	491	500	506		0.0%	0.0%	0.0%
Depreciation	219	212	207		3.8%	3.4%	3.1%
Reported EBIT	273	288	299		(2.8%)	(2.4%)	(2.0%)
Net Financial Items	(79)	(35)	(31)		4.1%	23.3%	32.6%
PBT	193	253	268		(5.4%)	(5.1%)	(4.9%)
Tax	(48)	(64)	(68)		(5.4%)	(5.5%)	(5.6%)
Minority Interests	0	0	0		0.0%	0.0%	0.0%
Reported Net Income	145	188	200		(5.4%)	(5.5%)	(5.6%)
Underlying Cash Net Income	190	188	200		24.0%	(5.0%)	(4.7%)
Reported EPS	0.93	1.21	1.28		(5.4%)	(5.5%)	(5.6%)
Net debt	724	680	637		4.8%	12.7%	23.8%
Capex	160	158	159		0.0%	0.0%	0.0%

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change

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dimitri.kallianiotis@citi.com

Hold/Low Risk	2L
Price (09 Dec 10)	€16.04
Target price	€17.00
Expected share price return	6.0%
Expected dividend yield	8.7%
Expected total return	14.7%
Market Cap	€42,485M US\$56,331M

Price Performance (RIC: FTE.PA, BB: FTE FP)



France Telecom (FTE.PA) Ready for a Fight

- **Getting ready to face a new entrant** — FT is likely to continue pushing its quadruple play offers to lock in customers ahead of the arrival of Free in mobile. Latest proposal from ARCEP to reduce maximum contract duration on mobile to 12 or even 6 months are unhelpful. Margins are likely to come under pressure due to limited scope to cut costs to offset falling tariffs.
- **Waiting for 4G auction before negotiating on 3G roaming** — We are still waiting to know which form the 4G auction will take but we provisionally forecast FT to pay €600m for 4G spectrum in 2H11. We believe that FT is in a good position to bid on 4G spectrum and negotiate 3G roaming with Free. FT is likely to wait until the terms of the 4G auction are known before negotiating on 3G roaming to remain in a strong bargaining position.
- **EBITDA need to stabilise before stock can rerate** — FT is the cheapest stock among the telco mega caps trading on 9.1x PE 2011E (sector on 10.0x) and forward dividend yield of 9.0% (sector on 6.9%). FT needs to prove that it can stabilize EBITDA to avoid being seen as a value trap in our view.
- **Need to decide which colour to use for UK JV** — We expect FT and DT to decide by middle of 2011 on which brand(s) to use long term for their UK mobile JV. We fear that a protracted decision on the brand could have a negative impact on the execution of cost cutting synergies. We expect the Orange brand to remain as Orange has twice as many postpaid subscribers as T-Mobile and FT carries around €2bn of goodwill on the Orange brand.
- **Mobile segmentation bearing fruits** — Orange is successfully segmenting its mobile strategy which has allowed it to increase mobile data revenues and limit the revenue erosion on voice and SARCs. We believe that FT is in better position than historically to protect value share in mobile.
- **M&A strategy inconsistent** — Despite the commitment made by FT to pay at least a flat dividend over the next 3 years, the market remains concerned about FT's M&A policy following the expensive acquisition of a stake in Moroccan mobile and press speculation that FT might be interested in Syria, Iraq and Serbia. CEO recently stated that in the absence of good M&A opportunities FT would consider a share buyback. Any concrete action on share buyback at 4Q10 results could be a positive catalyst.

France Telecom (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	53,487.0	45,944.0	45,479.2	45,953.8	45,683.8
Net Income (€M)	4,809.0	4,234.0	4,438.5	4,649.6	4,736.4
Diluted EPS (€)	1.84	1.60	1.68	1.76	1.78
Diluted EPS (Old) (€)	1.84	1.60	1.71	1.82	1.80
PE (x)	8.5	9.8	9.4	9.0	8.8
EV/EBITDA (x)	4.6	5.6	5.2	5.0	5.0
DPS (€)	1.40	1.40	1.40	1.40	1.40
Net Div Yield (%)	8.9	8.9	8.9	8.9	8.9

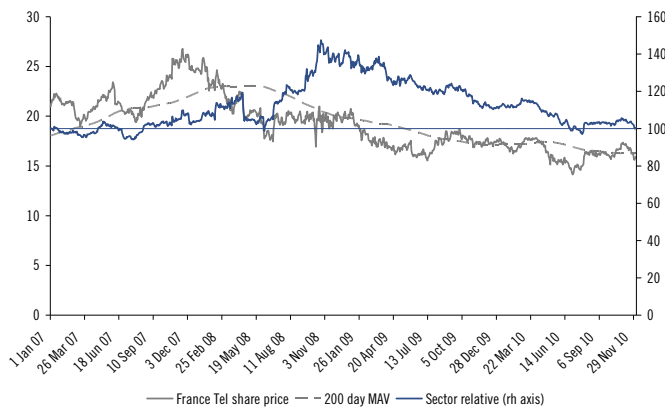
Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	8.6	9.9	9.4	9.0	8.9
EV/EBITDA adjusted (x)	4.6	5.6	5.2	5.0	5.0
P/BV (x)	1.5	1.6	1.5	1.5	1.5
Dividend yield (%)	8.8	8.8	8.8	8.8	8.8
Per Share Data (€)					
EPS adjusted	1.84	1.60	1.68	1.76	1.78
EPS reported	1.56	1.14	2.08	1.76	1.78
BVPS	10.56	9.82	10.23	10.32	10.37
DPS	1.40	1.40	1.40	1.40	1.40
Profit & Loss (€M)					
Net sales	53,487	45,944	45,479	45,954	45,684
Operating expenses	-42,935	-37,567	-36,295	-36,635	-36,505
EBIT	10,552	8,377	9,184	9,319	9,179
Net interest expense	-2,766	-2,160	-1,927	-1,743	-1,571
Non-operating/exceptionals	-501	-657	-50	-50	-50
Pre-tax profit	7,285	5,560	7,207	7,526	7,558
Tax	-2,793	-2,295	-2,481	-2,591	-2,602
Extraord./Min.Int./Pref.div.	-423	-268	773	-285	-220
Reported net income	4,069	2,997	5,498	4,650	4,736
Adjusted earnings	4,809	4,234	4,438	4,650	4,736
Adjusted EBITDA	18,328	14,794	15,476	15,529	15,326
Growth Rates (%)					
Sales	2.9	-14.1	-1.0	1.0	-0.6
EBIT adjusted	-4.9	-23.5	16.9	1.5	-1.5
EBITDA adjusted	-3.2	-19.3	4.6	0.3	-1.3
EPS adjusted	-25.5	-12.8	4.5	4.8	1.3
Cash Flow (€M)					
Operating cash flow	14,999	13,457	12,899	13,036	12,305
Depreciation/amortization	7,776	6,417	6,292	6,210	6,147
Net working capital	159	775	100	100	100
Investing cash flow	-7,487	-3,914	-5,598	-6,203	-5,679
Capital expenditure	-7,140	-5,362	-5,931	-6,534	-6,177
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-6,057	-8,260	-6,430	-6,427	-6,427
Borrowings	-649	-3,555	-2,000	-2,000	-2,000
Dividends paid	-5,578	-3,752	-4,430	-4,427	-4,427
Change in cash	1,323	1,339	871	406	199
Balance Sheet (€M)					
Total assets	95,295	92,044	91,603	90,376	89,246
Cash & cash equivalent	4,800	3,949	5,020	5,627	6,026
Accounts receivable	6,163	5,494	5,494	5,494	5,494
Net fixed assets	26,534	24,321	23,960	24,285	24,316
Total liabilities	64,097	63,296	61,296	59,296	57,296
Accounts payable	9,519	7,795	7,795	7,795	7,795
Total Debt	41,163	39,665	37,665	35,665	33,665
Shareholders' funds	31,198	28,748	30,307	31,080	31,950
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	34.3	32.2	34.0	33.8	33.5
ROE adjusted	16.7	15.8	16.7	17.1	17.2
ROIC adjusted	10.1	8.0	9.9	10.2	10.3
Net debt to equity	116.6	124.2	107.7	96.6	86.5
Total debt to capital	56.9	58.0	55.4	53.4	51.3

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2011: A year of transition

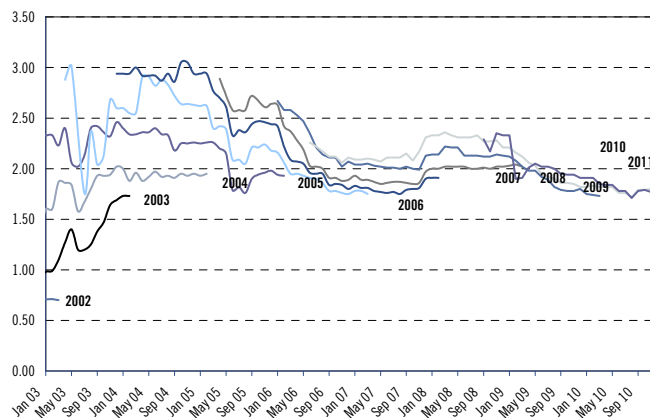
2011 is an important year for FT especially with respect to its domestic market. In France next year should be dominated by spectrum auction, potential conclusion of a 3G roaming agreement with Free, push to quadruple play and possibly the renegotiation of the senior part time plan.

Figure 103. France Telecom has lately performed in line after lengthy underperformance (left axis €/share; right axis index: end-2006=100)



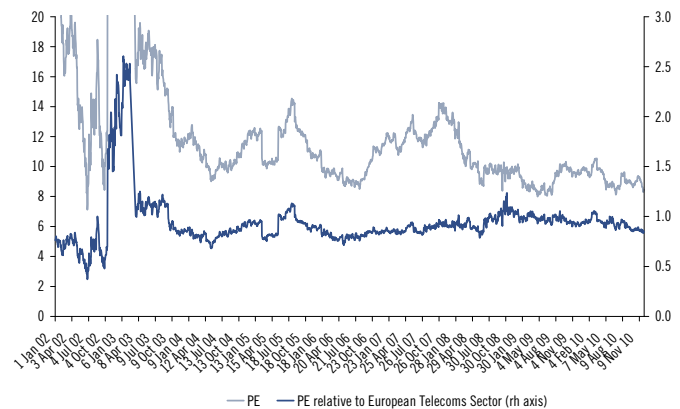
Source: DataStream

Figure 105. Consensus EPS has lately been declining (€)



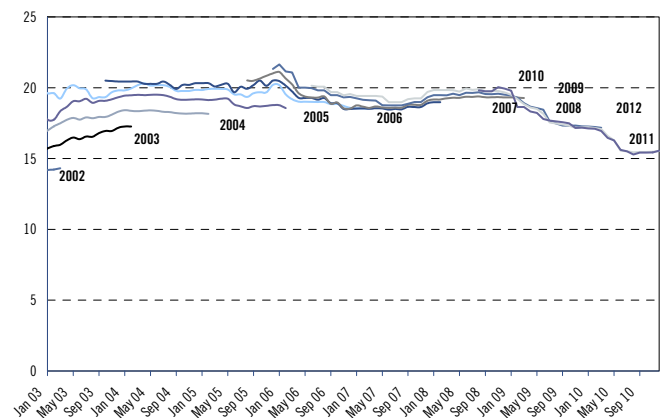
Source: DataStream

Figure 104. France Telecom trades slightly below the sector average on PE (1 year forward)



Source: DataStream

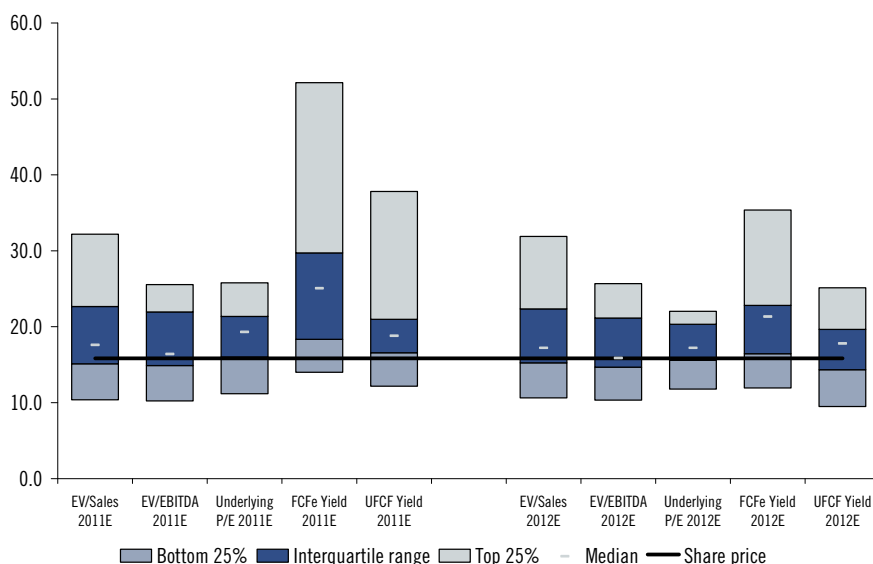
Figure 106. EBITDA consensus may have stabilized (€bn)



Source: DataStream

Figure 107. Compared to its incumbent and wireless peers in Europe FT trades close to the lower quartile on our 2011 estimates and 2012 estimates

€/share



Source: Powered by dataCentral

3G Roaming unlikely before 4G auction

Free is planning to enter the mobile market in 2012. So 2011 will be the year when operators get themselves ready to face a new competitor who has announced its intentions to halve prices in a market with relatively high prices. Main issue for Free is to secure a 3G roaming agreement. While Bouygues and SFR have stated their intentions not to offer a 3G roaming agreement, FT's position is more ambiguous with FT's CEO leaving the question open by saying that FT is prepared to offer a 2G roaming agreement but does not think that it is yet the time to discuss about 3G roaming.

We believe that it is unlikely that FT will make its decision on offering 3G roaming until the 4G spectrum auction is completed or at least the terms of the auction are known. The main reason we believe that FT will want to wait is that if the 4G spectrum auction includes mandatory roaming conditions then it makes sense for FT to offer 3G roaming. This would not necessarily be the case if FT pays a high price for 4G spectrum and does not have to share its 4G network and spectrum with other operators.

In its consultation paper published on 27 July, ARCEP the French regulator explored the possibility of requesting operators to offer roaming for 4G (similar to what's happening for 2G/3G in the most remote areas in France where one operator deploys its network and offer roaming to other operators). ARCEP justifies its position on roaming requirements by the limited amount of spectrum available in 800MHz (2x 30MHz) which means that there might not be enough for 4 operators and it would be negative for competition to prevent one operator from acquiring 4G spectrum in the 800MHz band. While requesting 4G roaming is likely to promote competition and help the life of the new entrant, the main risk from the French government's point of view is that operators refuse to pay up for 4G spectrum if it is associated with roaming conditions. Indeed according to an article in French newspaper *La Tribune* published on 26 November 2010 the French government wants to raise a minimum of €2bn from the 4G auction (a tall order since the French government got €1.9bn from the 3G auction in 2001 at a time when mobile was growing). No doubt the recent 4G auction in Germany during which operators spent over €4bn to buy 4G spectrum has shown how auction could help replenish the state coffers. According to the same article from *La Tribune* the 4G auction in France could be delayed to the second half of the year as less obligations may be associated with 4G spectrum to make it more attractive. We believe that if the government decides to drop the roaming obligation proposed by ARCEP for 4G then FT could decide to pay up for 4G spectrum and not offer 3G roaming or at least delays its decision. In case ARCEP carries on with its proposal and oblige the operator(s) who win 4G spectrum auction to offer 4G roaming then we expect FT to offer 3G roaming and to pay a relatively limited amount for 4G spectrum.

Overall FT is in relatively good position as it can afford to wait (FT doesn't have any capacity issue due to lack of spectrum) and may get more spectrum at a relatively low cost or more spectrum at a high cost but with a new entrant in a difficult position due to lack of spectrum and potentially no 3G roaming.

In the table below we show the current spectrum allocation in France which shows that the new mobile entrant will have the lowest amount of spectrum of any operator in Europe which will make it critical to obtain a roaming agreement or more spectrum through the 4G auction. We expect ARCEP to first proceed with the auction of 2x70MHz of 2.6GHz spectrum (low bidding pressure as there is enough spectrum for all 4 operators) and then auction 2x30MHz of 800MHz (Eric Besson the French Industry Minister said that he wants a 4G coverage of 99% of the country by 2025 by at least 2 operators and that 4 lots could be allocated: two of 10MHz and two of 5MHz).

Figure 108. Current spectrum allocation in France (in dense areas and pre 4G auction)

Operator	900MHz	1800MHz	2.1GHz	Total spectrum
Orange	10	23.8	19.6	53.4
SFR	10	23.8	19.8	53.6
Bouygues	9.8	26.6	14.8	51.2
Free	5	0	5	10
Total	34.8	74.2	59.2	168.2

Source: Citi Investment Research and Analysis and ARCEP

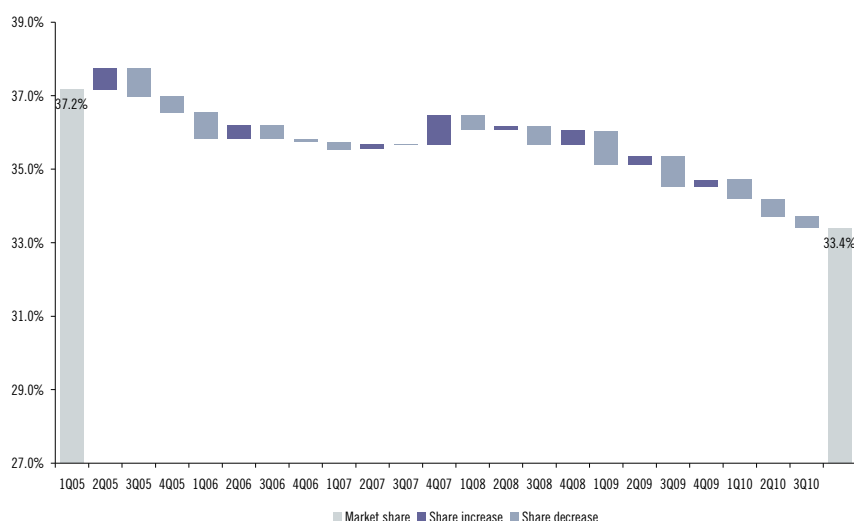
Taking hard decisions on EE

We expect FT and DT to come to a decision by mid 2011 on which brand(s) to keep for Everything Everywhere their UK's joint venture.

Performance has improved in 3Q10 in terms of top-line but Vodafone is becoming more aggressive and EE needs to decide which brand(s) to push and which to drop to deliver on its cost savings.

We still believe in the strategic rationale behind the merger of Orange UK and T-Mobile UK but were hoping for a quicker decision on the brand to ensure the transition period is cut to a minimum to avoid EE being the target of its competitors. Overall we see upside from EE if it manages to keep its market share as network and marketing savings should materialize in the coming years.

Figure 109. Everything Everywhere under pressure to stabilize market share in UK mobile



Source: Company data and Citi Investment Research and Analysis

Hoping for less M&A and more buyback

At the 2Q10 results, FT's CEO announced a commitment to pay a minimum dividend of €1.4 per share for the fiscal years 2010, 2011 and 2012. More recently the CEO commented that the company could look at share buybacks if there were no attractive M&A opportunities.

We remain cautious on FT's M&A strategy as we expect the market to continue being negative on M&A as any acquisition is likely to be done at a significant premium to FT's multiples and publicly quoted emerging telecoms stocks. Any comments on a potential stabilization of EBITDA and the start of a share buyback programme at the full year results could be a positive catalyst.

Sum of the Parts

Figure 110. France Telecom's Sum of the Parts

Asset	Stake	Driver (2011)	EV (€m)	Net debt end 2011E (€m)	FT share of equity	Per Share (€)	As a % of Group Equity value
French Fixed line	100.00%	5.0x EV/EBITDA	24,527	0	24,527	9.27	33%
French Mobile	100.00%	5.0x EV/EBITDA	19,559	0	19,559	7.39	26%
French assets			44,086		44,086	16.65	60%
Spanish Fixed line	99.98%	€300/subscriber	326	0	326	0.12	0%
Spanish Mobile	99.98%	5.5x EV/EBITDA	4,320	0	4,319	1.63	6%
TPSA Poland	49.79%	Listed Value	6,762	-1,173	2,782	1.05	4%
UK	50.00%	DDM - 10%	12,814	-1,396	5,709	2.16	8%
Main Mobile Assets (incl. Polish fixed)			24,222	-1,173	13,137	4.96	18%
Mobistar	52.91%	Listed Value	3,081	-375	1,432	0.54	2%
Switzerland Mobile	100.00%	2.0x EV/Revenues	1,951	0	1,951	0.74	3%
Mobinil	36.30%	Listed Value	3,307	-802	909	0.34	1%
Mobilrom (Romania)	96.82%	1.8x EV/Revenues	1,820	0	1,762	0.67	2%
Slovakia Mobile	100.00%	1.8x EV/Revenues	1,374	0	1,374	0.52	2%
Jordan	51.00%	1.8x EV/Revenues	782	0	399	0.15	1%
Senegal Mobile	42.33%	1.8x EV/Revenues	1,225	0	519	0.20	1%
Ivory Coast	85.00%	1.8x EV/Revenues	954	0	811	0.31	1%
Dominican Republic	100.00%	1.8x EV/Revenues	835	0	835	0.32	1%
Mali	29.71%	1.8x EV/Revenues	578	0	172	0.06	0%
Cameroon	99.50%	1.8x EV/Revenues	472	0	470	0.18	1%
Moldavia	94.31%	1.8x EV/Revenues	289	0	272	0.10	0%
Kenya	40.00%	1.8x EV/Revenues	174	0	70	0.03	0%
Madagascar	71.80%	1.8x EV/Revenues	108	0	78	0.03	0%
Botswana	43.70%	1.8x EV/Revenues	225	0	98	0.04	0%
Other	65.00%	2.0x EV/Revenues	572	0	372	0.14	1%
RoW Assets			17,749	-1,177	11,524	4.35	16%
Enterprise	100.00%	4.0x EV/EBITDA	5,519	0	5,519	2.08	7%
IC&SS	100.00%	5.0x EV/EBITDA	-851	0	-851	-0.32	-1%
Sonaecom	20.00%	Listed Value			98	0.04	0%
One	35.00%				300	0.11	0%
Orange BNP Paribas Services	50.00%		80	0	40	0.02	
Total Assets			90,805	-2,351	73,853	27.90	100%
Pension and provision for senior plan					-1,994	-0.75	
NPV of tax assets					1,044	0.39	
Debt adjustment for minorities and other				2,351		0.89	
Net debt (2011E)				-27,775		-10.49	
Equity Value		number of shares	2,647			17.9	
Discount applied for fibre and M&A risk						5%	
Fair Value						17.0	

Source: Citi Investment Research and Analysis

Forecast Changes

We have reduced our EPS forecasts (by -1.8% for FY10E, -3.4% for FY11E and -1.4% for FY12E) to reflect lower margin expectations for France, Poland and Rest of the World.

Figure 111. Forecast Changes

	New 2010E	New 2011E	New 2012E	Old 2010E	Old 2011E	Old 2012E	change % 2010	change % 2011	change % 2012
France	23,291	22,626	21,849	23,291	22,626	21,849	0.0%	0.0%	0.0%
o/w personal	10,774	10,717	10,084	10,774	10,717	10,084	0.0%	0.0%	0.0%
o/w home	13,547	12,909	12,731	13,547	12,909	12,731	0.0%	0.0%	0.0%
Spain	3,806	3,774	3,833	3,806	3,774	3,833	0.0%	0.0%	0.0%
o/w personal	3,146	3,142	3,212	3,146	3,142	3,212	0.0%	0.0%	0.0%
o/w home	659	632	621	659	632	621	0.0%	0.0%	0.0%
Poland	3,887	4,001	3,988	3,887	4,001	3,988	0.0%	0.0%	0.0%
o/w personal	1,920	2,029	2,104	1,920	2,029	2,104	0.0%	0.0%	0.0%
o/w home	2,272	2,188	2,094	2,272	2,188	2,094	0.0%	0.0%	0.0%
RoW	8,311	9,259	9,538	8,311	9,259	9,538	0.0%	0.0%	0.0%
IC&SS	1,609	1,701	1,784	1,609	1,701	1,784	0.0%	0.0%	0.0%
Enterprise	7,217	7,262	7,347	7,217	7,262	7,347	0.0%	0.0%	0.0%
Elimination (and Other pre-2007)	-2,642	-2,670	-2,654	-2,642	-2,670	-2,654	0.0%	0.0%	0.0%
Total Revenues	45,479	45,954	45,684	45,479	45,954	45,684	0.0%	0.0%	0.0%
EBITDA	15,476	15,529	15,326	15,476	15,792	15,543	0.0%	-1.7%	-1.4%
margin	34.0%	33.8%	33.5%	34.0%	34.4%	34.0%	0.0 ppt	-0.6 ppt	-0.5 ppt
Depreciation and amortisation	-6,292	-6,210	-6,147	-6,292	-6,210	-6,144	0.0%	0.0%	0.1%
Operating Income	9,184	9,319	9,179	9,184	9,582	9,400	0.0%	-2.7%	-2.3%
Finance Costs net	-1,977	-1,793	-1,621	-1,837	-1,810	-1,759	7.6%	-0.9%	-7.8%
Profit before Tax	7,207	7,526	7,558	7,348	7,772	7,641	-1.9%	-3.2%	-1.1%
Income tax	-2,481	-2,591	-2,602	-2,530	-2,676	-2,631	-1.9%	-3.2%	-1.1%
Share of minorities	490	550	560	500	550	549	-2.0%	0.0%	2.1%
NI	5,498	4,650	4,736	5,581	4,811	4,802	-1.5%	-3.4%	-1.4%
Adjusted EPS	1.68	1.76	1.78	1.71	1.82	1.80	-1.8%	-3.4%	-1.4%
Free Cash Flow (FT definition)	7,768	7,551	6,878	7,908	7,798	7,008	-1.8%	-3.2%	-1.9%
Capex	5,531	5,734	5,677	5,531	5,734	5,627	0.0%	0.0%	0.9%
Capex to Sales	12.2%	12.5%	12.4%	12.2%	12.5%	12.3%	0.0 ppt	0.0 ppt	0.1 ppt
Net Debt	30,645	28,038	25,639	30,504	27,652	25,122	0.5%	1.4%	2.1%
Net debt to EBITDA	2.0x	1.8x	1.7x	2.0x	1.8x	1.6x			

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change

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Buy/Low Risk	1L
Price (09 Dec 10)	€11.01
Target price	€13.50
Expected share price return	22.7%
Expected dividend yield	6.4%
Expected total return	29.0%
Market Cap	€17,307M
	US\$22,947M

Price Performance (RIC: KPN.AS, BB: KPN NA)



KPN NV (KPN.AS) The best de-equitisation play

- **More buybacks to come** — Over the last 6 years KPN has bought back over a third of its equity. We expect this trend to continue and KPN to buyback 11% of its shares over the next two years (€1bn buyback in 2011 and 2012). Our strategists expect de-equitisation to be a key theme in 2011.
- **Don't underestimate mobile data opportunity** — We believe that KPN is now well positioned to benefit from mobile data growth thanks to: 1) the rollout of mobile data networks in Germany and Belgium, 2) the launch of the iPhone in the Netherlands, 3) aggressive new data tariffs in Germany starting at €11/month including a smartphone.
- **Attractive valuation** — KPN trades on 8.5x PE 11E (sector on 10.0x) and FCF yield to equity of 12% (sector on 11%). We believe this is undeserved considering that revenues should grow again in 2011, generous returns (7.7% forward dividend yield plus €1bn of share buyback) and mobile data upside. KPN should grow EPS by 8% between 2010-13E vs. 2% for the sector thanks to the benefits from de-equitisation and early refinancing.
- **Full year results the next catalyst** — Market is still skeptical that KPN can return to growing revenues without sacrificing margins. We expect management to reiterate its guidance for next year of growing EBITDA and FCF thanks to the untapped mobile data growth opportunity for 2011. We also expect KPN to increase its dividend to €0.85 per share and initiate a new €1bn share buyback programme.
- **Regulatory visibility** — KPN already had mobile auctions in its two main mobile markets: the Netherlands and Germany. Mobile termination glide paths with severe cuts have already been announced in Germany, Belgium and the Netherlands. We believe that KPN is now one of our stocks with the highest level of regulatory visibility.
- **Fibre to help fight back cable** — Cable remains the main threat to KPN's fixed domestic business. While management made positive comments on the take-up of fibre, numbers continue to be disappointing with fibre activations running at c.10k per quarter. The successful rollout of fibre is critical for KPN to stabilize fixed line losses running at c.6% per year.

KPN NV (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	14,602.0	13,509.0	13,391.4	13,417.1	13,477.7
Net Income (€M)	1,332.0	2,178.0	1,790.1	1,955.1	1,967.5
Diluted EPS (€)	0.77	1.33	1.13	1.30	1.39
Diluted EPS (Old) (€)	0.77	1.33	1.13	1.31	1.40
PE (x)	14.4	8.3	9.8	8.5	7.9
EV/EBITDA (x)	5.5	5.4	5.2	5.0	4.9
DPS (€)	0.60	0.69	0.80	0.85	0.94
Net Div Yield (%)	5.4	6.3	7.3	7.7	8.5

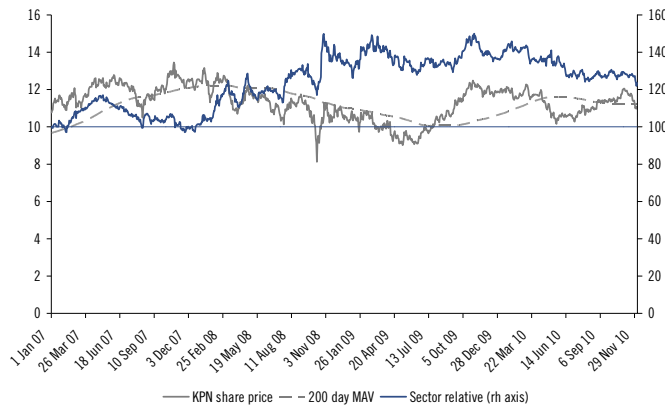
Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	14.4	8.3	9.8	8.5	8.0
EV/EBITDA adjusted (x)	5.6	5.4	5.2	5.0	4.9
P/BV (x)	5.0	4.7	3.9	3.2	2.7
Dividend yield (%)	5.4	6.2	7.2	7.7	8.5
Per Share Data (€)					
EPS adjusted	0.77	1.33	1.13	1.30	1.39
EPS reported	0.77	1.33	1.13	1.30	1.39
BVPS	2.19	2.36	2.82	3.45	4.15
DPS	0.60	0.69	0.80	0.85	0.94
Profit & Loss (€M)					
Net sales	14,602	13,509	13,391	13,417	13,478
Operating expenses	-12,005	-10,659	-10,125	-10,092	-10,106
EBIT	2,597	2,850	3,267	3,325	3,372
Net interest expense	-704	-808	-886	-734	-722
Non-operating/exceptionals	-6	-6	-6	-6	-6
Pre-tax profit	1,887	2,036	2,375	2,585	2,644
Tax	-550	139	-583	-620	-645
Extraord./Min.Int./Pref.div.	-5	3	-2	-10	-32
Reported net income	1,332	2,178	1,790	1,955	1,967
Adjusted earnings	1,332	2,178	1,790	1,955	1,967
Adjusted EBITDA	5,058	5,192	5,469	5,490	5,477
Growth Rates (%)					
Sales	15.6	-7.5	-0.9	0.2	0.5
EBIT adjusted	4.5	9.7	14.6	1.8	1.4
EBITDA adjusted	3.5	2.6	5.3	0.4	-0.2
EPS adjusted	-5.4	73.6	-15.2	15.3	6.5
Cash Flow (€M)					
Operating cash flow	4,304	3,776	3,929	3,924	3,822
Depreciation/amortization	2,461	2,342	2,202	2,165	2,105
Net working capital	692	10	50	50	0
Investing cash flow	-1,699	-1,829	-2,188	-1,843	-1,780
Capital expenditure	-1,925	-1,767	-2,231	-1,943	-1,880
Acquisitions/disposals	226	-62	43	100	100
Financing cash flow	-1,420	-67	-2,154	-2,236	-2,243
Borrowings	714	1,923	0	0	0
Dividends paid	-981	-1,039	-1,154	-1,236	-1,243
Change in cash	1,185	1,880	-413	-155	-201
Balance Sheet (€M)					
Total assets	23,913	24,851	24,545	22,273	22,048
Cash & cash equivalent	1,199	2,690	2,690	690	690
Accounts receivable	2,536	1,999	1,949	1,899	1,899
Net fixed assets	7,736	7,523	8,062	8,635	9,205
Total liabilities	20,154	21,010	20,182	17,223	16,326
Accounts payable	2,352	2,418	1,177	2,062	966
Total Debt	12,041	13,371	13,784	9,939	10,140
Shareholders' funds	3,759	3,841	4,363	5,050	5,721
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	34.6	38.4	40.8	40.9	40.6
ROE adjusted	32.2	57.3	43.6	41.5	36.5
ROIC adjusted	9.7	14.9	13.3	13.5	13.7
Net debt to equity	288.4	278.1	254.3	183.1	165.2
Total debt to capital	76.2	77.7	76.0	66.3	63.9

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De-equitisation Play

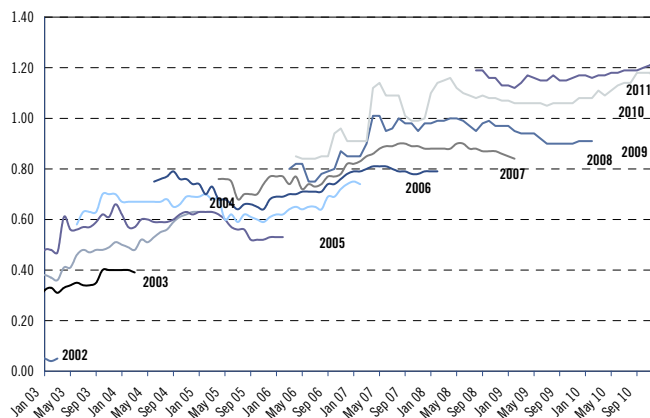
We believe that KPN is the best de-equitisation play in the sector based on its history and our forward expectations as illustrated in Figure 117.

Figure 112. KPN has underperformed the sector since end-09 (left axis €/share; right axis index: end-2006=100)



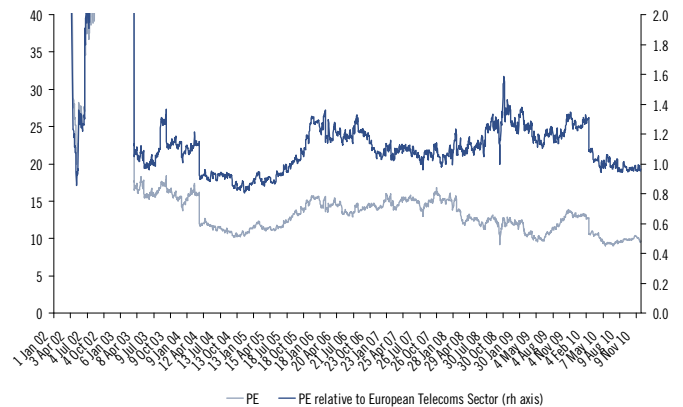
Source: DataStream

Figure 114. Consensus EPS has consistently risen (€)



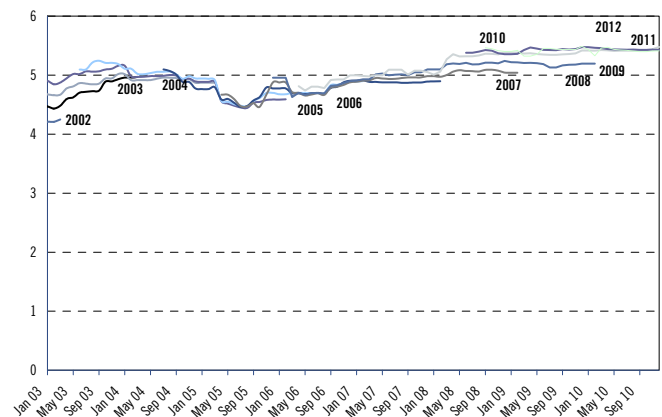
Source: DataStream

Figure 113. KPN trades close to the sector average on PE (1 year forward)



Source: DataStream

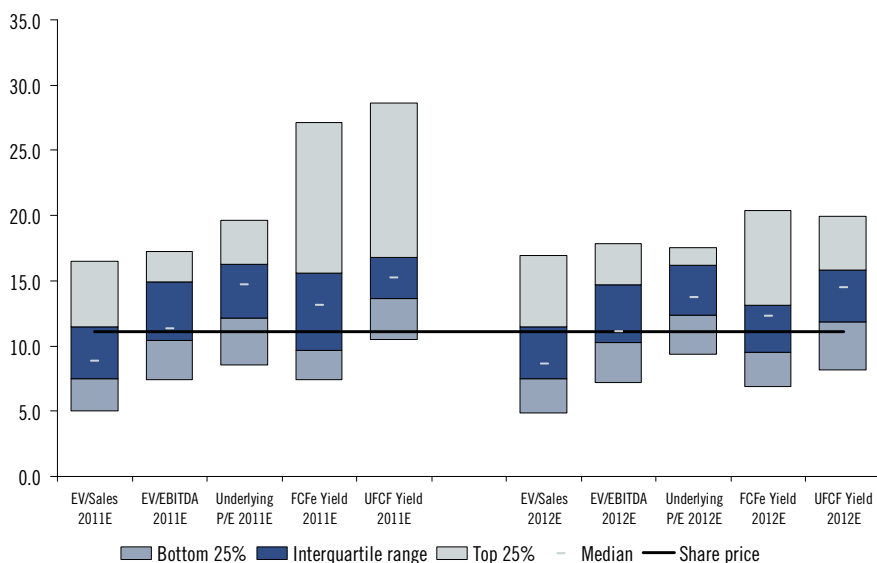
Figure 115. EBITDA consensus has been heading up (€bn)



Source: DataStream

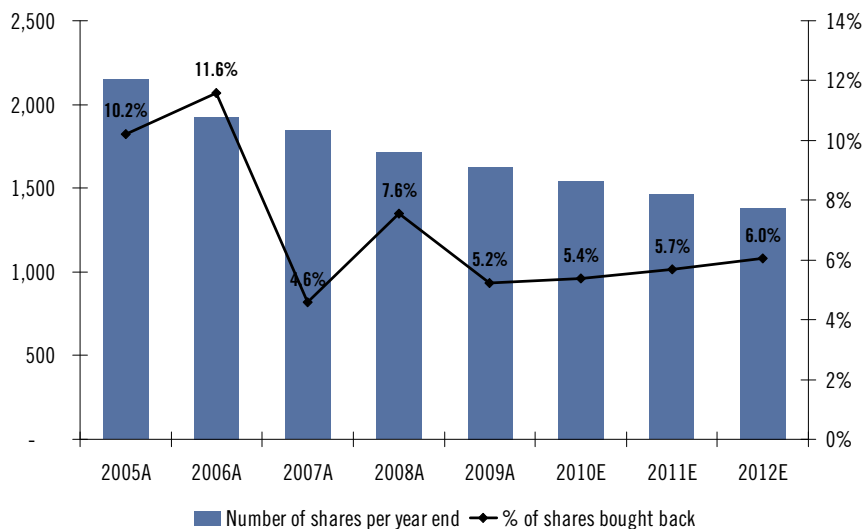
Figure 116. Compared to its incumbent and wireless peers in Europe KPN trades around the lower quartile on our 2011 estimates

€/share



Source: Powered by dataCentral

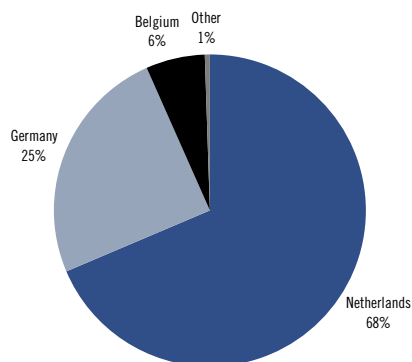
Figure 117. Rapidly declining number of shares for KPN



Source: Citi Investment Research and Analysis and company data

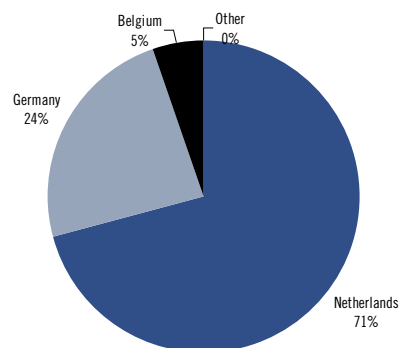
Split by countries

Figure 118. 2011E sales breakdown per country



Source: Citi Investment Research and Analysis

Figure 119. 2011E EBITDA breakdown per country



Source: Citi Investment Research and Analysis

Forecast changes

We have lowered our EPS estimates by 0.5% and 0.7% for FY11E and FY12E to reflect the more severe termination cuts in Germany than we anticipated. We have increased our capex estimates by 3% for FY11E and FY12E to take into account the investment in mobile data capacity in Germany and Belgium plus fibre investment in the Netherlands.

Figure 120. Forecast Changes fro KPN (In €m except per share data)

	NEW			OLD			Change		
	2010E	2011E	2012E	2010E	2011E	2012E	2010	2011	2012
Revenue									
E-Plus	3,237	3,315	3,477	3,253	3,365	3,530	-0.5%	-1.5%	-1.5%
Base	800	829	852	800	815	837	0.0%	1.8%	1.8%
Mobile International	4,197	4,317	4,505	4,213	4,343	4,533	-0.4%	-0.6%	-0.6%
Consumer	3,870	3,737	3,691	3,870	3,737	3,691	0.0%	0.0%	0.0%
Business	2,407	2,381	2,346	2,407	2,381	2,346	0.0%	0.0%	0.0%
Wholesale	3,615	3,615	3,490	3,615	3,615	3,490	0.0%	0.0%	0.0%
Getronics	1,946	1,983	2,035	1,946	1,983	2,035	0.0%	0.0%	0.0%
Total Netherlands	9,295	9,199	9,070	9,295	9,199	9,070	0.0%	0.0%	0.0%
Group Revenues	13,391	13,417	13,478	13,408	13,443	13,506	-0.1%	-0.2%	-0.2%
EBITDA									
E-Plus	1,359	1,309	1,356	1,366	1,329	1,376	-0.5%	-1.5%	-1.5%
Base	280	290	290	280	277	285	0.0%	4.7%	1.8%
Mobile International	1,623	1,591	1,654	1,630	1,598	1,669	-0.4%	-0.4%	-0.9%
Consumer	1,103	1,095	1,096	1,103	1,095	1,096	0.0%	0.0%	0.0%
Business	806	809	798	806	809	798	0.0%	0.0%	0.0%
Wholesale	1,797	1,814	1,752	1,797	1,814	1,752	0.0%	0.0%	0.0%
Getronics	130	136	143	130	136	143	0.0%	0.0%	0.0%
Total Netherlands	3,871	3,890	3,823	3,871	3,890	3,823	0.0%	0.0%	0.0%
Group EBITDA	5,469	5,490	5,477	5,476	5,497	5,492	-0.1%	-0.1%	-0.3%
EBITDA margin									
E-Plus	42.0%	39.5%	39.0%	42.0%	39.5%	39.0%	0.0 ppt	0.0 ppt	0.0 ppt
Base	35.0%	35.0%	34.0%	35.0%	34.0%	34.0%	0.0 ppt	1.0 ppt	0.0 ppt
Mobile International	38.7%	36.8%	36.7%	38.7%	36.8%	36.8%	0.0 ppt	0.1 ppt	-0.1 ppt
Consumer	28.5%	29.3%	29.7%	28.5%	29.3%	29.7%	0.0 ppt	0.0 ppt	0.0 ppt
Business	33.5%	34.0%	34.0%	33.5%	34.0%	34.0%	0.0 ppt	0.0 ppt	0.0 ppt
Wholesale	49.7%	50.2%	50.2%	49.7%	50.2%	50.2%	0.0 ppt	0.0 ppt	0.0 ppt
Getronics	6.7%	6.9%	7.0%	6.7%	6.9%	7.0%	0.0 ppt	0.0 ppt	0.0 ppt
Total Netherlands	41.6%	42.3%	42.1%	41.6%	42.3%	42.1%	0.0 ppt	0.0 ppt	0.0 ppt
Group EBITDA	40.8%	40.9%	40.6%	40.8%	40.9%	40.7%	0.0%	0.0%	0.0%
D&A	(2,202)	(2,165)	(2,105)	(2,202)	(2,165)	(2,105)	0.0%	0.0%	0.0%
Operating Result	3,267	3,325	3,372	3,274	3,332	3,387	-0.2%	-0.2%	-0.4%
PBT	2,375	2,585	2,644	2,382	2,592	2,659	-0.3%	-0.3%	-0.6%
Analyst Adj Earnings	1,790	1,955	1,967	1,796	1,964	1,982	-0.3%	-0.5%	-0.7%
EPS reported	1.13	1.30	1.39	1.13	1.31	1.40	-0.3%	-0.5%	-0.7%
DPS	0.80	0.85	0.94	0.80	0.85	0.94	0.0%	0.0%	0.0%
Capex	1,946	1,943	1,880	1,948	1,879	1,819	-0.1%	3.4%	3.4%
FCF	2,329	2,382	2,368	2,333	2,458	2,446	-0.2%	-3.1%	-3.2%
Net debt	11,513	11,668	11,869	11,510	11,594	11,721	0.0%	0.6%	1.3%

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change

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Sell/Low Risk	3L
Price (09 Dec 10)	€46.03
Target price	€39.00
Expected share price return	-15.3%
Expected dividend yield	8.7%
Expected total return	-6.6%
Market Cap	€2,762M
	US\$3,662M

Price Performance (RIC: MSTAR.BR, BB: MOBB BB)



Mobistar SA (MSTAR.BR) 3 Reasons to stay underweight

- **Maintain Sell** — We maintain our Sell/Low risk recommendation and target price of €39 on the back of poor outlook for the Belgian market with intensifying competition and subsidies likely to affect margins over the next few years. We reiterate our main three arguments for being underweight the stock: 1) Growing threat of mobile handset subsidies after a "quiet" 2010, 2) Lack of strong fixed network to compete in a convergent market and 3) Increasing risk from Telenet's push in mobile.
- **Probability of handset subsidies is too high to ignore** — Belgian operators this year have been disciplined and with the exception of Telenet none has decided to go down the route of handset subsidies. However things could change in a market hard hit by termination rates, the likely end of Mobistar's iPhone exclusivity and Base launching limited offers including subsidies. We argue in a worse case scenario: €100 subsidy/handset, for 2m postpaid subs and 18-month customer lifetime, subsidies could cost Mobistar €133m pa.
- **At a disadvantage in a convergent world** — Mobistar launched its TV offer in October 2010. Although the early press coverage was positive, and the offer is still in its early days, we remain cautious on the potential for Mobistar to compete with Belgacom and Telenet in TV, given the lack of significant competitive advantage in this field and quite a late arrival to the market. Longer term, we argue any significant fixed/mobile synergies are limited due to the weakness of Mobistar's fixed network which uses satellite vs. Telenet's cable network and Belgacom's VDSL network.
- **More competition from Telenet** — Telenet has started its move to a full MVNO model. We argue this is a negative for Mobistar as it will increase price competition in the market and eventually this should translate into lower wholesale revenues for Mobistar. We estimate this to c. -1% impact on Mobistar's top-line. Telenet might also look at acquiring 4G spectrum.
- **Next year guidance the main catalyst** — We expect Q4 (results out on 11 February) to be solid especially as FY10 guidance is undemanding. We worry however that the market could be disappointed with 2011 guidance. We are 5% below 11E EPS consensus as we see earnings declining by 7.9% yoy due to termination cuts (45% cut last Aug) and higher SARCs. The main attraction of the stock is its forward dividend yield of 8.3% and under levered balance sheet.

Mobistar SA (EUR)

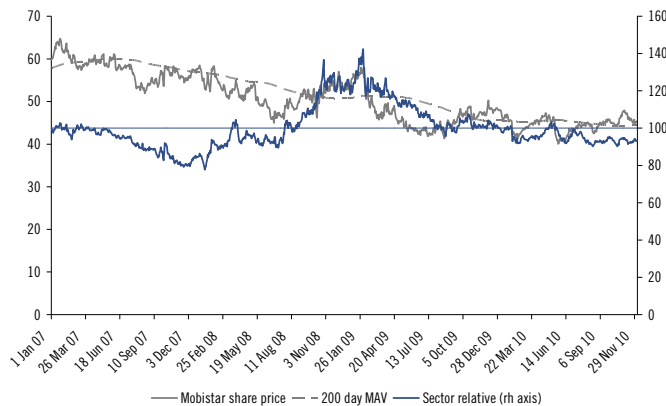
Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	1,566.8	1,604.8	1,696.1	1,687.9	1,683.9
Net Income (€M)	280.1	260.3	246.0	226.6	223.2
Diluted EPS (€)	4.54	4.34	4.10	3.78	3.72
Diluted EPS (Old) (€)	4.54	4.34	4.10	3.78	3.72
PE (x)	10.1	10.6	11.2	12.2	12.4
EV/EBITDA (x)	4.9	5.4	5.7	6.0	6.2
DPS (€)	4.55	4.55	4.00	3.78	3.72
Net Div Yield (%)	9.9	9.9	8.7	8.2	8.1

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	10.1	10.6	11.2	12.1	12.3
EV/EBITDA adjusted (x)	4.9	5.4	5.7	5.9	6.1
P/BV (x)	6.1	6.2	6.6	6.9	6.9
Dividend yield (%)	9.9	9.9	8.7	8.2	8.1
Per Share Data (€)					
EPS adjusted	4.54	4.34	4.10	3.78	3.72
EPS reported	4.54	4.34	4.10	3.78	3.72
BVPS	7.54	7.34	6.89	6.67	6.61
DPS	4.55	4.55	4.00	3.78	3.72
Profit & Loss (€M)					
Net sales	1,567	1,605	1,696	1,688	1,684
Operating expenses	-1,148	-1,202	-1,322	-1,331	-1,327
EBIT	419	403	374	357	357
Net interest expense	-6	-5	-7	-19	-24
Non-operating/exceptionals	0	0	0	0	0
Pre-tax profit	413	398	368	338	333
Tax	-133	-138	-122	-112	-110
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	280	260	246	227	223
Adjusted earnings	280	260	246	227	223
Adjusted EBITDA	592	567	543	526	526
Growth Rates (%)					
Sales	1.7	2.4	5.7	-0.5	-0.2
EBIT adjusted	-2.5	-3.8	-7.1	-4.7	0.1
EBITDA adjusted	-0.3	-4.2	-4.3	-3.1	0.0
EPS adjusted	-1.3	-4.5	-5.5	-7.9	-1.5
Cash Flow (€M)					
Operating cash flow	444	446	543	396	392
Depreciation/amortization	173	164	168	169	169
Net working capital	-11	20	50	0	0
Investing cash flow	-174	-149	-305	-173	-373
Capital expenditure	-160	-146	-166	-173	-173
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-285	-294	-73	-240	-27
Borrowings	312	-20	200	0	200
Dividends paid	-349	-273	-273	-240	-227
Change in cash	-15	3	165	-18	-8
Balance Sheet (€M)					
Total assets	1,200	1,153	1,345	1,332	1,528
Cash & cash equivalent	7	10	136	118	110
Accounts receivable	217	204	179	179	179
Net fixed assets	530	549	686	690	694
Total liabilities	748	712	932	932	1,132
Accounts payable	284	266	281	281	281
Total Debt	318	298	498	498	698
Shareholders' funds	453	441	414	400	397
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	37.8	35.3	32.0	31.1	31.2
ROE adjusted	45.9	58.3	57.6	55.7	56.0
ROIC adjusted	37.2	35.6	33.8	31.7	28.1
Net debt to equity	68.8	65.3	87.6	95.0	148.1
Total debt to capital	41.3	40.3	54.6	55.4	63.7

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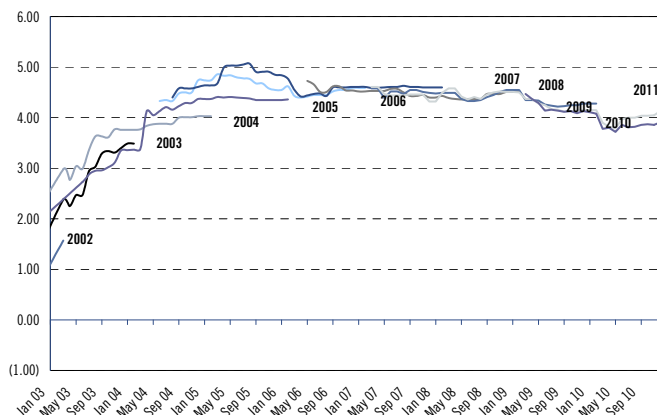
Staying a seller

Figure 121. Mobistar has underperformed the sector since mid-09 but lately performed inline (left axis €/share; right axis index: end-2006=100)



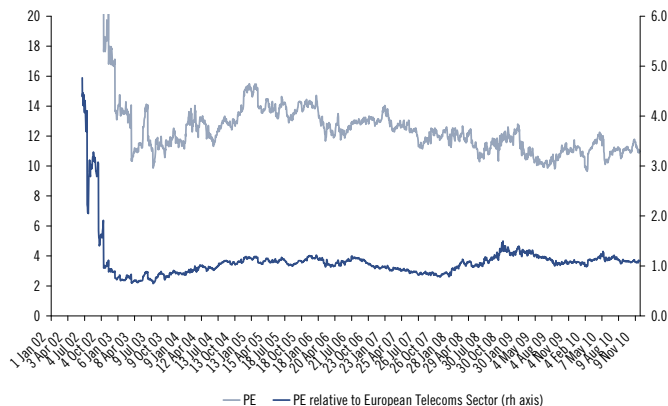
Source: DataStream

Figure 123. Consensus EPS has lately recovered after weakness (€)



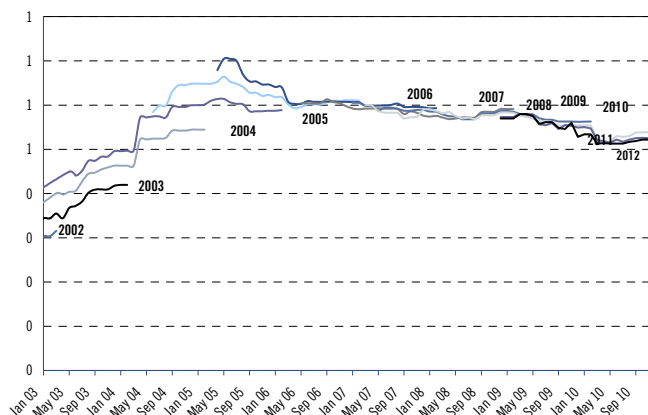
Source: DataStream

Figure 122. Mobistar trades slightly above the sector average on PE (1 year forward)



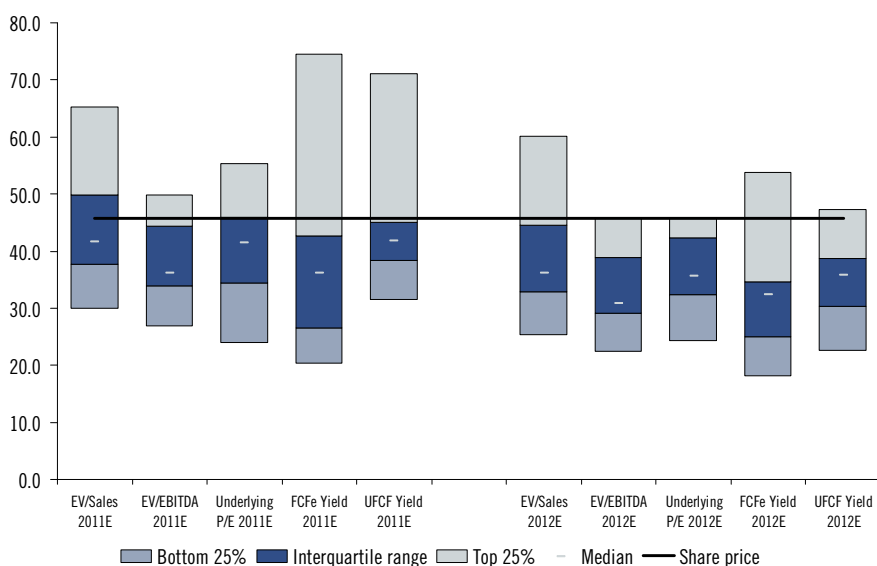
Source: DataStream

Figure 124. EBITDA consensus has stabilised (€bn)



Source: DataStream

Figure 125. Compared to its incumbent and wireless peers in Europe Mobistar trades around the upper quartile on our 2011 estimates and above the upper quartile on our 2012 estimates
€/share



Source: Powered by dataCentral

Company Focus

- Company Update
- Rating Change
- Estimate Change

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Hold/High Risk	2H
<i>from Buy/High Risk</i>	
Price (09 Dec 10)	€7.35
Target price	€8.00
Expected share price return	8.8%
Expected dividend yield	2.6%
Expected total return	11.4%
Market Cap	€3,603M
	US\$4,777M

Price Performance (RIC: OTEr.AT, BB: HTO GA)



OTE (OTEr.AT)

Recent rally is justified but hard to extend

- **Up 30% over last 3 months, Cut to Hold** — OTE is up c.30% over the last 3 months (sector is flat). We believe that the new CEO is the main reason behind this rally. Mr Tzamas the new CEO should be in a better position to restructure OTE and negotiate with the regulator but macro is not improving and consensus earnings are still at risk. We cut OTE to a Hold from Buy as we believe valuation is not attractive enough to reflect our high risk rating. OTE trades on 4.4x EV/ EBITDA 11E (sector on 5.1x) and forward PE of 12.2x (sector on 10.0x).
- **Positive noise on mobile pricing** — The unlimited on-net promotions for pre-paid which halved pre-paid ARPU expire in Jan for Wind Hellas and Cosmote. We understand that both are unlikely to renew those promotions as long as Vodafone (which unlimited offers expire in June 11) does not try to take share. New owners at Wind Hellas should bring more price rationality.
- **Uneasy relationship with regulator continues** — Last week, the Greek regulator told OTE to remove its €9.90/month DSL offer which had been successful in reducing churn. This is obviously highly unhelpful with OTE still struggling to find a way to retain subscribers and charge a premium for its services. Main positive are comments from altnets such as Forthnet to focus more on profitability than market share going forward.
- **Solid progress on cost cutting** — One of the few positives from recent results has been the resilience of margins. Salary costs in fixed came down 6% yoy in Q3 and with 34% of revenues spent on salaries there is scope to cut costs further. However in mobile margins could fall if the top-line trend does not show significant improvement.
- **More colour expected at full year results** — New CEO indicated that OTE would provide a new business plan at the time of the Q4 results. This should provide much needed visibility. We don't think that the dividend will change materially though due to the Greek tax regime on dividends.
- **Helpful hand from DT** — Management mentioned that DT could be the lender of last resort. This is positive as €2.2bn of OTE's bonds are maturing next year and S&P put OTE's rating on credit watch. Despite the ambition from the Greek government to raise €7bn from privatisations by 2013 we think it will be difficult short term to justify selling at the current price when the last stake sold by the government to DT was sold at €27.5 per share.

OTE (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	6,407.3	5,984.1	5,545.5	5,344.0	5,266.4
Net Income (€M)	604.8	458.0	242.9	302.1	341.9
Diluted EPS (€)	1.23	0.93	0.50	0.62	0.70
Diluted EPS (Old) (€)	1.23	0.93	0.50	0.63	0.71
PE (x)	6.0	7.9	14.8	11.9	10.5
EV/EBITDA (x)	3.6	4.0	4.3	4.4	4.2
DPS (€)	0.75	0.19	0.19	0.21	0.24
Net Div Yield (%)	10.2	2.6	2.6	2.8	3.2

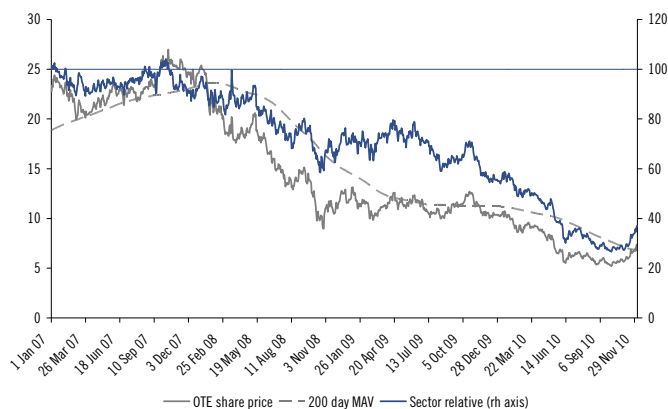
Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	6.1	8.0	15.2	12.2	10.8
EV/EBITDA adjusted (x)	3.7	4.0	4.4	4.4	4.2
P/BV (x)	2.8	3.0	2.7	2.4	2.1
Dividend yield (%)	10.0	2.5	2.5	2.8	3.1
Per Share Data (€)					
EPS adjusted	1.23	0.93	0.50	0.62	0.70
EPS reported	1.23	0.82	0.49	0.59	0.67
BVPS	2.68	2.49	2.79	3.17	3.61
DPS	0.75	0.19	0.19	0.21	0.24
Profit & Loss (€M)					
Net sales	6,407	5,984	5,546	5,344	5,266
Operating expenses	-5,350	-4,983	-4,768	-4,585	-4,475
EBIT	1,058	1,001	777	759	791
Net interest expense	-260	-264	-300	-273	-241
Non-operating/exceptionals	46	43	24	0	0
Pre-tax profit	844	781	501	486	550
Tax	-246	-380	-308	-205	-223
Extraord./Min.Int./Pref.div.	4	3	45	10	3
Reported net income	602	404	238	291	330
Adjusted earnings	605	458	243	302	342
Adjusted EBITDA	2,321	2,126	1,929	1,837	1,814
Growth Rates (%)					
Sales	1.4	-6.6	-7.3	-3.6	-1.5
EBIT adjusted	5.7	-12.4	-16.2	-4.3	4.2
EBITDA adjusted	4.5	-8.4	-9.2	-4.8	-1.3
EPS adjusted	23.1	-24.3	-47.0	24.4	13.2
Cash Flow (€M)					
Operating cash flow	1,621	1,288	1,079	1,330	1,290
Depreciation/amortization	1,213	1,155	1,116	1,058	1,002
Net working capital	-380	-404	-486	-24	-55
Investing cash flow	-1,871	-1,212	-798	-770	-745
Capital expenditure	-964	-891	-805	-777	-752
Acquisitions/disposals	-917	-329	0	0	0
Financing cash flow	148	-1,006	-96	-88	-97
Borrowings	522	-637	0	0	0
Dividends paid	-374	-368	-96	-88	-97
Change in cash	-102	-930	185	472	448
Balance Sheet (€M)					
Total assets	11,425	10,294	10,158	10,352	10,555
Cash & cash equivalent	1,428	869	1,064	1,541	1,994
Accounts receivable	1,194	1,153	1,153	1,153	1,153
Net fixed assets	5,873	5,625	5,314	5,033	4,782
Total liabilities	9,251	8,314	8,033	8,039	8,028
Accounts payable	944	813	813	813	813
Total Debt	6,048	5,422	5,422	5,422	5,422
Shareholders' funds	2,174	1,980	2,125	2,313	2,528
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	36.2	35.5	34.8	34.4	34.4
ROE adjusted	36.2	36.1	18.8	20.7	20.6
ROIC adjusted	12.3	9.1	7.8	9.0	9.7
Net debt to equity	212.5	230.0	205.1	167.7	135.6
Total debt to capital	73.6	73.3	71.8	70.1	68.2

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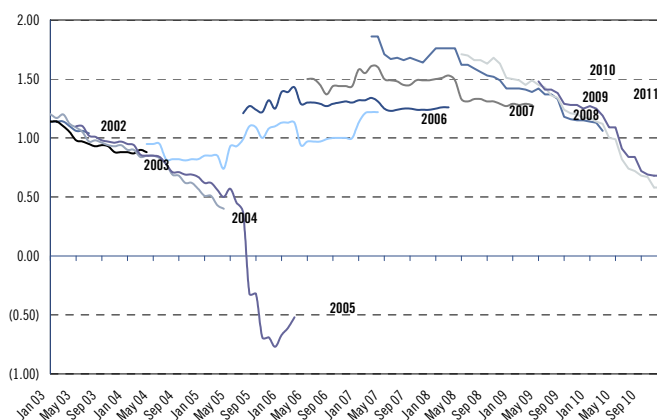
OTE Performance and Outlook

Figure 126. OTE has lately seen a small recovery following extended underperformance (left axis €/share; right axis index: end-2006=100)



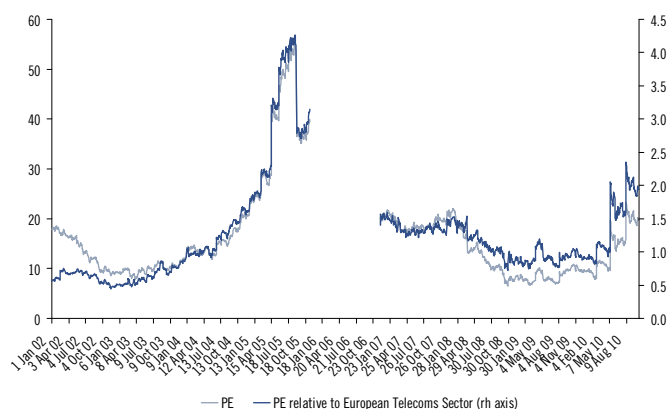
Source: DataStream

Figure 128. Consensus EPS has been falling rapidly (€)



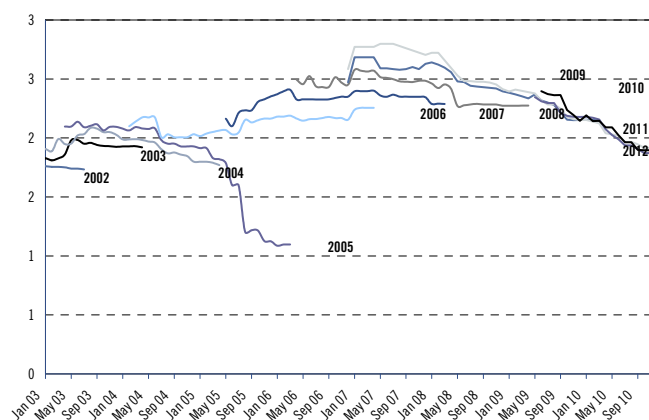
Source: DataStream

Figure 127. OTE currently trades well above the sector average on PE (1 year forward)



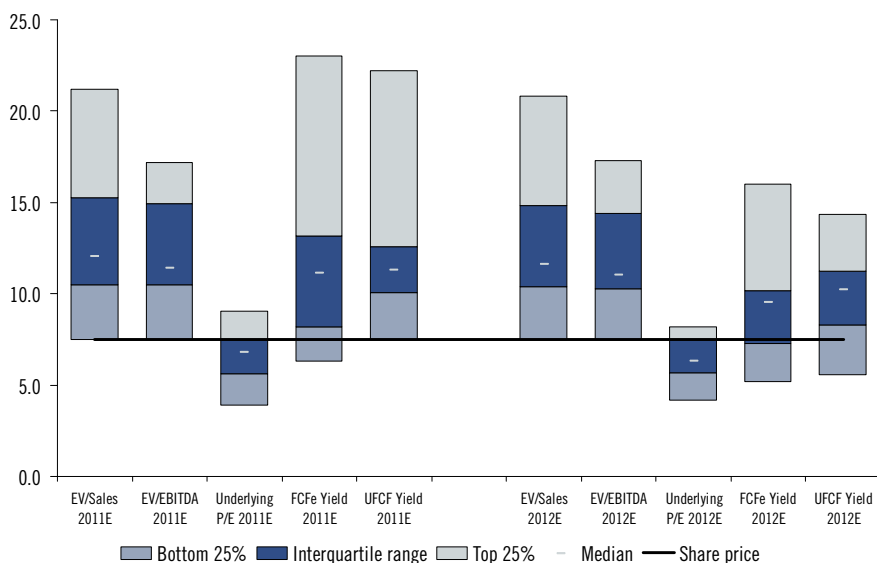
Source: DataStream

Figure 129. EBITDA consensus has been falling recently (€bn)



Source: DataStream

Figure 130. Compared to its incumbent and wireless peers in Europe OTE trades below the lower quartile on our 2011 FCF yields
€/share



Source: Powered by dataCentral

Valuation

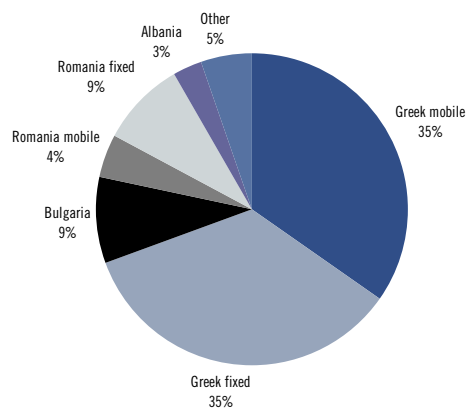
Our €8 target price is based on our DCF valuation. Below we show the details of our Sum of the Parts for OTE.

Figure 131. OTE Sum of the Parts

	Stake (%)	EV	/ Share Value	As a % of Group EV	Metric	2011E
Greek Fixed	100%	2,877	5.9	36%	EV/EBITDA multiple	4.5x
Greek mobile	100%	3,192	6.5	40%	EV/EBITDA multiple	5.0x
Bulgarian mobile	100%	725	1.5	9%	EV/EBITDA multiple	4.5x
Romanian mobile	86%	350	0.7	4%	EV/EBITDA multiple	5.0x
Albanian mobile	95%	226	0.5	3%	EV/EBITDA multiple	4.5x
Romanian fixed	54.0%	358	0.7	4%	EV/EBITDA multiple	4.0x
Total Consolidated Assets		7,727	15.8	96%		
Serbia Telecom	20.0%	308	0.6	4%	Sector EV/EBITDA multiple	4.5x
Total Associates		308	0.6	4%		
Group Enterprise Value		8,035	16.4			
Real estate gains beyond 2010		0				
Less Net Debt 2011		-3,881	-7.9	-48.3%		
Group Equity Value		4,155	8.5	51.7%		
Shares outstanding (m)		490				
Per share valuation		8.5				

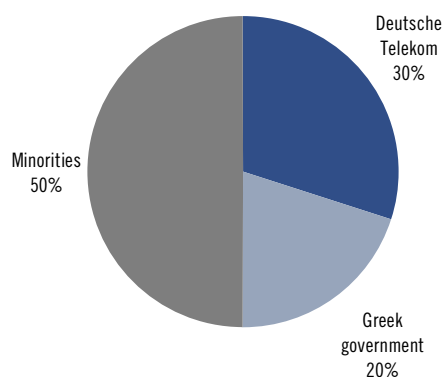
Source: Citi Investment Research and Analysis

Figure 132. 2011E EBITDA split per country



Source: Company reports, Citi Investment Research and Analysis

Figure 133. OTE's current ownership



Source: Citi Investment Research and Analysis

Forecast Changes

We have made small changes to our EPS forecasts (cut of 2% for 2011E and 1% for 2012E) to reflect lower expectations for RomTelecom. Note that a new tax bill is expected to come in Greece in the next couple of days or weeks. This could have a material impact on OTE. At the moment we forecast an effective tax rate of 62% for FY10E, 42% for FY11E, 41% for FY12E and 35% post 2012E. Visibility on taxes is very limited but Greek government could decide to simply the current tax system which includes different tax rates if companies pay dividends (40% tax rate), retain all earning (20% tax rate) and make large profits (10% special and incremental tax expected to end post 2012 on top).

Figure 134. OTE Forecast Changes (In €m except per share data)

	New			Old			Delta		
	2010E	2011E	2012E	2010E	2011E	2012E	2010E	2011E	2012E
Revenues									
Greek Fixed	2,012	1,930	1,874	2,012	1,930	1,874	0.0%	0.0%	0.0%
Rom Telecom	702	669	639	702	672	642	0.0%	-0.5%	-0.5%
Cosmote	2,649	2,555	2,557	2,649	2,555	2,557	0.0%	0.0%	0.0%
Other	183	190	196	183	190	196	0.0%	0.0%	0.0%
	5,546	5,344	5,266	5,546	5,347	5,270	0.0%	-0.1%	-0.1%
<i>growth (%)</i>	<i>-7.3%</i>	<i>-3.6%</i>	<i>-1.5%</i>	<i>-7.3%</i>	<i>-3.6%</i>	<i>-1.5%</i>	<i>0pp</i>	<i>0pp</i>	<i>0pp</i>
EBITDA									
Greek Fixed reported	666	619	580	666	619	580	0.0%	0.0%	0.0%
Rom Telecom	156	166	172	156	173	173	0.0%	-4.4%	-0.5%
Cosmote	977	934	940	977	939	949	0.0%	-0.6%	-0.9%
Other	95	99	102	95	99	102	0.0%	0.0%	0.0%
	1,893	1,817	1,794	1,893	1,830	1,804	0.0%	-0.7%	-0.5%
<i>margin (%)</i>	<i>34.1%</i>	<i>34.0%</i>	<i>34.1%</i>	<i>34.1%</i>	<i>34.2%</i>	<i>34.2%</i>	<i>0pp</i>	<i>0pp</i>	<i>0pp</i>
Underlying EBITDA	1,929	1,837	1,814	1,929	1,850	1,824	0.0%	-0.7%	-0.5%
<i>margin (%)</i>	<i>34.8%</i>	<i>34.4%</i>	<i>34.4%</i>	<i>35%</i>	<i>35%</i>	<i>35%</i>	<i>0pp</i>	<i>0pp</i>	<i>0pp</i>
Group D&A	-1,116	-1,058	-1,002	-1,116	-1,059	-1,003	0.0%	0.0%	0.0%
EBIT	777	759	791	777	772	801	0.0%	-1.7%	-1.2%
Interest	-300	-273	-241	-300	-273	-241	0.0%	0.0%	0.0%
Tax	-308	-205	-223	-308	-209	-227	0.0%	-1.9%	-2.0%
Net Income (reported)	238	291	330	238	297	335	0.0%	-2.2%	-1.5%
Net Income (underlying)	243	302	342	243	309	347	0.0%	-2.2%	-1.4%
<i>growth (%)</i>	<i>-47.0%</i>	<i>24.4%</i>	<i>13.2%</i>	<i>-47.0%</i>	<i>27.1%</i>	<i>12.3%</i>	<i>0pp</i>	<i>-3pp</i>	<i>1pp</i>
EPS (underlying)	0.50	0.62	0.70	0.50	0.63	0.71	0.0%	-2.2%	-1.4%
DPS	0.19	0.21	0.24	0.19	0.21	0.24	0.0%	-2.2%	-1.5%
Capex	805	777	752	805	777	753	0.0%	-0.1%	-0.1%
Net Debt	4,358	3,881	3,428	4,358	3,852	3,396	0.0%	0.7%	0.9%
ND/EBITDA	2.3	2.1	1.9	2.3	2.1	1.9			
FCF to equity	289	565	550	289	594	554	0.0%	-4.8%	-0.9%

Source: Citi Investment Research and Analysis

Company Focus

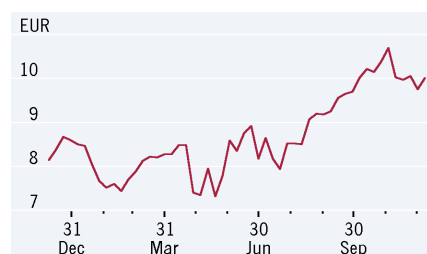
■ Company Update

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Hold/Medium Risk	2M
Price (09 Dec 10)	€10.00
Target price	€8.50
Expected share price return	-15.0%
Expected dividend yield	23.0%
Expected total return	8.0%
Market Cap	€8,759M
	US\$11,613M

Price Performance (RIC: PTC.LS, BB: PTC PL)



Portugal Telecom (PTC.LS)

Solid long term fundamentals, near term risk

- **Not hard to see long term upside** — PT plans to return a quarter of its market cap (including special dividends) by May 2011 and half its market cap by May 2015. The company has always met dividend commitments and more often than not exceeded them. Domestic cash flow generation is expected to grow progressively in the coming years as PT has completed (or already communicated and budgeted) the bulk of NGA investments and the fixed business is nearing EBITDA inflection. Assuming the deal with Oi is completed as planned; PT will inherit a poor asset in a great market. Given its proven track record of turnarounds, it may be able to extract significantly more in the medium term than the market's valuation of its stake, or the 6.3x 2009 EBITDA it expects to pay for its stake.
- **Valuation more attractive than headlines imply** — Adjusting for the special dividend, PT trades broadly in line on earnings and at a c.10% discount to the sector on FCF yield. This limits downside risk in our view.
- **But risky for now** — We anticipate downgrades and disappointment relating to TMN. This is down to macro pressure, MTR cuts and some aggressive pricing in the market (which we see as temporary). As service revenue decline runs at double digit rates, we expect to see EBITDA pressure, despite cost cutting. We also expect the market to be relatively cautious on Oi. Oi is increasing capex as it battles to stabilize its position and to launch new services (like pay TV) in order to offset the decline in fixed voice and access line migrations to GVT. Investors may also remain concerned about Portuguese sovereign risk, which in the past (April/May 2010) put the shares under pressure. We are surprised the shares have been unaffected by more recent concerns over Portugal and believe this leaves them exposed to some near term pressure. We see this more of a headwind than the driver of a big downward move, as shares are well supported by valuation.
- **Looking for a better entry point** — We expect 2011 to be a challenging year for PT, but still see merit in owning the shares. We believe it is time to take a back seat and wait for a better entry point, or for the negative news-flow and downgrade risk for domestic mobile to be well understood by the market. We reiterate our Hold recommendation, price target of €8.5 (excluding the special dividend).

Portugal Telecom (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	6,720.7	6,784.3	3,750.3	6,594.0	6,574.4
Net Income (€M)	636.5	636.5	468.3	777.9	818.8
Diluted EPS (€)	0.65	0.73	0.53	0.89	0.93
Diluted EPS (Old) (€)	0.65	0.73	0.53	0.89	0.93
PE (x)	15.4	13.8	18.7	11.3	10.7
EV/EBITDA (x)	6.3	6.7	9.7	5.4	5.9
DPS (€)	0.58	0.58	0.65	0.65	0.68
Net Div Yield (%)	5.7	5.7	6.5	6.5	6.8

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	15.6	14.0	19.0	11.4	10.8
EV/EBITDA adjusted (x)	6.3	6.7	9.7	5.4	6.0
P/BV (x)	37.6	6.7	1.3	1.3	1.3
Dividend yield (%)	5.7	5.7	6.4	6.4	6.7
Per Share Data (€)					
EPS adjusted	0.65	0.73	0.53	0.89	0.93
EPS reported	0.59	0.78	6.72	0.89	0.93
BVPS	0.27	1.50	7.58	7.81	8.07
DPS	0.58	0.58	0.65	0.65	0.68
Profit & Loss (€M)					
Net sales	6,721	6,784	3,750	6,594	6,574
Operating expenses	-5,664	-5,874	-3,193	-5,408	-5,397
EBIT	1,057	911	557	1,186	1,178
Net interest expense	-272	-302	-200	-222	-165
Non-operating/exceptionals	143	411	149	157	166
Pre-tax profit	927	1,020	506	1,121	1,179
Tax	-233	-233	-131	-302	-317
Extraord./Min.Int./Pref.div.	-120	-103	5,513	-41	-43
Reported net income	574	684	5,887	778	819
Adjusted earnings	637	637	468	778	819
Adjusted EBITDA	2,435	2,413	1,426	2,398	2,400
Growth Rates (%)					
Sales	9.3	0.9	-44.7	75.8	-0.3
EBIT adjusted	-5.4	-16.5	-29.2	71.8	-0.7
EBITDA adjusted	3.3	-0.9	-40.9	68.1	0.1
EPS adjusted	8.1	11.7	-26.4	66.1	5.3
Cash Flow (€M)					
Operating cash flow	1,976	1,738	1,145	2,020	2,106
Depreciation/amortization	1,268	1,438	736	1,212	1,223
Net working capital	17	-173	-150	-150	-100
Investing cash flow	-1,708	-868	4,728	-3,008	-1,151
Capital expenditure	-1,242	-1,268	-772	-1,217	-1,151
Acquisitions/disposals	-494	400	5,500	-1,791	0
Financing cash flow	-1,655	-637	-1,456	-1,398	-612
Borrowings	0	0	0	0	0
Dividends paid	-575	-589	-1,418	-1,398	-612
Change in cash	-1,189	43	5,116	-3,048	343
Balance Sheet (€M)					
Total assets	13,714	14,831	17,567	18,594	18,647
Cash & cash equivalent	1,125	1,518	6,605	3,557	3,900
Accounts receivable	1,394	1,538	3,868	1,838	1,938
Net fixed assets	4,638	4,862	2,759	6,281	6,209
Total liabilities	12,513	12,446	9,826	10,604	10,388
Accounts payable	1,374	1,339	720	720	720
Total Debt	6,696	7,046	7,017	7,017	7,017
Shareholders' funds	1,200	2,385	7,741	7,990	8,260
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	36.2	35.6	38.0	36.4	36.5
ROE adjusted	80.9	81.9	11.8	11.5	11.8
ROIC adjusted	10.5	6.9	5.3	7.4	6.2
Net debt to equity	464.3	231.8	5.3	43.3	37.7
Total debt to capital	84.8	74.7	47.5	46.8	45.9

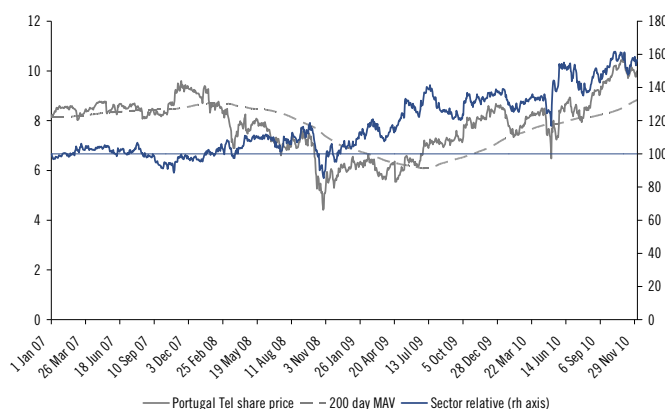
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Pause before the next move

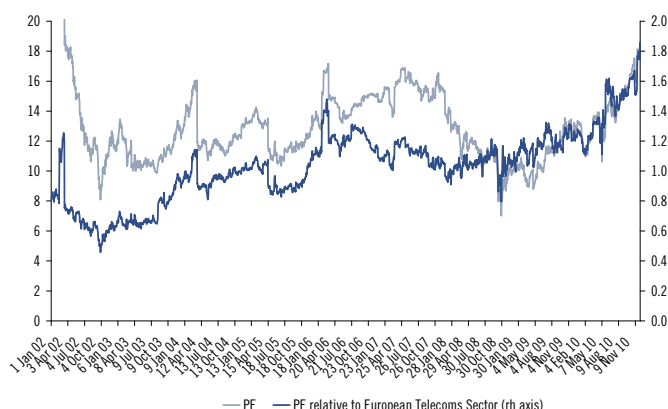
PT has invested heavily in upgrading its network since 2008 and has launched new services. We think it should now start to enjoy the fruits of this investment easing pressure on cash flow generation. The management remains focused on medium to long term value creation and the added balance sheet flexibility that PT enjoys post the sale of Vivo gives PT more time to invest in turning around Oi, assuming the deal goes through in 1Q 2011. This commitment to long term value creation is at the core of PT's success and what makes it a desirable medium term to long term investment. But 2011 looks to be a challenging year and we expect the stock (which has consistently outperformed peers and the market) to face some headwinds.

Figure 135. PT has outperformed the sector (left axis €/share; right axis index: end-2006=100)



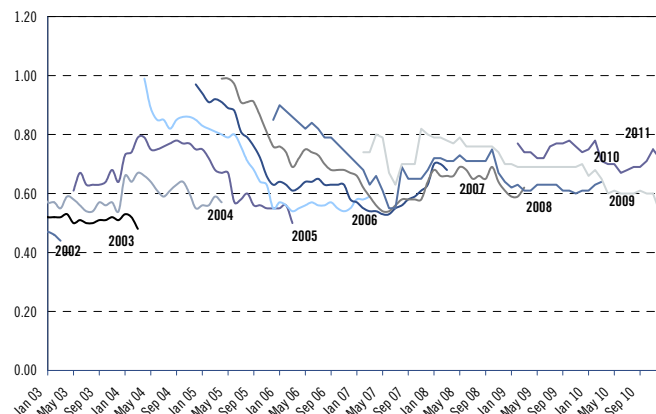
Source: DataStream

Figure 136. PT trades above the sector average on PE (1 year forward)



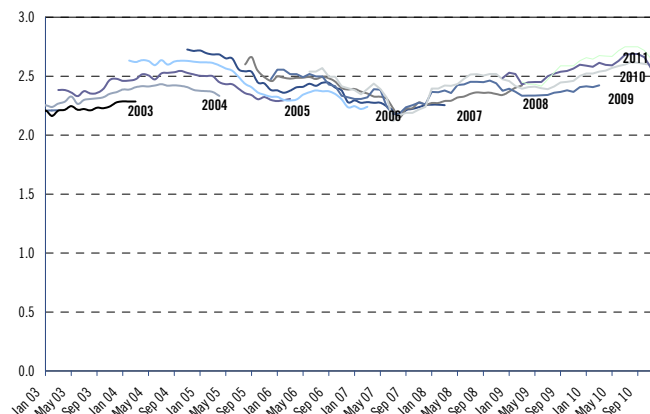
Source: DataStream

Figure 137. Consensus EPS down recently (€)



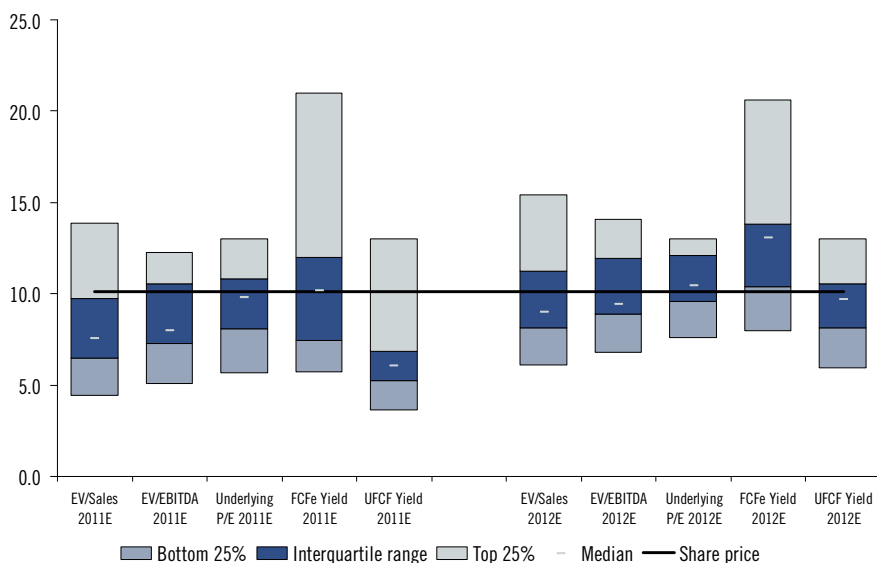
Source: DataStream

Figure 138. EBITDA consensus falls on sale of Vivo (€bn)



Source: DataStream

Figure 139. Compared to its incumbent and wireless peers in Europe PT trades above the median on our 2011 estimates and roughly at the median on 2012 estimates
€/share



Source: Powered by dataCentral

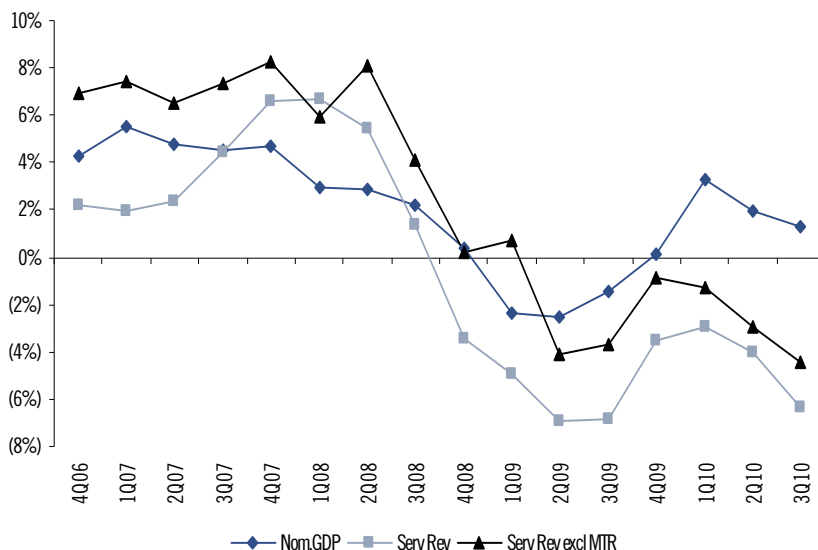
Upcoming events and news

- **Approval of first part of special dividend:** PT intends to pay €1/share dividend before the end of the year. We expect the board meeting approval in time for Christmas. The remaining €0.65/share special dividend (which requires approval at the AGM) will be paid together with the normal dividend (of also €0.65) in April/May 2011.
- **Completion of the Oi transaction:** We expect to get more clarity on the terms of the transaction in early 2011, with completion due before the end of 1Q 2011. The terms of the deal are yet to be finalized as there are a lot of moving parts at different parts of the structure. We expect the terms to be different from the initial expectations set in late July. The capital increase appears set to raise c.BRL7bn rather than the BRL9.5bn on which PT based its pro-forma estimates and the BRL12bn headline figure. We still expect the deal to go through with adjustments, but in line with PT's key conditions: PT will pay no more than R\$8.4bn for a stake of at least 22.38% and an implied multiple of 6.3x EV/EBITDA.
- **Spectrum:** The 800Mhz spectrum is going to be available in Portugal after April 2012, when the analogue switch-off is expected to take place. The intentions of the regulator in terms of the use of spectrum are unclear. We expect to get more clarity on whether the spectrum will be made available to the MNOs and when towards the end of the year.
- **New MTR announcement:** The current Portuguese MTR glide-path runs until end-2011. We expect Anacom to start a consultation in 2011 but past experience suggests that the final decision could come a few months later, so probably in 2012.

Domestic mobile to get worse before it gets better

We recently downgraded our estimates for TMN, following a disappointing quarter and the announcement of further austerity measures, which should continue to impact the mobile market more than the fixed. We look for 11.5% service revenue decline in 1H 2011. This is not a problem that is specific to TMN, which has managed to defend its revenue market share very effectively.

Figure 140. Service revenue growth of the mobile market (YoY)



Source: Citi Investment Research and Analysis based on company reports

But austerity and MTR cuts to drive a significant deterioration in service revenue for the market as a whole. We estimate c.-2ppt impact from MTR cuts in 1H 2011 vs 3Q 2010 and another -1.5ppt from austerity measures. More rational pricing should mitigate but it is unlikely for the market to turn until 2H 2011, maybe even 2012.

Oi turnaround needs more investment

Oi hosted its investor day in New York on November 30th. The key takeaway was that the company needed to increase its investment intensity materially in the coming years to leverage demand for fixed and mobile broadband and halt market share losses in both markets. In response, we increased our 2011 capex estimates by 20% to R\$4.93bn. The increased capex for 2011 will negatively impact PT's consolidated FCF generation by c.€92m.

Sum of Parts Valuation

Both on a relative (after adjusting for the special dividend) and an absolute basis, PT is attractive in our view. Our DCF based valuation stands at €9.7/share, by using a WACC of 9.6% for the Portuguese business. Our target price is derived by our SOP valuation, which 15% lower at €8.2/share. We take the view that Portuguese assets could trade at depressed valuations and below fair value until the market gets more comfortable with the sovereign situation.

Figure 141. Sum of Parts

Asset	Stake (%)	EV (€m)	Net (debt) (€m)	PT stake (€m)	Per Share Value (€)	As a % of Group EV	Implied 2011E EV/EBITDA	Metric
Wireline	100.0%	3,482		3,482	4.0	30.4%	4.7x	Peer multiple
Domestic Mobile (TMN)	100.0%	2,438		2,438	2.8	21.3%	4.2x	Peer multiple
Telemar	22.38%	22,271	(2,560)	4,411	5.0	38.5%	4.8x	Peer multiple adj for shared control
less Brasil Tel minority				(803)	(0.9)	(7.0%)	4.8x	Multiple matching Telemar
MTC (Namibia)	25.50%	314		80	0.1	0.7%	3.6x	FY11E EBITDA (€87m)
Dedic (Brazilian call centre)	87.50%	257		225	0.3	2.0%		1.0x FY11E sales (R\$625m)
CVT (Cape Verde)	30.00%	267		80	0.1	0.7%	8.0x	FY11E EBITDA (€87m)
CST (Sao Tome)	38.25%	52		20	0.0	0.2%	12.2x	FY11E EBITDA (€4m)
Consolidated Assets				9,934	11.3	86.7%		
Unitel (Angola)	18.75%	4,958		930	1.1	8.1%	7.0x	FY11E EBITDA (€708m)
CTM (Macau)	28.00%	606		170	0.2	1.5%	5.4x	FY11E EBITDA (€112m)
UOL (Brazilian ISP)	29.00%	474		137	0.2	1.2%		Market Value
Directories	25.00%	180		45	0.1	0.4%		
East Timor	41.12%	122		50	0.1	0.4%	6.2x	FY11E EBITDA (€20m)
Other		190		190	0.2	1.7%		Guinea-Bissau, Mozambique, Botswana
Total Other Assets				1,522	1.7	13.3%		
Group Enterprise Value				11,455	13.1	100.0%		
FY11E Net (Debt)				(3,460)	(4.0)	(30.2%)		
less Telemar net debt included above				573	0.7	5.0%		
Unfunded Pension Liabilities				(1,118)	(1.3)	(9.8%)		3Q10 after tax liability + no additional contrib.
Group Equity Value				7,450	8.5	65.0%		

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Target Price Change
- Transfer of Coverage

Georgios Ierodionou
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georgios.ierodionou@citi.com

Buy/Low Risk	1L
Price (09 Dec 10)	SFr418.50
Target price	SFr440.00
	<i>from SFr410.00</i>
Expected share price return	5.1%
Expected dividend yield	5.0%
Expected total return	10.2%
Market Cap	SFr21,679M
	US\$21,972M

Price Performance (RIC: SCMN.VX, BB: SCMN VX)



Swisscom AG (SCMN.VX)

Swiss safe heaven

- **Domestic competitive outlook remains supportive** — The Swiss market is rational. Sunrise, with new private equity parents, is attempting to grow in mobile data rather than via low-end customers. The recent agreed reduction of MTRs is unlikely to drive price cuts, as none of the operators has an incentive to see a price war to stimulate (or gain share in) mobile voice.
- **Mobile data to be distinguished by speed** — In contrast to much of Europe's move to tiered data tariffs (by download volume), Swisscom is distinguishing its tariffs based upon speed (high: 28Mb/s / low: 7.2Mb/s). Mobile data remains priced at a significant premium (3-5x) over fixed broadband and so the threat of substitution remains modest.
- **Comprehensive spectrum auction expected in 2011** — Licenses for GSM spectrum expire in 2013, for UMTS it is 2016. The Swiss regulator is expected to aggregate both and reauction in 2011. More detail is expected in the next few months, but this surely provides an opportunity to reallocate and repurpose spectrum in advance of LTE rollouts. We do not think that costs should be a concern; in the past the regulator has accepted minimal payments (c.SFr50m/technology). 800MHz may come in addition.
- **Fibre focus in fixed** — Investment is being sensibly split with utility companies. Swisscom is offering access to NGA to its retail customers, while utility companies offer wholesale products to Swisscom's competitors: We do not see a compelling case for alternative providers (especially ULL operators) to migrate to these products.
- **M&A to come?** — Italy is likely to be the centre of any M&A as according to management there is no M&A likely in Switzerland which will "move the [cash flow] needle". One asset looms large: Albacom, BT's Global Service outpost in Italy has been frequently mentioned in press speculation, while BT has repeatedly denied any interest in selling. Tiscali is another quick way to gain scale and synergy value, but agreeing on price may prove difficult.
- **Outlook** — Swisscom continues to offer a stable macro environment and core operations with upside from mobile data. We roll forward our DCF- valuation and increase our price target to CHF440 from CHF410. The Fastweb minorities offer makes financial sense, however it has reduced the expected dividend, we forecast CHF21/share. The main risk is M&A, where Swisscom has a mixed track record. The market could accept a sensible deal in Italy, even if it means lower dividend growth (and/or no buybacks) in the medium term. But as Fastweb's growth has started to disappoint, Swisscom may see a deal as necessity rather than an option and could be more flexible than its shareholders would like. With this note we transfer coverage to Georgios Ierodionou from Simon Weeden.

Swisscom AG (CHF)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (SFrM)	12,198.0	12,001.0	11,929.6	11,873.2	12,014.5
Net Income (SFrM)	1,756.0	1,928.0	1,805.9	1,945.1	2,109.5
Diluted EPS (SFr)	33.90	37.22	34.86	37.55	40.72
Diluted EPS (Old) (SFr)	33.90	37.22	34.86	37.55	40.72
PE (x)	12.3	11.2	12.0	11.1	10.3
EV/EBITDA (x)	6.7	6.8	6.6	6.4	6.1
DPS (SFr)	19.00	20.00	21.00	24.00	26.00
Net Div Yield (%)	4.5	4.8	5.0	5.7	6.2

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	12.3	11.2	12.0	11.1	10.3
EV/EBITDA adjusted (x)	6.7	6.8	6.6	6.4	6.1
P/BV (x)	4.0	3.4	3.0	2.7	2.5
Dividend yield (%)	4.5	4.8	5.0	5.7	6.2
Per Share Data (\$Fr)					
EPS adjusted	33.90	37.22	34.86	37.55	40.72
EPS reported	33.90	37.22	34.86	37.55	40.72
BVPS	104.03	123.73	137.43	153.11	168.97
DPS	19.00	20.00	21.00	24.00	26.00
Profit & Loss (\$FrM)					
Net sales	12,198	12,001	11,930	11,873	12,014
Operating expenses	-9,558	-9,323	-9,237	-9,057	-9,005
EBIT	2,640	2,678	2,692	2,817	3,009
Net interest expense	-488	-336	-386	-316	-303
Non-operating/exceptionals	47	43	45	45	45
Pre-tax profit	2,199	2,385	2,352	2,546	2,751
Tax	-448	-460	-561	-601	-641
Extraord./Min.Int./Pref.div.	5	3	15	0	0
Reported net income	1,756	1,928	1,806	1,945	2,109
Adjusted earnings	1,756	1,928	1,806	1,945	2,109
Adjusted EBITDA	4,789	4,666	4,677	4,719	4,788
Growth Rates (%)					
Sales	10.0	-1.6	-0.6	-0.5	1.2
EBIT adjusted	5.0	1.4	0.5	4.6	6.8
EBITDA adjusted	6.4	-2.6	0.2	0.9	1.5
EPS adjusted	-15.1	9.8	-6.3	7.7	8.5
Cash Flow (\$FrM)					
Operating cash flow	4,111	4,380	3,801	3,803	3,844
Depreciation/amortization	2,149	1,988	1,985	1,903	1,779
Net working capital	-277	0	70	0	0
Investing cash flow	-1,751	-1,061	-1,935	-1,846	-1,794
Capital expenditure	-2,050	-1,987	-1,935	-1,846	-1,794
Acquisitions/disposals	172	812	0	0	0
Financing cash flow	-2,283	-3,744	-1,036	-1,088	-1,243
Borrowings	-715	-1,963	0	0	0
Dividends paid	-1,036	-984	-1,036	-1,088	-1,243
Change in cash	48	-426	829	869	806
Balance Sheet (\$FrM)					
Total assets	22,738	21,960	22,740	23,552	24,374
Cash & cash equivalent	1,811	956	1,529	2,398	3,204
Accounts receivable	2,798	2,926	2,926	2,926	2,926
Net fixed assets	8,070	8,044	8,251	8,194	8,209
Total liabilities	16,975	15,232	15,302	15,302	15,302
Accounts payable	2,186	2,314	2,384	2,384	2,384
Total Debt	11,792	10,010	10,010	10,010	10,010
Shareholders' funds	5,763	6,728	7,438	8,250	9,072
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	39.3	38.9	39.2	39.7	39.9
ROE adjusted	32.0	32.7	26.7	25.8	25.3
ROIC adjusted	12.5	12.9	12.3	12.7	13.6
Net debt to equity	173.2	134.6	114.0	92.3	75.0
Total debt to capital	67.2	59.8	57.4	54.8	52.5

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Swisscom performance and outlook

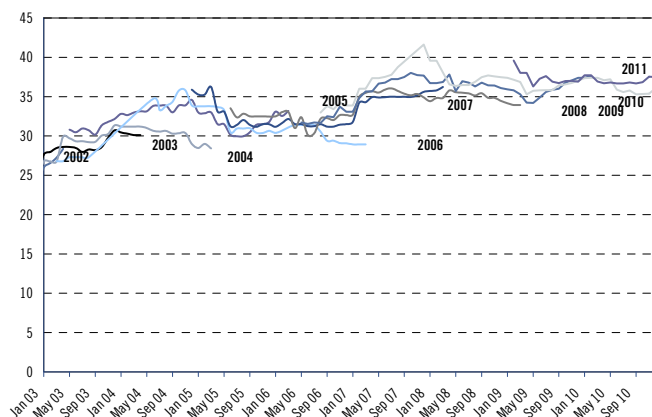
Swisscom has been a steady performer in recent years: a solid domestic business and very low exposure to macro risks means it is still regarded by some as a 'safe haven'. And the premium valuation is justified in our view. But Swisscom has disappointed in terms of shareholder returns over the past 3-4 years. At a time when some of the larger and traditionally more acquisitive companies in the sector have pledged more of their cash flow to shareholder returns (rather than M&A), Swisscom's shareholders have seen only modest increases in shareholder returns (in c.5% increments) and no buybacks. At these levels, we believe that for the shares to make further progress, the company needs to increase returns or leave scope for potential positive surprise in the medium term.

Figure 142. Swisscom has steadily outperformed the sector since mid-08 (left axis SFr/share; right axis index: end-2006=100)



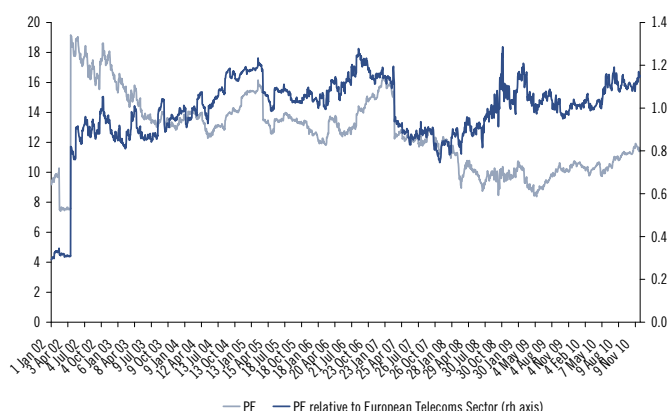
Source: DataStream

Figure 144. Consensus EPS has been slowly improving (SFr)



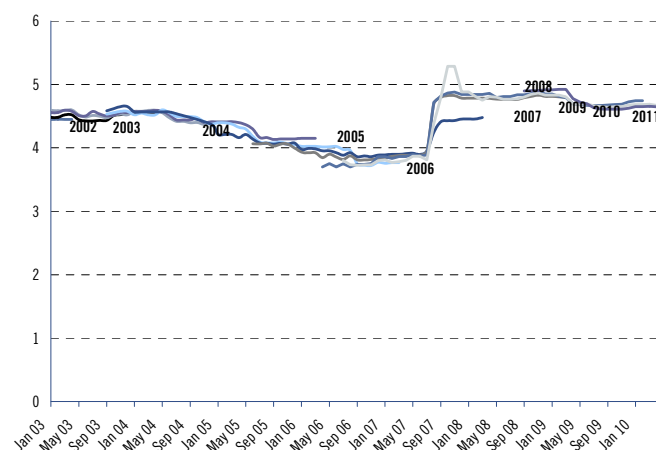
Source: DataStream

Figure 143. Swisscom trades above the sector average on PE and the premium has lately been rising (1 year forward)



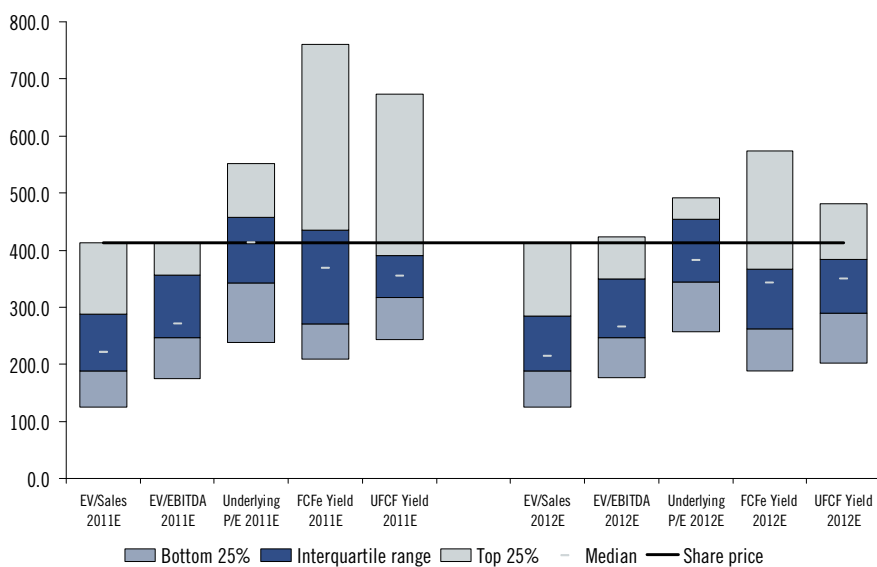
Source: DataStream

Figure 145. EBITDA consensus has been stable (SFrbn)



Source: DataStream

Figure 146. Compared to its incumbent and wireless peers in Europe Swisscom trades at a premium SFr/share



Source: Powered by dataCentral

Company Focus

- Company Update
- Estimate Change
- Transfer of Coverage

Laurie Fitzjohn-Sykes, CFA
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laurie.fitzjohnsykes@citi.com

Hold/Medium Risk	2M
Price (09 Dec 10)	SKr146.50
Target price	SKr150.00
Expected share price return	2.4%
Expected dividend yield	4.3%
Expected total return	6.6%
Market Cap	SKr65,054M
	US\$9,463M

Price Performance (RIC: TEL2b.ST, BB: TEL2B SS)

Tele2 AB (TEL2b.ST)
Beware of the Bear

- **Short term momentum, longer term risks** – Tele2's operations in Russia and Sweden are performing strongly. We do not see a reason for this to change in the short term. However in relation to Russia we highlight longer term risks from the lack of a data network and the threat from a stronger competitor when Svazinvest's merger is complete. Russia is 47% of our SOTP, Sweden 30%.
- **Russian growth** – Operational trends remain strong as Tele2 increases its market share within new regions, underlying Russian revenue growth in 3Q10 was 39%. In addition Russian EBITDA grew 66% as margins in the old regions increased to 48%.
- **Russian longer term risks** – Tele2 does not have a 3G license and it looks unlikely that it will secure a 4G license in Russia. Tele2 is currently positioned as a discount voice operator, offering some data services via EDGE. The question is when the lack of a data network will start to weigh on growth. While this may not be for a few years, we argue that it is still a significant risk which should be reflected in the valuation.
- **Swedish mobile growth** – The Swedish mobile market continues to have significantly higher growth than other European markets, 3Q10 growth excl MTR cuts of 8.9% vs European average 2.2%. Tele2 gained market share in 3Q10 as it is successfully expanding into the post-paid segment.
- **Tax dispute and special dividend** – Tele2 is expecting to hear the result of its tax dispute by mid January. The total potential liability is SEK 4.6bn (7.5% of market cap) we argue that Tele2 is unlikely to lose this case, consensus has not factored in a payment. A positive resolution in this case should allow Tele2 to confirm a special dividend in February 2011. This could be in the region of SEK 10/share, which would only increase leverage to 0.5x 2011E net debt/EBITDA.
- **Forecast changes** - We increase our 2010E EPS by 1.1% and cut our 2011E EPS forecast by -1.5%. This is driven by updating for recent FX changes as well as a small reduction in our Russian margin assumption due to increased price competition from the main three operators. With this note we transfer coverage to Laurie Fitzjohn Sykes from Simon Weeden.

Tele2 AB (SEK)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (SKrM)	39,505.0	39,265.0	40,115.0	40,246.4	42,010.4
Net Income (SKrM)	2,411.0	4,519.0	6,637.6	5,169.7	5,878.5
Diluted EPS (SKr)	5.47	10.24	15.03	11.71	13.31
Diluted EPS (Old) (SKr)	5.47	10.24	14.89	11.88	13.67
PE (x)	26.8	14.3	9.7	12.5	11.0
EV/EBITDA (x)	8.0	6.9	6.0	5.8	5.2
DPS (SKr)	5.00	5.85	6.24	6.90	7.64
Net Div Yield (%)	3.4	4.0	4.3	4.7	5.2

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	27.1	14.5	9.9	12.7	11.1
EV/EBITDA adjusted (x)	8.1	7.0	6.0	5.9	5.2
P/BV (x)	2.3	2.3	2.0	1.9	1.7
Dividend yield (%)	3.4	3.9	4.2	4.7	5.1
Per Share Data (\$K)					
EPS adjusted	5.47	10.24	15.03	11.71	13.31
EPS reported	5.47	10.24	15.03	11.71	13.31
BVPS	63.93	64.49	73.71	79.21	85.66
DPS	5.00	5.85	6.24	6.90	7.64
Profit & Loss (\$K)					
Net sales	39,505	39,265	40,115	40,246	42,010
Operating expenses	-34,800	-33,629	-33,299	-33,378	-34,266
EBIT	4,705	5,636	6,816	6,868	7,745
Net interest expense	-400	-358	-397	-154	-10
Non-operating/exceptionals	-2,467	-251	694	0	0
Pre-tax profit	1,838	5,027	7,114	6,714	7,735
Tax	-120	-426	-516	-1,544	-1,856
Extraord./Min.Int./Pref.div.	693	-82	40	0	0
Reported net income	2,411	4,519	6,638	5,170	5,879
Adjusted earnings	2,411	4,519	6,638	5,170	5,879
Adjusted EBITDA	8,175	9,185	10,394	10,618	11,725
Growth Rates (%)					
Sales	-9.0	-0.6	2.2	0.3	4.4
EBIT adjusted	79.6	19.8	20.9	0.8	12.8
EBITDA adjusted	23.0	12.4	13.2	2.2	10.4
EPS adjusted	245.8	87.2	46.9	-22.1	13.7
Cash Flow (\$K)					
Operating cash flow	7,896	9,118	9,977	8,919	9,859
Depreciation/amortization	3,470	3,549	3,577	3,750	3,981
Net working capital	107	922	274	0	0
Investing cash flow	-2,680	-954	-5,205	-5,663	-5,231
Capital expenditure	-4,608	-4,340	-4,072	-5,663	-5,231
Acquisitions/disposals	1,597	3	-1,133	0	0
Financing cash flow	-6,379	-8,075	-3,950	-2,746	-3,039
Borrowings	-2,433	-5,872	-1,700	0	0
Dividends paid	-3,492	-2,202	-2,580	-2,746	-3,039
Change in cash	-1,209	62	725	510	1,589
Balance Sheet (\$K)					
Total assets	47,133	40,379	44,702	47,126	49,965
Cash & cash equivalent	4,609	1,426	2,151	2,661	4,251
Accounts receivable	7,815	5,770	7,832	7,832	7,832
Net fixed assets	15,566	15,344	15,838	17,752	19,002
Total liabilities	18,932	11,914	12,179	12,179	12,179
Accounts payable	2,095	1,888	1,829	1,829	1,829
Total Debt	9,561	3,597	3,949	3,949	3,949
Shareholders' funds	28,201	28,465	32,523	34,947	37,786
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	20.7	23.4	25.9	26.4	27.9
ROE adjusted	8.8	16.0	21.8	15.4	16.2
ROIC adjusted	15.9	18.9	22.4	17.2	18.1
Net debt to equity	17.6	7.6	5.5	3.7	-0.8
Total debt to capital	25.3	11.2	10.8	10.2	9.5

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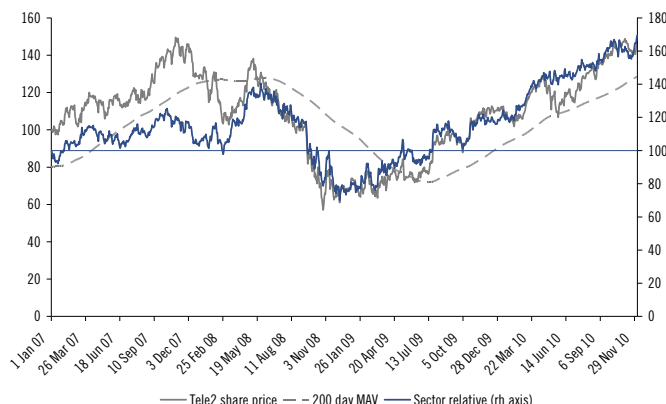


Tele2 performance and outlook

Tele2's operations in Sweden and Russia have performed strongly throughout 2010 leading to forecast upgrades and strong share price performance. We do not see a reason for this to change in the short term, however we highlight the longer term risks in Russia from not having a data network and the risk from a merged Svyazinvest/RTOs/Rostelecom in 1-2 years. In the short term there is also the risk around the tax court case, while we argue that Tele2 should win this case, the potential liability is large (SEK 4.6bn 7.5% market cap) and consensus has not factored in any payment or a significant special dividend if they win the case.

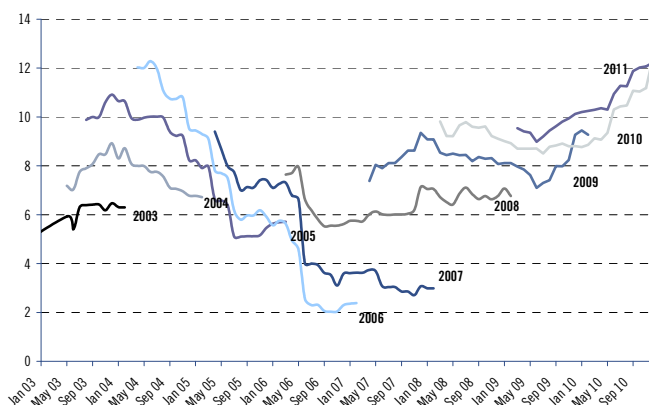
Tele2 trades at a premium to the sector due to its higher growth profile. On our forecasts Tele2 trades on 6.3x 2011 EV/EBITDA a 25% premium to the sector. We forecast 8.6% 2011-14 EBITDA CAGR, vs the sector average of 1.4%. We argue that the strong operations are already reflected in the valuation premium, due to the longer term risks around Russia we do not see any further upside.

Figure 147. Tele2 has performed strongly since mid-09 (left axis SEK/share; right axis index: end-2006=100)



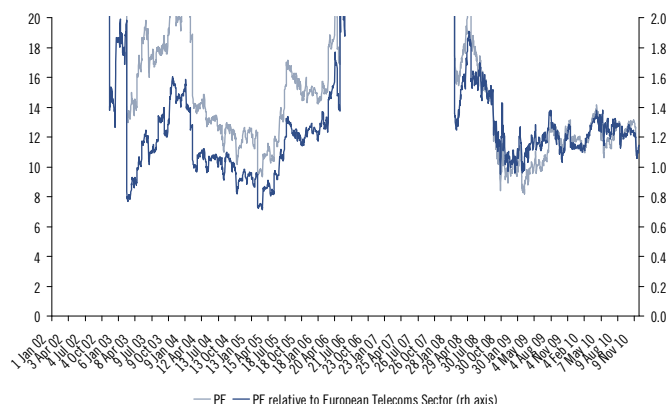
Source: DataStream

Figure 149. Consensus EPS has seen consistent upgrades (SEK)



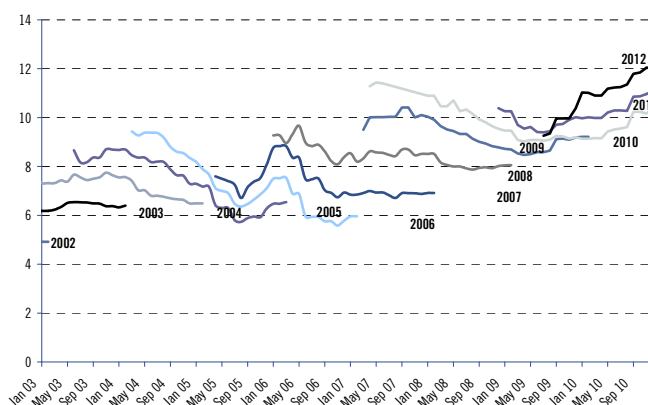
Source: DataStream

Figure 148. Tele2 trades slightly above the sector average on PE (1 year forward)



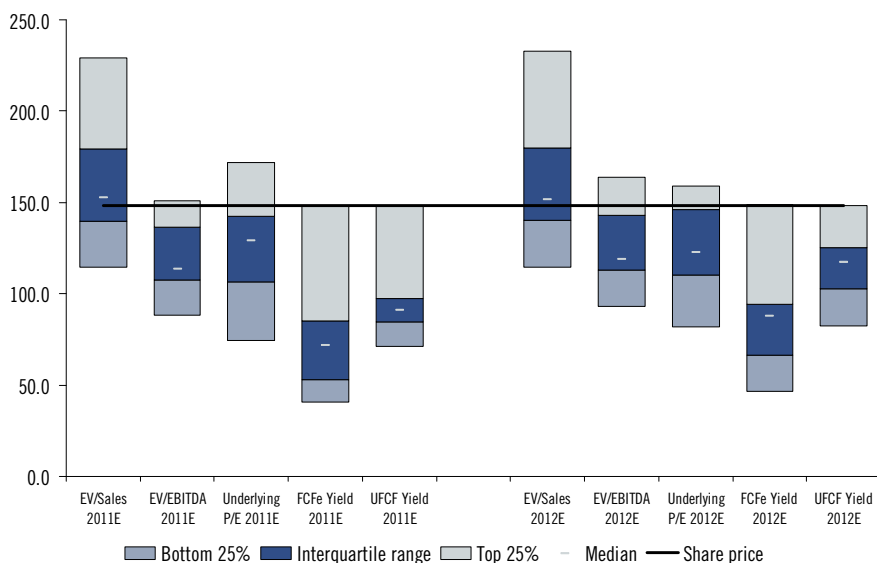
Source: DataStream

Figure 150. EBITDA consensus has seen consistent upgrades (SEKbn)



Source: DataStream

Figure 151. Compared to its incumbent and wireless peers in Europe Tele2 trades at or above the upper quartile on both our 2011 and 2012 estimates
SEK/share

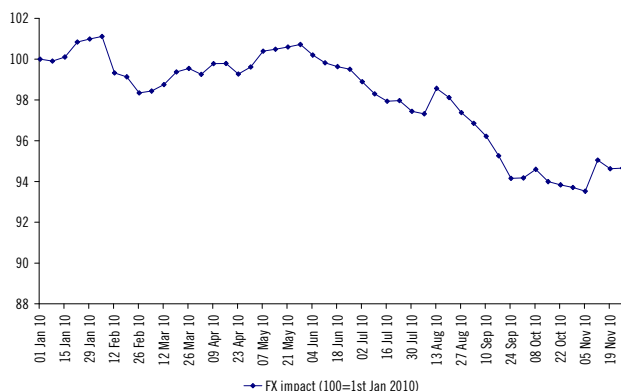


Source: Powered by dataCentral

Currency Risk

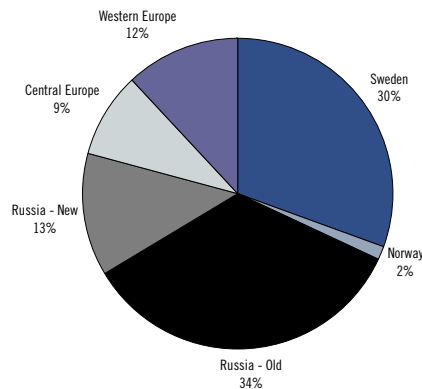
Tele2's main currency exposure is to the Russian Ruble and the Euro. Russia is 35% of 2010E EBITDA, Euro denominated EBITDA is 23% of total. There has been a negative impact on Tele2 from the appreciation of SEK in 2H10, this will come through as an FX headwind on growth in 2011.

Figure 152. FX changes impact on the SOTP



Source: Citi Investment Research and Analysis

Figure 153. EV SOTP split

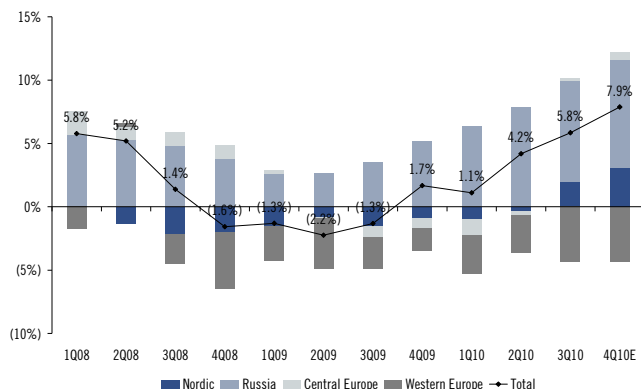


Source: Citi Investment Research and Analysis

Russia driving revenue growth

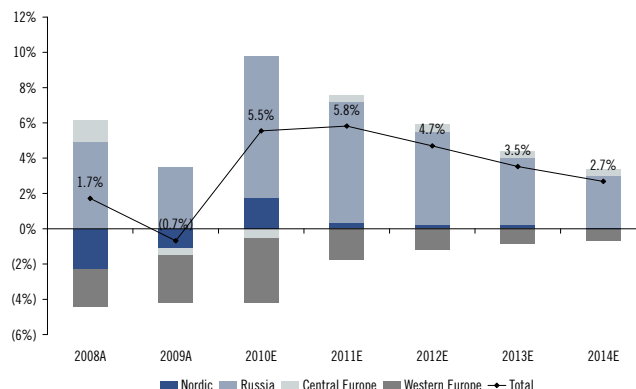
Russia continues to drive group revenue growth and we forecast this should continue for at least the next few years. We calculate the Tele2 has a c.18% revenue market share within the old regions and c.10% within the new regions. We forecast the new region market share increasing to c.21% along with the old regions.

Figure 154. Local currency revenue growth, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 155. Local currency revenue growth, yearly

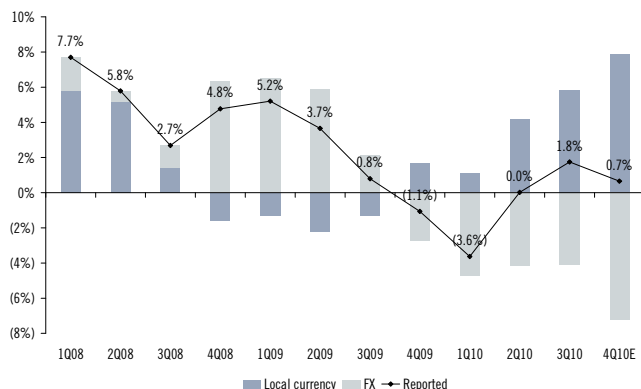


Source: Company reports, Citi Investment Research and Analysis

FX headwind increasing in 4Q10 and continuing into 2011

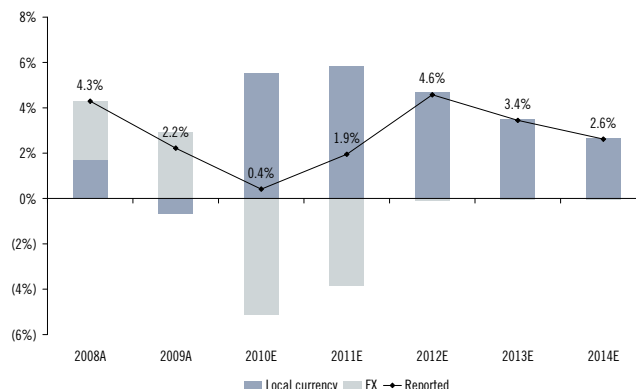
We forecast the FX headwind increasing from -4.1ppt on revenue in 3Q10 to -7.2ppt in 4Q10 and -3.9ppt in 2011.

Figure 156. Revenue growth and FX impact, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 157. Revenue growth and FX impact, yearly

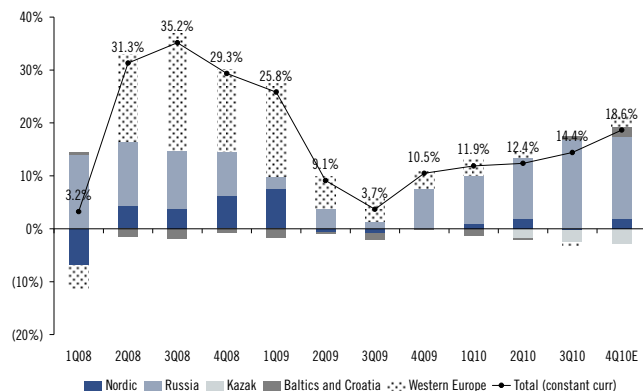


Source: Company reports, Citi Investment Research and Analysis

Kazakhstan investment to depress EBITDA in 2011

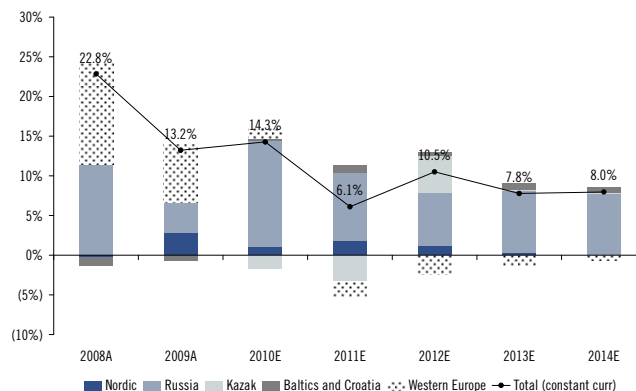
Tele2 plans to re-launch its operations in Kazakhstan in 1H11 which will depress EBITDA in 2011. Other than this EBITDA should be driven by growth in Russia. Tele2 guides that new regions in Russia reach breakeven within 18 months, the last new regions were launched in 4Q09, therefore the new regions should become EBITDA positive in 2H11.

Figure 158. Local currency EBITDA growth, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 159. Local currency EBITDA growth, yearly



Source: Company reports, Citi Investment Research and Analysis

Longer term risk in Russia

Tele2 has been gaining market share rapidly in Russia by positioning itself as a discount voice operator. Tele2 did not secure a 3G license, however it does provide data services via 2.5G Edge. We highlight the risk that as data take-up increases Tele2's competitive position will worsen. The three main operators have 3G licenses and offer data services. We argue the falling 3G handset prices will increase data take-up in emerging markets sooner than expected.

One solution for Tele2 would be to secure a 4G license, however we argue that the most likely winners of the 4G licenses are the current 3 main operators and the merged entity of Svyazinvest/RTOs/Rostelecom.

In addition to the lack of a data network there is the risk of a resurgent Svyazinvest post the current planned merger between Rostelecom and the RTOs (regional telecoms operators). This is a complex merger process which will take 1-2 years. However the end result will most likely be a merged entity with a significant government stake. The RTOs mobile operations are currently losing market share, we highlight the risk they may become more effective competition to Tele2.

Leverage, Dividends

- **Dividend policy:** Target a progressive ordinary dividend over medium term
- **Leverage policy:** Net debt/EBITDA should be in line with industry and markets Tele2 operates in

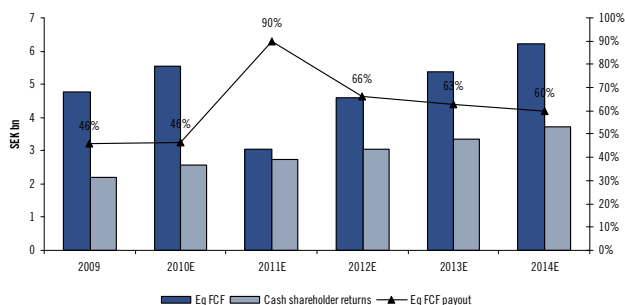
Tele2 targets leverage to be in-line with the industry, however leverage is currently significantly lower than this at 0.2x 2010 net debt/EBITDA on our numbers, vs the sector average of 1.9x. Therefore there is scope for a significant increase in leverage, through shareholder returns or further acquisitions.

One reason for the current low leverage is an outstanding tax case, which has a total potential liability of SEK 4.6bn, 7.5% of market cap. This relates to a tax loss booked by Tele2 in 2001 from the fall in value of an asset. The county administrative court has said this was not a real loss, the case has now been put forward to the administrative court of appeal.

Tele2 does not believe it should have to pay this amount, however it does view the potential liability as debt and therefore is unlikely to announce a special dividend until this matter is resolved. Consensus currently does not factor any payment in for this tax case.

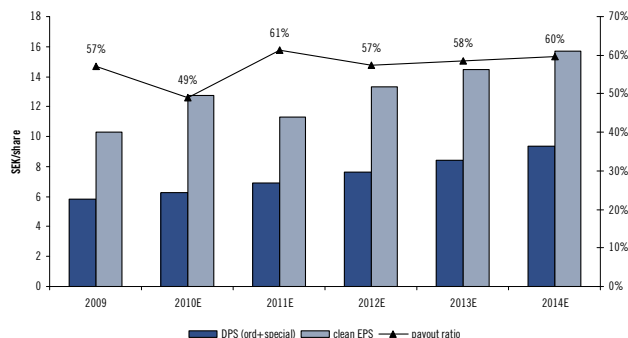
Tele2 expects a decision on this tax case by end of January, which in the case of a favourable decision would open the way for the February board meeting to decide a special dividend. A special dividend could be in the region of SEK 10/share which would only take leverage to 0.5x 2011 net debt/EBITDA. We forecast a special dividend of SEK 2.0/share, balancing the risk of the tax case.

Figure 160. Cash Shareholder returns payout ratio – 2010 Eq FCF benefits from temporarily low capex and positive working capital



Source: Company reports, Citi Investment Research and Analysis

Figure 161. Dividend payout ratio – We forecast a steady payout of c.60% for the ordinary and special dividend combined



Source: Company reports, Citi Investment Research and Analysis

Upcoming news flow

- **Tax dispute** – Expect a decision on tax dispute mentioned above by end January.
- **Special dividend announcement** – A favourable decision in the tax case should open the way for a special dividend announcement.
- **Russian additional 2G licenses** – There are 32 2G licenses coming up for sale in Urals, Siberia and the Far East. 24 of these were previously auctioned but were handed back. We expect the auction by the end of 2010 or early in 2011. We expect Tele2 to be interested in these licenses.
- **Ongoing news flow on Svyazinvest/Rostelecom/RTO merger** – Svyazinvest is in the process of merging with the RTOs and Rostelecom. This impacts Tele2 due to the likelihood of Tele2 securing the 4G license.

Valuation

Figure 162. SOTP Valuation

Division	Stake	Enterprise value	Net (debt) 2011	Valuation Method	Tele2 equity	% of Tele2 EV	Value/ share	EV/ Sales	EV/ EBITDA
Sweden	100%	21,085	0	6.0x 2011 EV/EBITDA	21,085	31.3%		1.7x	6.0x
Norway	100%	1,017	0	5.0x 2011 EV/EBITDA	1,017	1.5%		0.4x	5.0x
Russia – Old regions	100%	22,008	0	5.2x 2011 EV/EBITDA	22,008	32.7%		2.4x	5.2x
Russia – New regions	100%	8,607	0	5.0x 2015 EV/EBITDA	8,607	12.8%		2.8x	
Estonia	100%	1,005	0	4.5x 2011 EV/EBITDA	1,005	1.5%		1.1x	4.5x
Lithuania	100%	2,003	0	4.5x 2011 EV/EBITDA	2,003	3.0%		1.6x	4.5x
Latvia	100%	1,644	0	4.5x 2011 EV/EBITDA	1,644	2.4%		1.4x	4.5x
Croatia	100%	1,124	0	0.8x 2011 EV/Sales	1,124	1.7%		0.8x	12.5x
Kazakhstan	100%	181	0	1.0x 2011 EV/Sales	181	0.3%		1.0x	(0.4x)
Netherlands	100%	6,875	0	4.5x 2011 EV/EBITDA	6,875	10.2%		1.3x	4.5x
Germany	100%	1,156	0	4.0x 2011 EV/EBITDA	1,156	1.7%		1.0x	4.0x
Austria	100%	1,048	0	4.0x 2011 EV/EBITDA	1,048	1.6%		0.7x	4.0x
Other	100%	(400)	0	5.0x 2011 EV/EBITDA	(400)	(0.6%)		(0.4x)	5.0x
Total		67,354			67,354		152.9	1.7x	6.3x
Net debt (2011)					(1,288)				
Total Core					66,066		150.0		

Source: Citi Investment Research and Analysis

Figure 163. DCF Valuation (SEK m)

Year to Mar	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
EBITDA	9,185	10,394	10,618	11,725	12,621	13,609	14,366	14,477	14,559	14,615	14,675	14,739
Mvt in working capital	1,174	924	0	0	0	0	0	0	0	0	0	0
Capex	(4,340)	(4,072)	(5,663)	(5,231)	(5,143)	(4,976)	(4,710)	(4,603)	(4,662)	(4,713)	(4,768)	(4,824)
Tax paid	(883)	(944)	(1,544)	(1,856)	(2,124)	(2,490)	(2,681)	(2,710)	(2,733)	(2,746)	(2,757)	(2,766)
Interest paid	(358)	(397)	(154)	(10)	26	71	126	184	235	277	308	327
FCF	4,778	5,905	3,256	4,628	5,380	6,215	7,101	7,347	7,399	7,432	7,458	7,476
Adjustments												
Interest & dividends	358	397	154	10	(26)	(71)	(126)	(184)	(235)	(277)	(308)	(327)
Tax shield on interest	(95)	(105)	(41)	(3)	7	19	33	49	62	73	82	87
Unlevered FCF	5,041	6,197	3,369	4,636	5,360	6,162	7,008	7,212	7,227	7,229	7,232	7,235
Cost of capital											€ mn	£/share
Market gearing (D/E)	33.0%						Value of yrs 1-7 cash flows				33,873	76.9
Weight average tax rate	26.5%		Equity market premium		5.0%		Terminal Value				33,474	76.0
Risk free rate	4.0%		Asset beta		1.50		Enterprise value				67,347	152.9
Bond spread	2.8%		Geared beta		1.87		Post BS events					0.0
Cost of debt	6.8%		Cost of equity		13.4%		Net debt (2011)				(1,288)	(2.9)
WACC	11.3%						Equity value				66,060	150.0
							Dividend exc from net debt				0	0.0
Perpetuity growth (post yr 9)	1.5%						Price objective ex div					150.0

Source: Citi Investment Research and Analysis

Forecast Changes

We increase our 2010E EPS by 1.1% and cut our 2011E EPS forecast by -1.5%. This is driven by updating for recent FX moves as well as the following changes.

- **Russia** – We have marginally increased our revenue growth assumptions for Russia due to remodeling on a more granular basis. However we have cut our margin assumptions due to increased price competition from the main three operators.
- **Special dividend** - We have increased our forecast for a special dividend due to the current low leverage level.

Figure 164. Forecast Changes (SEK m)

	New Forecasts			Diff.			
	2010E	2011E	2012E		2010	2011	2012
Net Sales							
Sweden	12,167	12,303	12,412		1.1%	(0.7%)	(0.8%)
Norway	3,008	2,851	2,839		(0.1%)	(0.9%)	(0.9%)
Russia	10,379	12,235	14,173		(0.3%)	1.0%	3.2%
Total	40,115	40,246	42,010		0.1%	(0.4%)	0.6%
EBITDA							
Sweden	3,359	3,514	3,551		1.3%	1.8%	0.4%
Norway	176	203	300		(0.1%)	(0.9%)	(0.9%)
Russia	3,651	4,263	4,950		(0.2%)	(1.9%)	(0.4%)
Total	10,394	10,618	11,725		0.2%	(0.5%)	(1.1%)
One off items	510	0	0				
Depreciation and amortisation	(3,577)	(3,750)	(3,981)		0.1%	0.5%	1.4%
Associate companies	75	0	0				
EBIT	7,401	6,868	7,745		0.2%	(1.1%)	(2.4%)
Net interest expenses	(397)	(154)	(10)		1.4%	18.9%	(276.2%)
Other financial items	109	0	0				
PBT	7,114	6,714	7,735		1.1%	(1.5%)	(2.6%)
Tax	(516)	(1,544)	(1,856)		3.5%	(1.5%)	(2.6%)
Discontinued	43	0	0				
Minorities	(3)	0	0				
Net income (attrib)	6,638	5,170	5,879		1.0%	(1.5%)	(2.6%)
Clean Net income	5,589	5,170	5,879		1.1%	(1.5%)	(2.6%)
EPS	15.1	11.7	13.3		1.0%	(1.5%)	(2.6%)
clean EPS	12.7	11.7	13.3		1.1%	(1.5%)	(2.6%)
DPS (ordinary)	4.2	4.7	5.2		0.0%	0.0%	0.0%
DPS (special)	2.0	2.2	2.4		14.3%	25.7%	38.3%
DPS	6.2	6.9	7.6		4.2%	7.0%	9.6%
Capex (P&L)	3,963	5,663	5,231		1.2%	3.9%	7.8%
Net Debt EoP	1,798	1,288	(302)	absolute	56	434	1,111

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change
- Transfer of Coverage

Georgios Ierodionou

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georgios.ierodionou@citi.com

Hold/Medium Risk	2M
Price (09 Dec 10)	€0.97
Target price	€1.10
Expected share price return	12.9%
Expected dividend yield	5.1%
Expected total return	18.1%
Market Cap	€17,904M US\$23,739M

Price Performance (RIC: TLIT.MI, BB: TIT IM)



Telecom Italia SpA (TLIT.MI) Focus on mobile overshadows fixed resurgence

- **Old problems, new solutions?** — The turnaround of domestic mobile (or lack of it) is set to dominate as the hot topic for 2011 also. We expect even better results from wireline and TIM Brazil to provide downside support. We also expect FCF to reach €2.9bn, on improved working capital moves (by c.€250m) and other (c.€390m relates to last year's Sparkle payment). Depending on conditions in the debt market, we believe this could allow for a more meaningful improvement in dividends than ours and the market's 10% assumption.
- **Mobile in focus, mixed outlook** — We expect modest improvement in mobile trends, mostly down to easier comps rather than underlying improvement. The summer on-net promotion blamed for the deterioration in service revenues will continue to impact prepaid ARPU in 4Q 2010. We cut our estimates for the domestic business by c.1.8% for revenues (-2.8% in 2012) and 1.3% for EBITDA (-2.2% in 2012). TIM's new promotions in both the contract and the prepaid market are more balanced, so we should see a gradual improvement in 2011.
- **Fixed resurgence continues** — The final decision on ULL rates announced by Agcom calls for a 9% YoY increase in the fee by January 2012. We expect TI to increase its monthly fee, after some of the major ULLers increased their prices. This coupled with solid operating trends should translate to further reduction to service revenue decline.
- **TIM Brazil solid** — TIM's revival is on track with service revenue and margin improvement running ahead of TI's guidance. Coupled with a strong BRL, it mitigates shortfalls in domestic mobile. TIM's successful push in the long distance market is a winning formula as the groups that control the other MNOs hesitate to cannibalise a core business (c.BRL15bn worth) of their fixed subsidiaries. TIM is also more active in mobile broadband, another source of service revenue growth.
- **Dividend to the rescue?** — As TI's operating performance remains mixed and concerns around mobile are unlikely to be addressed in the near term, we believe the best way to keep shareholders on board is to come up with a more generous and progressive (but also realistic) shareholder returns policy. We do not expect this to happen just now - but a higher than the 10% expected (by both CIRA and the market) increase in the dividend for 2010 may buy management time to turn TIM Italy round. With this note we transfer coverage to Georgios Ierodionou from Simon Weeden.

Telecom Italia SpA (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	28,999.8	27,163.0	27,413.5	28,897.6	28,431.0
Net Income (€M)	2,177.0	1,581.0	2,671.5	2,463.7	2,396.6
Diluted EPS (€)	11	8	14	13	12
Diluted EPS (Old) (€)	11	8	14	13	13
PE (x)	8.6	11.8	7.0	7.6	7.8
EV/EBITDA (x)	4.9	4.8	4.5	4.1	4.1
DPS (€)	5	5	6	6	7
Net Div Yield (%)	5.2	5.2	5.7	6.2	7.2

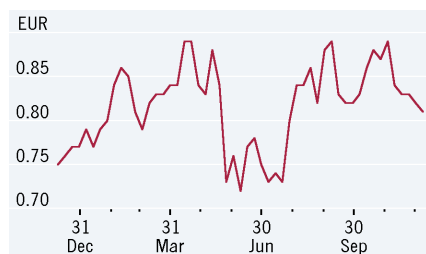
Company Focus

- Company Update
- Estimate Change
- Transfer of Coverage

Georgios Ierodionou
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georgios.ierodionou@citi.com

Hold/Medium Risk	2M
Price (09 Dec 10)	€0.80
Target price	€0.88
Expected share price return	9.5%
Expected dividend yield	7.6%
Expected total return	17.0%
Market Cap	€17,904M
	US\$23,739M

Price Performance (RIC: TLITn.MI, BB: TITR IM)

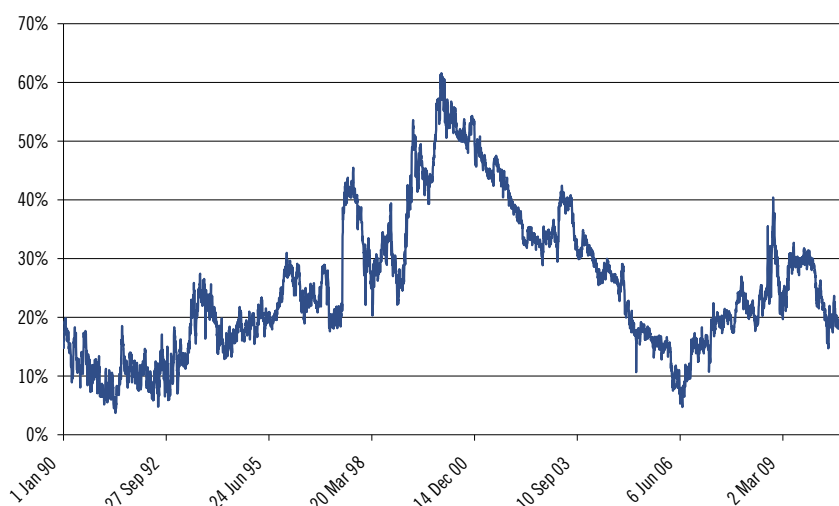


Telecom Italia SpA (TLITn.MI)

A safer entry to the story

- **Dividends yield still a key attraction** — We expect TI to increase dividends (by c.10%) in 2011, something that should invite more interest from investors that are looking at yields and shareholder returns. We believe that income investors will always prefer the saving shares because of the higher yield. This type of investor will find the discount high and unwarranted. The types of investors that tend to push the discount wider tend to be more speculative (M&A focused).
- **But a lot of the correction already happened** — TI savers outperformed the ordinary shares by c.17% year to date. The discount, currently standing at c.17% is still too high to be justified by fundamentals in our view, but it had been higher in the past. At these levels, we believe that investment in TI is more about the business than the two types of shares. We keep our Hold rating. With this note we transfer coverage to Georgios Ierodionou from Simon Weeden.

Figure 165. Trading discount, TI savers vs. ordinaries, since 1990



Source: Citi Investment Research and Analysis

Telecom Italia SpA (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	28,999.8	27,163.0	27,413.5	28,897.6	28,431.0
Profit Before Tax (€M)	2,894.0	3,339.0	4,056.6	4,389.1	4,464.5
Diluted EPS (¢)	11	8	14	13	12
Diluted EPS (Old) (¢)	11	8	14	13	13
PE (x)	7.1	9.7	5.8	6.3	6.4
EV/EBITDA (x)	4.9	4.8	4.5	4.1	4.1
DPS (¢)	0	0	0	0	0
Net Div Yield (%)	0.0	0.0	0.0	0.0	0.0

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	7.2	9.9	5.8	6.3	6.5
EV/EBITDA adjusted (x)	4.9	4.8	4.5	4.2	4.1
P/BV (x)	0.6	0.6	0.6	0.5	0.5
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (€)					
EPS adjusted	11	8	14	13	12
EPS reported	11	8	14	13	12
BVPS	136	135	143	150	156
DPS	0	0	0	0	0
Profit & Loss (€M)					
Net sales	29,000	27,163	27,414	28,898	28,431
Operating expenses	-23,260	-21,402	-21,383	-22,655	-22,299
EBIT	5,740	5,761	6,031	6,242	6,132
Net interest expense	-2,607	-2,221	-2,086	-1,870	-1,684
Non-operating/exceptionals	-239	-201	112	17	17
Pre-tax profit	2,894	3,339	4,057	4,389	4,465
Tax	-677	-1,121	-1,242	-1,504	-1,602
Extraord./Min.Int./Pref.div.	-40	-637	-143	-422	-466
Reported net income	2,177	1,581	2,671	2,464	2,397
Adjusted earnings	2,177	1,581	2,671	2,464	2,397
Adjusted EBITDA	11,090	11,115	11,410	11,971	11,733
Growth Rates (%)					
Sales	-7.3	-6.3	0.9	5.4	-1.6
EBIT adjusted	-17.6	-0.2	4.3	-0.5	-1.8
EBITDA adjusted	-4.5	0.2	2.7	4.9	-2.0
EPS adjusted	-11.0	-27.3	69.0	-7.8	-2.7
Cash Flow (€M)					
Operating cash flow	8,221	4,853	6,842	7,796	7,924
Depreciation/amortization	5,350	5,354	5,379	5,729	5,601
Net working capital	933	-689	-900	-663	-481
Investing cash flow	-4,916	-3,877	-3,360	-4,613	-4,944
Capital expenditure	-5,459	-3,924	-4,360	-4,613	-4,944
Acquisitions/disposals	-6	-6	0	0	0
Financing cash flow	-2,409	-881	-6,442	-6,289	-5,214
Borrowings	-718	180	-5,328	-4,900	-3,700
Dividends paid	-1,615	-1,032	-1,029	-1,125	-1,222
Change in cash	739	328	-2,961	-3,107	-2,234
Balance Sheet (€M)					
Total assets	86,223	86,181	81,248	77,721	74,793
Cash & cash equivalent	8,241	9,031	6,237	3,130	896
Accounts receivable	8,005	7,462	7,907	8,586	8,531
Net fixed assets	15,116	14,902	13,433	12,059	10,964
Total liabilities	59,398	59,061	52,571	47,548	43,270
Accounts payable	10,682	11,019	10,565	10,580	10,045
Total Debt	42,767	42,980	37,652	32,752	29,052
Shareholders' funds	26,825	27,120	28,677	30,173	31,522
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	38.2	40.9	41.6	41.4	41.3
ROE adjusted	8.4	6.1	10.0	8.8	8.2
ROIC adjusted	8.3	7.7	8.0	7.6	7.3
Net debt to equity	128.7	125.2	109.5	98.2	89.3
Total debt to capital	61.5	61.3	56.8	52.0	48.0

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Mobile progress is slow

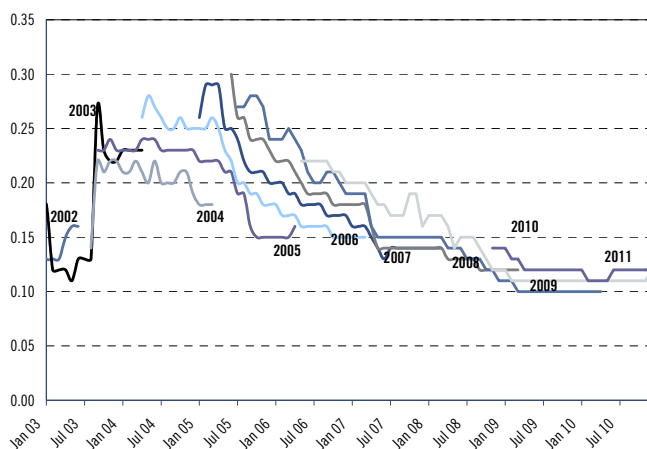
TIM Italy continues to lose market share and has fallen behind Vodafone in terms of service revenues, with the gap expected to get wider in 2011. With some of the on-net promotions responsible for ARPU dilution in 3Q 2010 expiring in December, we expect only modest underlying improvement in 4Q. But the new shift to smart-phones and targeted pre-paid promotions to new customers should translate to better trends during 2011, though progress could be slow. Fixed is solid and TI's position in the market is strong enough operationally for some modest price increases to come through. The stock has been a serial underperformer for years and we believe that unless operational and financial performance stabilises and/or we get more clarity (perhaps a positive surprise on cash returns), it will remain range bound.

Figure 166. TI has underperformed the sector (left axis €/share; right axis index: end-2006=100)



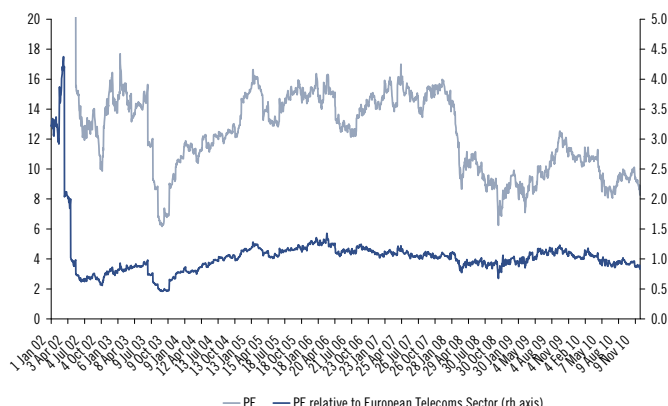
Source: DataStream

Figure 168. Consensus EPS has stabilized recently (€)



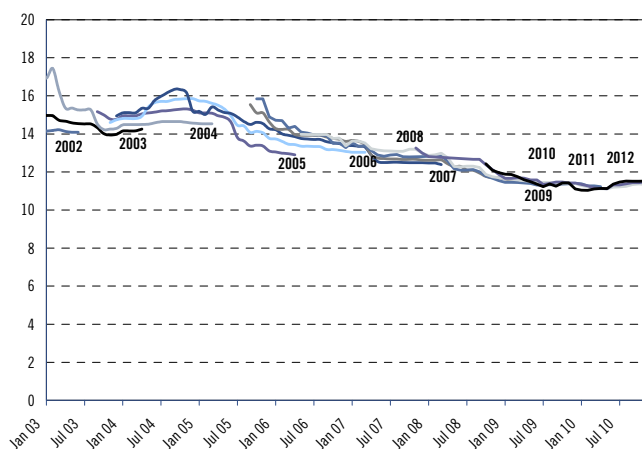
Source: DataStream

Figure 167. TI trades at a discount to the sector average on PE (1 year forward)



Source: DataStream

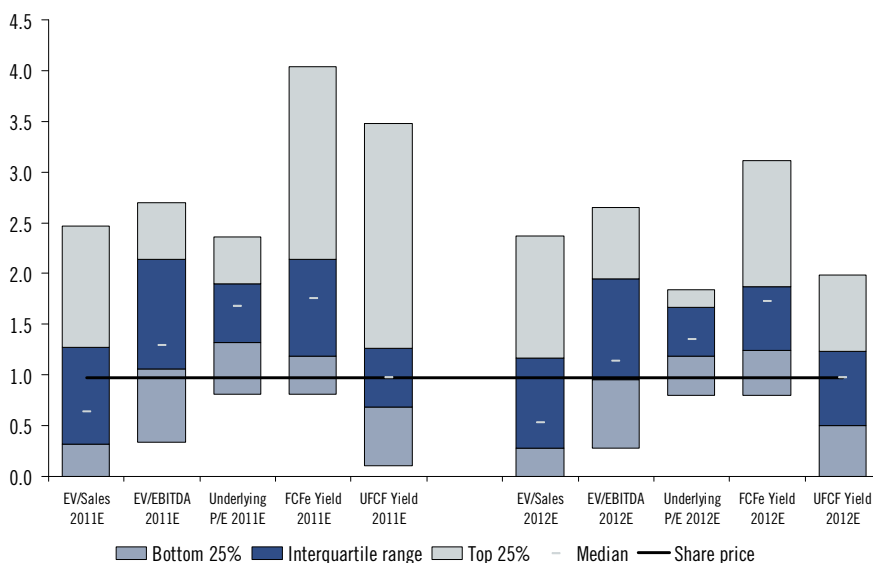
Figure 169. EBITDA consensus increasing due to consolidation of Telecom Argentina (€bn)



Source: DataStream

Figure 170. Compared to its incumbent and wireless peers in Europe TI trades below the median on our 2011 estimates and on 2012 estimates

€/share



Source: Powered by dataCentral

Significant upcoming events

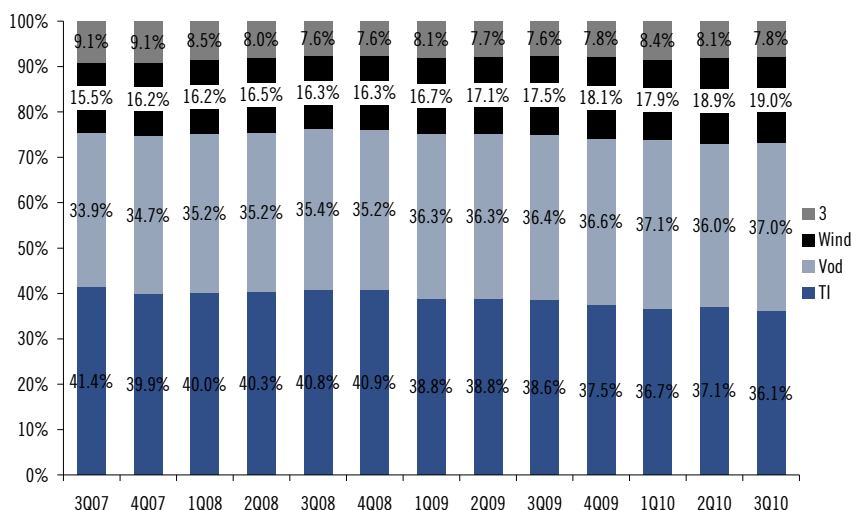
- TI could increase line rental in 2011: We estimate ULL fees will increase from €8.49 before May 2010 to €9.02 by January 2011. We would not rule out competition passing the increase through to the retail offers. We would expect TI to increase the monthly fee (which is no longer regulated) in response to the confirmation that fees will rise.
- Agcom to decide on new MTRs: The consultation has started but we would not expect a decision before the summer. The current MTR glide-path runs to mid-2012, with the rate falling to 4.5c. We would expect Agcom to cut deeper, but we wouldn't expect an impact in 2011.
- Spectrum: Government is willing to conclude the auction by the end of 2011 for 800Mhz, 1.8Ghz, 2.6Ghz. The 800Mhz are unlikely to be released before the end of 2012, something that could delay the process. The government expects to cash in around €2bn. A lot depends on the structure of the auction.
- Fixed termination rate: Currently at standing at 0.57c per minute, symmetric for all operators, we expect a reduction in the rate for next year of around 10%. This is incrementally negative, but as exposure to voice interconnection is falling, it is unlikely to significantly impact the performance of the fixed line business.
- Less than €5bn of maturing debt: We do not expect liquidity to be an area of concern for TI in 2011. But given the higher than average leverage and recent adverse moves in the Italian bond market, TI remains very exposed to debt markets.

Mobile recovery uncertain

The problems that TIM is facing are not terminal. Other MNOs in Italy are delivering decent trends, so as long as TIM reduces the pace of market share loss, its performance should improve materially. The problem is purely one of execution: TIM should not indefinitely underperform Vodafone, especially now that it is trailing behind in terms of service revenues (and the gap in residential is widening fast) in our view.

Figure 171. TIM fell behind Vods and the gap is widening

Mobile service revenue market share (%)



Source: Citi Investment Research and Analysis, based on company reports

- **Loss of service revenue share to continue:** TIM has ceded its market leadership to Vodafone and the gap is set to increase further in 2011. TIM remains the market leader in business, which means that in the consumer market the gap is even wider.
- **But pace to slow down:** The poor performance in 3Q 2010 was down to mispricing of prepaid offers, which led to considerable cannibalisation. These offers were withdrawn from the market by September. We believe the new strategy to push more smart-phones and to focus on stimulating the contract market is more sensible and could prove more rational in the medium term. We expect VAS to start showing signs of growth as we have seen in most other European markets.

Ongoing fixed recovery

The fixed line business is delivering solid KPIs and improving financial performance particularly on an underlying basis.

- **Regulatory clarity** – A series of key regulatory decisions have been finalized and have broadly been in line with what TI expected and communicated to the market: symmetry in fixed voice termination, symmetry in win back terms, higher ULL fees (after two separate decisions to increase them). TI was also granted flexibility in setting the retail monthly rental.

- **Operational stability** – We have seen a marked improvement in competitive intensity in 2010. All of the main competitors have reached scale and are ready to be more rational. Vodafone was the main player pushing for broadband market share in 2009, despite a poor quality network inherited by Tele2. But Vodafone increased its prices by c.€5/month last November and given higher ULL fees going forward, we expect flattish pricing.
- **Scope for retail price to move up, premium valuation justified?** – TI's market share is stabilizing at higher levels than its European peers in both access and voice. This is down to the lack of cable presence in the country and very good management of the relationship between the incumbent and the regulator since the new management took over.

Valuation

Figure 172. Sum of Parts

Asset	Stake	EV	Net (debt)	Method	TI market value	Blended €/share
Italy - Wireline	100.0%	25,507	0	4.5x 2011E EBITDA	25,507	1.32
Italy - Wireless	100.0%	14,560	0	4.1x 2011E EBITDA	14,560	0.76
TIM Brazil	66.27%	11,713	(771)	6.0x 2011E EBITDA	7,251	0.38
Telecom Argentina	16.2%	3,419	56	Market price (Peso 19.0/share)	563	0.03
TI Media	68.0%	460	(113)	Market price (EUR 0.24/share)	236	0.01
Olivetti	100.0%	196	0	0.5x 2011E Sales	196	0.01
ETEC-SA (Cuba)	27.0%	1,070	0	Book value, Dec 09	289	0.01
Central costs/other	100.0%	5	0	4.5x 2010E EBITDA	5	0.00
Group EV					48,607	
Other net debt (2011E)			(28,793)		(28,793)	(1.49)
Equity value					19,813	
Implied blended per-share value					1.03	
Implied value per ordinary share					1.10	
Implied value per savings share					0.88	

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change
- Transfer of Coverage

Georgios Ierodionou
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georgios.ierodionou@citi.com

Hold/Low Risk	2L
Price (09 Dec 10)	€17.30
Target price	€17.50
Expected share price return	1.2%
Expected dividend yield	8.5%
Expected total return	9.7%
Market Cap	€78,957M US\$104,689M

Price Performance (RIC: TEF.MC, BB: TEF SM)



Telefonica SA (TEF.MC) More realistic expectations

- **As balanced as it has ever been** — We argue the shares are less exposed to disappointment than in the past two years. The outlook looks more realistic, at least from an operational perspective. We are still unconvinced that the 2012 dividend target of €1.75/share is a done deal, or that this level is sustainable for years to follow, but this may be a 2012 debate.
- **Spain weaker for longer** — Our concerns extend beyond macro and therefore we see service revenue pressure in the medium term. We expect TEF to continue to lose market share in mobile and broadband and that prices (the highest in Europe) will come under sustained pressure for years. We believe that the market has started to appreciate the problems for 2011 but is not prepared for a permanent drag to group numbers thereafter (2012 onwards).
- **LatAm stronger, margins to turn** — Synergies from the Telesp/Vivo integration should come in time to offset the problems that Telesp is due to face as GVT launches services in 3Q 2011. But the rest of the footprint is performing well, with KPIs improving, service revenue reaccelerating and in our view margins about to stabilize or even grow on an underlying basis.
- **Despite risks in Venezuela and Argentina** — We continue to be cautious on operations in inflationary environments. A devaluation of the bolivar could mean that an underlying improvement in EBITDA and margins across LatAm is not reflected in reported numbers. In Argentina inflation is running much higher than the official rate and the pace of growth that TEF and TI are delivering.
- **Europe solid as expected** — despite some headwinds from MTRs in Germany and soon in the UK, we expect strong performance as O2 continues to gain market share in the former and benefits from in market consolidation in the latter. We may see capital intensity remaining at higher levels for longer due to data demand and the need to improve service quality in the UK.
- **The elephant is yet to enter the room** — we believe the main debate will ultimately centre on the €1.75 dividend commitment for 2012 and whether this could be a sustainable level in the future. We believe it is too early to call as a lot depends on management's willingness to increase the payout ratio above 90% of equity FCF and on whether Spain shows signs of improvement: as long as there is hope, the dividend commitment stands. With this note we transfer coverage to Georgios Ierodionou from Simon Weeden.

Telefonica SA (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	57,946.0	56,731.0	60,244.3	64,257.4	64,987.6
Net Income (€M)	7,897.0	8,029.0	8,693.1	8,464.3	8,391.1
Diluted EPS (€)	1.70	1.76	1.90	1.85	1.84
Diluted EPS (Old) (€)	1.70	1.76	1.90	1.96	1.99
PE (x)	10.2	9.8	9.1	9.3	9.4
EV/EBITDA (x)	5.4	5.4	5.5	5.4	5.3
DPS (€)	1.00	1.15	1.40	1.55	1.75
Net Div Yield (%)	5.8	6.6	8.1	9.0	10.1

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	10.2	9.8	9.1	9.3	9.4
EV/EBITDA adjusted (x)	5.4	5.4	5.5	5.4	5.3
P/BV (x)	4.7	3.6	3.0	2.8	2.8
Dividend yield (%)	5.8	6.6	8.1	9.0	10.1
Per Share Data (€)					
EPS adjusted	1.70	1.76	1.90	1.85	1.84
EPS reported	1.63	1.58	2.62	1.78	1.77
BVPS	3.66	4.76	5.81	6.12	6.25
DPS	1.00	1.15	1.40	1.55	1.75
Profit & Loss (€M)					
Net sales	57,946	56,731	60,244	64,257	64,988
Operating expenses	-44,353	-43,343	-46,257	-49,857	-50,409
EBIT	13,593	13,388	13,987	14,400	14,578
Net interest expense	-2,797	-3,307	-2,716	-3,150	-3,205
Non-operating/exceptionals	-173	5	178	202	233
Pre-tax profit	10,623	10,086	11,449	11,453	11,606
Tax	-3,089	-2,450	-2,930	-2,981	-3,071
Extraord./Min.Int./Pref.div.	58	-420	3,443	-368	-442
Reported net income	7,592	7,216	11,961	8,103	8,093
Adjusted earnings	7,897	8,029	8,693	8,464	8,391
Adjusted EBITDA	22,639	22,344	22,830	23,972	24,195
Growth Rates (%)					
Sales	2.7	-2.1	6.2	6.7	1.1
EBIT adjusted	23.1	-1.5	4.5	3.0	1.2
EBITDA adjusted	10.6	-1.3	2.2	5.0	0.9
EPS adjusted	12.3	3.7	8.0	-2.6	-0.9
Cash Flow (€M)					
Operating cash flow	16,310	16,120	16,744	17,157	17,499
Depreciation/amortization	9,046	8,956	8,843	9,572	9,617
Net working capital	-1,137	-384	-31	-159	-60
Investing cash flow	-9,286	-7,561	-18,110	-10,864	-9,015
Capital expenditure	-7,861	-7,592	-10,197	-8,909	-9,060
Acquisitions/disposals	-1,492	-14	-7,958	-2,000	0
Financing cash flow	-7,421	-2,182	-2,791	-9,078	-8,837
Borrowings	-740	3,603	3,500	-2,000	-1,000
Dividends paid	-6,681	-5,785	-6,291	-7,078	-7,837
Change in cash	-2,742	9,075	-4,157	-2,786	-354
Balance Sheet (€M)					
Total assets	99,896	108,141	117,315	116,403	115,462
Cash & cash equivalent	10,932	13,755	9,598	6,813	6,459
Accounts receivable	9,315	10,622	11,167	11,792	11,866
Net fixed assets	30,546	32,003	32,116	32,104	32,247
Total liabilities	80,334	83,867	88,343	86,039	84,399
Accounts payable	7,939	7,365	7,927	8,447	8,468
Total Debt	53,665	57,306	62,029	60,029	59,029
Shareholders' funds	19,562	24,274	28,971	30,364	31,062
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	39.1	39.4	37.9	37.3	37.2
ROE adjusted	42.3	41.2	36.0	31.1	29.7
ROIC adjusted	15.1	16.1	14.6	13.6	13.6
Net debt to equity	218.4	179.4	181.0	175.3	169.2
Total debt to capital	73.3	70.2	68.2	66.4	65.5

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In need of new direction

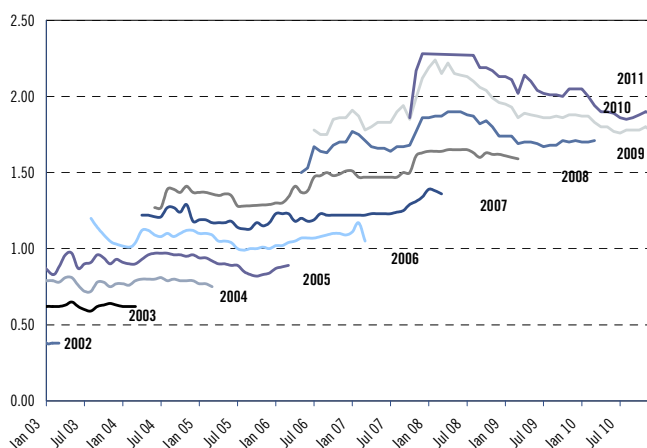
2010 was a difficult year for TEF, which started badly with the devaluation of the Bolivar and concerns about the 'peripheral' economies in Europe. Press speculation of a merger with TI which never materialized, gave way to a formal offer to buy PT's stake in Vivo. We believe the acquisition of Vivo was necessary and with it TEF addressed the biggest gap in its footprint. The stock recovered only to come under pressure again when the market started to appreciate that Spain may take much longer to stabilize than previously expected. Looking into 2011, we believe that operations will be the focus and LatAm could surprise on the upside on an underlying basis. But there are still skeletons in TEF's closet (Venezuela and Argentina), which could undermine solid trends elsewhere. Spain is also likely to be a source of further negative news-flow, even if the market seems to incorporate it at this stage. We therefore expect the shares to be range-bound in the near term and reiterate our Hold recommendation.

Figure 173. TEF has recently underperformed the sector (left axis €/share; right axis index: end-2006=100)



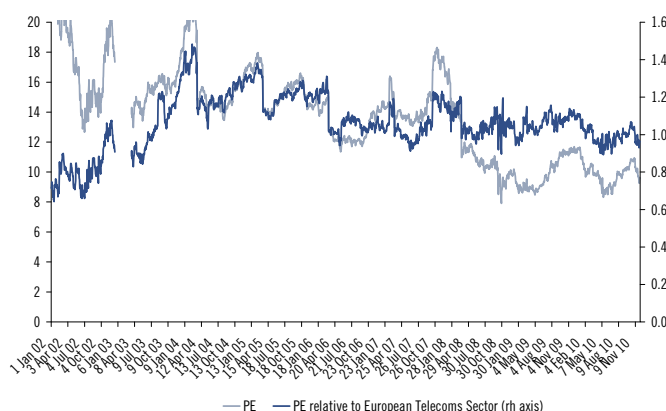
Source: DataStream

Figure 175. Consensus EPS has started to stabilize, though some improvement is down to exceptionals (€)



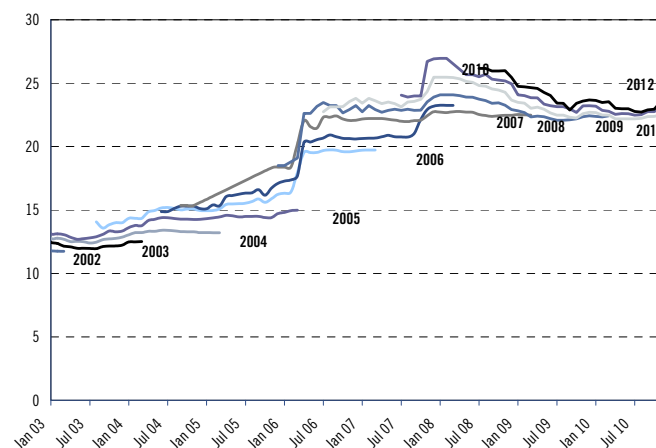
Source: DataStream

Figure 174. TEF trades in line with the sector average on PE (1 year forward)



Source: DataStream

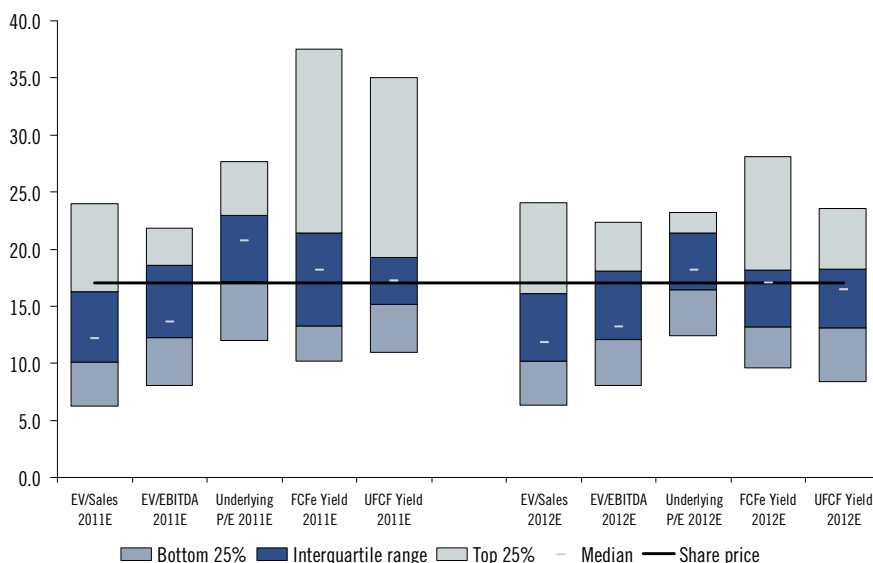
Figure 176. EBITDA consensus has lately been rising due to Vivo's changed scope of consolidation (€bn)



Source: DataStream

Figure 177. Compared to its incumbent and wireless peers in Europe TEF trades around the median on our 2011 estimates and on 2012 estimates

€/share



Source: Powered by dataCentral

Significant upcoming events

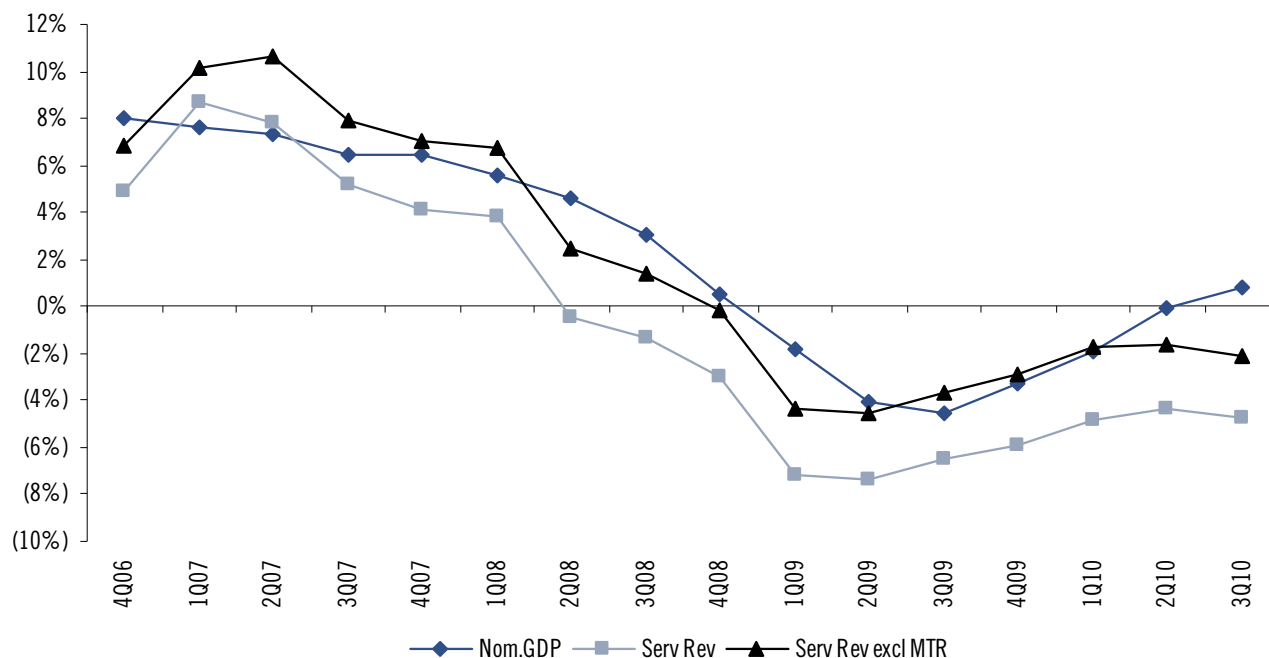
- **Spectrum auctions in Spain-** the consultation is expected to start in early 2011. The spectrum to be made available includes 800Mhz, some residual 900Mhz spectrum, any 1800Mhz returned back due to refarming and 2600Mhz. The 800Mhz spectrum will be made available from Jan 1st 2015 and will be auctioned in six blocks of 2x 5MHz. this is similar to the German auction process. We would expect Movistar and Vodafone to get at least two blocks each. This leaves two blocks of 800Mhz and 5.8Mhz of 900Mhz spectrum for Orange and Yoigo. Based on the price paid by the operators in Germany, we would expect TEF to pay around €400-500m, but could come towards the bottom end, if not lower, as the spectrum will not be in use for another four years.
- **Vivo/Telesp merger-** we expect an update early in the year on the plans for the merger of the two assets in Brazil. This is probably the main priority for 2011, as we predict a more challenging environment for Telesp from 2H 2011 onwards, when GVT is expected to launch commercially in Sao Paulo.
- **Investor day coming soon-** We expect the next investor day some time in 1H 2011. We suspect the agenda will not be too dissimilar from previous investor days, but the focus may be completely different. Will TEF continue to give four year guidance? Will it set targets for dividends to 2014? Could dividend grow post 2012?

Spain weaker for longer

The market has started to reflect the risk of a protracted decline in service revenues, particularly in mobile. Loss of market share and price pressure in mobile and broadband means progress will be slow even if demand improves. We see more scope for downward revisions to estimates beyond 2011.

- The most significant risk is that of a protracted decline in mobile market share and pricing, which in our view is already taking shape. TEF's share of service revenues is already falling by c.1pp YoY. This, combined with the headwinds from ongoing cuts to MTRs and the impact of higher taxes, should translate into weak trends for longer.

Figure 178. Market growth impacted by austerity and MTR cuts.



Source: Citi Investment Research and Analysis, Datastream

We also see pressure to margins- TEF has been very proactive in cutting costs and though not exhausted, we believe further cost cutting potential is limited. In 2010, TEF managed to squeeze c. €80m of savings from the introduction of a new billing system. We believe that these savings are hard to repeat and would not rule out a reversal given the state of the economy.

LatAm growth improves

Operating performance has improved materially during 2010 and service revenues are beginning to respond, after disappointing numbers during 2009. But the situation is perhaps better than the market perceives and TEF may start to deliver better than expected margins from 4Q 2010 onwards.

- Easier comps: Even though TEF does not provide sufficient breakdown of operating expenses, we believe - based on KPIs delivered during this period and verbal indications by management- that the commercial costs (SACs, direct costs, advertising) incurred towards the end of 2009 were significantly higher than the start.
- We see scope for performance to continue to improve and we believe that as service revenue continue to accelerate and turn to positive real growth, profitability will also start to benefit. In 4Q 2010 we could start to see the margin improvement coming through.

But we still have some concerns

- **Venezuela** - With the bolivar trading around VEF8/\$ in the parallel market, we argue another big correction to numbers is due. Aside from the P&L impact, we expect another stepped change in net debt, as TEF will have to recognise the change in the value of its net cash position (which stood at \$1.3bn according to management during the 3Q 2010 conference call).
- **Argentina** - In late November, the Argentinean authorities have requested assistance from the IMF to design, construct and implement a new price index across the country. If this is implemented, it is widely expected that official inflation rates will increase dramatically. This should put TEF's growth into context: real growth is marginal and not the impressive headline number that is being delivered.
- **Capex pressure** - As demand for mobile broadband and pay TV accelerates in the coming years, we expect more pressure to invest. AMX and Oi have already updated the market with new guidance for significantly higher investment in order to address increasing demand. We would like TEF to follow to ensure it is as well positioned to capture growth opportunities.
- **Europe solid, regulation risk** - O2 should continue to gain market share in Germany and defend its position in the UK successfully. The steep MTR cut announced in Germany should reduce headline growth, but being a challenger O2 is less exposed compared to T-mobile and Vodafone. Also, since its fixed line division is not regulated, the cut may not be passed to retail offers.

Balance sheet flexibility, despite higher leverage

Post the Vivo acquisition, Hansenet and some adjustments to cash position in Venezuela, Telefonica's leverage is still within the 2-2.5x Net Debt/EBITDA target range. Though we recognize TEF has enough financial flexibility, we list commitments/ adverse movements that could drive leverage higher.

- **Licenses** - We expect the Spanish spectrum auction to cost c. €400-500m (see earlier section).
- **Another Bolivar devaluation?** - The Venezuelan Bolivar is already trading at VEF8/\$ in the parallel market compared to the official rate of VEF4.3/\$. Though the timing is uncertain, another devaluation is only a matter of time and the longer it takes the bigger the move will need to be. During the 3Q conference call, the Chief Strategy Officer confirmed that TEF's net cash position is equivalent to \$1.3bn.
- **Ramping up the dividends:** We expect TEF to pay €6.7bn of dividends in 2011 and €7.5bn in 2012. The significant increase is part of TEF's multiyear progressive dividend policy set in 2009. We believe that despite the challenging environment in Spain, TEF will try to honour its commitment. But it implies one of the highest payout ratios in Europe, which makes it difficult to reduce net debt.
- **China Unicom:** TEF is targeting a 10% stake in the Chinese strategic partner and has already reached 8.4%. We estimate the remaining 1.6% should cost c. €400m.

Valuation

We cut our group revenue (EBITDA) estimates by 1.5% (2.8%) in 2011 and 2.0% (3.7%) in 2012, due to changes to our domestic mobile estimates and O2's. We now forecast a 5.5% (-4.6) decline in service revenues in 2011 (2012) for Movistar Spain. We also cut our revenue assumptions for O2 by c.€380m on worse than expected MTR cuts in Germany and also assume a similar scenario for MTR cuts in the UK. Our valuation remains unchanged, after we move our estimates forward to 2011.

Figure 179. Sum of Parts

Operation	Stake end-2009	Total EV	Net (debt) 2011E	Total MV	Telefonica MV	% of EV	EV/EBITDA 2010E	EV/EBITDA 2011E
Spain								
Fixed	100%	25,114	0	25,114	25,114	18.8%	5.4x	5.6x
Mobile	100%	23,379	0	23,379	23,379	17.5%	5.5x	6.1x
Total		48,493	0	48,493	48,493	36.3%	5.4x	5.8x
Latin America								
Brazil Fixed (Telesp)	87.95%	11,430	(737)	10,693	9,404	7.0%	4.9x	5.0x
Brazil Mobile (Vivo)	63.22%	13,888	(800)	13,088	9,378	7.0%	5.8x	5.7x
Argentina Fixed	100%	2,087	0	1,309	1,309	1.0%	5.0x	4.6x
Argentina Mobile	100%	4,067	0	4,067	4,067	3.0%	6.0x	5.5x
Chile Fixed	97.89%	1,843	(523)	1,319	1,292	1.0%	4.6x	4.3x
Chile Mobile	100%	3,431	0	3,431	3,431	2.6%	6.0x	5.6x
Colombia Fixed	52.03%	1,516	0	1,516	789	0.6%	6.0x	5.9x
Colombia Mobile	100%	1,666	0	1,666	1,666	1.2%	6.0x	5.8x
Peru Fixed	98.34%	3,449	(640)	2,808	2,762	2.1%	8.5x	8.7x
Peru Mobile	100%	2,620	0	2,620	2,620	2.0%	6.5x	6.8x
Mexico - Wireless	100%	4,556	0	4,556	4,556	3.4%	7.0x	6.7x
Venezuela - Wireless	100%	5,347	0	5,347	5,347	4.0%	5.0x	3.6x
Central America	99.99%	1,198	0	1,198	1,198	0.9%	6.0x	5.9x
Ecuador	100%	724	0	724	724	0.5%	6.0x	5.5x
Other	100%	2,814	0	2,814	2,814	2.1%	6.0x	5.4x
Total		60,635	(2,701)	57,155	51,355	38.5%	6.2x	5.4x
Europe								
UK	100%	11,180	0	11,180	11,180	8.4%	6.0x	5.3x
Germany	100%	6,963	0	6,963	6,963	5.2%	6.0x	5.5x
Ireland	100%	1,464	0	1,464	1,464	1.1%	5.5x	5.4x
Czech Rep (Cesky Telecom)	69.41%	5,515	33	5,548	3,851	2.9%	5.7x	5.8x
Other	100%	287	0	287	287	0.2%	6.0x	5.5x
Total		25,410	33	25,443	23,746	17.8%	5.9x	5.4x
Associates and other								
Telecom Italia - Telco SPA	46.18%	2,995	(2,187)	808	373	0.3%		
Portugal Telecom	1.86%			7,650	142	0.1%		
Lycos Europe	32.10%			24	8	0.0%		
Hispasat	13.23%				50	0.0%		
China Unicom	8.37%			24,243	2,029	1.5%		
ZON Multimedia	5.40%			995	54	0.0%		
BBVA	0.98%			39,410	386	0.3%		
Amper	6.10%			134	8	0.0%		
Total				73,263	3,050	2.3%		
Enterprise Value					126,644			
Net debt not included above			(50,481)	(50,481)	(50,481)	(37.8%)		
Dividend adj (ex-2010)					3,286			
Unfunded pension liabilities			(3,167)	(3,167)	(3,167)	(2.4%)		
NPV of tax/synergy					3,609			
Equity value					79,891	59.8%		
Shares outstanding (mn)					4,564			
Per share value (EUR)					17.5			

Source: Citi Investment Research and Analysis

Company Focus

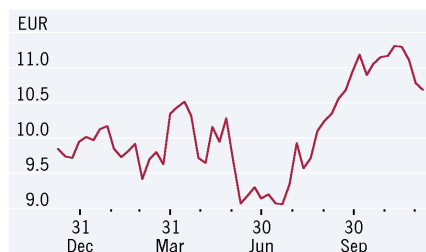
- Company Update
- Estimate Change
- Transfer of Coverage

Georgios Ierodionou

+44-20-7986-4086
georgios.ierodionou@citi.com

Hold/Medium Risk	2M
Price (09 Dec 10)	€10.48
Target price	€10.50
Expected share price return	0.2%
Expected dividend yield	7.2%
Expected total return	7.4%
Market Cap	€4,640M
	US\$6,153M

Price Performance (RIC: TELA.VI, BB: TKA AV)



Telekom Austria (TELA.VI) Another challenging year ahead

- **Investor day in focus** — TA is hosting an investor day in Vienna on December 17th. This will be a chance to update the market on operating performance across the footprint and the management's latest thoughts on shareholder returns. In our view, the general principles are unlikely to change: TA wants to defend cash flow generation despite challenging conditions and maintain a minimum dividend commitment that provides downside support. But some tweaks are possible: Is TA more comfortable with 2x net debt to EBITDA as its target or does it stick to 1.8-2.0x? Is additional cash flow flexibility diverted towards higher dividends or buybacks?
- **Core markets remain challenging** — the Austrian market remains very competitive, with no sign of market correction. Bulgaria mobile is unlikely to deteriorate further, but a recovery is unlikely in the foreseeable future in our view.
- **From price and subsidy war** — Orange avoided promotions offering a 50% discount on the monthly fee this year, but it instead opted for heavy subsidies, particularly on its iPhone contracts. Mobilkom followed this promotion, which means that SACs will start to increase materially from 4Q 2010 onwards. The market remains as competitive as in the past, but although this may have a material impact on profitability in the early stages it does not constitute a major deterioration of market conditions.
- **Fixed improving gradually** — the operational performance is already the best in Europe, though this comes at a heavy price on ARPU and revenues. We expect improving trends as the pace of cannibalisation slows, but the shift in the revenue mix from voice to new services (like TV) is bad for margins.
- **Bulgaria stabilizing at weak levels** — with macro conditions improving, we expect performance to remain weak but not deteriorate further. This should provide some comfort that the situation is not completely out of control, but it is very early to look for any sort of stabilization in the coming years, in view of regulatory impact and price pressure.
- **We update our forecasts and cut estimates on depreciation** — we reiterate our Hold recommendation and update our estimates. The main adjustment relates to depreciation estimates, which we increase by 5% in 2011. Our €10.50 target price, based on a SOTP fade DCF valuation model, remains unchanged. With this note we transfer coverage to Georgios Ierodionou from Dimitri Kallianiotis.

Telekom Austria (EUR)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (€M)	5,170.3	4,802.0	4,640.2	4,577.3	4,556.9
Net Income (€M)	-48.8	94.9	305.6	322.6	445.3
Diluted EPS (€)	-0.11	0.21	0.69	0.73	1.01
Diluted EPS (Old) (€)	-0.11	0.21	0.73	0.92	1.09
PE (x)	-95.0	48.9	15.2	14.4	10.4
EV/EBITDA (x)	6.4	4.4	4.7	4.6	4.3
DPS (€)	0.75	0.75	0.75	0.75	0.70
Net Div Yield (%)	7.2	7.2	7.2	7.2	6.7

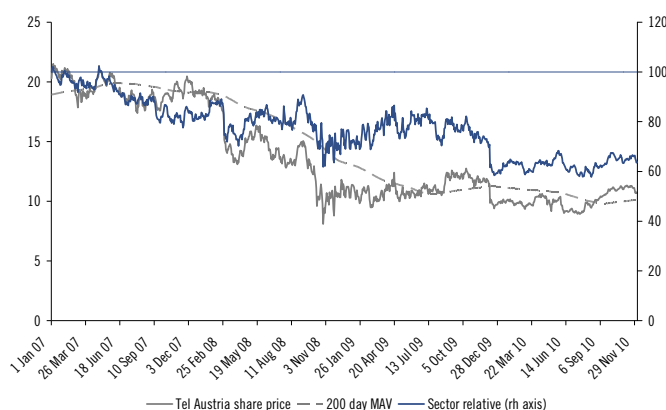
Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	nm	49.8	15.5	14.7	10.6
EV/EBITDA adjusted (x)	6.4	4.5	4.7	4.6	4.3
P/BV (x)	2.2	2.9	2.9	2.9	2.7
Dividend yield (%)	7.0	7.0	7.0	7.0	6.6
Per Share Data (€)					
EPS adjusted	-0.11	0.21	0.69	0.73	1.01
EPS reported	-0.11	0.21	0.69	0.73	1.01
BVPS	4.87	3.64	3.72	3.70	3.95
DPS	0.75	0.75	0.75	0.75	0.70
Profit & Loss (€M)					
Net sales	5,170	4,802	4,640	4,577	4,557
Operating expenses	-5,035	-4,458	-4,058	-3,979	-3,826
EBIT	136	344	582	598	731
Net interest expense	-205	-220	-198	-190	-167
Non-operating/exceptionals	-7	-18	-2	0	0
Pre-tax profit	-76	106	382	408	564
Tax	28	-11	-76	-86	-118
Extraord./Min.Int./Pref.div.	0	0	0	0	0
Reported net income	-49	95	306	323	445
Adjusted earnings	-49	95	306	323	445
Adjusted EBITDA	1,296	1,794	1,645	1,627	1,668
Growth Rates (%)					
Sales	5.1	-7.1	-3.4	-1.4	-0.4
EBIT adjusted	-82.2	153.8	69.2	2.8	22.1
EBITDA adjusted	-30.1	38.4	-8.3	-1.1	2.5
EPS adjusted	-110.1	294.4	221.9	5.6	38.1
Cash Flow (€M)					
Operating cash flow	1,564	1,385	1,299	1,312	1,352
Depreciation/amortization	1,161	1,450	1,063	1,029	937
Net working capital	-130	-184	-20	0	0
Investing cash flow	-855	-930	-763	-691	-637
Capital expenditure	-808	-711	-764	-691	-637
Acquisitions/disposals	14	13	0	0	0
Financing cash flow	-523	-153	-912	-332	-332
Borrowings	-191	179	-580	0	0
Dividends paid	-332	-332	-332	-332	-332
Change in cash	187	303	-376	288	383
Balance Sheet (€M)					
Total assets	8,997	8,499	7,227	7,218	7,331
Cash & cash equivalent	477	949	372	660	1,044
Accounts receivable	728	673	726	726	726
Net fixed assets	2,976	2,675	2,376	2,039	1,739
Total liabilities	6,842	6,885	5,582	5,582	5,582
Accounts payable	589	524	475	475	475
Total Debt	3,879	4,070	3,327	3,327	3,327
Shareholders' funds	2,156	1,611	1,646	1,636	1,750
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	25.1	37.4	35.4	35.6	36.6
ROE adjusted	-2.1	5.0	18.8	19.7	26.3
ROIC adjusted	2.2	5.1	8.9	9.4	11.9
Net debt to equity	157.8	193.7	179.6	163.0	130.5
Total debt to capital	64.3	71.6	66.9	67.0	65.5

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Core still under pressure

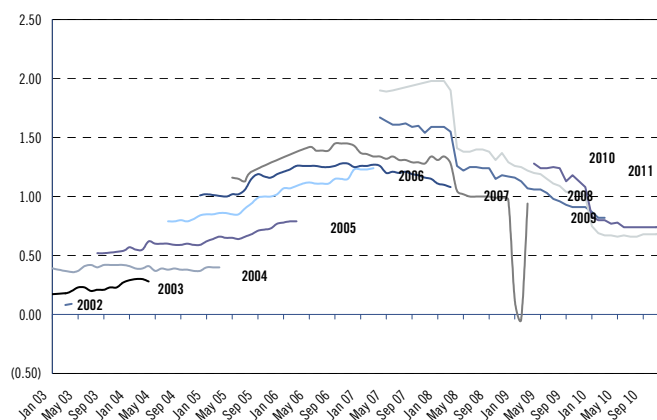
TA's operational performance has deteriorated both at home and across its international operations in recent years. TA has faced systematic earnings downgrades and as a result the stock has underperformed the rest of the sector. A commitment to keep the dividend at €0.65/share provides some downside support, but for the shares to progress we believe the outlook needs to improve. We do not see this catalyst as imminent, but a more rational domestic market would be enough for a serious rerating. We believe this is long overdue, but high leverage (Orange) and unacceptable ROCE (H3G) are yet to drive the process. The transition to LTE and the auction for the digital dividend could be a driver, but we would like to see tangible evidence before we turn more positive.

Figure 180. TKA has performed roughly in line with the sector since end-09 (left axis €/share; right axis index: end-2006=100)



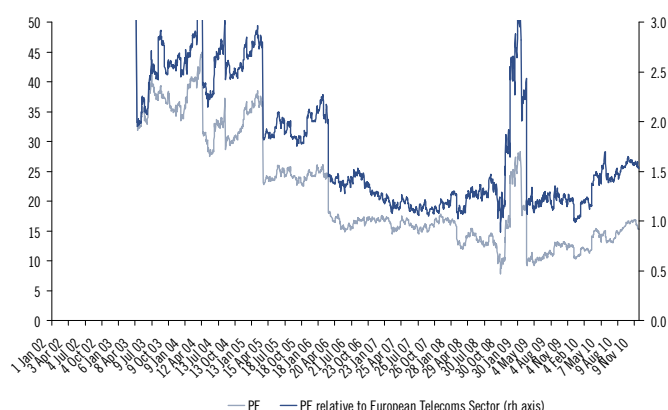
Source: DataStream

Figure 182. Consensus EPS has lately stabilized after falling (€)



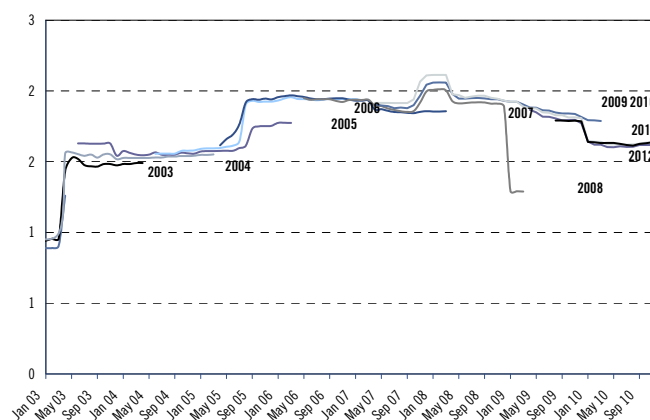
Source: DataStream

Figure 181. Telekom Austria trades well above the sector average on PE due to higher depreciation and amortization of Purchase Price Allocation (1 year forward)



Source: DataStream

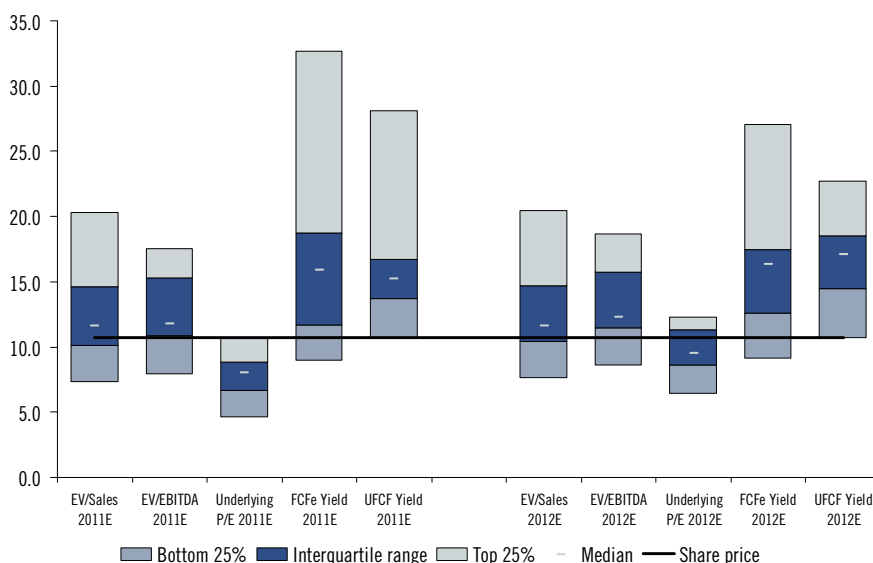
Figure 183. EBITDA consensus has started to stabilise (€bn)



Source: DataStream

Figure 184. Compared to its incumbent and wireless peers in Europe TKA trades below the median on our 2011 estimates and around the lower quartile on our 2012 estimates

€/share



Source: Powered by dataCentral

Significant upcoming news events

- **Investor day (Dec 17th)** – TA plans to update the market on strategy, guidance and uses of cash flow. We expect to get an update on the progress of fixed to mobile integration in Austria and an update on prospects in the international operations from the local teams. We expect the market to concentrate on the uses of cash, but would not anticipate any change to the core principle that there is a dividend floor at €0.65/share. But as the financial conditions have improved in the market, we would rule out a return to the 2x net debt to EBITDA target, rather than the 1.8-2.0x currently. But our view is TA will only meaningfully change its return policy if the operating trends improve and we see signs of stabilization. Given that management tended to err to the side of caution (and with good reason), we would expect any changes to be modest and conditional on more stable EBITDA trends.
- **Spectrum** – The Austrian regulator is expected to auction the 800Mhz in late 2011/ early 2012. We expect the auction to be competitive, but since the regulator is yet to set the framework, the potential cost is hard to predict. This could prove to be a major catalyst for more rational behaviour in the mobile market, particularly as highly leveraged Orange and unprofitable H3G will be forced to make significant investments to acquire and develop the spectrum.
- **Telekom Serbia privatization** – Three parties are left in the process, but TA is unlikely to acquire the asset given its significant exposure to wireline.
- **Serbian volte face in the telecom tax** – the Serbian Minister of Telecommunications Jasna Matic announced in October the abolition of the 10% tax on telecom services, which was introduced as an anti-crisis measure the year before. Though the announcement coincided with the privatisation process, the move may also be due to the adverse impact the tax had on usage.

Core markets continue to face challenges

The challenging environment across TA's operations continues to weigh on performance, even though some modest improvement is expected into 2011.

In domestic mobile, the market remains very competitive, though there has been a shift away from price cuts to more subsidies. Orange – the instigator of previous price wars – started to offer the iPhone 4 for free on its two most expensive 24 month contracts. Competitors including Mobikom matched this offer, which means that SAC could increase materially in the 4Q 2011.

Compared to previous campaigns including last year's half monthly fee promotions during Christmas, this is not unexpected. But it should have a meaningful impact on margins, which should come under pressure during this period. The benefits in the form of better service revenue trends may take more time to come through, which means the initial impact from the shift to higher prices and subsidies is the worst.

In fixed, TA continued to deliver solid KPIs, with competition marginalized. The move to mobile substitution is less acute than in the past on the access side, but voice traffic is still in steep decline. TA's new revenue streams partly mitigate but these are lower margin products, which mean that EBITDA should continue to be under pressure.

Bulgaria: The macro environment is showing slow progress but any improvement is likely to be modest, with competition from Vivatel and the impact from interconnection cuts putting more pressure on Mtel's margins.

Valuation

Figure 185. Discounted cash flow valuation by division

	Stake (%)	Enterprise Value (€)	Per Share Value (€)	As a % of Group EV	Metric	2010E EV/EBITDA	2011E EV/EBITDA
Domestic Fixed Line	100%	2,372	5.4	28.9% DCF (7.5% WACC, 0% terminal growth)		4.8x	4.8x
Domestic Mobile (Mobikom)	100%	2,734	6.2	33.3% DCF (7.5% WACC, 0% terminal growth)		5.0x	5.4x
Total Domestic Telecom Assets		5,105	11.5	62.2%		4.9x	5.1x
Velcom (Belarus)	100%	717	1.6	8.7% DCF (11.5% WACC, 1% terminal growth)		4.7x	4.0x
Mobilitel (Bulgarian Mobile)	100%	1,365	3.1	16.6% DCF (12% WACC, 0% terminal growth)		4.8x	5.2x
VIPnet (Croatian Mobile)	100%	677	1.5	8.3% DCF (11.5% WACC, 0% terminal growth)		4.3x	4.5x
Mobikom (Liechtenstein)	100%	13	0.0	0.2% 2010E EBITDA multiple		4.0x	4.0x
Vip operator (FYROM)	100%	33	0	0.4%			n.m.
Vip mobile (Serbia)	100%	120	0	1.5%			n.m.
Si.mobil (Slovenian Mobile)	100%	173	0.4	2.1% DCF (11.5% WACC, 0% terminal growth)		3.6x	3.6x
Total International Mobile		3,099	7.0	37.8%		4.9x	4.8x
Total Consolidated Assets		8,205	18.5	100.0%			
Group Enterprise Value		8,205	18.5			5.0x	5.0x
2010E Net Debt		3,511	7.9	42.8%			
Group Equity Value		4,694	10.6				

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change
- Transfer of Coverage

Laurie Fitzjohn-Sykes, CFA
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laurie.fitzjohnsykes@citi.com

Buy/Medium Risk	1M
Price (09 Dec 10)	NKr93.15
Target price	NKr120.00
Expected share price return	28.8%
Expected dividend yield	3.4%
Expected total return	32.3%
Market Cap	NKr154,432M US\$25,688M

Price Performance (RIC: TEL.OL, BB: TEL NO)



Telenor ASA (TEL.OL) Rising Uncertainty Creates Valuation Opportunity

- **Growth profile offsets rising risk** – Telenor continues to trade at a discount to the sector due to a number of risks overhanging the stock, uncertainty in India, domestic operations and direct/indirect M&A. However we argue that the attractive growth profile provided by emerging market assets combined with the attractive valuation more than compensates for the additional risk.
- **Attractive valuation and higher growth** - On our calculations excluding India Telenor trades on 4.6x 2011E EV/EBITDA a small discount to the sector. In addition (excluding India) Telenor offers significantly higher growth than the sector with a 4.0% 2011-14E EBITDA CAGR vs the sector at 1.4%. We exclude India because it temporarily reduces 2010 and 2011 EBITDA.
- **Emerging market growth** – Telenor's emerging market assets grew 12% in 3Q10 in local currency, this is being driven by economic growth, rising penetration and mobile data take up. We argue that the falling price of 3G handsets should increase data take up in emerging markets sooner than expected. Emerging markets are 33% of Telenor's EV and 36% of its equity value based on our SOTP valuation.
- **Indian uncertainty** – Uncertainty in India now encompasses a possible payment following the 2008 2G auction investigation, when consolidation will be allowed, in addition to operational performance. We acknowledge these risks but argue they are reflected in the valuation. We calculate the worst case payment due to the 2G auction investigation to be NOK 7/share, vs a NOK 3/share fall since the announcement, suggesting the risk is already reflected.
- **M&A Risk** – Telenor retains leverage at a low level of 0.7x 2010E net debt/EBITDA and states that M&A is part of its strategy. Investors are attaching a significant risk to this due to the value destruction from management's decision to enter the Indian market. While India has damaged management's reputation, overall Telenor has one of the strongest operationally track records.
- **Forecast changes** – We update our forecasts for the latest FX movements. With this note we transfer coverage to Laurie Fitzjohn Sykes from Simon Weeden.

Telenor ASA (NOK)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (NkrM)	96,167.1	97,650.0	94,275.8	99,247.8	102,090.2
Net Income (NkrM)	14,154.3	10,481.0	9,786.3	13,160.4	16,192.2
Diluted EPS (Nkr)	8.48	6.33	5.94	8.15	10.27
Diluted EPS (Old) (Nkr)	8.48	6.33	5.92	7.95	9.89
PE (x)	11.0	14.7	15.7	11.4	9.1
EV/EBITDA (x)	6.2	5.9	5.9	5.1	4.5
DPS (Nkr)	0.00	2.50	3.29	4.12	5.72
Net Div Yield (%)	0.0	2.7	3.5	4.4	6.1

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	11.1	14.8	15.8	11.5	9.1
EV/EBITDA adjusted (x)	6.2	6.0	5.9	5.1	4.5
P/BV (x)	1.9	2.0	1.8	1.7	1.6
Dividend yield (%)	0.0	2.7	3.5	4.4	6.1
Per Share Data (Nkr)					
EPS adjusted	8.48	6.33	5.94	8.15	10.27
EPS reported	7.83	5.22	8.92	8.08	10.20
BVPS	48.83	45.83	51.58	55.15	59.94
DPS	0.00	2.50	3.29	4.12	5.72
Profit & Loss (NkrM)					
Net sales	96,167	97,650	94,276	99,248	102,090
Operating expenses	-80,459	-84,330	-81,600	-83,876	-83,481
EBIT	15,708	13,320	12,676	15,372	18,609
Net interest expense	-2,299	-2,092	-1,030	-1,171	-1,169
Non-operating/exceptionals	5,963	3,574	8,836	5,073	6,278
Pre-tax profit	19,372	14,802	20,482	19,274	23,719
Tax	-4,329	-4,290	-4,916	-5,437	-6,108
Extraord./Min.Int./Pref.div.	-1,978	-1,861	-876	-783	-1,525
Reported net income	13,065	8,651	14,690	13,054	16,086
Adjusted earnings	14,154	10,481	9,786	13,160	16,192
Adjusted EBITDA	30,433	31,122	28,941	31,230	34,450
Growth Rates (%)					
Sales	4.3	1.5	-3.5	5.3	2.9
EBIT adjusted	3.4	-15.2	-4.8	21.3	21.1
EBITDA adjusted	4.7	2.3	-7.0	7.9	10.3
EPS adjusted	-19.5	-25.4	-6.1	37.1	26.0
Cash Flow (NkrM)					
Operating cash flow	24,371	25,865	22,990	24,472	27,023
Depreciation/amortization	14,101	17,598	15,910	15,708	15,691
Net working capital	1,470	243	2,669	0	0
Investing cash flow	-13,545	-8,909	-11,360	-11,524	-11,201
Capital expenditure	-17,465	-13,014	-12,493	-13,829	-14,551
Acquisitions/disposals	2,970	-580	-1,162	0	0
Financing cash flow	-9,496	-13,235	-6,639	-11,857	-13,073
Borrowings	-534	-12,218	1,900	0	0
Dividends paid	-7,192	-1,530	-6,318	-7,909	-9,025
Change in cash	2,084	2,627	4,991	1,091	2,749
Balance Sheet (NkrM)					
Total assets	187,172	166,031	169,216	171,196	175,733
Cash & cash equivalent	8,925	11,479	16,470	17,561	20,310
Accounts receivable	0	0	0	0	0
Net fixed assets	59,772	55,598	57,034	59,946	63,592
Total liabilities	98,604	80,966	77,640	77,640	77,640
Accounts payable	0	0	0	0	0
Total Debt	56,033	39,342	37,042	37,042	37,042
Shareholders' funds	88,568	85,065	91,576	93,556	98,093
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	31.6	31.9	30.7	31.5	33.7
ROE adjusted	18.9	13.4	12.2	15.3	17.9
ROIC adjusted	10.4	8.2	8.0	10.8	13.8
Net debt to equity	53.2	32.8	22.5	20.8	17.1
Total debt to capital	38.8	31.6	28.8	28.4	27.4

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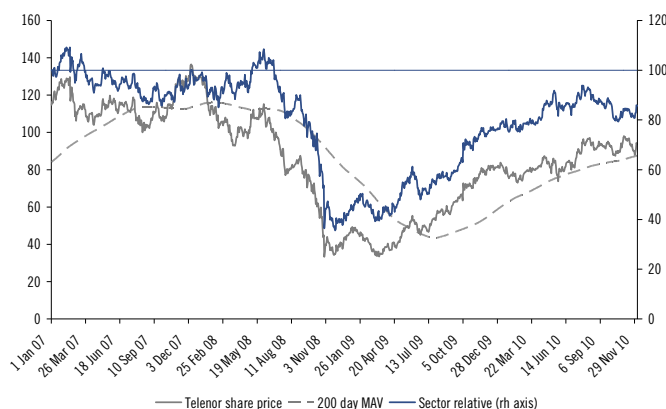
Telenor performance and outlook

Increasing uncertainty has been weighing on Telenor's shares, this has come from India, domestic operations and direct/indirect M&A risk. On our calculations (excluding India) Telenor trades on 4.6x 2011E EV/EBITDA a slight discount to the sector. In addition excluding India Telenor offers significantly higher growth than the sector with a 4.0% 2011-14E EBITDA CAGR vs the sector at 1.4%.

We highlight that while there is indirect M&A risk in associate holdings, Telenor is receiving associate dividends in contrast to Telia for which a dividend from Megafon may be a few years away.

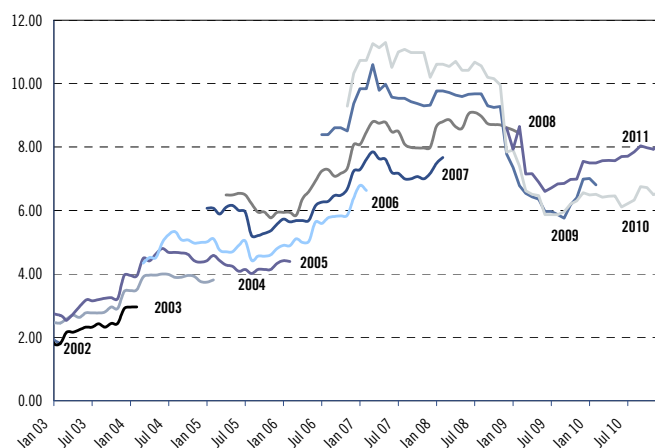
We acknowledge the higher risks, however we argue that the attractive growth profile provided by emerging market assets more than compensates for this.

Figure 186. Telenor has outperformed the sector until recently (left axis NOK/share; right axis index: end-2006=100)



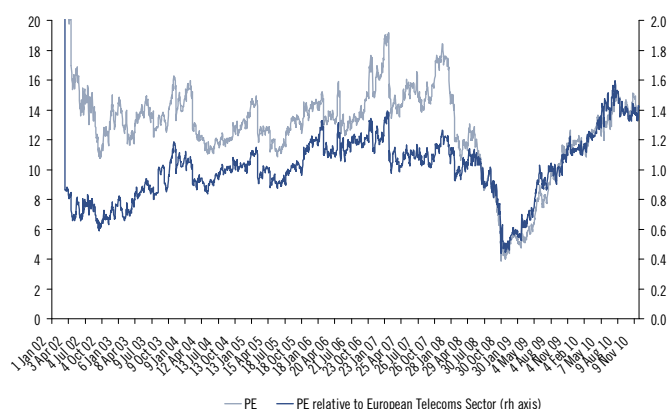
Source: DataStream

Figure 188. Consensus EPS has lately recovered somewhat (NOK)



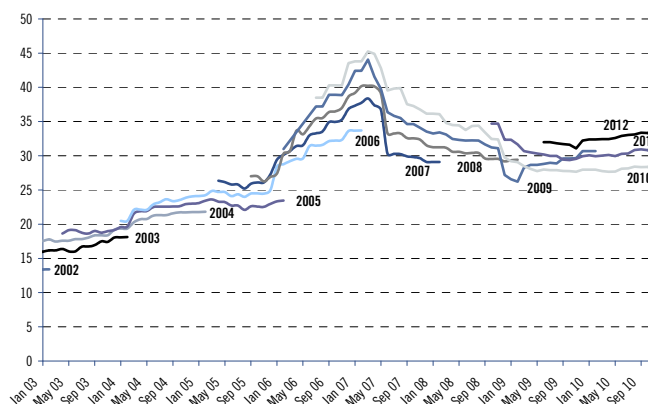
Source: DataStream

Figure 187. Telenor trades well above the sector average on PE (1 year forward)



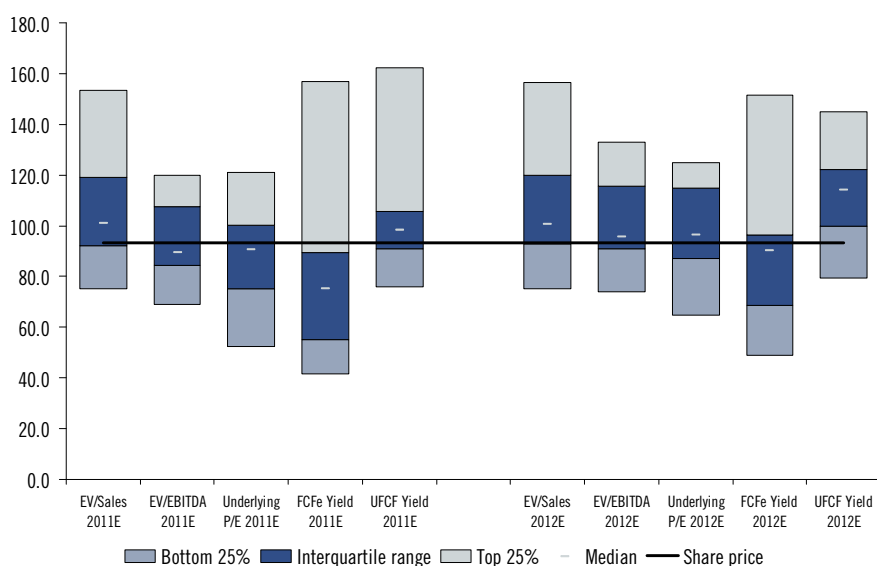
Source: DataStream

Figure 189. EBITDA consensus has lately been moving slightly up (NOKbn)



Source: DataStream

Figure 190. Compared to its incumbent and wireless peers in Europe Telenor generally trades at or above the median
NOK/share



Source: Powered by dataCentral

4.9x 2011E EV/EBITDA excluding India

To provide an adjusted EV/EBITDA excluding India we increase EV by the forecast value of future losses from Indian operations and remove Indian losses from EBITDA for the current year. For 2011E this reduces the EV/EBITDA from 5.1x to 4.6x.

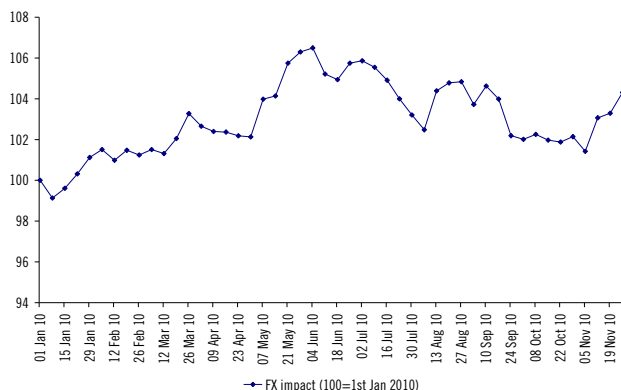
Figure 191. EV/EBITDA excluding India

	2010E	2011E	2012E	2013E
Price	95	95	99	103
#shares	1,635	1,596	1,558	1,532
MV	155,933	151,573	154,880	157,221
net debt	19,020	17,929	15,180	7,423
EV	174,952	169,502	170,060	164,644
associates	48,196	48,196	48,196	48,196
minorities	36,810	36,810	36,810	36,810
Adj EV	163,567	158,116	158,674	153,259
EV/EBITDA	5.7	5.1	4.6	4.1
Excl india				
EV adjustment	9,682	3,982	0	0
EV adj	173,249	162,098	158,674	153,259
India EBITDA	(4,500)	(4,000)	(2,000)	(28)
EBITDA excl india	33,441	35,230	36,450	37,661
EV/EBITDA	5.2	4.6	4.4	4.1

Source: Citi Investment Research and Analysis

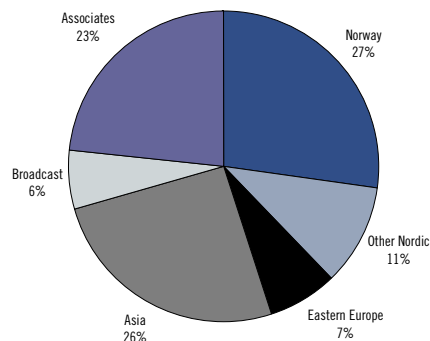
FX risk from a diverse range of assets

Figure 192. FX changes impact on the SOTP



Source: Citi Investment Research and Analysis

Figure 193. EV SOTP split



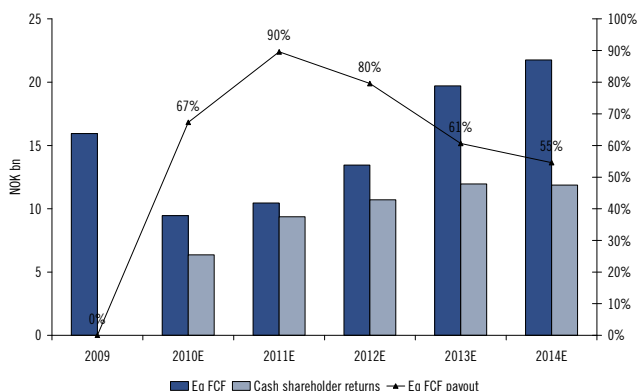
Source: Citi Investment Research and Analysis

Leverage and Dividends

- **Dividend policy:** Ordinary dividend 40-60% of normalised net income. In addition Telenor plans to use buybacks to deliver shareholder returns in line with the sector (c.6.5%).
- **Leverage policy:** Committed to maintain net debt/EBITDA below 1.6x. On our forecasts Telenor is well below this as at 0.7x 2010 net debt/EBITDA.

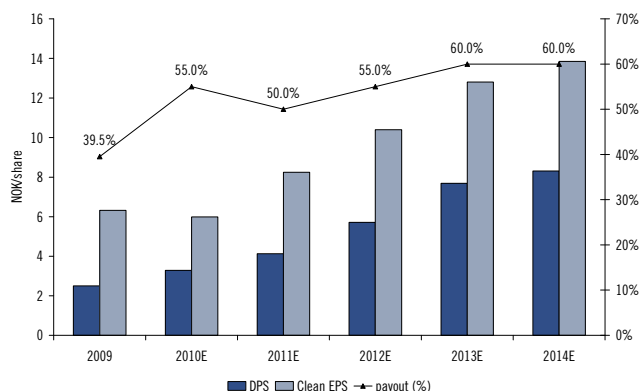
Telenor is currently maintaining leverage significantly below its upper limit, this is to provide the flexibility for M&A which Telenor includes on its priorities for capital allocation. Investors are attaching a significant risk to this in our view probably due to the value destruction from managements decision to enter the Indian market.

Figure 194. Cash Shareholder returns payout ratio – We forecast a buyback for the next 3 years increasing total shareholder returns to be in line with the sector



Source: Citi Investment Research and Analysis

Figure 195. Dividend payout ratio – We forecast the ordinary dividend payout increasing to the top end of the 40-60% range



Source: Citi Investment Research and Analysis

India Uncertainty

The investigation into the 2008 2G license auctions has now become a political issue which makes the outcome less clear. The Department of Telecommunications (DoT) has stated it plans to issue notices to the current holders of licenses issued in 2008 for which eligibility requirements were not met, asking why the licenses should not be cancelled. Operators will be given 60 days to respond.

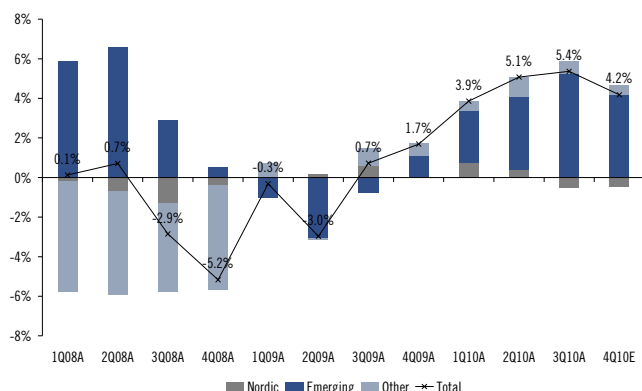
The worst case scenario would be if Telenor has to pay the difference between the 2008 2G price and that implied by the recent 3G auction price. Based on the same \$/Mhz/pop on our calculations this would be INR 131bn (NOK 17bn) additional payment, this equates to NOK 7 per share. However this is a worst case and we would expect any payment to be considerably less than this. Since the resignation of the India Telecoms minister Telenor has fallen NOK 3, therefore we argue this risk is already discounted in the shares.

In addition the DoT may serve similar notices to those license holders which have not met the roll-out requirements. For Telenor this is 8 out of its 21 licenses where it has not commercially launched services. The DoT said if roll-out requirements were not met within a year licenses could be cancelled. In our view a reduction in the number of circles Uninor operates in would not be a significant negative.

Lower handset prices driving emerging markets growth

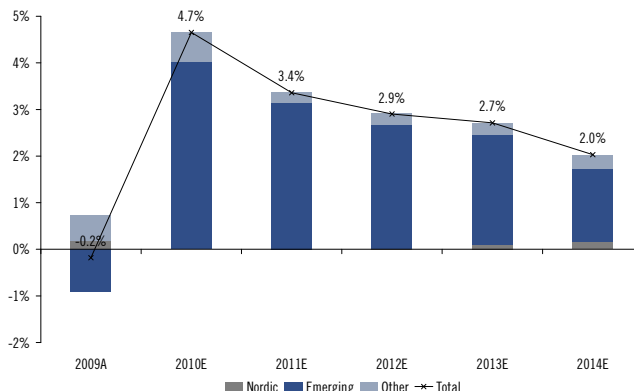
Telenor's emerging market assets are driving group revenue growth. In 3Q10 emerging markets grew 11.7% in local currency. We forecast a slight moderation in 4Q10 and 2011. However with the falling price of smartphones driving mobile data we argue that risk is to the upside for emerging market growth.

Figure 196. Local currency revenue growth, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 197. Local currency revenue growth, yearly

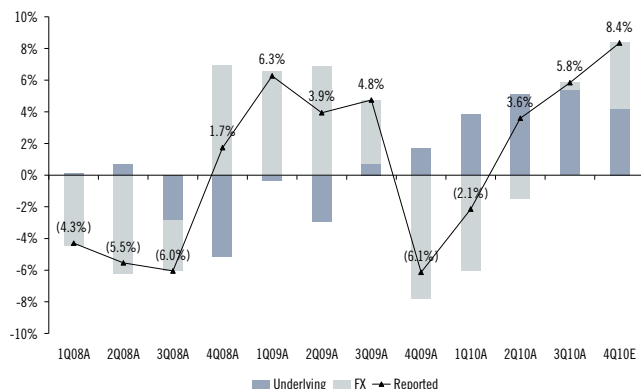


Source: Company reports, Citi Investment Research and Analysis

FX tailwind

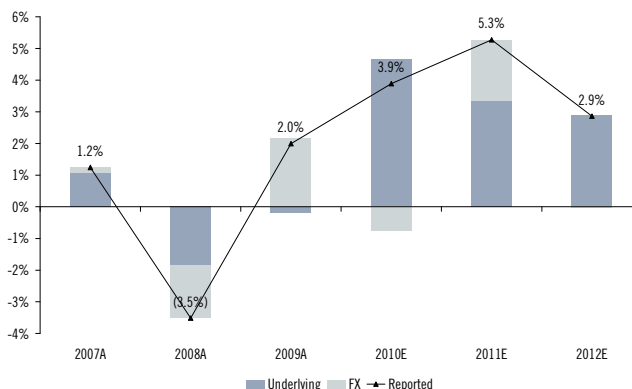
Based on our calculations FX had a broadly neutral impact on the 3Q10 growth rate, however we calculate a +4.2ppt tailwind in 4Q10 and +1.9ppt in 2011.

Figure 198. Revenue growth and FX impact, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 199. Revenue growth and FX impact, yearly

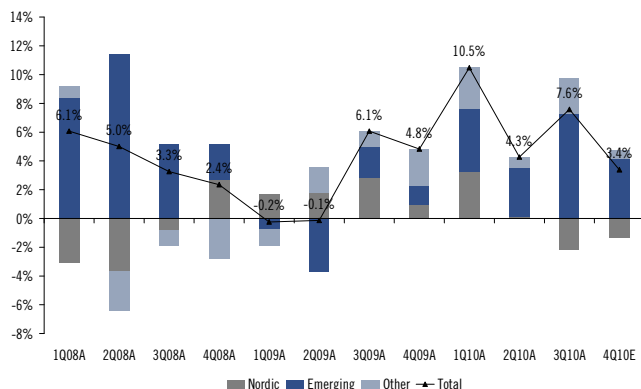


Source: Company reports, Citi Investment Research and Analysis

Network swap outs delaying Nordic margin improvement

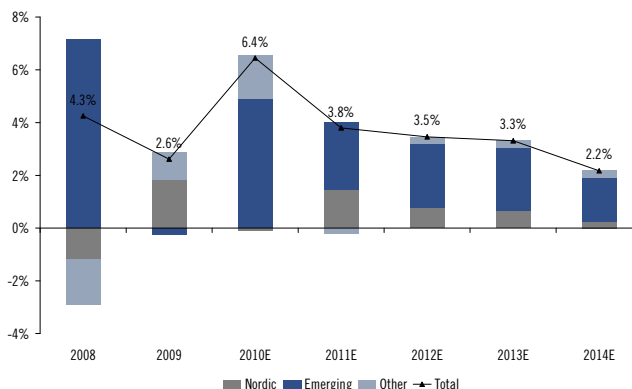
The mobile network swaps are delaying margin improvement in the Nordic markets, as can be seen from a yoy reduction in Nordic EBITDA in 3Q10. We forecast Nordic margin improvement in 2011 and beyond contributing to group EBITDA growth along with emerging markets growth.

Figure 200. Local currency EBITDA growth excl India, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 201. Local currency EBITDA growth excl India, yearly



Source: Company reports, Citi Investment Research and Analysis

Weak Norway Mobile

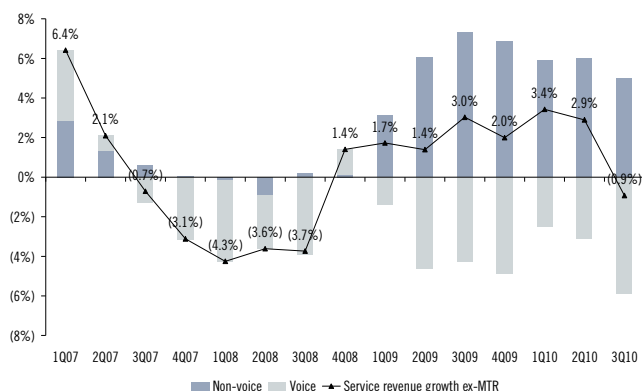
The Norwegian mobile market saw growth worsen to -0.9% 3Q10 (excl MTR cut) from 2.9% 2Q10. This was at odds with the majority of other Northern countries which saw continued strong growth in 3Q10.

Telenor stated that this was caused by lower usage in the corporate segment and the reduction in international roaming rates. This is supported by Figure 202 which shows voice deteriorated while data remained strong. Figure 203 shows that the weakness in voice was primarily driven by a reduction in minutes growth, with slightly high decline in yield.

In addition Tele2 and One Call (Network Norway) are being more aggressive with voice and data bundles. We therefore would expect growth in the Norwegian mobile market to remain weak for the next few quarters.

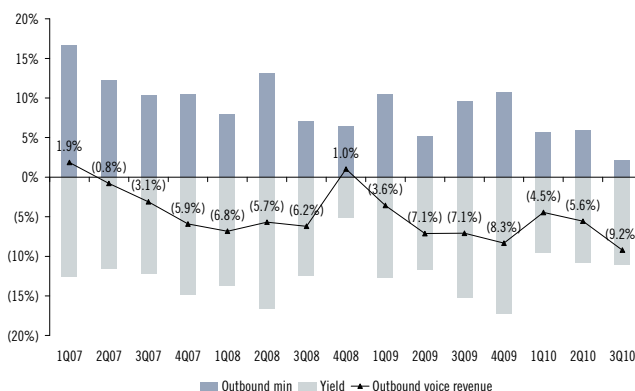
We also highlight potential upcoming M&A and potential new entrants in the market. There has been press speculation that Tele2 Norway may sell to its network partner Network Norway. In addition 3 Hutch still has a 3G license, however it has not rolled out a network.

Figure 202. Norway mobile service revenue growth (excl MTR cuts) – voice and non-voice contribution



Source: Company reports, Citi Investment Research and Analysis

Figure 203. Outbound voice revenue growth – minutes growth and yield decline



Source: Company reports, Citi Investment Research and Analysis

Valuation

We present below our updated DCF and SOTP valuations. Associate holdings listed market value has increased recently, offsetting this we decrease our valuation of Norway following our analysis of worsening voice pricing trends.

Figure 204. SOTP Valuation (NOK m)

Division	Stake	Enterprise value	Net (debt) 2011	Valuation Method	Telenor equity	% of Telenor EV	Value/ share	EV/ Sales	EV/ EBITDA
Norway	100%	58,259	0	5.5x 2011 EV/EBITDA	58,259	27.9%	36.5	2.2x	5.5x
Denmark	100%	8,666	0	5.0x 2011 EV/EBITDA	8,666	4.1%	5.4	1.2x	5.0x
Sweden	100%	13,640	0	5.5x 2011 EV/EBITDA	13,640	6.5%	8.5	1.4x	5.5x
Total Nordic		80,564	0		80,564	38.6%	50.5	1.9x	5.4x
Hungary	100%	9,132	0	4.5x 2011 EV/EBITDA	9,132	4.4%	5.7	1.9x	4.5x
Serbia	100%	4,632	0	4.5x 2011 EV/EBITDA	4,632	2.2%	2.9	1.8x	4.5x
Montenegro	100%	1,165	0	4.5x 2011 EV/EBITDA	1,165	0.6%	0.7	1.9x	4.5x
Thailand	66%	22,457	370	Market value +10%	15,066	7.2%	9.4	1.5x	4.4x
Malaysia	49%	37,998	(848)	Market value	18,204	8.7%	11.4	3.4x	7.9x
Bangladesh	56%	22,960	0	6.5x 2011 EV/EBITDA	12,858	6.2%	8.1	3.3x	6.5x
Pakistan	100%	9,978	0	6.0x 2011 EV/EBITDA	9,978	4.8%	6.3	1.9x	6.0x
India	67%	(3,982)	0	FCF loss post end-11	(2,668)	(1.3%)	(1.7)	(2.6x)	1.0x
Total Emerging		104,339	(478)		68,365	32.7%	42.8	2.2x	7.2x
Broadcast	100%	12,677	0	5.5x 2011 EV/EBITDA	12,677	6.1%	7.9	1.4x	5.5x
Other	100%	(1,637)	0	5.0x 2011 EV/EBITDA	(1,637)	(0.8%)	(1.0)	(0.5x)	5.0x
Total Core		195,943	(478)		159,969		100.3	2.0x	6.3x
Associates	38.8%	144,789	(20,702)	Market value	48,196	23.1%	30.2		4.1x
EDB Business Partners	27.0%	5,640	(3,000)		713	0.3%	0.4		
Total Group		346,372	(24,180)		208,877		130.9		
Net debt, 2011	100%		(17,451)		(17,451)	(8.4%)			
Total Group		346,372	(41,631)		191,426		120.0		

Source: Citi Investment Research and Analysis

Figure 205. DCF Valuation (NOK m)

Year to Mar	2009	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E	2018E	2019E	2020E
EBITDA	30,918	28,585	31,080	34,300	37,483	38,653	39,442	40,108	40,823	41,499	42,141	42,791
Mvt in working capital	243	2,669	0	0	0	0	0	0	0	0	0	0
Capex inc spectrum	(13,666)	(12,855)	(13,829)	(14,551)	(11,392)	(11,709)	(12,235)	(12,482)	(12,717)	(12,944)	(13,163)	(13,386)
Dividends from associates	4,757	1,495	2,305	3,351	4,078	5,816	5,754	5,754	5,754	5,754	5,754	5,754
Dividends to minorities	(1,530)	(2,178)	(2,488)	(2,365)	(2,550)	(2,702)	(2,849)	(2,936)	(3,036)	(3,124)	(3,201)	(3,278)
Tax paid	(2,491)	(5,942)	(5,437)	(6,108)	(6,835)	(7,583)	(8,317)	(8,734)	(9,141)	(9,514)	(9,858)	(10,189)
Interest paid	(2,242)	(1,806)	(1,171)	(1,169)	(1,070)	(717)	(345)	(2)	330	650	961	1,264
FCF	15,989	9,969	10,460	13,458	19,713	21,757	21,450	21,709	22,013	22,321	22,634	22,957
Adjustments												
Interest & dividends	2,242	1,806	1,171	1,169	1,070	717	345	2	(330)	(650)	(961)	(1,264)
Tax shield on interest	(740)	(596)	(387)	(386)	(353)	(237)	(114)	(1)	109	215	317	417
Unlevered FCF	17,491	11,179	11,245	14,241	20,430	22,237	21,681	21,710	21,792	21,885	21,990	22,109
Cost of capital											NOK mn	NOK
Market gearing (D/E)	33.0%						Value of yrs 1-7 cash flows				110,555	69.3
Weight average tax rate	33.0%				5.0%		Terminal Value				98,844	62.0
Risk free rate	4.5%		Eq.risk premium		1.45		Enterprise value				209,399	131.2
Bond spread	1.0%		Geared beta		1.77		Post BS events					0.0
Cost of debt	5.5%		Cost of equity		13.3%		Net debt (end-11)				(17,929)	(11.2)
WACC	10.9%						Equity value				191,470	120.0
							Dividend exc from net debt				0	0.0
							Equity value ex div					120.0
Perp growth (post yr 9)	1.0%											

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Estimate Change
- Transfer of Coverage

Laurie Fitzjohn-Sykes, CFA

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laurie.fitzjohnsykes@citi.com

Hold/Medium Risk	2M
Price (09 Dec 10)	SKr54.10
Target price	SKr55.00
Expected share price return	1.7%
Expected dividend yield	4.6%
Expected total return	6.3%
Market Cap	SKr242,934M
	US\$35,340M

Price Performance (RIC: TLSN.ST, BB: TLSN SS)



TeliaSonera AB (TLSN.ST)

Premium valuation, not without risk

- **Strong operations, premium valuation** – Telia continues to have some of the strongest operations within the European operators and trades on a premium valuation. We highlight the risks to these operational trends and we do not see further upside to the current premium valuation.
- **Premium valuation** – On our forecasts Telia trades at 6.1x 2011E EV/EBITDA, a 24% premium to the sector. This is despite offering EBITDA growth only slightly above the sector average, we forecast Telia as a 3.0% 2011-14 EBITDA CAGR, vs the sector average of 1.4%.
- **Strong Swedish mobile** – The Swedish mobile market continues to have significantly higher growth than other European markets, growth of 8.6% excl MTR cuts in 3Q10 vs the European average of 1.7%, excl MTR cuts. However this is partly at the expense of cannibalising fixed, which saw a further worsening of trends in 3Q10. Telia is exposed here as it has a higher market share in fixed than mobile.
- **Limited further domestic margin improvement** – Telia has delivered successful domestic cost cutting over recent years, we argue there is now limited further margin improvement available.
- **No sign of cash from Megafon** – The ownership dispute around Megafon and Turkcell continues with little sign of a resolution. Megafon is c.25% of our SOTP valuation but does not pay a dividend. However Megafon recently reported good 3Q10 results ahead of forecasts, 15.5% mobile revenue growth and 9.6% growth in mobile EBITDA.
- **Reliance on Spain** – Spanish mobile contributed 3ppt out of a group local currency revenue growth of 3.8% in 3Q10. Yoigo now has 4% market share, we highlight the risk that as Yoigo gains markets share the larger operators could act more aggressively to maintain market share.
- **Forecast changes** – We update our forecasts for FX. With this note we transfer coverage to Laurie Fitzjohn-Sykes from Simon Weeden.

TeliaSonera AB (SEK)

Year to 31 Dec	2008A	2009A	2010E	2011E	2012E
Sales (SKrM)	103,585.0	109,161.0	106,465.8	107,182.3	109,961.2
Net Income (SKrM)	19,011.0	18,854.0	20,806.6	21,019.3	22,210.3
Diluted EPS (SKr)	4.23	4.20	4.63	4.68	4.95
Diluted EPS (Old) (SKr)	4.23	4.20	4.62	4.63	4.90
PE (x)	12.8	12.9	11.7	11.6	10.9
EV/EBITDA (x)	7.3	6.5	6.3	5.9	5.5
DPS (SKr)	1.80	2.25	2.50	2.76	2.97
Net Div Yield (%)	3.3	4.2	4.6	5.1	5.5

Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	12.9	13.0	11.8	11.6	11.0
EV/EBITDA adjusted (x)	7.3	6.5	6.3	5.9	5.5
P/BV (x)	1.9	1.8	1.7	1.6	1.5
Dividend yield (%)	3.3	4.1	4.6	5.1	5.4
Per Share Data (\$K)					
EPS adjusted	4.23	4.20	4.63	4.68	4.95
EPS reported	4.23	4.20	4.63	4.68	4.95
BVPS	29.04	30.15	32.53	34.71	36.90
DPS	1.80	2.25	2.50	2.76	2.97
Profit & Loss (\$K)					
Net sales	103,585	109,161	106,466	107,182	109,961
Operating expenses	-84,033	-86,852	-82,657	-82,576	-84,021
EBIT	19,552	22,309	23,808	24,606	25,940
Net interest expense	-2,237	-2,710	-2,030	-2,009	-1,936
Non-operating/exceptionals	9,096	8,015	7,698	8,133	8,724
Pre-tax profit	26,411	27,614	29,476	30,731	32,729
Tax	-4,969	-6,334	-6,485	-7,068	-7,528
Extraord./Min.Int./Pref.div.	-2,431	-2,426	-2,185	-2,643	-2,991
Reported net income	19,011	18,854	20,807	21,019	22,210
Adjusted earnings	19,011	18,854	20,807	21,019	22,210
Adjusted EBITDA	32,954	36,666	36,889	37,837	39,337
Growth Rates (%)					
Sales	7.5	5.4	-2.5	0.7	2.6
EBIT adjusted	8.9	13.8	-1.7	6.3	5.4
EBITDA adjusted	6.2	11.3	0.6	2.6	4.0
EPS adjusted	7.6	-0.8	10.4	1.0	5.7
Cash Flow (\$K)					
Operating cash flow	27,086	30,991	28,821	31,749	32,691
Depreciation/amortization	12,106	12,932	13,560	13,030	13,196
Net working capital	-565	-1,220	-900	500	500
Investing cash flow	-19,634	-17,627	-14,846	-15,284	-15,056
Capital expenditure	-15,758	-13,967	-13,766	-15,284	-15,056
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	-4,359	-2,568	-19,660	-13,869	-15,392
Borrowings	15,505	8,585	-7,604	0	0
Dividends paid	-19,864	-11,153	-12,288	-13,869	-15,392
Change in cash	4,024	10,662	-5,686	2,595	2,243
Balance Sheet (\$K)					
Total assets	264,286	269,670	272,359	282,505	292,314
Cash & cash equivalent	11,853	22,488	16,802	19,397	21,640
Accounts receivable	25,581	23,321	24,221	23,721	23,221
Net fixed assets	61,946	61,222	61,222	61,222	61,222
Total liabilities	122,838	127,171	119,156	119,510	119,510
Accounts payable	0	0	0	0	0
Total Debt	60,467	68,663	60,847	60,847	60,847
Shareholders' funds	141,448	142,499	153,202	162,995	172,804
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	31.8	33.6	34.6	35.3	35.8
ROE adjusted	15.4	14.2	14.8	13.9	13.8
ROIC adjusted	9.1	9.2	9.0	9.4	9.7
Net debt to equity	34.4	32.4	28.7	25.4	22.7
Total debt to capital	29.9	32.5	28.4	27.2	26.0

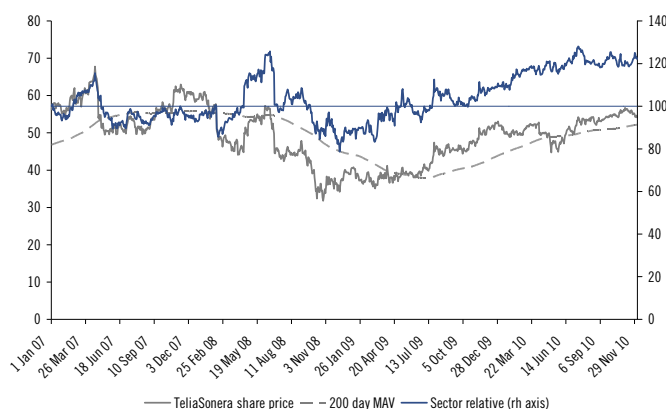
For further data queries on Citi's full coverage universe
please contact CIRA Data Services Europe at
CIRADatServicesEMEA@citi.com or +44-207-986-4050

TeliaSonera performance and outlook

Telia has delivered consistent strong operational performance over a number of years and correspondingly trades on a valuation premium. We argue that there are operational risks, for example from mobile cannibalisation of fixed in Sweden. In addition cash flows remain weak due to dividends to minorities and a lack of dividends from Megafon. Telia trades on 6.1x 2011E EV/EBITDA, a 24% premium to the sector, on our forecasts.

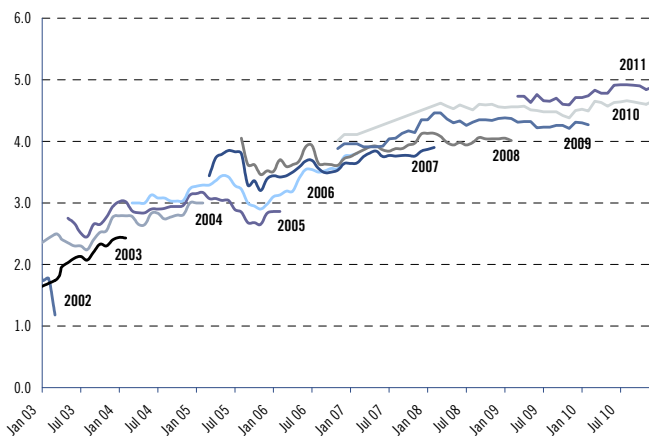
Telia is a strong match for the themes we are positive on for 2011, emerging market data growth and a preference for North vs South of Europe. However the premium valuation and lack of upcoming catalysts leaves limited upside and we maintain a Hold.

Figure 206. TeliaSonera has lately performed in line with the sector after a period of strength (left axis SEK/share; right axis index: end-2006=100)



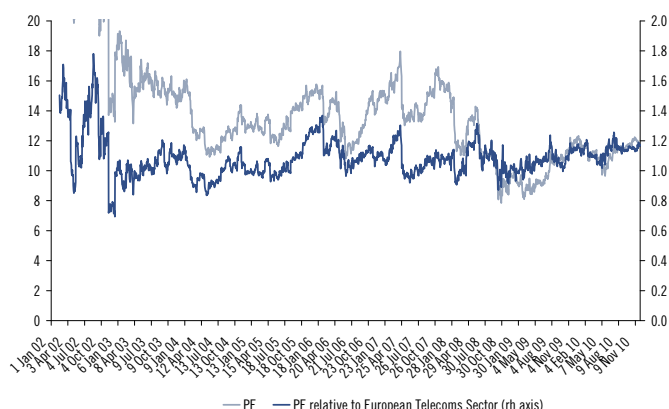
Source: DataStream

Figure 208. Consensus EPS has been on a strong run (SEK)



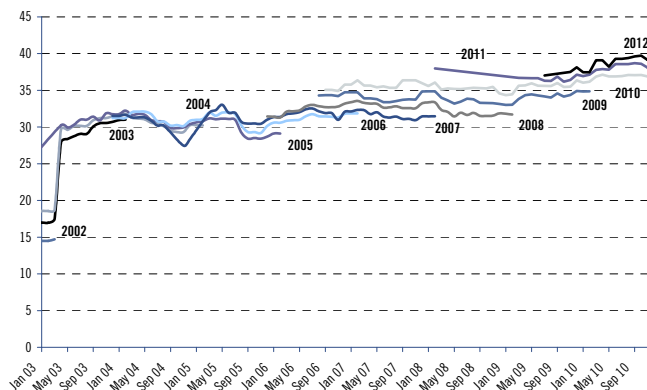
Source: DataStream

Figure 207. TeliaSonera trades above the sector average on PE (1 year forward)



Source: DataStream

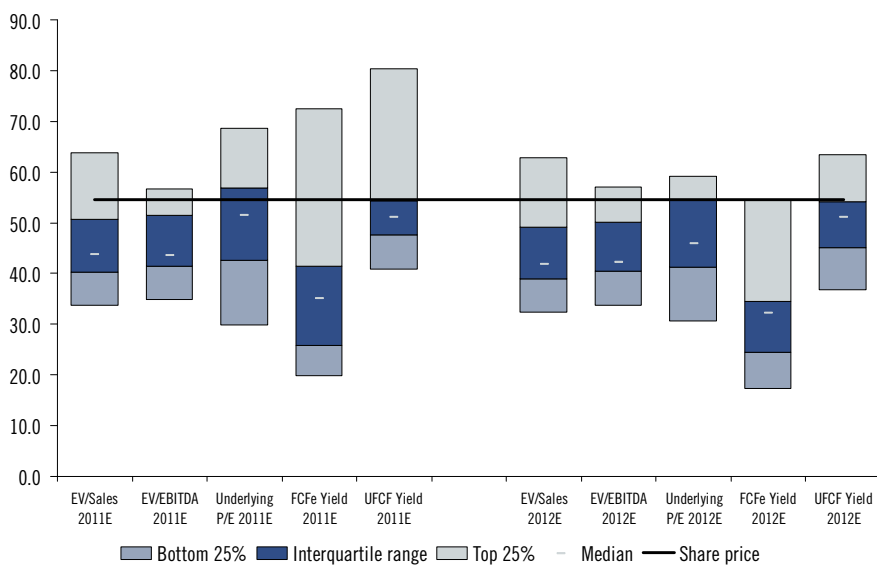
Figure 209. EBITDA consensus has lately been increasing (SEKbn)



Source: DataStream

Figure 210. Compared to its incumbent and wireless peers in Europe TeliaSonera generally trades in line with the top 25% of its peers

SEK/share



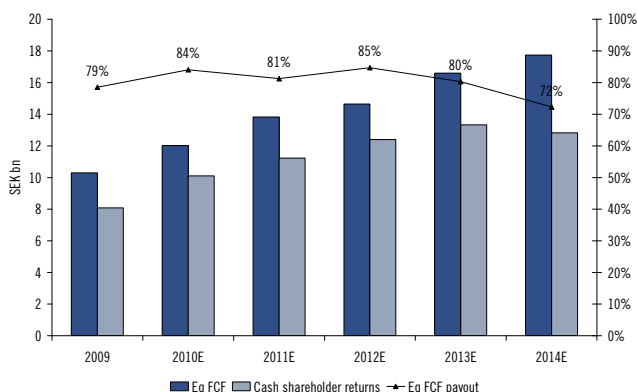
Source: Powered by dataCentral

Leverage and Dividends

- **Dividend policy:** Telia targets an ordinary dividend of at least 50% of net income. Excess capital may be returned to shareholders depending on cash at hand, cash flow and investment plans.
- **Leverage policy:** Target a solid investment grade credit rating A- to BBB+. Telia currently has low leverage at 1.2x 2010E net debt/EBITDA, vs the sector average of 1.9x.

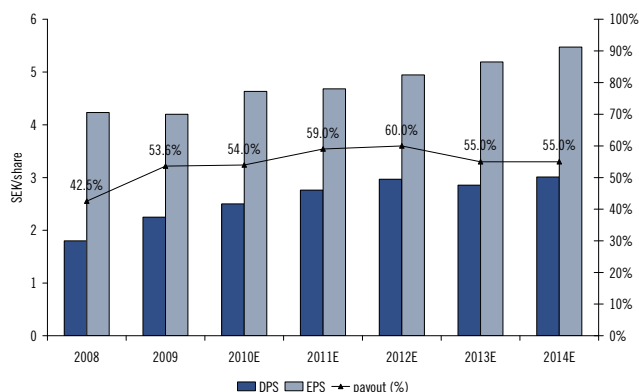
Telia has said it would like to do a buyback on recent results conference calls, however it would like to buyback from the Swedish and Finnish governments to avoid increasing their stakes. There is currently uncertainty around whether the Swedish government will reduce its stake, this has delayed a decision on a buyback. Management said there would be a further update at the 4Q10 results. A further use of cash would be M&A within Eurasia.

Figure 211. Dividend cash payout ratio – Lack of a dividend from Megafon increases the cash payout ratio to 80-85%



Source: Company reports, Citi Investment Research and Analysis

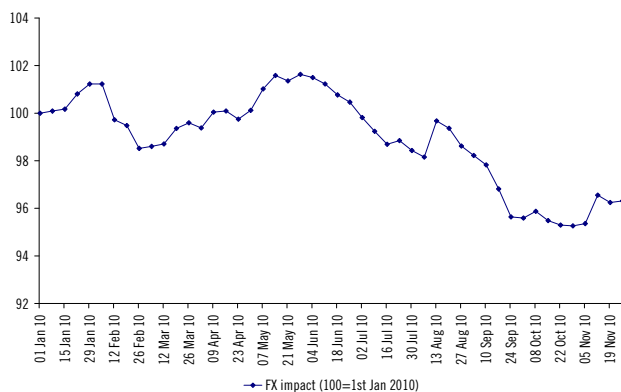
Figure 212. Dividend payout ratio - target payout ratio of above 50%



Source: Company reports, Citi Investment Research and Analysis

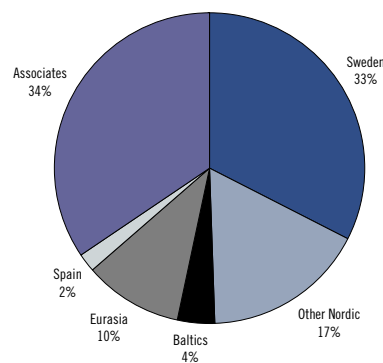
FX risk from a diverse collection of assets

Figure 213. FX changes impact on the SOTP



Source: Citi Investment Research and Analysis

Figure 214. EV SOTP split



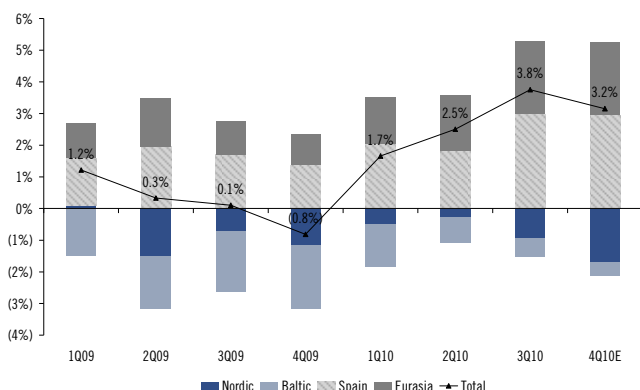
Source: Citi Investment Research and Analysis

Revenue growth reliance on Spain

In Figure 215 and Figure 216 we show the underlying growth in local currency broken down by region. Spain contributed 3ppt to group growth in 3Q10, vs total group growth of 3.8%. In contrast Spain is only 2% of EV in our SOTP valuation. Yoigo's (Telia Spain) service revenue market share is now 4.3% a 2ppt increase yoy.

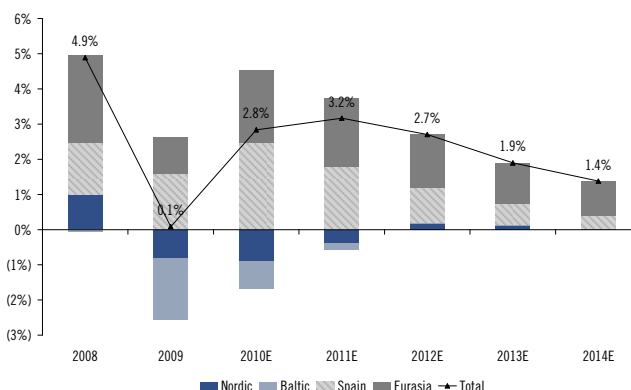
We highlight the risk that the larger operators may through the use of MVNOs or discount brands start to more aggressively defend market share. However we currently forecast Yoigo's market share increasing to 5.5%, this could arguably keep increasing to 10%

Figure 215. Local currency revenue growth, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 216. Local currency revenue growth, yearly

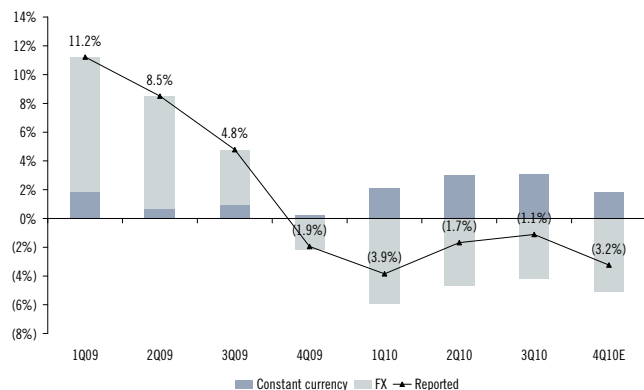


Source: Company reports, Citi Investment Research and Analysis

FX Headwind

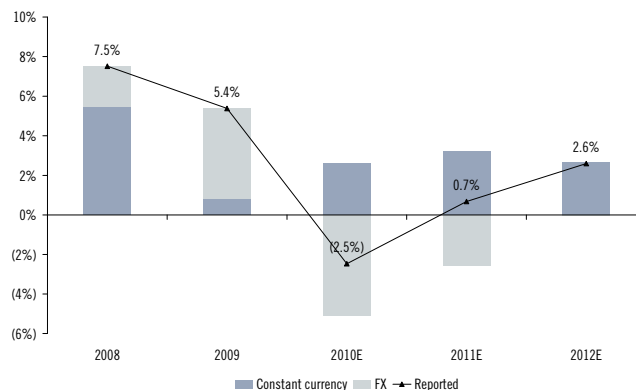
On our calculations Telia had a 4.2ppt headwind on revenue growth in 3Q10, we forecast this increasing to -5.1ppt in 4Q10 and a -2.6ppt headwind in 2011.

Figure 217. Revenue growth and FX impact, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 218. Revenue growth and FX impact, yearly

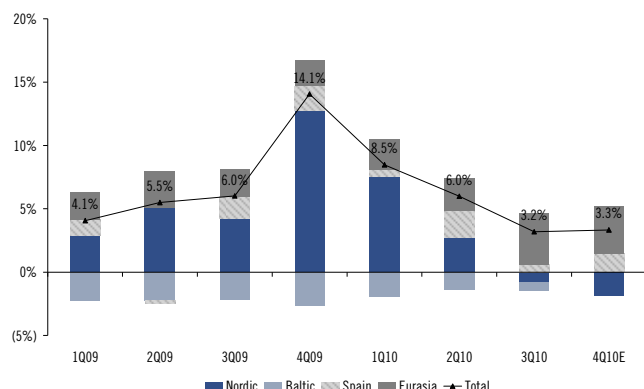


Source: Company reports, Citi Investment Research and Analysis

EBITDA growth in lower ownership assets

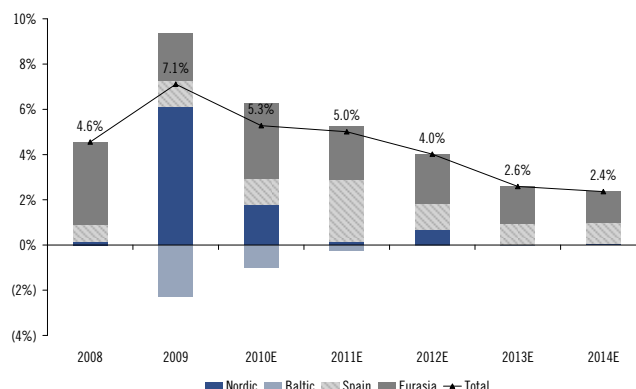
Telia has successfully carried out domestic cost cutting in the last few years, however there is now relatively little further upside in our view. Local currency revenue growth is now predominantly driven by Eurasia, due to the 17% growth rate and 50% margins. We highlight the longer term risk to margins in Eurasia as the markets mature and competition increases. In addition Telia's average economic ownership of its assets in Eurasia is 48%, therefore EBITDA growth in Eurasia leads to a corresponding rise in dividends paid to minorities, and hence lower FCF growth.

Figure 219. Local currency EBITDA growth, quarterly



Source: Company reports, Citi Investment Research and Analysis

Figure 220. Local currency EBITDA growth, yearly

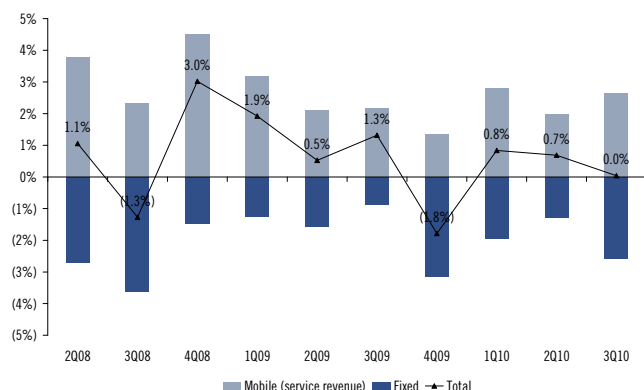


Source: Company reports, Citi Investment Research and Analysis

Risk from mobile cannibalisation of fixed

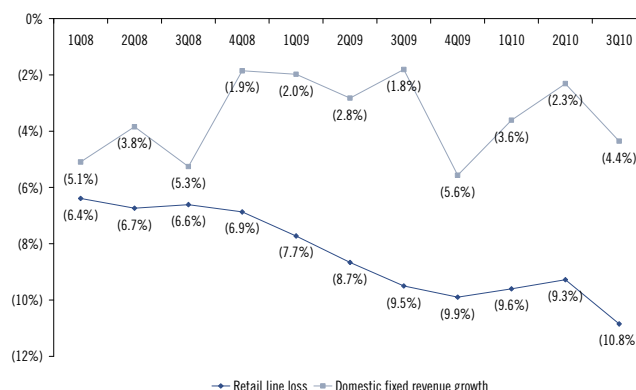
The Swedish mobile market has the highest growth amongst European countries, with 8.6% yoy growth excluding the impact of MTR cuts in 3Q10, vs the European average of 1.7%. Part of this high growth is from cannibalizing fixed as can be seen in Figure 222 fixed revenue and line loss trends worsened in 3Q10. In addition Telia's mobile and fixed revenue growth fell to 0% (we use mobile service revenue to strip out the impact of Telia's unusual accounting policy on booking handset revenues upfront), as shown in Figure 221.

Figure 221. Sweden mobile service revenue + fixed revenue growth



Source: Company reports, Citi Investment Research and Analysis

Figure 222. Telia Sweden fixed retail line loss and revenue growth



Source: Company reports, Citi Investment Research and Analysis

Valuation

Figure 223. TeliaSonera sum of the parts valuation comes to SEK55/share
SEKm

Division	Stake	Enterprise value	Net (debt) 2011	Valuation Method	Telia equity	% of Telia EV	Value/ share	EV/ Sales	EV/ EBITDA
Swedish Fixed-line	100%	37,190		5.5x 2010 EV/EBITDA	37,190	12.9%		2.1x	5.5x
Finnish Fixed-line	100%	8,631		5.0x 2010 EV/EBITDA	8,631	3.0%		1.6x	5.0x
Total Domestic Fixed-Line		45,821			45,821	15.9%	10.2	2.0x	5.4x
Swedish Mobile	100%	42,583		6.5x 2010 EV/EBITDA	42,583	14.8%		2.7x	6.5x
Finnish Mobile	100%	15,129		5.0x 2010 EV/EBITDA	15,129	5.2%		1.6x	5.0x
Total Domestic Mobile	100%	57,712			57,712	20.0%	12.9	2.3x	6.1x
Norway Fixed	100%	1,162		5.0x 2010 EV/EBITDA	1,162	0.4%		1.0x	5.0x
Norway Mobile	100%	17,093		6.0x 2010 EV/EBITDA	17,093	5.9%		2.1x	6.0x
Denmark Fixed	100%	695		6.0x 2010 EV/EBITDA	695	0.2%		0.7x	6.0x
Denmark Mobile	100%	6,266		5.0x 2010 EV/EBITDA	6,266	2.2%		1.0x	5.0x
Wholesale	100%	11,889		4.8x 2010 EV/EBITDA	11,889	4.1%		1.1x	4.8x
Other Nordic		37,105			37,105	12.9%	8.3	1.4x	5.4x
Lithuania Fixed	60%	3,989		5.0x 2010 EV/EBITDA	2,393	0.8%		2.0x	5.0x
Lithuanian Mobile	100%	2,855		5.5x 2010 EV/EBITDA	2,855	1.0%		1.9x	5.5x
Latvia Mobile	60%	3,710		5.5x 2010 EV/EBITDA	2,236	0.8%		2.2x	5.5x
Estonian Fixed	58%	2,673		5.0x 2010 EV/EBITDA	1,559	0.5%		1.5x	5.0x
Estonian Mobile	60%	3,511		5.5x 2010 EV/EBITDA	2,110	0.7%		2.2x	5.5x
Baltic Assets		16,738			11,153	3.9%	2.5	1.9x	5.3x
Eurasia	48%	61,138		7.0x 2010 EV/EBITDA	29,356	10.2%		3.5x	7.0x
Spanish Mobile	76%	7,769		1.0x 2010 EV/Sales	5,904	2.0%		1.0x	16.7x
Other ops	100%	2,080		4.0x 2010 EV/EBITDA	2,080	0.7%		0.4x	4.0x
Total Core		228,363			189,132	65.6%	42.1	2.1x	6.0x
Associates									
Turkish Mobile (Turkcell)	37%	87,925	16,290	Market Value	38,872	13.5%		2.0x	5.0x
Russian Mobile (Megafon)	44%	117,153	20,449	5.0x 2010 EV/EBITDA	60,270	20.9%		2.3x	5.0x
Total					288,274		64.2		
Net debt (2011)					(41,450)				
Total Core					246,824		55.0		

Source: Citi Investment Research and Analysis

Company Focus

- Company Update
- Target Price Change
- Estimate Change

Simon Weeden

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simon.weeden@citi.com

Buy/Low Risk	1L
Price (09 Dec 10)	£1.64
Target price	£1.95
	from £1.85
Expected share price return	19.0%
Expected dividend yield	5.4%
Expected total return	24.4%
Market Cap	£85,491M
	US\$135,114M

Price Performance (RIC: VOD.L, BB: VOD LN)



Vodafone Group PLC (VOD.L)

More of the same, please

- **Retain Buy** — We retain our Buy rating on Vodafone and increase our price target to 195p (from 185p due to stronger long term growth expectations) which is 11.5x cal 2011 underlying earnings. The strong rally in the stock in 2H10 (22% return in sterling) has in our view been driven by three important factors: (1) recovering revenue growth, (2) better visibility of the payout from Verizon Wireless and (3) increased confidence in capital discipline as the company has announced exits from its investments in China and Japan. Nonetheless this leaves the stock trading at only 9.7x 2011E earnings and a 2012/13 FCF to equity (by then inc VZW) of 12.5%. Minor estimate changes leave EBITDA down around 1% due to slower growth in Spain and Italy and MTR cuts in Germany.
- **News flow outlook still net positive** — 2011 could see more, sizeable asset sales as well as a firming up of the VZW dividend plans. The company is still targeting positive organic revenue growth from Europe (vs -0.7% in 2Q10/11) in around 4Q10/11 or 1Q11/12 dependent on MTR cuts and performance in Southern Europe. German MTR cuts for 1 Dec are 49% which reduces European service revenue growth by 80bp on our estimates.
- **Capital intensity set to rise in Europe, fall outside** — capex to sales for Vodafone in Europe was 11.3% in 2009/10 and the company expects a similar absolute level of capex in this financial year, at constant currencies. With revenue down slightly (1.4% organic on our forecasts), this guidance implies another small increase yoy in capex to sales (to 11.4%). We expect capital intensity (excl spectrum) to increase over the next few years as the company seeks to better exploit growth opportunities, conducts remaining network swap outs and refarming of 2G spectrum, and selectively invests in local fibre partnerships.
- **Dividend income to drive FCF** — Vodafone's policy is to "generate free cash flow or liquidity from non-controlled assets and investments". In the case of Verizon Wireless we expect the tax implications of an exit to be too adverse and therefore that Vodafone will wait for an increased dividend. For Verizon Comms to meet its own dividend and other obligations we expect it to borrow to meet maturities at the parent company level during 2011, and its management is indicating a discussion about reinstating a VZW dividend by end 2011 possibly for implementation in 2012. Our forecasts currently assume resumption in early calendar 2012 with impact from Vodafone's 2012/13 fiscal year (Figure 236).

Vodafone Group PLC (GBP)

Year to 31 Mar	2009A	2010A	2011E	2012E	2013E
Sales (£M)	41,017.0	44,472.0	45,447.0	45,576.5	45,853.4
Profit Before Tax (£M)	4,189.0	8,674.0	13,224.9	11,528.7	12,370.7
Diluted EPS (p)	15.7	16.0	15.7	17.2	18.0
Diluted EPS (Old) (p)	15.7	16.0	15.7	17.2	18.0
PE (x)	10.5	10.2	10.4	9.6	9.1
EV/EBITDA (x)	5.2	5.0	4.9	4.6	4.3
DPS (p)	7.8	8.3	8.9	9.5	11.9
Net Div Yield (%)	4.7	5.1	5.4	5.8	7.3

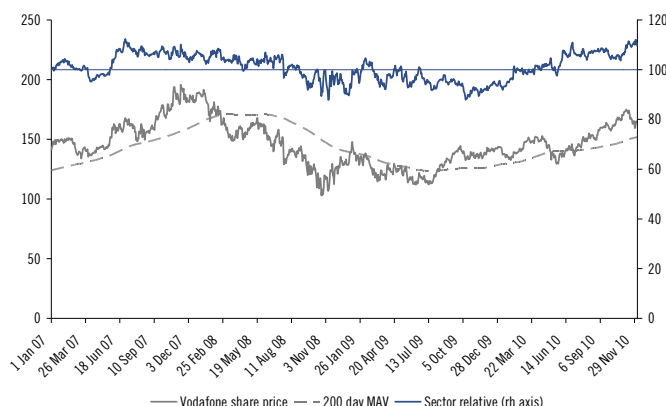
Fiscal year end 31-Mar	2009	2010	2011E	2012E	2013E
Valuation Ratios					
P/E adjusted (x)	10.5	10.2	10.4	9.6	9.1
EV/EBITDA adjusted (x)	5.2	5.0	4.9	4.6	4.3
P/BV (x)	1.0	1.0	0.9	0.9	0.8
Dividend yield (%)	4.7	5.1	5.4	5.8	7.3
Per Share Data (p)					
EPS adjusted	15.7	16.0	15.7	17.2	18.0
EPS reported	5.8	16.4	20.7	17.2	18.0
BVPS	164.2	171.6	185.1	192.4	197.9
DPS	7.8	8.3	8.9	9.5	11.9
Profit & Loss (£M)					
Net sales	41,017	44,472	45,447	45,577	45,853
Operating expenses	-33,351	-37,634	-38,947	-38,570	-38,333
EBIT	7,666	6,838	6,500	7,006	7,521
Net interest expense	-1,289	-902	-1,080	-984	-826
Non-operating/exceptionals	-2,188	2,738	7,805	5,506	5,676
Pre-tax profit	4,189	8,674	13,225	11,529	12,371
Tax	-1,109	-56	-2,111	-2,391	-2,688
Extraord./Min.Int./Pref.div.	-2	27	-214	-273	-407
Reported net income	3,078	8,645	10,899	8,864	9,277
Adjusted earnings	8,290	8,471	8,288	8,864	9,277
Adjusted EBITDA	14,490	14,735	14,623	15,020	15,335
Growth Rates (%)					
Sales	15.6	8.4	2.2	0.3	0.6
EBIT adjusted	6.5	-12.3	-2.5	6.9	7.3
EBITDA adjusted	10.0	1.7	-0.8	2.7	2.1
EPS adjusted	25.8	2.4	-1.9	9.1	4.9
Cash Flow (£M)					
Operating cash flow	11,045	11,658	10,459	11,480	11,905
Depreciation/amortization	6,824	8,011	8,068	8,014	7,815
Net working capital	16	452	260	-51	-54
Investing cash flow	-6,545	-7,019	-1,654	-4,982	-66
Capital expenditure	-6,060	-6,314	-9,303	-6,937	-7,020
Acquisitions/disposals	-1,240	-2,282	5,776	0	1,567
Financing cash flow	-1,677	-4,865	-7,992	-7,913	-7,802
Borrowings	3,427	-740	-1,000	-2,000	-2,000
Dividends paid	-4,175	-4,195	-4,888	-5,146	-5,834
Change in cash	2,823	-226	814	-1,415	4,037
Balance Sheet (£M)					
Total assets	152,699	156,985	159,057	160,024	161,903
Cash & cash equivalent	7,585	6,479	7,293	5,877	9,914
Accounts receivable	4,955	7,116	7,039	6,948	6,862
Net fixed assets	19,250	20,642	21,046	21,442	21,733
Total liabilities	67,922	66,175	63,517	58,075	56,826
Accounts payable	12,963	14,082	14,421	14,398	14,902
Total Debt	37,767	36,390	34,626	32,726	30,836
Shareholders' funds	84,777	90,810	95,540	101,950	105,077
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	35.3	33.1	32.2	33.0	33.4
ROE adjusted	10.1	9.6	8.9	9.1	9.3
ROIC adjusted	8.1	7.7	5.0	5.2	5.5
Net debt to equity	35.6	32.9	28.6	26.3	19.9
Total debt to capital	30.8	28.6	26.6	24.3	22.7

For further data queries on Citi's full coverage universe
please contact CIRA Data Services Europe at
CIRADatServicesEMEA@citi.com or +44-207-986-4050

More of the same, please

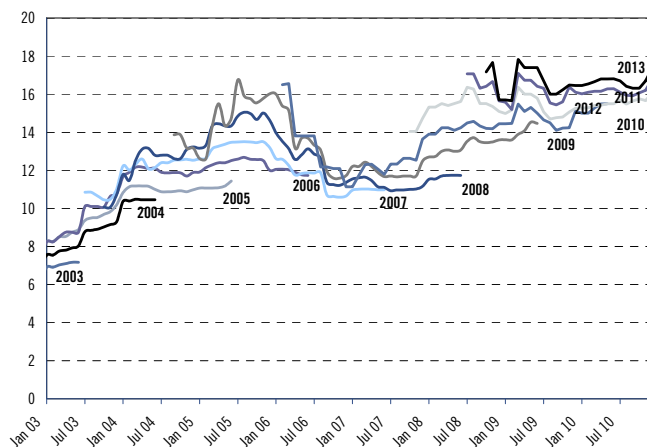
In 2010, year to date, Vodafone has delivered a total shareholder return of 22% in sterling and outperformed the sector by 16% - in 2011 a repeat performance looks possible to us. Vivendi is continuing to express an interest in Vodafone's stake in SFR and should have the firepower once it exits NBC Universal around end-2010. Completion of that transaction should further reinforce Vodafone's new reputation for capital discipline and allow it to nearly triple the size of its share buyback. If, as we expect, Verizon Wireless is armed with the iPhone from January, as well as a network which still rates highly with customers, it should have a strong start to the year. 2011 may be the year of 3G data in emerging markets as cheaper smartphones become available, although the same effect in the developed world could prompt a wider wave of upgrades and challenge operators' tight discipline on handset subsidies threatening margins. Later in 2011 we expect clarity on the Verizon Wireless dividend, if not the dividend itself which we currently forecast for early 2012.

Figure 224. Vodafone has outperformed the sector significantly since end-09 (left axis p/share; right axis index: end-2006=100)



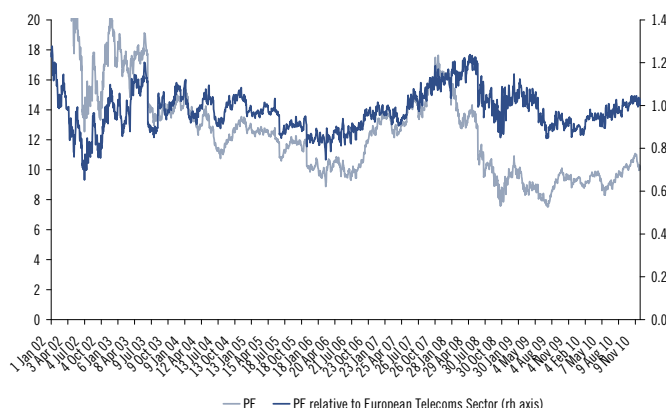
Source: DataStream

Figure 226. Consensus EPS has lately been heading up (p)



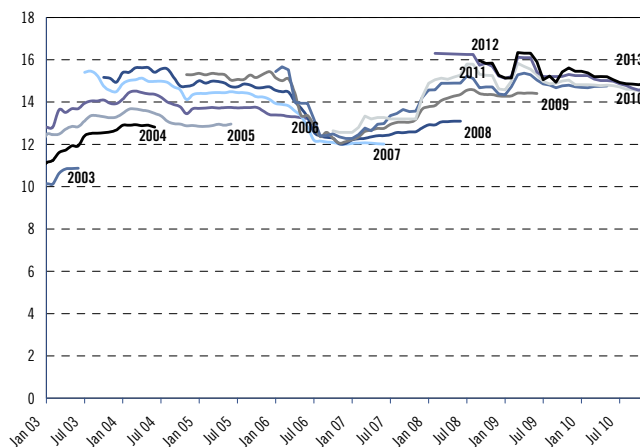
Source: DataStream

Figure 225. Vodafone trades below the sector average on PE (1 year forward)



Source: DataStream

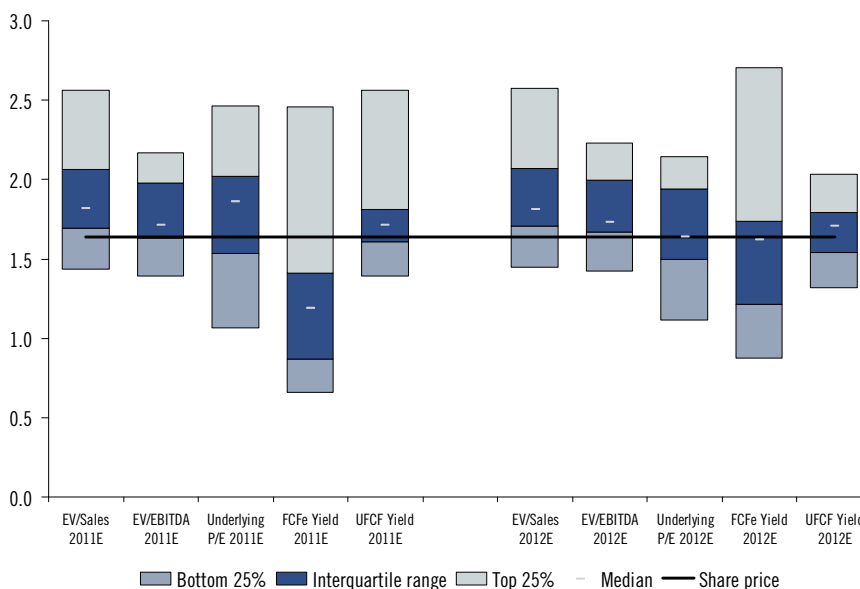
Figure 227. EBITDA consensus has lately been declining slightly (£bn)



Source: DataStream

Figure 228. Compared to its incumbent and wireless peers in Europe Vodafone generally trades between the median and lower quartile on our 2011 and 2012 estimates

£/share



Source: Powered by dataCentral

Significant upcoming events:

- **SFR:** Vivendi has indicated its interest in Vodafone's 43.85% stake in SFR. Vivendi's expected exit from NBC Universal around end-2010 could be a trigger to resolve ownership, giving Vodafone room to significantly increase its share buyback.
- **Verizon Wireless** may, according to industry commentators, start offering a CDMA version of the **iPhone in January 2011** which, given its reputation for a strong network, could have a material impact on the business.
- **European Commission is due to decide on the future shape of EU roaming regulations by Spring 2011** as the current regime expires in summer 2012. The Commission is unhappy with the lack of competitive pricing below the current price caps and looking at new options such as allowing customers to select networks themselves while travelling. Vodafone's new data roaming prices mean, for example, customers on £40 price plans or more in the UK will be able to use up to 25MB per day when travelling in the European Economic Area & Switzerland for no extra cost, or customers can take their domestic data plans abroad by paying €2 per day. This looks like both a move on the travelling smartphone market and an attempt to head off more intrusive regulation.
- **Indian capital gains tax case returns to India's Supreme Court on 19 July 2011** (delayed from February) and Vodafone's challenge against the move by the Indian tax office to treat it as an agent of the seller (Hutchison) is due to be heard by the Mumbai High Court on 8 February. The tax authority is claiming 112.18bn rupees (£1.53bn) and against this Vodafone has had to make a deposit of 25bn rupees (£0.34bn) into the Supreme Court registry, having had to obtain special permission to make the payment by wire transfer rather than bankers draft.

- **India's market review** may have been derailed by the dispute over the issuance of spectrum in 2008 (which for Vodafone was minor, its Spacotel spectrum allocation dated from 2006/7). Nonetheless we still think there is a chance that consolidation rules could be clarified around 2Q11, albeit disputes over retrospective changes to previous spectrum sales could delay operators from applying them.
- **The Essar put option is exercisable up to 8 May 2011** having opened on 8 May 2010. In our view the Essar Group will probably leave it until the last moment to decide to ensure it has the maximum information at its disposal and it may decide to retain its investment. Under the option, Essar can either put the whole of its 33% stake in Vodafone Essar to Vodafone at a value of US\$5bn or it can sell between US\$1bn and US\$5bn worth at an independently set fair market value plus \$750m. While we would expect that the option to sell the entire amount for \$5bn would be financially its best course of action should it decide to sell, during 2010 Essar and Vodafone renegotiated the partial option (according to press reports, adding the extra \$750m to compensate Essar for the high 3G licence prices) which suggests to us that Essar Group may still be interested in making use of that.
- **Verizon Wireless dividend:** for Verizon Comms to meet its own dividend and other obligations we expect it to borrow to meet maturities at the parent company level during 2011, and its management is indicating a discussion about reinstating a VZW dividend by end 2011 possibly for implementation in 2012. The CEO says that he expects to discuss resuming the VZW dividend with Vodafone at end-2011. S&P's downgrade of VZ's credit rating to A- from A may encourage an earlier decision. Once the dividend conversation is due, in our view, Vodafone and Verizon may also discuss VZ's future in VOD Italy, a minority which we value at around €4.5bn.
- **Accounting for Vodafone Italy:** Vodafone owns 76.9% of its Italian business, but it is considered a joint venture under IFRS and is proportionately consolidated. The IASB is considering changes to the accounting of joint ventures, with equity accounting being one possible outcome. While implementation will probably be two years away, at least, and a new category - joint operation - is being considered which would retain proportionate accounting, the finalisation of this change could come in 2011.
- **Spectrum auctions:** France and possibly Spain and South Africa are on the agenda for 2011. In the UK Ofcom is due to issue a consultation at end-Feb, which is due to end in May resulting in a decision by Autumn 2011 and an auction probably in 1H12.
- **Second J-Phone receipts:** Vodafone is due to receive the final payment of ¥200bn (£1.5bn) in April 2012 for the sale of its securities in Softbank Mobile and has left its options open regarding use of funds.

Leverage set to fall under current forecasts

Vodafone has agreed the sale of its preferred equity and subordinated loan in Softbank Mobile which are left over from its disposal of J-Phone and have a face value of ¥400bn and as part of the deal is giving up warrants over 10% of Softbank Mobile which were subject to earn out provisions. The consideration will be received in two tranches: ¥212.5bn (£1.6bn) in December 2010 and ¥200bn (£1.5bn) in April 2012.

The company has indicated that the first tranche of receipts will be used to reduce net debt, which in practice we expect to mean paying down its Yen denominated debt which stood at £3.1bn (net of derivatives) at end March 2010. Vodafone is continuing the £2.8bn buyback (£1bn complete by 8 Dec) which it announced following the sale of its stake in China Mobile but is holding back from announcing more for now to give it flexibility in case it needs capital, in particular, in India and for spectrum.

Vodafone management is probably comfortable building itself some buffer within its target A- credit rating given it has some potential calls on capital which are uncertain. These include the Essar Group's put option over Vodafone Essar which remains open until 8 May 2011 but which is included in reported net debt already under IFRS. In addition potential calls on capital include:

- Indian tax capital gains tax claim against Vodafone.
- Potential for corporate activity in India post the government's review of consolidation rules given the acute shortage of spectrum that the large operators suffer there.
- Spectrum costs in the UK (we have forecast £450m in calendar 1Q12), Spain (€400m in 2012/13) and South Africa where Black Economic Empowerment rules for this spectrum round may be revisited.

We currently assume only the announced buyback of £2.8bn and while the company held back from adding to that when it announced the sale of the securities in Japan a sale of SFR would, we expect, allow the company to substantially increase the buyback or look at another form of special distribution.

The Polish Question

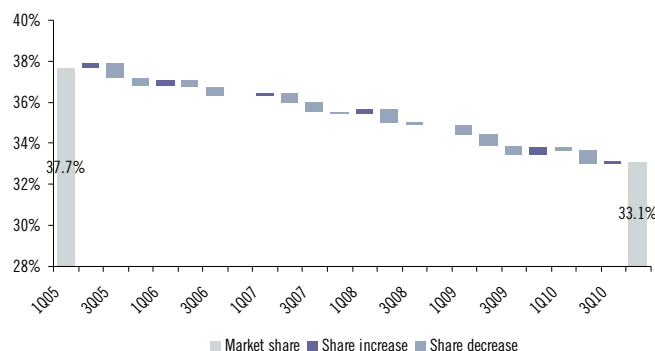
Although its stake in Polkomtel represents only about 1% of its sum of the parts valuation, Vodafone will set something of a precedent with its decision over how to proceed in Poland. It currently owns 24.4% of Polkomtel which operates under the Plus brand and is narrowly the market leader by revenue. Vodafone and its Polish partners have effectively put the business up for sale.

Vodafone has pre-emption rights over the other shareholders' holdings and as Poland is not only in Europe, one of Vodafone's nominated core geographies, but an EU country with a population similar to Spain, exiting is not the only realistic option. The question of whether and at what price Vodafone would exercise its pre-emption rights rather than sell is pertinent.

In 2008 Vodafone exercised its pre-emption rights proportionately paying €177m for 4.8%, implying a market value of €3.7bn and an EV of €4.0bn for the whole of Polkomtel (6.2x 2008 reported EBITDA).

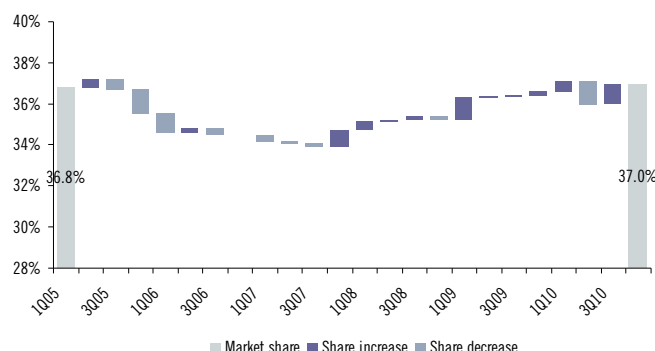
The same 6.2x EBITDA multiple today (on our 2010 estimates) would imply an EV of around €3.7bn, lower because although the Zloty has appreciated slightly against the Euro, the company's EBITDA fell 14% in 2009. This multiple would imply a price for Vodafone's 24.4% stake of about €780m (ex a number of dividends paid in the meantime). Alternatively, it implies a cost for Vodafone of pre-empting on the other shareholders at €3.2bn plus around €470m of additional debt to consolidate.

Figure 229. Vodafone Germany has been losing share, especially since the arrival of the iPhone (quarterly changes in service revenue market share)



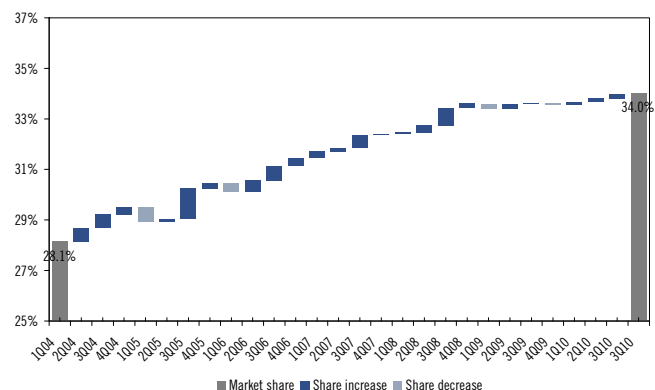
Source: Company Reports and CIRA Estimates

Figure 231. Italy has seen gains in share since end 2007, stabilising lately (quarterly changes in service revenue market share)



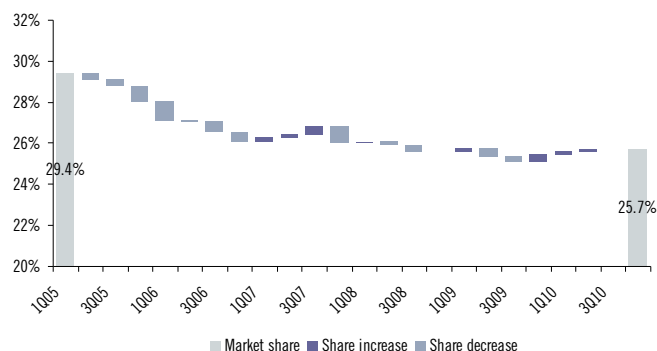
Source: Company Reports and CIRA Estimates

Figure 233. Verizon Wireless has continued to gain share despite facing the iPhone (quarterly changes in service revenue market share)



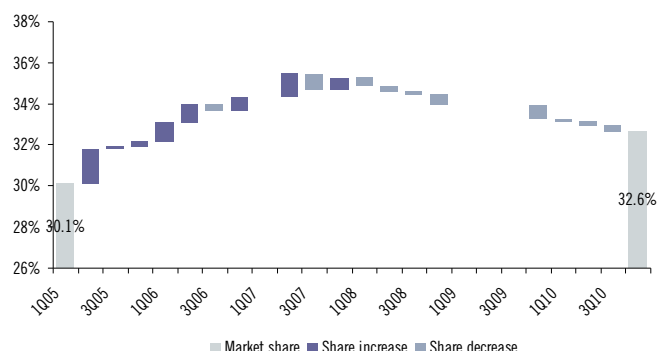
Source: Citi Investment Research and Analysis

Figure 230. In the UK serial share loss slowed from early 2007 but has now been reversed (quarterly changes in service revenue market share)



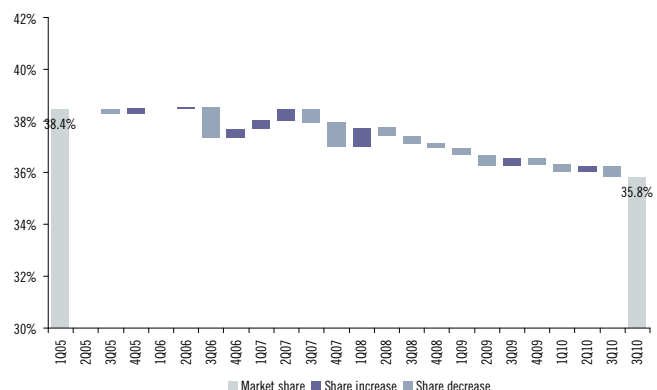
Source: Company Reports and CIRA Estimates

Figure 232. Vodafone Spain share gains reversed due partly to economic mix (quarterly changes in service revenue market share)



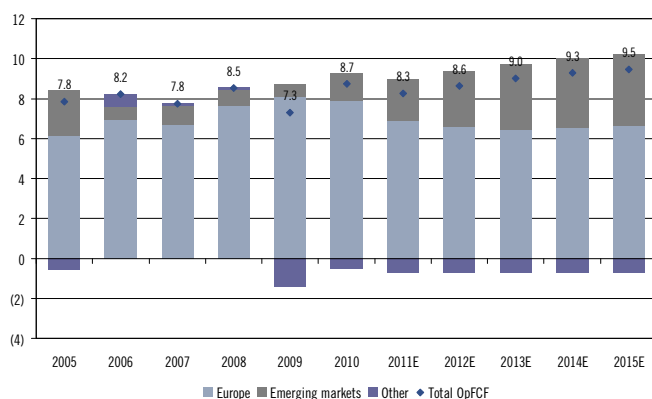
Source: Company Reports and CIRA Estimates

Figure 234. SFR in France has seen share loss moderate in 2010, (quarterly changes in service revenue market share)



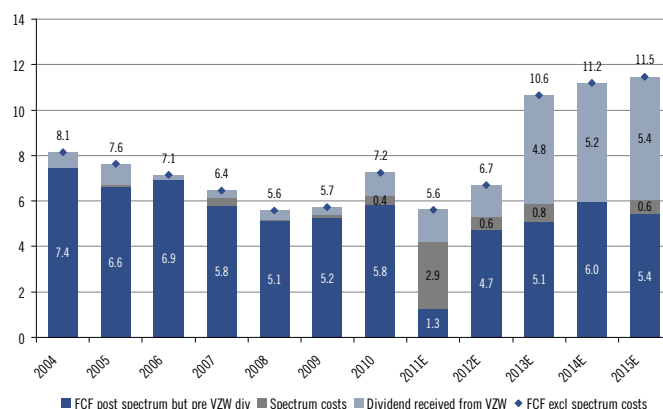
Source: Citi Investment Research and Analysis

Figure 235. We expect OpFCF (pre spectrum) to grow due to emerging market assets more than offsetting declines in Europe (£bn, year to March)



Source: Company Reports and CIRA Estimates

Figure 236. We expect FCF (inc spectrum) to be boosted once the dividend from Verizon Wireless reaches its full potential (£bn, year to March)



Source: Company Reports and CIRA Estimates

Valuation

Figure 237. Vodafone discounted cash flow valuation comes to 195p/share
£m, year to March

Free cash flow	2009	2010	2011E	2012E	2013E	2014E	2015E
EBITDA	14,490	14,849	14,567	15,020	15,335	15,706	15,947
Movements in working cap	16	452	260	(51)	(54)	(57)	(59)
Restructuring/other	128	36	56	0	0	0	0
Capex inc spectrum	(6,060)	(6,314)	(9,303)	(6,937)	(7,020)	(6,323)	(7,052)
Tax paid	(2,421)	(2,273)	(3,202)	(2,339)	(2,352)	(2,636)	(2,818)
Interest paid	(1,168)	(1,406)	(1,223)	(1,150)	(1,024)	(845)	(721)
Divs received	755	1,577	1,874	1,955	5,387	5,849	6,031
Divs paid to minorities	(162)	(56)	(358)	(355)	(352)	(441)	(446)
Free cash flow	5,578	6,865	2,671	6,143	9,920	11,254	10,881
Interest/divs added back	575	(115)	(293)	(450)	(4,011)	(4,563)	(4,864)
Tax shield on interest	(309)	(372)	(323)	(304)	(271)	(224)	(191)
Unlevered FCF	5,844	6,378	2,055	5,389	5,638	6,467	5,826
Value of yrs 1-8 cash flows	37,374						
Fade period value	32,018						
Terminal value	12,231						
Other	0						
Enterprise value	81,624						
Post BS events	1,480						
Minority equity value	(7,545)						
Associate equity value	51,160						
Net debt @ end 2012E	(27,086)						
Equity value	99,632						
Number of shares (mn)	51,190						
Implied share price (£)	1.95						
Market gearing (D/E)							33.0%
Tax rate							26.5%
Risk free rate							3.3%
Bond spread							1.0%
Equity market premium							4.5%
Asset beta							1.10
WACC							7.9%
Capex growth during fade period							3.0%
TY ROCE spread over WACC							3.0%
Perpetuity growth (post yr 25)							1.5%
Implied perp growth post year 4							(0.1%)

Source: Company Reports and CIRA Estimates

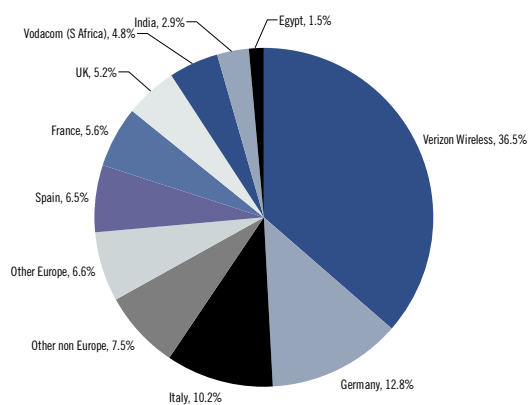
Figure 238. Vodafone sum of the parts valuation comes to 200p/share ex the next 12 months dividends

£m

	Driver (2011)/ Share Price	Market Capitalis'n £m	Net (Debt) Mar 2012 £m	Enterprise value £m	VOD Stake Mar 2012 %	VOD Equity £m	VOD Equity p/share	Share of equity %
Europe								
Germany	5.5 x EBITDA	15,929	0	15,929	100.0%	15,929	31.1	15.5%
Italy	5.0 x EBITDA	16,527	(824)	17,350	76.9%	12,709	24.8	12.4%
Spain	5.0 x EBITDA	8,096	0	8,096	100.0%	8,096	15.8	7.9%
UK	5.0 x EBITDA	6,433	0	6,433	100.0%	6,433	12.6	6.3%
Other Europe								
Albania	5.5 x EBITDA	589	0	589	99.9%	588	1.1	0.6%
Greece	4.5 x EBITDA	1,042	0	1,042	99.9%	1,041	2.0	1.0%
Ireland	4.5 x EBITDA	1,290	0	1,290	100.0%	1,290	2.5	1.3%
Malta	€800/sub	160	0	160	100.0%	160	0.3	0.2%
Netherlands	5.0 x EBITDA	3,006	0	3,006	100.0%	3,006	5.9	2.9%
Portugal	4.5 x EBITDA	2,136	0	2,136	100.0%	2,136	4.2	2.1%
Total Europe		55,208	(824)	56,031	93.1%	51,388	100.4	50.1%
Africa & Central Europe								
Czech Republic	5.5 x EBITDA	581	0	581	100.0%	581	1.1	0.6%
Egypt	6.0 x EBITDA	3,320	(433)	3,753	54.9%	1,823	3.6	1.8%
Ghana	€250/sub	669	(144)	813	70.0%	468	0.9	0.5%
Hungary	5.5 x EBITDA	1,052	0	1,052	100.0%	1,052	2.1	1.0%
Poland (Polkomtel)	6.0 x EBITDA	3,822	31	3,791	24.4%	932	1.8	0.9%
Romania	5.5 x EBITDA	1,529	0	1,529	100.0%	1,529	3.0	1.5%
South Africa (Vodacom)	SAR 68.09	9,127	(1,342)	10,469	65.0%	5,933	11.6	5.8%
Turkey	8.0 x EBITDA	1,890	0	1,890	100.0%	1,890	3.7	1.8%
Total Africa & Central Europe		21,990	(1,888)	23,878	64.6%	14,209	27.8	13.9%
Asia Pacific & Middle East								
Australia	5.5 x EBITDA	1,505	0	1,505	50.0%	753	1.5	0.7%
Fiji	€200 per pop	233	83	151	49.0%	114	0.2	0.1%
India (Vodafone Essar)	6.5 x EBITDA	5,339	(2,189)	7,528	67.0%	3,577	7.0	3.5%
Qatar	€500 per pop	391	0	391	23.0%	90	0.2	0.1%
New Zealand	5.5 x EBITDA	1,112	0	1,112	100.0%	1,112	2.2	1.1%
Total Asia Pac & Middle East		8,581	(2,106)	10,687	65.8%	5,646	11.0	5.5%
Associates & investments								
SFR, France	6.0 x EBITDA	16,012	(4,853)	20,865	43.9%	7,021	13.7	6.8%
Kenya (Safaricom)	KES 4.50	1,431	158	1,273	35.0%	501	1.0	0.5%
Verizon Wireless, US	DDM minus 10%	101,405	726	100,678	45.0%	45,632	89.1	44.5%
India (Bharti)	INR 339 -30%	6,305	(809)	7,114	4.4%	275	0.5	0.3%
Total		210,932	(9,595)	220,527	59.1%	124,672	243.5	121.6%
Other liabilities								
Net debt not included above		(21,725)	(21,725)	0	100.0%	(21,725)	(42.4)	(21.2%)
India put excess over fair value		(1,457)	(1,457)	0	100.0%	(1,457)	(2.8)	(1.4%)
VZW pref share cont liability		(283)	(283)	0	100.0%	(283)	(0.6)	(0.3%)
Deferred receipts		1,550	1,550	0	100.0%	1,550	3.0	1.5%
Pension liability		(237)	(237)	0	100.0%	(237)	(0.5)	(0.2%)
Subtotal/Average		(22,153)	(22,153)	0	100.0%	(22,153)	(43.3)	(21.6%)
Total sum of the parts		200 per share		31.10 per ADR		102,520	51.19	bn shares

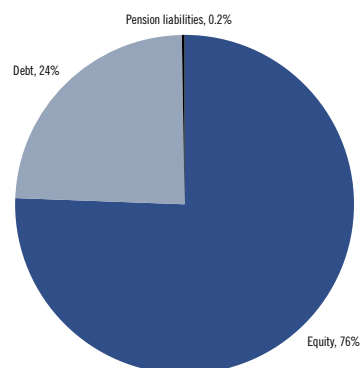
Source: DataStream, Company Reports and CIRA Estimates

Figure 239. Sum of the parts breakdown by geography
% of EV



Source: Datastream, Citi Investment Research and Analysis

Figure 240. Sum of the parts split between equity and liabilities
% of EV



Source: Datastream, Citi Investment Research and Analysis

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Country section

Belgium

Fixed

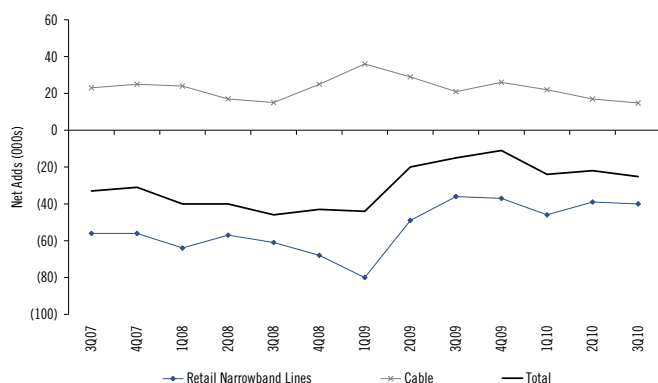
- **Increasing gap between revenue growth and GDP** – Trend in fixed revenue growth deteriorated during the quarter: -3% yoy vs. -2.2% in 2Q10. It is still lagging GDP recovery, and the gap is increasing on a qoq basis, evolving from 4.2pp difference in 1Q10 to c. 6pp gap in 3Q10. Incumbents' fixed revenues were down 3% in the quarter compared with -2.2% in 2Q10. This is mainly due to high levels of competition in the BB and triple-play market. We note Telenet now has more than 37% BB market share.

Mobile

- **Next focus is on subsidies** – After a 2010 affected by steep MTR cuts, we expect 2011 to be the year that generalized handset subsidies are introduced. Belgacom and Base could take advantage of the imminent end of iPhone exclusivity and start subsidizing iPhones in order to gain share in the high-end customer base. This is likely to have a negative impact on operator's margins across the board.

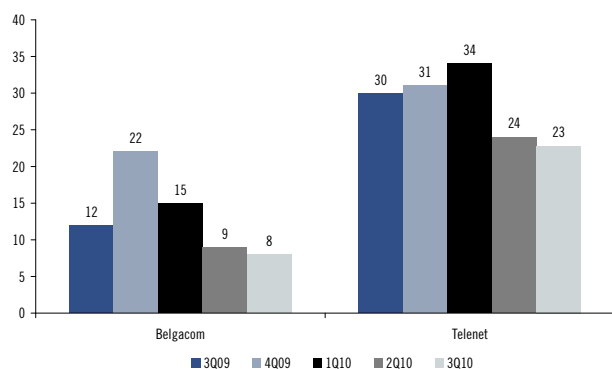
Fixed Charts

Figure 241. Telephony Net Adds (000s)



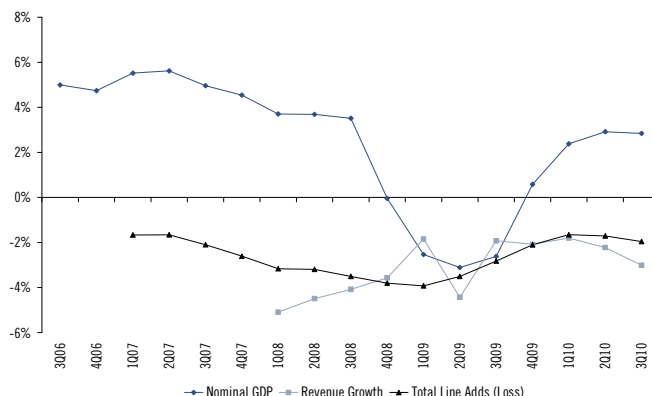
Source: Company reports and Citi Investment Research and Analysis

Figure 243. Broadband Subscriber Net Additions (000s)



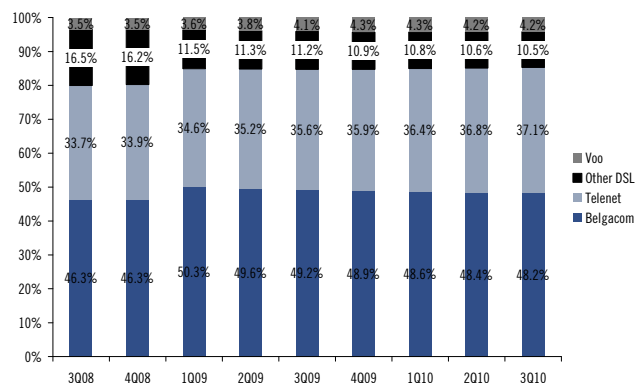
Source: Company reports and Citi Investment Research and Analysis

Figure 242. YoY Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports and Citi Investment Research and Analysis

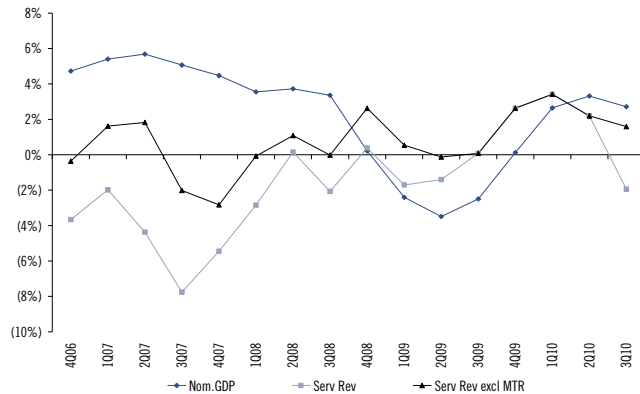
Figure 244. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

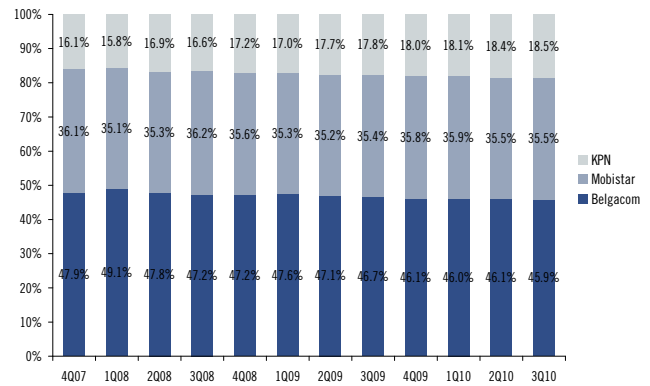
Mobile Charts

Figure 245. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



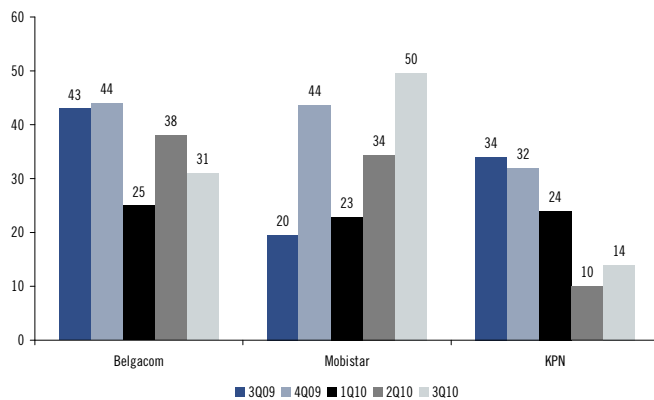
Source: Company reports and Citi Investment Research and Analysis

Figure 246. Service Revenue Market Share



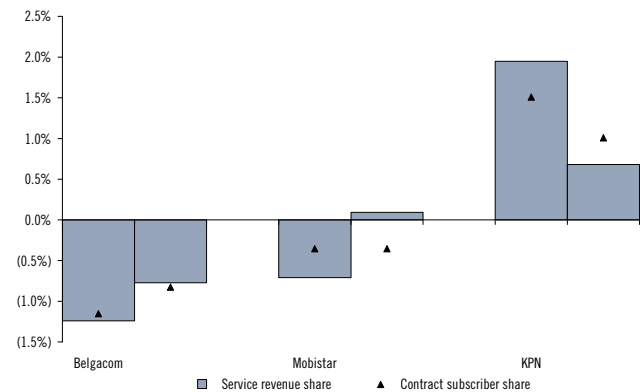
Source: Company reports and Citi Investment Research and Analysis

Figure 247. Post-Paid Net Adds



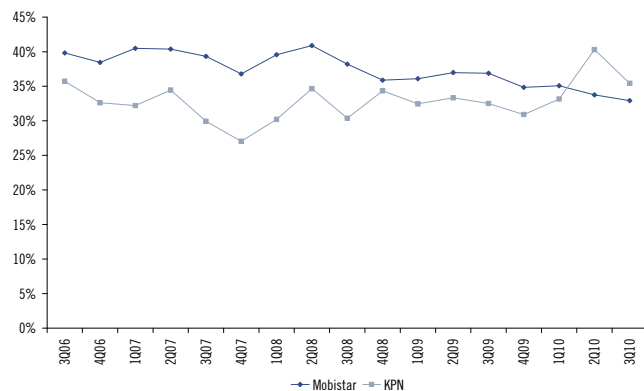
Source: Company reports and Citi Investment Research and Analysis

Figure 248. Change in Service Revenue and Contract Sub Share



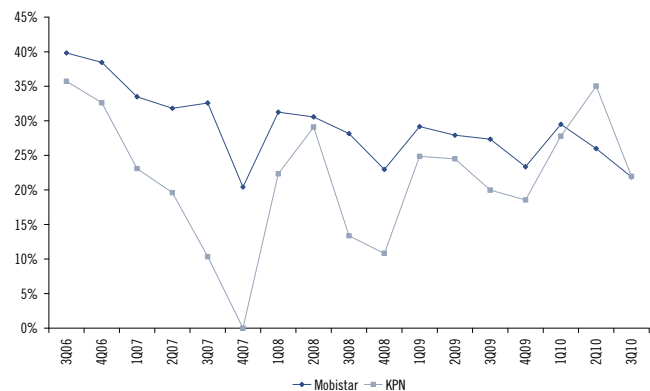
Source: Company reports and Citi Investment Research and Analysis

Figure 249. EBITDA Margin



Source: Company reports and Citi Investment Research and Analysis

Figure 250. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 251. Belgium Mobile Market Information

Belgium	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
Belgacom	472	441	451	458	441	437	430	445	437	438	430	445	421
Mobistar	336	332	323	338	339	329	319	332	332	340	335	342	326
KPN	147	148	145	162	155	159	154	167	167	171	169	178	170
Total	955	921	919	958	935	925	903	944	936	949	934	965	918
Service Revenue Growth, yoy													
Belgacom	(4.3%)	(4.8%)	(1.7%)	(1.5%)	(6.6%)	(0.9%)	(4.7%)	(2.8%)	(0.9%)	0.2%	0.0%	0.0%	(3.6%)
Mobistar	(12.3%)	(6.2%)	(4.4%)	(0.7%)	1.0%	(1.1%)	(1.1%)	(1.6%)	(2.1%)	3.4%	5.0%	2.9%	(1.7%)
KPN	(7.5%)	(5.7%)	(2.7%)	7.3%	5.4%	7.4%	6.2%	3.1%	7.7%	7.5%	9.7%	6.6%	1.8%
Total	(7.8%)	(5.4%)	(2.8%)	0.2%	(2.1%)	0.4%	(1.7%)	(1.4%)	0.1%	2.6%	3.4%	2.2%	(1.9%)
Service Revenue Market Share													
Belgacom	49.4%	47.9%	49.1%	47.8%	47.2%	47.2%	47.6%	47.1%	46.7%	46.1%	46.0%	46.1%	45.9%
Mobistar	35.2%	36.1%	35.1%	35.3%	36.2%	35.6%	35.3%	35.2%	35.4%	35.8%	35.9%	35.5%	35.5%
KPN	15.4%	16.1%	15.8%	16.9%	16.6%	17.2%	17.0%	17.7%	17.8%	18.0%	18.1%	18.4%	18.5%
Post-pay Customers, 000s													
Belgacom	2,248	2,333	2,429	2,482	2,509	2,570	2,621	2,678	2,721	2,765	2,790	2,828	2,859
Mobistar	1,740	1,775	1,807	1,855	1,891	1,940	1,979	2,014	2,033	2,077	2,100	2,134	2,184
KPN	494	512	518	533	548	569	583	612	646	678	702	712	726
Call Volumes, mn min/qtr													
Belgacom	2,220	2,388	2,467	2,551	2,378	2,494	2,455	2,541	2,434	2,555	2,372	2,450	2,364
Mobistar	1,639	1,788	1,863	1,939	1,816	1,899	1,871	1,933	1,823	1,893	1,782	1,869	1,818
KPN	1,066	1,146	1,140	1,169	1,159	1,224	1,291	1,299	1,184	1,349	1,404	1,489	1,313
Total	4,925	5,322	5,470	5,659	5,354	5,616	5,617	5,773	5,441	5,797	5,559	5,809	5,496
Call Volume growth, yoy													
Belgacom	8.7%	13.3%	12.4%	10.4%	7.1%	4.4%	(0.5%)	(0.4%)	2.3%	2.5%	(3.4%)	(3.6%)	(2.9%)
Mobistar	11.7%	16.7%	16.0%	14.3%	10.8%	6.2%	0.4%	(0.3%)	0.4%	(0.3%)	(4.7%)	(3.3%)	(0.3%)
KPN	27.4%	23.7%	19.1%	4.8%	8.8%	6.8%	13.2%	11.2%	2.1%	10.3%	8.7%	14.7%	10.9%
Total	13.3%	16.5%	15.0%	10.5%	8.7%	5.5%	2.7%	2.0%	1.6%	3.2%	(1.0%)	0.6%	1.0%
Contract Churn, % p.a													
KPN	21.0%	22.0%	29.0%	18.0%	18.0%	21.0%	20.0%	21.0%	17.0%	24.0%	19.0%	21.0%	16.0%
EBITDA, €m													
Mobistar	149	142	143	157	150	141	134	144	142	146	138	144	137
KPN	55	50	55	70	58	68	62	68	65	64	67	81	68

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 252. Belgium Fixed Line Market Information

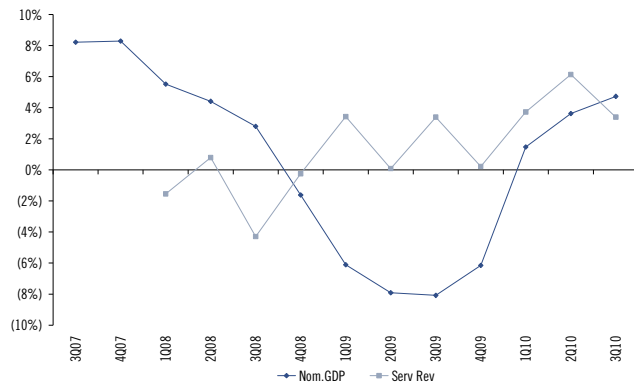
Belgium	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	1,202	1,237	1,285	1,295	1,315	1,345	1,487	1,487	1,499	1,521	1,536	1,545	1,553
Wholesale and ULL	470	470	470	470	470	470	340	340	340	340	340	340	340
Cable	949	975	1,009	1,033	1,058	1,088	1,132	1,170	1,210	1,251	1,285	1,309	1,332
Total	2,621	2,682	2,764	2,798	2,843	2,903	2,959	2,997	3,049	3,112	3,161	3,194	3,225
Broadband Subscribers (000s)													
Belgacom	1,202	1,237	1,285	1,295	1,315	1,345	1,487	1,487	1,499	1,521	1,536	1,545	1,553
Telenet	859	883	914	935	958	985	1,025	1,055	1,085	1,116	1,150	1,174	1,197
Other DSL	470	470	470	470	470	470	340	340	340	340	340	340	340
Voo	90	92	95	98	100	103	107	115	125	135	135	135	135
Total	2,621	2,682	2,764	2,798	2,843	2,903	2,959	2,997	3,049	3,112	3,161	3,194	3,225
Broadband Subscribers Net Adds (000s)													
Belgacom	26	35	48	10	20	30	142	0	12	22	15	9	8
Telenet	25	24	31	21	23	27	40	30	30	31	34	24	23
Other DSL	0	0	0	0	0	0	(130)	0	0	0	0	0	0
Voo	3	3	3	2	2	3	4	8	10	10	0	0	0
Total	54	62	82	33	45	60	56	38	52	63	49	33	31
Telephony Channels (000s)													
Incumbent retail	3,955	3,899	3,835	3,778	3,717	3,649	3,569	3,520	3,484	3,447	3,401	3,362	3,322
Incumbent wholesale (WLR)													
ULL (total)													
Cable	523	548	572	589	604	629	665	694	715	741	763	780	795
Total	4,478	4,447	4,407	4,367	4,321	4,278	4,234	4,214	4,199	4,188	4,164	4,142	4,117
Telephony Channels Net Adds (000s)													
Incumbent retail	(56)	(56)	(64)	(57)	(61)	(68)	(80)	(49)	(36)	(37)	(46)	(39)	(40)
Incumbent wholesale (WLR)													
ULL (total)													
Cable	23	25	24	17	15	25	36	29	21	26	22	17	15
Total	(33)	(31)	(40)	(40)	(46)	(43)	(44)	(20)	(15)	(11)	(24)	(22)	(25)
Pay TV Subscribers (000s)													
Belgacom	249	305	313	350	389	441	486	513	575	652	713	753	795
Telenet	1,716	1,729	1,695	1,688	1,654	2,402	2,386	2,374	2,363	2,342	2,318	2,303	2,288
Pay TV Subscribers Net Adds (000s)													
Belgacom	58	56	8	37	39	52	45	27	62	77	61	40	42
Telenet	(7)	13	(34)	(7)	(34)	748	(16)	(12)	(11)	(21)	(24)	(15)	(15)

Source: Company reports and Citi Investment Research and Analysis

Finland

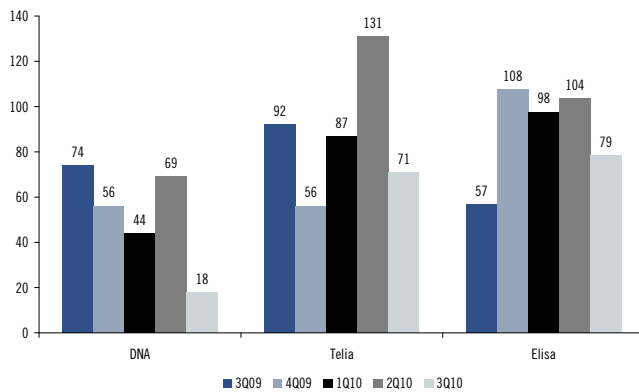
Mobile Charts

Figure 253. Revenue and GDP



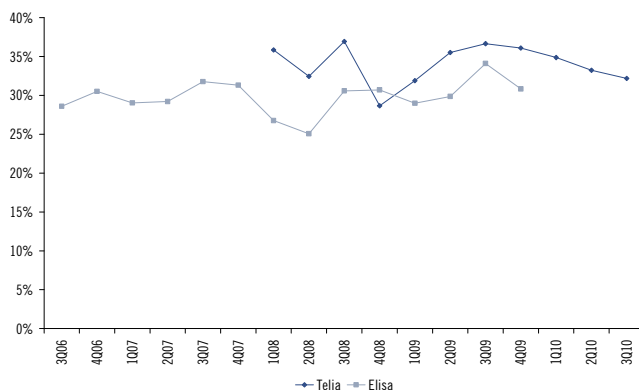
Source: Company reports, CIRA and Datasteam

Figure 255. Post-Paid Net Adds



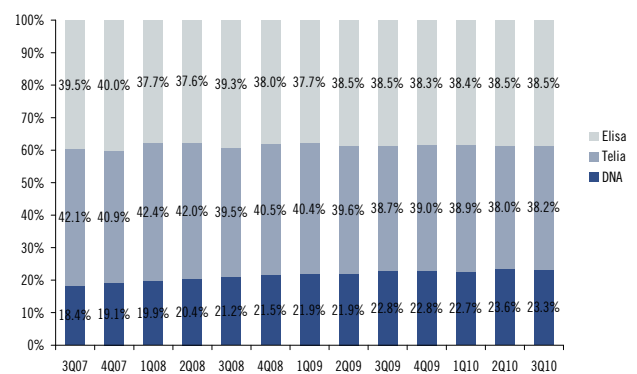
Source: Company reports and Citi Investment Research and Analysis

Figure 257. EBITDA Margin



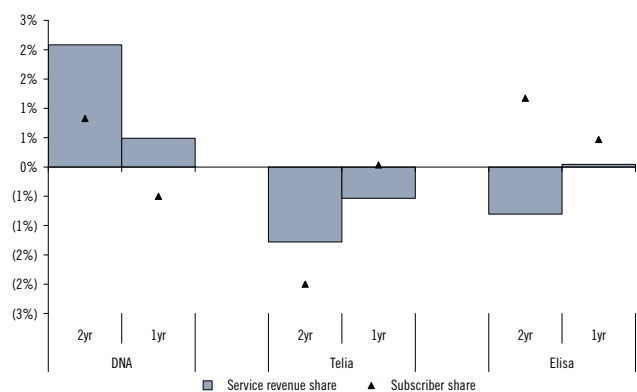
Source: Company reports and Citi Investment Research and Analysis

Figure 254. Service Revenue Market Share



Source: Company reports and Citi Investment Research and Analysis

Figure 256. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 258. Finland Mobile Market Information

Finland	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
DNA	95	100	97	104	105	113	110	113	117	119	118	129	124
Telia	218	214	205	216	196	212	202	203	199	204	202	207	203
Elisa	205	210	183	193	195	198	189	198	197	200	199	210	204
Total	518	524	484	513	496	523	501	514	513	524	520	545	530
Service Revenue Growth, yoy													
DNA	0.0%	0.0%	16.0%	17.7%	10.3%	12.7%	13.5%	7.7%	11.2%	6.1%	7.8%	14.2%	5.6%
Telia	(1.5%)	(1.6%)	(3.0%)	(0.6%)	(10.2%)	(1.3%)	(1.4%)	(5.7%)	1.4%	(3.6%)	(0.1%)	1.8%	2.0%
Elisa	6.0%	4.1%	(7.4%)	(5.1%)	(4.8%)	(5.4%)	3.5%	2.4%	1.2%	1.0%	5.4%	6.0%	3.5%
Total	0.0%	0.0%	(1.5%)	0.8%	(4.3%)	(0.3%)	3.4%	0.1%	3.4%	0.2%	3.7%	6.1%	3.4%
Service Revenue Market Share													
DNA	18.4%	19.1%	19.9%	20.4%	21.2%	21.5%	21.9%	21.9%	22.8%	22.8%	22.7%	23.6%	23.3%
Telia	42.1%	40.9%	42.4%	42.0%	39.5%	40.5%	40.4%	39.6%	38.7%	39.0%	38.9%	38.0%	38.2%
Elisa	39.5%	40.0%	37.7%	37.6%	39.3%	38.0%	37.7%	38.5%	38.5%	38.3%	38.4%	38.5%	38.5%
Post-pay Customers, 000s													
DNA	0	0	0	0	0	0	0	0	0	0	0	0	0
Telia	2,231	2,258	2,300	2,337	2,377	2,410	2,430	2,466	2,526	2,600	2,670	2,722	2,781
Elisa	0	0	0	0	0	0	0	0	0	0	0	0	0
Call Volumes, mn min/qtr													
DNA	1,189	1,252	1,317	1,444	1,442	1,576	1,591	1,669	1,683	1,767	1,780	1,818	1,775
Telia	2,123	2,143	2,179	2,302	2,217	2,340	2,281	2,311	2,287	2,382	2,398	2,470	2,439
Elisa	2,036	2,056	2,060	2,170	2,098	2,218	2,220	2,341	2,339	2,442	2,482	2,546	2,505
Total	5,347	5,452	5,555	5,915	5,757	6,134	6,093	6,321	6,308	6,591	6,661	6,834	6,720
Call Volume growth, yoy													
DNA			25.3%	27.0%	21.3%	25.8%	20.9%	15.6%	16.7%	12.1%	11.9%	8.9%	5.5%
Telia	(1.9%)	(0.7%)	4.2%	7.6%	4.4%	9.2%	4.7%	0.4%	3.2%	1.8%	5.1%	6.9%	6.7%
Elisa	9.7%	5.8%	6.2%	6.8%	3.1%	7.9%	7.8%	7.9%	11.5%	10.1%	11.8%	8.8%	7.1%
Total			9.3%	11.4%	7.7%	12.5%	9.7%	6.9%	9.6%	7.4%	9.3%	8.1%	6.5%
EBITDA, €m													
Telia	82	56	83	75	84	68	70	80	80	84	80	78	77
Elisa	70	71	53	51	65	64	56	59	69	64			

Source: Company reports and Citi Investment Research and Analysis

France

Fixed

■ **FT continues its comeback** — FT almost doubled its DSL net adds in Q3 and recorded the highest number of net adds in the market behind Bouygues. The launch of FT's new quadruple play offer should have a positive impact in Q4. Total fixed revenues for FT are still negative but are slightly improving on the back of lower market share gain from ULL and wholesale. FT has announced that it will increase its triple play tariffs by up to €3 next February.

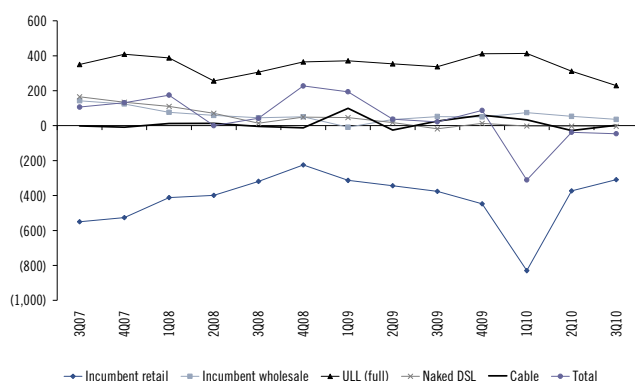
■ **Free still suffering from poor momentum** — Free only recorded 14k net adds in 3Q10 following an already very weak 2Q10 with 10k. Company indicated that Q4 is also likely to be weak but momentum change with the launch of new.

Mobile

■ **Strong commercial activity** — Net adds were very strong on the back of a commercial push of the iPhone 4. Mobile services revenue growth only improved marginally and is just about positive due to termination cuts effective in July. EBITDA margins are falling due to MTR cuts and price competition.

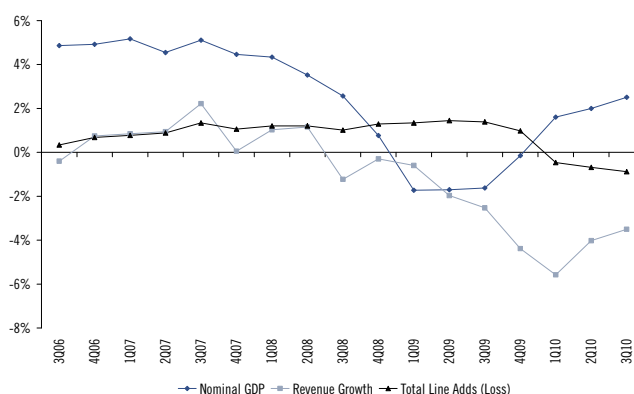
Fixed Charts

Figure 259. Telephony Net Adds (000s)



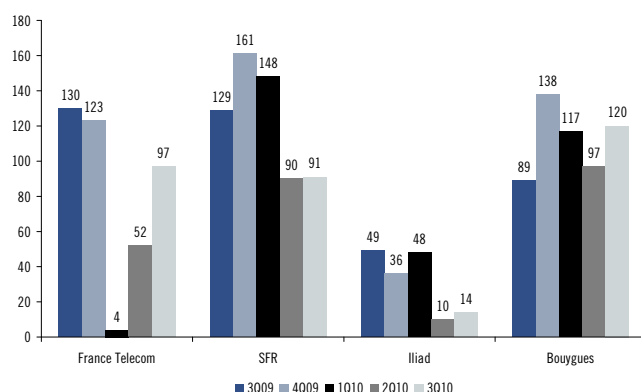
Source: Company reports and Citi Investment Research and Analysis

Figure 260. YoY Line Loss, Incumbent Revenue Growth and GDP



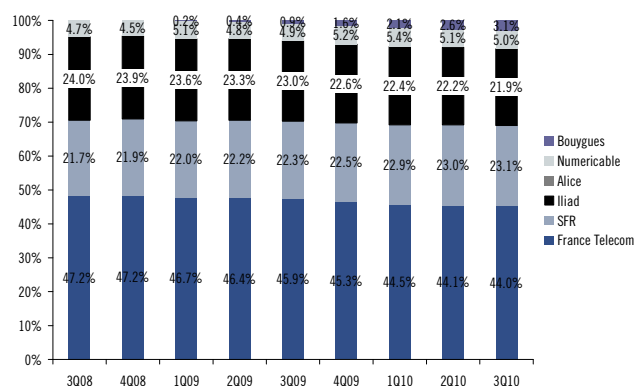
Source: Company reports, CIRA and Datastream

Figure 261. Broadband Subscriber Net Adds (000s)



Source: Company reports and Citi Investment Research and Analysis

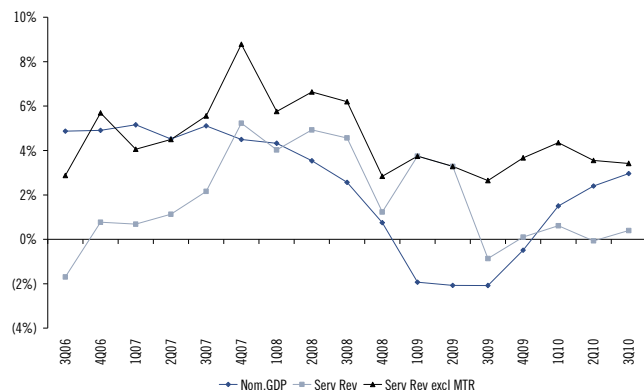
Figure 262. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

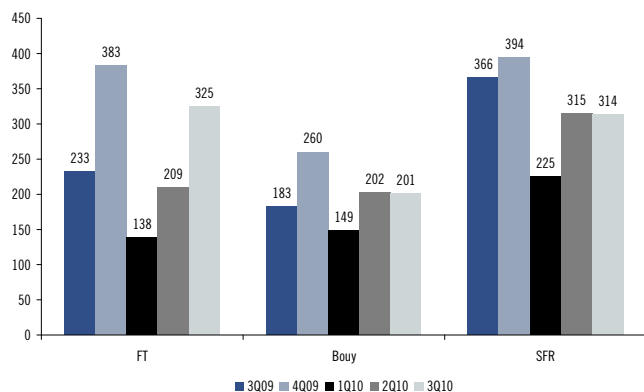
Mobile Charts

Figure 263. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



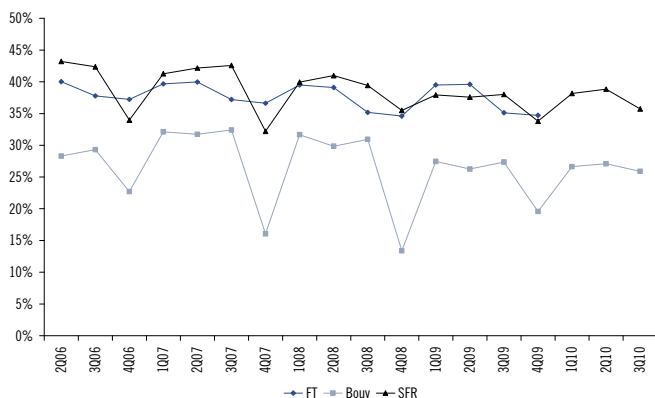
Source: Company reports, CIRA and Datastream

Figure 265. Post-Paid Net Adds



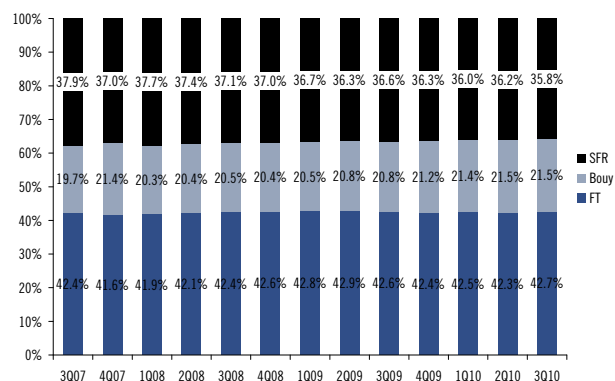
Source: Company reports and Citi Investment Research and Analysis

Figure 267. EBITDA Margin



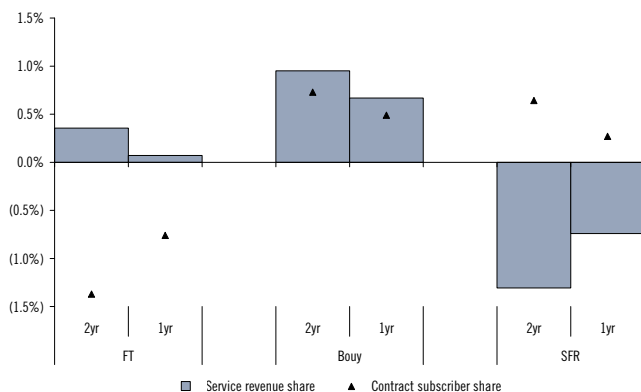
Source: Company reports and Citi Investment Research and Analysis

Figure 264. Service Revenue Market Share



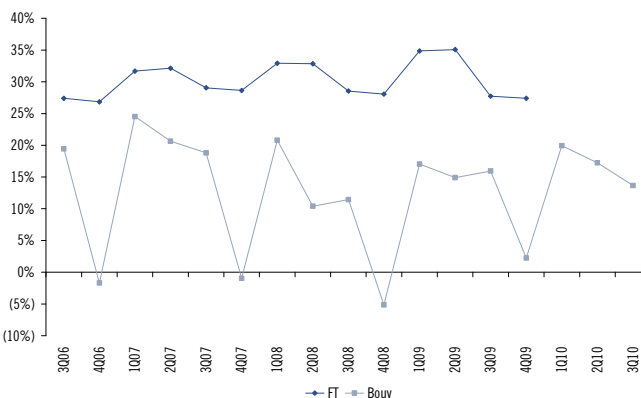
Source: Company reports and Citi Investment Research and Analysis

Figure 266. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Figure 268. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 269. France Mobile Market Information

France	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
Orange (FT)	2,384	2,401	2,317	2,413	2,493	2,491	2,455	2,538	2,488	2,482	2,453	2,500	2,502
Bouygues	1,110	1,236	1,124	1,171	1,207	1,194	1,175	1,232	1,213	1,243	1,237	1,269	1,257
SFR	2,135	2,137	2,086	2,144	2,186	2,160	2,104	2,146	2,134	2,126	2,079	2,143	2,099
Total	5,629	5,774	5,527	5,728	5,886	5,845	5,734	5,916	5,835	5,851	5,769	5,912	5,858
Service Revenue Growth, yoy													
Orange (FT)	0.6%	2.8%	3.7%	4.9%	4.6%	3.7%	6.0%	5.2%	(0.2%)	(0.4%)	(0.1%)	(1.5%)	0.6%
Bouygues	2.4%	13.9%	6.2%	10.5%	8.7%	(3.4%)	4.5%	5.2%	0.5%	4.1%	5.3%	3.0%	3.6%
SFR	3.8%	3.4%	3.3%	2.1%	2.4%	1.1%	0.9%	0.1%	(2.4%)	(1.6%)	(1.2%)	(0.1%)	(1.6%)
Total	2.2%	5.2%	4.0%	4.9%	4.6%	1.2%	3.7%	3.3%	(0.9%)	0.1%	0.6%	(0.1%)	0.4%
Service Revenue Market Share													
Orange (FT)	42.4%	41.6%	41.9%	42.1%	42.4%	42.6%	42.8%	42.9%	42.6%	42.4%	42.5%	42.3%	42.7%
Bouygues	19.7%	21.4%	20.3%	20.4%	20.5%	20.4%	20.5%	20.8%	20.8%	21.2%	21.4%	21.5%	21.5%
SFR	37.9%	37.0%	37.7%	37.4%	37.1%	37.0%	36.7%	36.3%	36.6%	36.3%	36.0%	36.2%	35.8%
Post-pay Customers, 000s													
Orange (FT)	15,355	15,699	15,875	16,161	16,557	16,977	17,114	17,327	17,560	17,943	18,081	18,290	18,615
Bouygues	6,577	6,766	6,869	6,959	7,042	7,196	7,304	7,483	7,666	7,926	8,075	8,277	8,478
SFR	11,988	12,292	12,442	13,049	13,267	13,580	13,760	14,047	14,413	14,807	15,032	15,347	15,661
Call Volumes, mn min/qtr													
France Telecom	13,791	14,176	14,394	14,566	14,578	14,769	14,933	14,882	14,812	14,886	15,197	14,998	14,870
Bouygues	7,792	7,990	7,936	7,962	7,575	7,687	7,771	7,892	7,605	7,779	8,153	8,217	8,258
SFR	13,236	13,579	13,617	13,858	13,572	13,676	13,778	13,943	13,617	13,587	13,909	13,905	13,911
Total	34,819	35,745	35,946	36,386	35,726	36,132	36,482	36,718	36,034	36,253	37,259	37,119	37,039
Call Volume growth, yoy													
France Telecom	10.0%	9.2%	7.5%	6.8%	5.7%	4.2%	3.7%	2.2%	1.6%	0.8%	1.8%	0.8%	0.4%
Bouygues	12.3%	10.6%	6.4%	6.2%	(2.8%)	(3.8%)	(2.1%)	(0.9%)	0.4%	1.2%	4.9%	4.1%	8.6%
SFR	9.4%	9.0%	6.3%	7.3%	2.5%	0.7%	1.2%	0.6%	0.3%	(0.6%)	1.0%	(0.3%)	2.2%
Total	10.3%	9.4%	6.8%	6.8%	2.6%	1.1%	1.5%	0.9%	0.9%	0.3%	2.1%	1.1%	2.8%
Contract Churn, % p.a													
Orange (FT)	10.9%	10.3%	9.7%	9.3%	9.3%	10.1%	10.9%	11.6%	12.4%	12.9%	13.1%	13.7%	13.9%
Data Revenue (excl messaging) % Service Revenue													
Orange (FT)	8.9%	9.0%	10.5%	10.1%	11.9%	11.4%	12.5%	12.1%	13.8%	14.6%	15.3%	14.8%	16.7%
EBITDA, €m													
Orange (FT)	950	956	973	1,014	951	950	1,045	1,080	941	939	1,025	1,044	0
Bouygues	398	202	379	376	400	177	348	354	364	278	357	377	366
SFR	942	726	873	914	907	807	827	850	852	777	834	872	798
Capex, €m													
Orange (FT)	209	209	163	163	180	180	123	123	198	198	152	152	0
Bouygues	167	214	130	245	252	245	132	153	152	246	90	137	173

Source: Citi Investment Research and Analysis

Fixed Data

Figure 270. France Fixed Line Market Information

France	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	6,913	7,299	7,633	7,850	8,096	8,350	8,574	8,680	8,810	8,933	8,937	8,989	9,086
Incumbent wholesale	2,273	2,289	2,297	2,290	2,252	2,221	2,189	2,157	2,105	2,032	1,959	1,941	1,945
ULL (total)	4,836	5,187	5,521	5,719	6,008	6,332	6,664	6,986	7,325	7,723	8,119	8,401	8,593
Cable	790	776	794	813	807	788	938	900	939	1,030	1,080	1,039	1,042
Total	14,812	15,551	16,245	16,672	17,163	17,691	18,365	18,723	19,179	19,718	20,095	20,370	20,666
Broadband Subscribers (000s)													
France Telecom	6,913	7,299	7,633	7,850	8,096	8,350	8,574	8,680	8,810	8,933	8,937	8,989	9,086
SFR	3,447	3,602	3,699	3,767	3,730	3,879	4,042	4,154	4,283	4,444	4,592	4,682	4,773
Iliad	2,767	2,904	3,041	3,134	4,125	4,225	4,337	4,371	4,420	4,456	4,504	4,514	4,528
Alice	882	901	954	902	0	0	0	0	0	0	0	0	0
Numericable	790	776	794	813	807	788	938	900	939	1,030	1,080	1,039	1,042
Bouygues	0	0	0	0	0	0	29	84	173	311	428	525	645
Total	14,812	15,551	16,245	16,672	17,163	17,691	18,365	18,723	19,179	19,718	20,095	20,370	20,666
Broadband Subscribers Net Adds (000s)													
France Telecom	331	386	334	217	246	254	224	106	130	123	4	52	97
SFR	66	155	97	68	(37)	149	163	112	129	161	148	90	91
Iliad	141	137	137	93	991	100	112	34	49	36	48	10	14
Alice	35	19	53	(52)	(902)	0	0	0	0	0	0	0	0
Numericable	(2)	(14)	18	20	(6)	(19)	150	(39)	39	91	50	(41)	3
Bouygues	0	0	0	0	0	0	29	55	89	138	117	97	120
Total	642	739	694	427	491	528	674	358	456	539	377	275	296
Telephony Channels (000s)													
Incumbent retail	29,133	28,607	28,195	27,796	27,477	27,252	26,939	26,595	26,219	25,771	24,941	24,568	24,259
Incumbent wholesale (WLR)	592	716	793	852	897	948	939	974	1,026	1,076	1,151	1,204	1,240
ULL (full)	3,215	3,624	4,012	4,268	4,574	4,939	5,310	5,664	6,002	6,414	6,827	7,139	7,368
Naked DSL	808	942	1,052	1,123	1,137	1,186	1,232	1,250	1,232	1,245	1,243	1,240	1,236
Cable	521	512	524	537	533	520	619	594	620	680	713	686	687
Total	34,269	34,401	34,576	34,576	34,618	34,845	35,039	35,077	35,099	35,186	34,875	34,837	34,790
Telephony Channels Net Adds (000s)													
Incumbent retail	(550)	(526)	(412)	(399)	(319)	(225)	(313)	(344)	(376)	(448)	(830)	(373)	(309)
Incumbent wholesale	143	124	77	59	45	51	(9)	35	52	50	75	53	36
ULL (full)	350	409	388	256	306	365	371	354	338	412	413	312	229
Naked DSL	165	134	110	71	14	49	46	18	(18)	13	(2)	(3)	(4)
Cable	(1)	(9)	12	13	(4)	(13)	99	(25)	26	60	33	(27)	2
Total	107	132	175	0	42	227	194	38	22	87	(311)	(38)	(46)
Pay TV Subscribers (000s)													
France Telecom	975	1,149	1,282	1,389	1,603	1,909	2,166	2,339	2,547	2,761	2,894	3,051	3,230
Pay TV Subscribers Net Adds (000s)													
France Telecom	138	174	133	107	214	306	257	173	208	214	133	157	179

Source: Company reports and Citi Investment Research and Analysis

Germany

Fixed

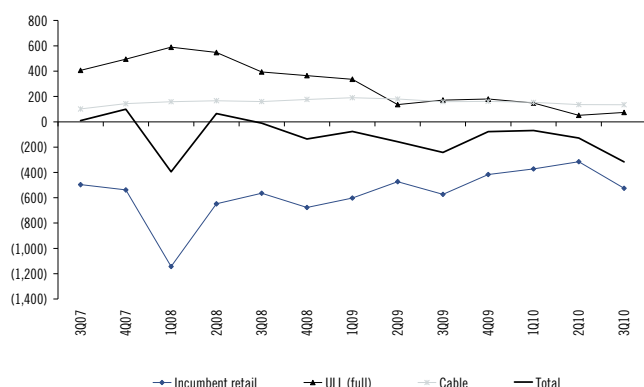
- **Seasonally high retail line loss** – DT's retail line loss worsened to -316k, however this is partly due to seasonal factors such as the anniversary of 2 year contracts.
- **Cable gains broadband market share** – Cable operators continued to gain market share with total net adds of 141k vs DT 49k, total broadband market 50k.

Mobile

- **Growth rises** – Service revenue growth excluding MTR cuts increased to 3.6% 3Q10 vs 3.0% 2Q10. This was driven by a reduction in voice yield decline, with data growth remaining stable.
- **End of iPhone exclusivity and MTR cuts** – T-Mobile Germany has been a star in 2010, therefore there will be a great deal of focus on the impact from MTR cuts and loss of iPhone exclusivity.

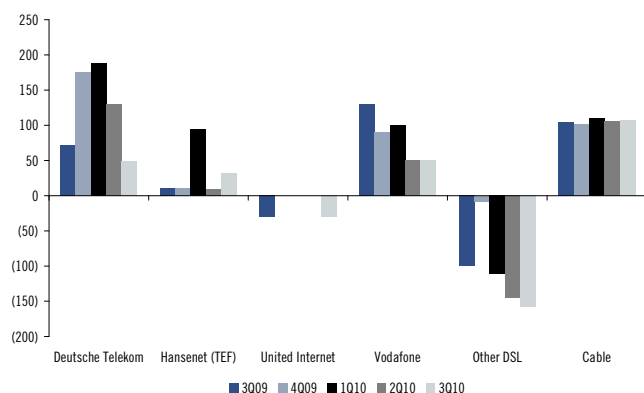
Fixed Charts

Figure 271. Telephony Net Adds (000s)



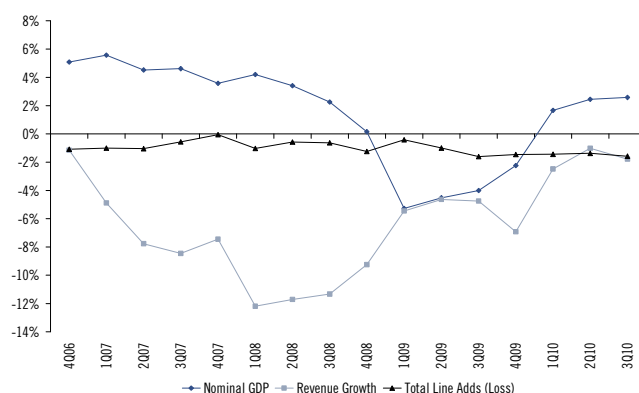
Source: Company reports and Citi Investment Research and Analysis

Figure 273. Broadband Subscriber Net Adds (000s)



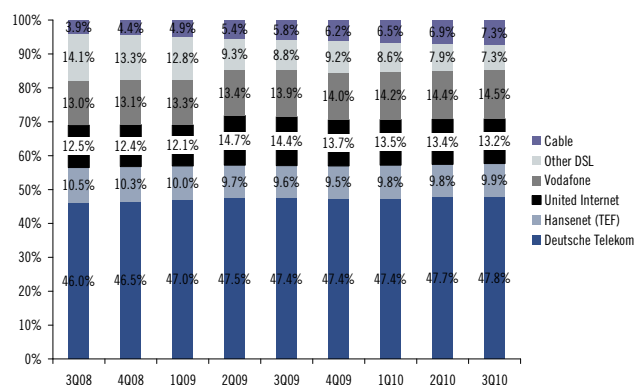
Source: Company reports and Citi Investment Research and Analysis

Figure 272. YoY Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

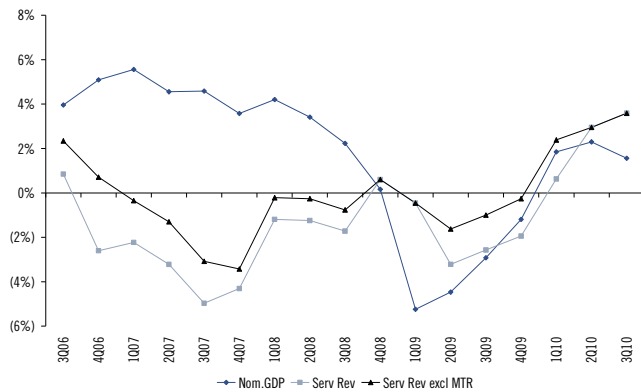
Figure 274. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

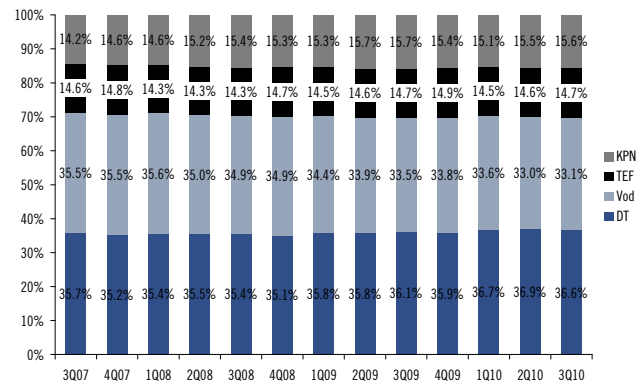
Mobile Charts

Figure 275. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



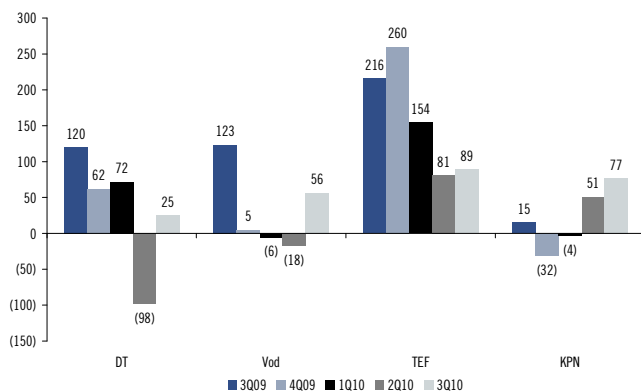
Source: Company reports, CIRA and Datastream

Figure 276. Service Revenue Market Share



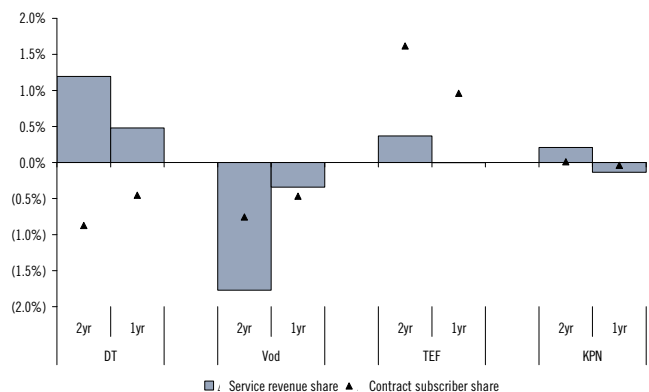
Source: Company reports and Citi Investment Research and Analysis

Figure 277. Post-Paid Net Adds



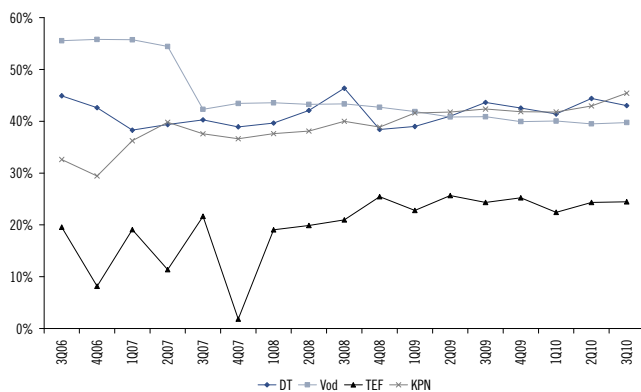
Source: Company reports and Citi Investment Research and Analysis

Figure 278. Change in Service Revenue and Contract Sub Share



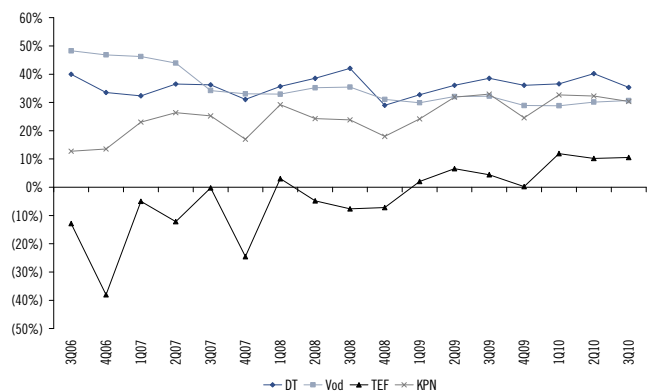
Source: Company reports and Citi Investment Research and Analysis

Figure 279. EBITDA Margin



Source: Company reports and Citi Investment Research and Analysis

Figure 280. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 281. German Mobile Market Information

Germany	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
T-Mobile (DT)	1,850	1,741	1,710	1,774	1,804	1,749	1,720	1,731	1,793	1,752	1,776	1,837	1,882
Vodafone	1,840	1,756	1,720	1,747	1,776	1,737	1,654	1,638	1,659	1,650	1,626	1,641	1,701
O2 (Telefonica)	755	731	690	716	729	732	695	707	729	729	702	726	755
KPN	735	721	705	757	782	761	734	757	779	751	729	772	800
Total	5,180	4,949	4,825	4,994	5,091	4,979	4,803	4,833	4,960	4,882	4,833	4,976	5,138
Service Revenue Growth, yoy													
T-Mobile (DT)	(4.9%)	(4.0%)	(2.2%)	(1.9%)	(2.5%)	0.5%	0.6%	(2.4%)	(0.6%)	0.2%	3.3%	6.1%	5.0%
Vodafone	(7.1%)	(6.6%)	(3.3%)	(4.0%)	(3.5%)	(1.1%)	(3.8%)	(6.2%)	(6.6%)	(5.0%)	(1.7%)	0.2%	2.5%
O2 (Telefonica)	(7.0%)	(6.9%)	(0.9%)	(1.6%)	(3.4%)	0.1%	0.7%	(1.2%)	(0.0%)	(0.4%)	1.0%	2.7%	3.6%
KPN	2.9%	4.2%	6.8%	8.1%	6.4%	5.5%	4.1%	0.0%	(0.4%)	(1.3%)	(0.7%)	2.0%	2.7%
Total	(5.0%)	(4.3%)	(1.2%)	(1.2%)	(1.7%)	0.6%	(0.5%)	(3.2%)	(2.6%)	(1.9%)	0.6%	3.0%	3.6%
Service Revenue Market Share													
T-Mobile (DT)	35.7%	35.2%	35.4%	35.5%	35.4%	35.1%	35.8%	35.8%	36.1%	35.9%	36.7%	36.9%	36.6%
Vodafone	35.5%	35.5%	35.6%	35.0%	34.9%	34.9%	34.4%	33.9%	33.5%	33.8%	33.6%	33.0%	33.1%
O2 (Telefonica)	14.6%	14.8%	14.3%	14.3%	14.3%	14.7%	14.5%	14.6%	14.7%	14.9%	14.5%	14.6%	14.7%
KPN	14.2%	14.6%	14.6%	15.2%	15.4%	15.3%	15.3%	15.7%	15.7%	15.4%	15.1%	15.5%	15.6%
Post-pay Customers, 000s													
T-Mobile (DT)	15,669	16,054	16,264	16,468	16,739	17,009	16,953	17,020	17,140	17,202	17,274	17,176	17,201
Vodafone	14,643	14,959	15,176	15,424	15,671	15,914	15,986	15,972	16,096	16,101	16,095	16,077	16,133
O2 (Telefonica)	5,993	6,237	6,442	6,735	6,881	6,967	7,085	7,225	7,440	7,700	7,855	7,936	8,025
KPN	6,170	6,297	6,345	6,437	6,542	6,676	6,739	6,785	6,800	6,768	6,764	6,815	6,892
Call Volumes, mn min/qtr													
Deutsche Telekom	6,775	6,935	7,195	7,475	7,643	7,829	7,848	8,082	8,353	8,592	8,622	8,836	9,162
Vodafone	8,210	8,662	8,818	9,206	9,218	9,478	9,464	9,314	9,234	9,659	9,697	9,798	9,770
Telefonica	4,555	4,953	5,618	5,741	5,512	5,454	5,555	5,819	5,775	6,108	6,223	6,299	6,292
KPN	5,646	6,333	6,430	6,861	6,920	7,413	7,467	7,998	8,036	8,426	8,497	8,865	8,767
Total	25,187	26,883	28,062	29,283	29,292	30,174	30,334	31,213	31,398	32,785	33,040	33,797	33,990
Call Volume growth, yoy													
Deutsche Telekom	12.7%	13.5%	13.4%	12.7%	12.8%	12.9%	9.1%	8.1%	9.3%	9.7%	9.9%	9.3%	9.7%
Vodafone	28.6%	25.2%	19.4%	16.3%	12.3%	9.4%	7.3%	1.2%	0.2%	1.9%	2.5%	5.2%	5.8%
Telefonica	16.8%	18.2%	30.7%	26.5%	21.0%	10.1%	(1.1%)	1.4%	4.8%	12.0%	12.0%	8.2%	9.0%
KPN	37.2%	38.0%	31.9%	28.8%	22.6%	17.1%	16.1%	16.6%	16.1%	13.7%	13.8%	10.8%	9.1%
Total	23.4%	23.3%	22.5%	19.9%	16.3%	12.2%	8.1%	6.6%	7.2%	8.7%	8.9%	8.3%	8.3%
Contract Churn, % p.a													
T-Mobile (DT)	14.4%	12.0%	13.2%	13.2%	13.2%	15.6%	18.0%	13.2%	12.0%	13.2%	15.6%	16.8%	13.2%
Vodafone	14.7%	14.5%	15.1%	16.0%	15.6%	15.2%	15.3%	16.0%	16.0%	17.8%	15.4%	16.9%	16.7%
KPN	21.0%	24.0%	21.0%	19.0%	19.0%	21.0%	21.0%	20.0%	20.0%	23.0%	20.0%	20.0%	20.0%
Data Revenue (excl messaging) % Service Revenue													
Vodafone	10.7%	11.4%	12.8%	12.7%	13.4%	14.3%	15.2%	15.8%	16.8%	17.7%	19.7%	20.6%	20.8%
O2 (Telefonica)	6.5%	6.8%	7.9%	7.3%	8.4%	9.0%	9.9%	10.2%	11.0%	12.8%	13.8%	12.5%	14.2%
EBITDA, €m													
T-Mobile (DT)	862	799	777	852	964	771	761	798	920	894	828	912	928
Vodafone	1,005	1,003	983	981	997	967	921	883	895	880	867	856	888
O2 (Telefonica)	197	17	163	178	192	237	202	230	235	252	241	291	304
KPN	289	278	284	308	336	317	322	333	347	331	321	345	386
Capex, €m													
T-Mobile (DT)	86	161	78	72	89	189	122	96	107	136	96	86	166
Vodafone	192	240	240	182	182	263	263	189	189	243	243	203	203
O2 (Telefonica)	199	245	137	221	262	304	184	171	192	250	113	169	173
KPN	95	149	64	111	135	171	135	79	77	137	70	86	128

Source: Citi Investment Research and Analysis

Fixed Data

Figure 282. German Fixed Line Market Information

Germany	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	8,493	9,019	9,558	9,898	10,242	10,594	10,984	11,229	11,301	11,477	11,665	11,795	11,844
Incumbent wholesale	3,524	3,524	3,401	3,169	2,905	2,537	2,209	1,952	1,752	1,621	1,523	1,354	1,143
ULL (total)	5,882	6,376	6,965	7,512	7,906	8,270	8,606	8,742	8,914	9,093	9,242	9,293	9,367
Cable	613	759	913	1,075	1,221	1,384	1,558	1,727	1,871	2,017	2,159	2,296	2,434
Total	18,512	19,678	20,837	21,654	22,274	22,785	23,357	23,650	23,838	24,208	24,589	24,738	24,788
Broadband Subscribers (000s)													
Deutsche Telekom	8,493	9,019	9,558	9,898	10,242	10,594	10,984	11,229	11,301	11,477	11,665	11,795	11,844
Hansenet (TEF)	2,244	2,349	2,372	2,361	2,343	2,344	2,325	2,289	2,300	2,310	2,404	2,413	2,445
United Internet	2,540	2,670	2,700	2,760	2,780	2,820	2,820	3,470	3,440	3,310	3,310	3,310	3,280
Freenet	1,270	1,280	1,190	1,100	1,050	940	910	0	0	0	0	0	0
Vodafone	2,387	2,531	2,675	2,781	2,887	2,994	3,100	3,180	3,310	3,400	3,500	3,550	3,600
Versatel	597	636	666	692	702	709	712	710	694	683	670	654	634
Telefonica (pre Hansenet)	37	75	125	165	198	215	232	253	272	285	0	0	0
Tele2	160	173	192	198	191	177	163	153	145	139	131	125	121
Kabel Deutschland	246	320	393	482	548	625	707	787	851	906	966	1,029	1,089
Unity Media	158	199	244	282	326	377	438	496	537	584	634	677	721
Other	171	186	447	624	659	609	553	639	505	587	750	595	430
Total	18,512	19,678	20,837	21,654	22,274	22,785	23,357	23,650	23,838	24,208	24,589	24,738	24,788
Broadband Subscribers Net Adds (000s)													
Deutsche Telekom	480	526	539	340	344	352	390	245	72	176	188	130	49
Hansenet (TEF)	64	105	23	(11)	(18)	1	(19)	(36)	11	10	94	9	32
United Internet	120	130	30	60	20	40	0	(50)	(30)	0	0	0	(30)
Freenet	50	10	(90)	(90)	(50)	(110)	(30)	0	0	0	0	0	0
Vodafone	144	144	144	106	106	106	106	80	130	90	100	50	50
Versatel	49	39	30	26	11	7	3	(2)	(16)	(11)	(13)	(16)	(20)
Telefonica	3	38	50	41	33	17	17	22	19	13			
Tele2	7	13	19	6	(7)	(14)	(14)	(10)	(8)	(6)	(8)	(6)	(4)
Kabel Deutschland	38	74	73	89	66	77	82	80	64	55	60		
Unity Media	33	41	45	38	44	51	61	58	41	47	50	43	44
Total	1,012	1,166	1,159	818	620	512	572	293	188	370	381	150	50
Telephony Channels (000s)													
Incumbent retail	31,872	31,334	30,191	29,543	28,978	28,301	27,699	27,226	26,653	26,236	25,864	25,549	25,024
Incumbent wholesale													
ULL (full)	5,882	6,376	6,965	7,512	7,906	8,270	8,606	8,742	8,914	9,093	9,242	9,293	9,367
Naked DSL													
Cable	557	700	859	1,025	1,185	1,361	1,551	1,731	1,890	2,050	2,204	2,339	2,474
Total	38,311	38,410	38,015	38,080	38,069	37,932	37,856	37,699	37,457	37,379	37,310	37,181	36,865
Telephony Channels Net Adds (000s)													
Incumbent retail	(497)	(538)	(1,143)	(648)	(565)	(677)	(602)	(473)	(573)	(417)	(372)	(315)	(525)
Incumbent wholesale													
ULL (full)	406	494	589	547	394	364	336	136	172	179	149	51	74
Naked DSL													
Cable	101	143	159	167	160	177	190	180	159	161	154	136	135
Total	10	99	(396)	66	(12)	(137)	(76)	(157)	(243)	(78)	(70)	(129)	(316)
Pay TV Subscribers (000s)													
DT	0	0	0	0	257	352	448	561	678	806	896	971	1,042
Sky Deutschland	0	0	0	0	2,411	2,399	2,371	2,364	2,431	2,470	2,471	2,476	2,521
Kabel Deutschland	9,156	9,113	8,980	9,258	9,282	9,205	9,247	9,184	9,111	9,044	9,002		
Unity Media	4,844	4,762	4,733	4,712	4,655	4,619	4,577	4,554	4,547	4,523	4,514	4,499	4,500
Total	0	0	0	0	16,605	16,575	16,643	16,663	16,767	16,843	16,931	16,973	17,097
Pay TV Subscribers Net Adds (000s)													
DT						95	96	113	117	128	90	75	71
Sky Deutschland						(12)	(28)	(7)	67	39	1	5	45
Kabel Deutschland	(102)	(43)	(133)	278	24	(77)	42	(63)	(73)	(67)	(42)	(33)	(3)
Unity Media	(77)	(82)	(29)	(21)	(57)	(36)	(42)	(23)	(7)	(24)	(9)	(15)	1
Total						(30)	68	20	104	76	88	42	124

Source: Company reports and Citi Investment Research and Analysis

Greece

Fixed

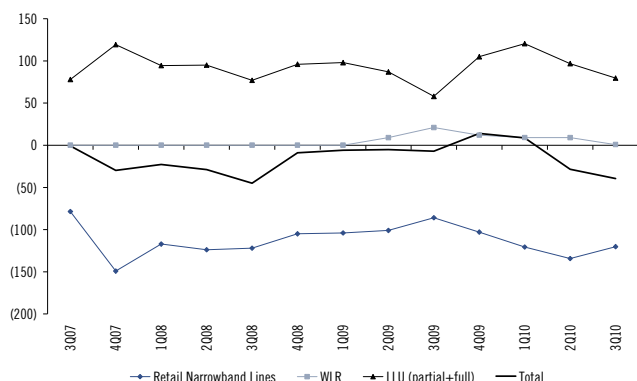
- **Record new low for OTE in broadband** — For the first time OTE reported negative net DSL additions due to its high price premium vs. ULL operators which are still reporting strong net additions. OTE launched a new broadband offers at €9.90/month and Forthnet has mentioned that it would focus on cash rather than market share. Both should help OTE protect market share in Q4.

Mobile

- **Revenue deterioration (again)** — We estimate that Greek service revenues declined by 19% in 3Q10. Cosmote continues to outperform while Wind Hellas which has now new owners following a second debt restructuring saw revenues declining by almost 30% for the second quarter in a row.
- **Good margins considering the environment** — All operators managed to grow EBITDA margin qoq which is positive considering the steepness in the revenue decline. Wind Hellas decided to largely stopped subsidizing handsets.

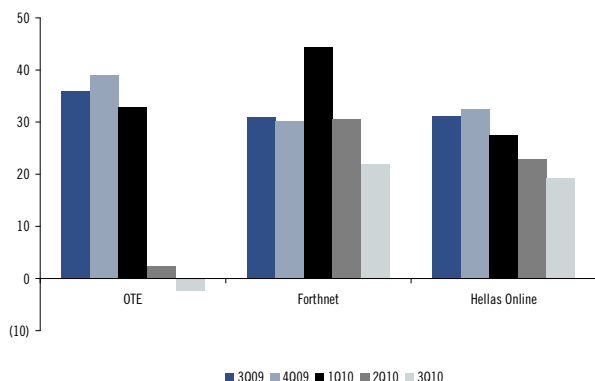
Fixed Charts

Figure 283. Telephony Net Adds (000s)



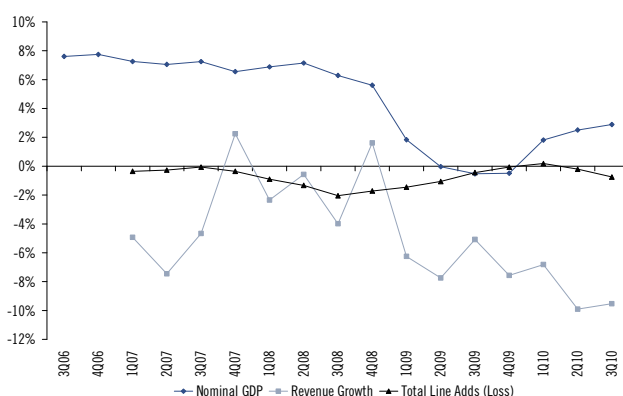
Source: Company reports and Citi Investment Research and Analysis

Figure 285. Broadband Subscriber Net Adds (000s)



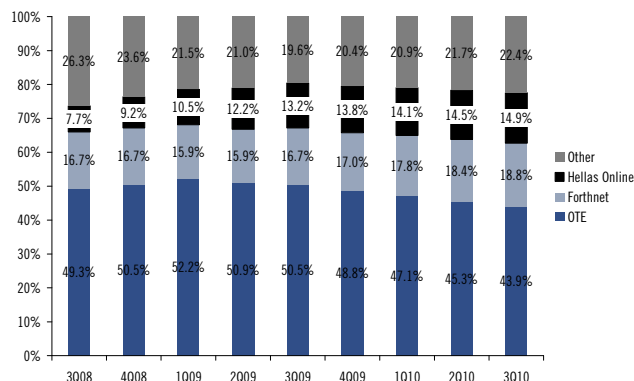
Source: Company reports and Citi Investment Research and Analysis

Figure 284. YoY Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

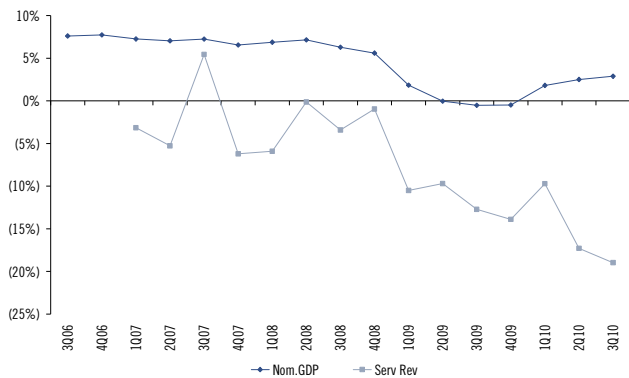
Figure 286. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

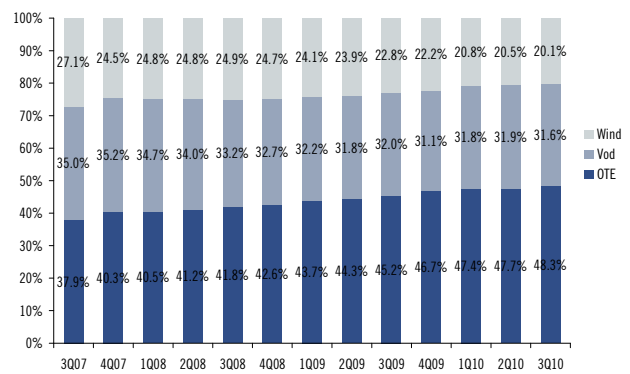
Mobile Charts

Figure 287. Revenue and GDP



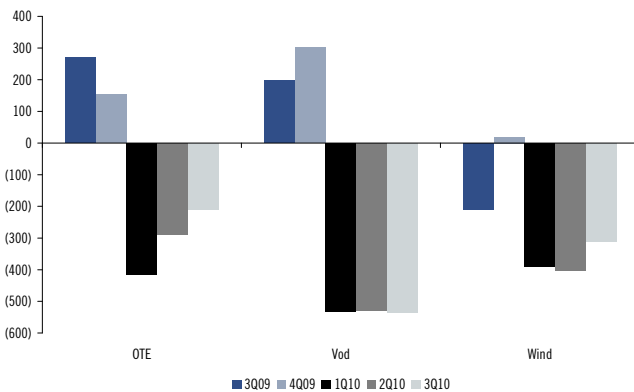
Source: Company reports, CIRA and Datastream

Figure 288. Service Revenue Market Share



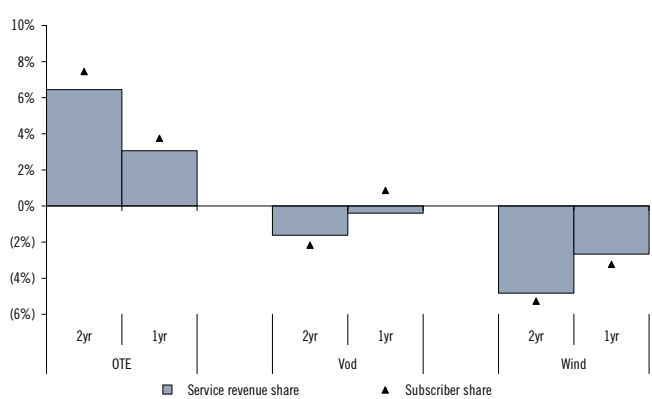
Source: Company reports and Citi Investment Research and Analysis

Figure 289. Total Net Adds



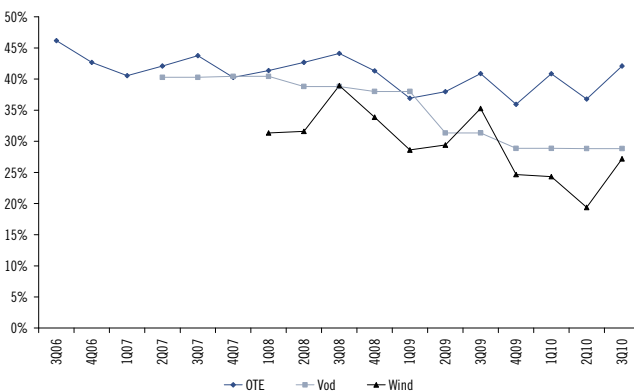
Source: Company reports and Citi Investment Research and Analysis

Figure 290. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Figure 291. EBITDA Margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 292. Mobile Market Information

Greece	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
OTE	449	421	411	440	478	440	397	427	451	416	388	380	390
Vodafone	414	367	351	363	380	338	292	307	319	277	261	254	256
Wind Hellas	321	256	252	265	285	256	218	230	227	198	170	163	163
Total	1,184	1,044	1,014	1,068	1,144	1,034	907	964	998	890	819	797	809
Service Revenue Growth, yoy													
OTE	10.4%	(5.5%)	(10.0%)	5.2%	6.6%	4.6%	(3.4%)	(2.9%)	(5.6%)	(5.6%)	(2.1%)	(11.0%)	(13.5%)
Vodafone	(4.6%)	(8.4%)	(4.9%)	(7.4%)	(8.3%)	(7.9%)	(16.9%)	(15.4%)	(15.9%)	(18.1%)	(10.8%)	(17.2%)	(20.0%)
Wind Hellas	13.8%	(4.1%)	0.0%	2.2%	(11.1%)	(0.1%)	(13.3%)	(13.1%)	(20.3%)	(22.6%)	(22.1%)	(29.1%)	(28.5%)
Total	5.5%	(6.2%)	(5.9%)	(0.1%)	(3.4%)	(1.0%)	(10.5%)	(9.7%)	(12.7%)	(13.9%)	(9.7%)	(17.3%)	(19.0%)
Service Revenue Market Share													
OTE	37.9%	40.3%	40.5%	41.2%	41.8%	42.6%	43.7%	44.3%	45.2%	46.7%	47.4%	47.7%	48.3%
Vodafone	35.0%	35.2%	34.7%	34.0%	33.2%	32.7%	32.2%	31.8%	32.0%	31.1%	31.8%	31.9%	31.6%
Wind Hellas	27.1%	24.5%	24.8%	24.8%	24.9%	24.7%	24.1%	23.9%	22.8%	22.2%	20.8%	20.5%	20.1%
Post-pay Customers, 000s													
OTE	0	0	0	0	0	0	0	0	0	0	0	0	0
Vodafone	1,631	1,702	1,731	1,757	1,776	1,780	1,760	1,724	1,701	1,698	1,686	1,675	1,656
Wind Hellas	993	1,016	1,030	1,053	1,074	1,081	1,069	1,059	1,054	1,059	1,067	1,055	1,036
Call Volumes, mn min/qtr													
OTE	2,946	3,113	3,398	3,692	3,955	4,201	4,891	5,574	5,946	6,197	6,243	6,494	6,571
Vodafone	2,282	2,244	2,262	2,395	2,443	2,370	2,281	2,402	2,411	2,309	2,221	2,438	2,485
Tellas	1,706	1,670	1,630	1,757	1,803	1,710	1,626	1,681	1,659	1,558	1,286	1,582	1,586
Total	6,934	7,027	7,289	7,844	8,201	8,280	8,798	9,657	10,015	10,064	9,750	10,514	10,643
Call Volume growth, yoy													
OTE	30.4%	32.4%	39.1%	35.9%	34.3%	34.9%	44.0%	51.0%	50.3%	47.5%	27.6%	16.5%	10.5%
Vodafone	3.0%	6.2%	14.0%	10.5%	7.1%	5.6%	0.8%	0.3%	(1.3%)	(2.6%)	(2.6%)	1.5%	3.1%
Tellas	17.2%	14.1%	9.1%	7.1%	5.7%	2.4%	(0.3%)	(4.3%)	(8.0%)	(8.9%)	(20.9%)	(5.9%)	(4.4%)
Total	16.9%	18.5%	23.1%	20.2%	18.3%	17.8%	20.7%	23.1%	22.1%	21.5%	10.8%	8.9%	6.3%
Contract Churn, % p.a													
Wind Hellas	23.8%	24.7%	24.2%	21.6%	22.2%	26.0%	29.3%	30.2%	30.9%				
EBITDA, €m													
OTE	205	178	176	194	220	192	164	180	208	174	177	155	185
Vodafone	167	148	142	141	148	129	111	96	100	80	75	73	74
Wind Hellas	149	102	94	99	132	105	76	82	98	61	52	39	54

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 293. Greek Fixed Line Market Information

Greece	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	530	577	646	687	740	830	938	970	1,006	1,045	1,078	1,080	1,078
Incumbent wholesale	227	247	215	205	184	142	90	79	73	78	71	65	61
ULL (total)	190	310	404	499	576	672	770	857	915	1,020	1,141	1,237	1,317
Cable	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	947	1,135	1,265	1,391	1,500	1,644	1,798	1,906	1,994	2,143	2,289	2,383	2,456
Broadband Subscribers (000s)													
OTE	530	577	646	687	740	830	938	970	1,006	1,045	1,078	1,080	1,078
Forthnet	189	200	217	231	250	274	286	303	334	364	409	439	461
Hellas Online	69	85	92	104	115	151	188	232	264	296	324	346	366
Wind Hellas	0	0	0	0	0	0	0	0	0	0	0	0	0
- other	159	272	310	370	395	389	386	401	391	438	479	517	551
Total	947	1,135	1,265	1,391	1,500	1,644	1,798	1,906	1,994	2,143	2,289	2,383	2,456
Broadband Subscribers Net Adds (000s)													
OTE	80	48	69	41	53	90	108	32	36	39	33	2	(3)
Forthnet	26	11	16	14	20	24	12	16	31	30	45	31	22
Other	43	112	39	59	25	(6)	(3)	15	(10)	47	41	38	34
Total	160	188	130	126	109	144	154	108	88	149	146	94	73
Telephony Channels (000s)													
Retail Narrowband Lines	6,003	5,854	5,737	5,613	5,491	5,386	5,282	5,181	5,095	4,992	4,871	4,737	4,617
WLR	0	0	0	0	0	0	0	9	30	42	51	60	61
ULL (partial+full)	190	310	404	499	576	672	770	857	915	1,020	1,141	1,237	1,317
Cable	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	6,194	6,164	6,141	6,112	6,067	6,058	6,052	6,047	6,040	6,054	6,063	6,034	5,995
Telephony Channels Net Adds (000s)													
Retail Narrowband Lines	(79)	(149)	(117)	(124)	(122)	(105)	(104)	(101)	(86)	(103)	(121)	(134)	(120)
WLR	0	0	0	0	0	0	0	9	21	12	9	9	1
ULL (partial+full)	78	119	94	95	77	96	98	87	58	105	121	97	80
Cable	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	(1)	(30)	(23)	(29)	(45)	(9)	(6)	(5)	(7)	14	9	(29)	(40)

Source: Company reports and Citi Investment Research and Analysis

Italy

Fixed

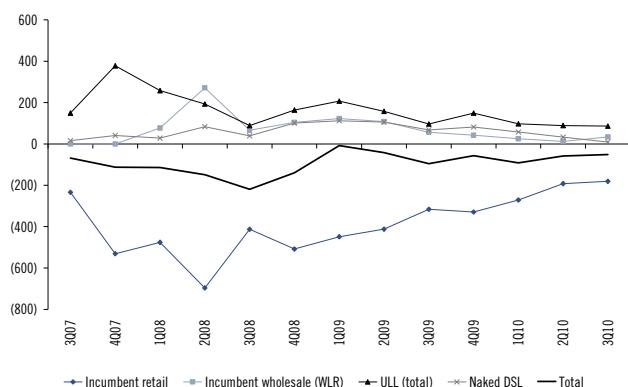
- **Slow but encouraging trends** – A seasonally weak quarter for broadband growth in which TI managed to limit its retail market share loss in broadband and retail line losses to just 181k. During this period, retail prices have been broadly stable by the major competitors, with the exception of Tiscali, which is trying to make another come back.

Mobile

- **Stable market, weak TIM** – Market service revenue has shown some deterioration, but that has been mostly been down to TIM and its aggressive summer promotions, which are no longer available. The story continues to be that of the winners (including Vodafone) and losers (TIM and H3G).

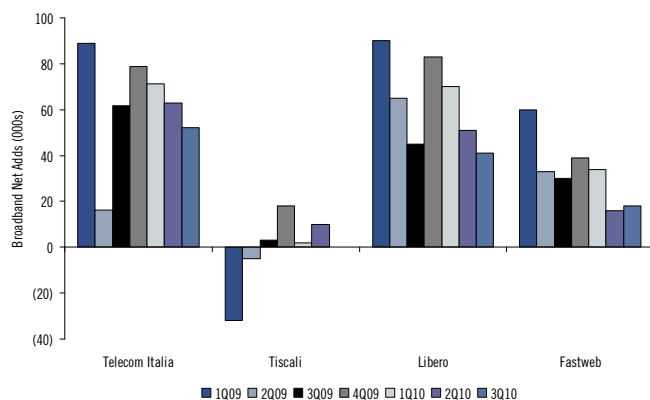
Fixed Charts

Figure 294. Telephony Net Adds



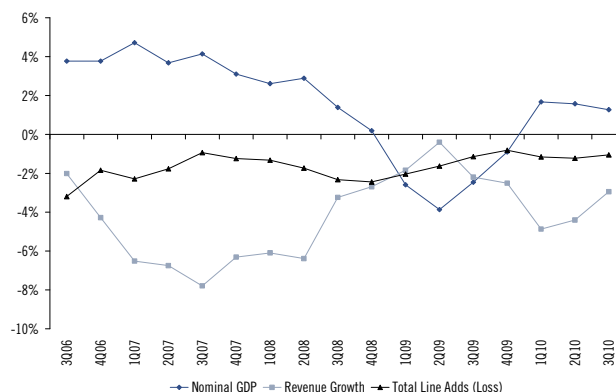
Source: Company reports and Citi Investment Research and Analysis

Figure 296. Broadband Subscriber Net Adds



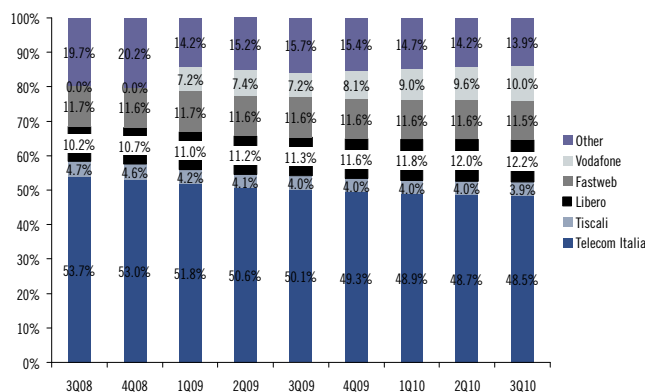
Source: Company reports and Citi Investment Research and Analysis

Figure 295. Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

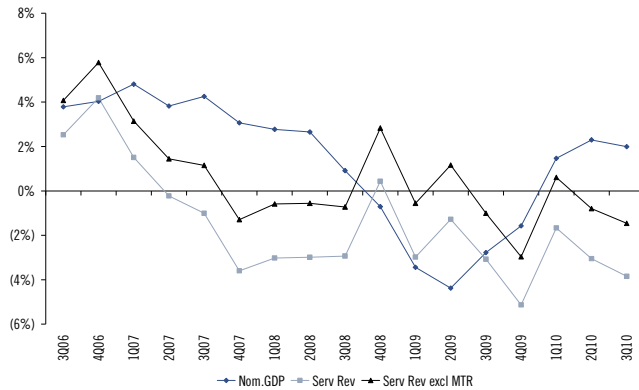
Figure 297. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

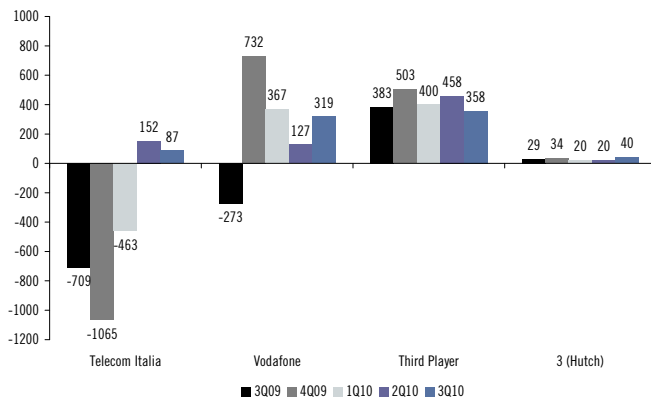
Mobile Charts

Figure 298. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



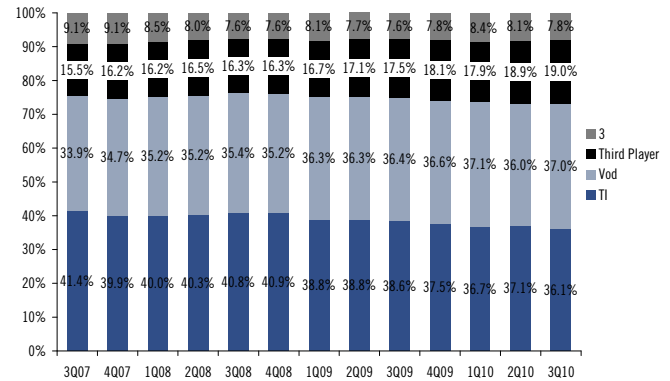
Source: Company reports, CIRA and Datastream

Figure 300. Subscriber Net Adds



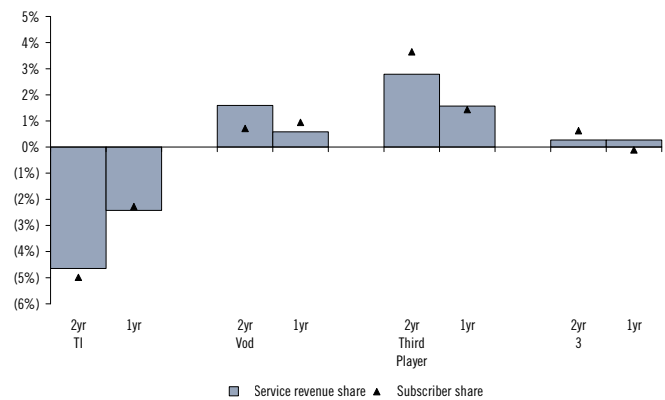
Source: Company reports and Citi Investment Research and Analysis

Figure 299. Service Revenue Market Share



Source: Company reports and Citi Investment Research and Analysis

Figure 301. Service Revenue Growth



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 302. Italian Mobile Market Information

Italy	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
Telecom Italia	2,366	2,187	2,118	2,199	2,261	2,250	1,993	2,092	2,072	1,959	1,850	1,936	1,867
Vodafone	1,936	1,903	1,861	1,921	1,961	1,938	1,863	1,956	1,955	1,912	1,873	1,878	1,910
Third operator	888	889	859	902	901	896	859	921	939	944	901	985	984
3 (Hutch)	521	500	452	434	420	420	417	417	407	407	422	422	405
Total	5,711	5,480	5,289	5,455	5,543	5,504	5,132	5,385	5,373	5,221	5,046	5,221	5,166
Service Revenue Growth, yoy													
Telecom Italia	(2.2%)	(7.5%)	(6.9%)	(5.3%)	(4.4%)	2.9%	(5.9%)	(4.8%)	(8.4%)	(12.9%)	(7.2%)	(7.5%)	(9.9%)
Vodafone	(2.7%)	(2.9%)	(0.1%)	0.2%	1.3%	1.8%	0.1%	1.8%	(0.3%)	(1.3%)	0.5%	(4.0%)	(2.3%)
Third operator	5.7%	4.6%	5.0%	1.7%	1.5%	0.8%	0.0%	2.1%	4.2%	5.4%	4.9%	6.9%	4.8%
3 (Hutch)	0.2%	(1.8%)	(9.4%)	(13.0%)	(19.3%)	(16.1%)	(7.8%)	(4.0%)	(3.1%)	(3.1%)	1.4%	1.4%	(0.4%)
Total	(1.0%)	(3.6%)	(3.0%)	(3.0%)	(2.9%)	0.4%	(3.0%)	(1.3%)	(3.1%)	(5.1%)	(1.7%)	(3.0%)	(3.8%)
Service Revenue Market Share													
Telecom Italia	41.4%	39.9%	40.0%	40.3%	40.8%	40.9%	38.8%	38.8%	38.6%	37.5%	36.7%	37.1%	36.1%
Vodafone	33.9%	34.7%	35.2%	35.2%	35.4%	35.2%	36.3%	36.3%	36.4%	36.6%	37.1%	36.0%	37.0%
Third operator	15.5%	16.2%	16.2%	16.5%	16.3%	16.3%	16.7%	17.1%	17.5%	18.1%	17.9%	18.9%	19.0%
3 (Hutch)	9.1%	9.1%	8.5%	8.0%	7.6%	7.6%	8.1%	7.7%	7.6%	7.8%	8.4%	8.1%	7.8%
Post-pay Customers, 000s													
Vodafone	2,418	2,608	2,850	3,058	3,228	3,423	3,635	3,797	3,933	4,091	4,172	4,311	4,448
Call Volumes, mn min/qtr													
Telecom Italia	11,909	12,254	12,360	12,572	12,427	12,359	11,819	12,272	12,025	12,453	12,104	12,805	13,188
Vodafone	9,051	9,651	9,813	10,094	10,010	10,622	10,337	10,566	10,291	10,765	10,733	11,033	10,860
Third operator	7,200	7,600	7,700	7,999	8,001	8,500	8,398	8,868	8,734	9,500	9,705	10,530	10,165
3 Hutch	2,874	3,049	3,127	3,276	3,309	3,497	3,464	3,664	3,624	3,839	3,818	4,017	3,947
Total	31,034	32,554	33,000	33,941	33,747	34,978	34,019	35,370	34,674	36,556	36,360	38,385	38,160
Call Volume growth, yoy													
Telecom Italia	11.4%	18.4%	18.4%	11.1%	4.4%	0.9%	(4.4%)	(2.4%)	(3.2%)	0.8%	2.4%	4.3%	9.7%
Vodafone	12.4%	16.9%	16.3%	13.0%	10.6%	10.1%	5.3%	4.7%	2.8%	1.3%	3.8%	4.4%	5.5%
Third operator	4.4%	10.4%	11.6%	8.1%	11.1%	11.8%	9.1%	10.9%	9.2%	11.8%	15.6%	18.7%	16.4%
3 Hutch	11.8%	17.7%	20.2%	16.9%	15.1%	14.7%	10.8%	11.8%	9.5%	9.8%	10.2%	9.6%	8.9%
Total	10.0%	15.9%	16.3%	11.5%	8.7%	7.4%	3.1%	4.2%	2.7%	4.5%	6.9%	8.5%	10.1%
Contract Churn, % p.a													
Vodafone	14.7%	17.5%	18.1%	17.6%	15.8%	17.3%	16.9%	19.8%	17.2%	23.3%	22.8%	25.3%	20.2%
Data Revenue (excl messaging) % Service Revenue													
Telecom Italia	9.4%	10.3%	12.1%	12.2%	12.7%	14.2%	11.7%	12.5%	13.8%	14.8%	16.2%	14.8%	15.7%
Vodafone	6.0%	6.8%	7.4%	7.5%	7.8%	8.4%	9.0%	8.7%	9.8%	10.2%	10.8%	11.0%	12.3%
EBITDA, €m													
Vodafone	1,044	952	931	1,016	1,038	992	954	1,073	1,073	1,025	1,004	1,037	1,054
Capex, €m													
Vodafone	139	236	236	192	192	212	212	222	222	226	226	200	200

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 303. Italian Fixed Line Market Information

Italy	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	6,215	6,427	6,541	6,564	6,610	6,754	6,843	6,859	6,921	7,000	7,071	7,134	7,186
Incumbent wholesale	1,180	1,163	1,187	1,228	1,304	1,380	1,486	1,584	1,646	1,741	1,788	1,825	1,847
ULL (total)	3,173	3,637	3,953	4,248	4,387	4,621	4,883	5,112	5,237	5,456	5,600	5,700	5,789
Cable	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	10,568	11,227	11,681	12,040	12,301	12,755	13,212	13,555	13,804	14,196	14,459	14,659	14,822
Broadband Subscribers (000s)													
Telecom Italia	6,215	6,427	6,541	6,564	6,610	6,754	6,843	6,859	6,921	7,000	7,071	7,134	7,186
Tiscali	518	552	580	574	581	586	554	549	552	570	572	582	582
Libero	942	1,022	1,115	1,198	1,250	1,360	1,450	1,515	1,560	1,643	1,713	1,764	1,805
Fastweb	1,251	1,313	1,388	1,398	1,441	1,482	1,542	1,575	1,605	1,644	1,678	1,694	1,712
Vodafone	0	0	0	0	0	0	950	1,000	1,000	1,150	1,300	1,400	1,476
Other	1,642	1,913	2,057	2,306	2,419	2,573	1,873	2,057	2,166	2,189	2,125	2,085	2,061
Total	10,568	11,227	11,681	12,040	12,301	12,755	13,212	13,555	13,804	14,196	14,459	14,659	14,822
Broadband Subscribers Net Adds (000s)													
Telecom Italia	142	212	114	23	46	144	89	16	62	79	71	63	52
Tiscali	18	34	28	(6)	7	5	(32)	(5)	3	18	2	10	0
Libero	44	80	93	83	52	110	90	65	45	83	70	51	41
Fastweb	55	62	75	10	43	41	60	33	30	39	34	16	18
Vodafone	0	0	0	0	0	0	950	50	0	150	150	100	76
Total	301	659	454	359	261	454	456	344	249	392	263	200	163
Telephony Channels (000s)													
Incumbent retail	22,655	22,124	21,648	20,952	20,539	20,031	19,582	19,170	18,854	18,525	18,254	18,062	17,881
Incumbent wholesale (WLR)	0	0	77	348	414	518	640	747	803	845	870	882	916
ULL (total)	2,583	2,961	3,218	3,411	3,500	3,664	3,871	4,028	4,124	4,273	4,370	4,459	4,545
Naked DSL	280	321	349	432	471	572	684	789	857	939	996	1,029	1,038
Cable	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	25,518	25,406	25,292	25,143	24,924	24,784	24,777	24,734	24,639	24,582	24,490	24,432	24,380
Telephony Channels Net Adds (000s)													
Incumbent retail	(234)	(531)	(476)	(696)	(413)	(508)	(449)	(412)	(316)	(329)	(271)	(192)	(181)
Incumbent wholesale (WLR)	0	0	77	271	66	104	122	108	56	42	25	12	34
ULL (total)	149	378	257	193	89	164	207	157	96	149	97	89	86
Naked DSL	16	41	28	83	39	101	112	105	68	81	57	33	9
Cable	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	(69)	(112)	(114)	(149)	(219)	(140)	(8)	(42)	(96)	(57)	(92)	(58)	(52)
Pay TV Subscribers (000s)													
TI	0	0	136	180	218	329	365	397	406	401	395	395	391
Sky Italia	0	0	0	0	4,600	4,700	4,800	4,800	4,800	4,800	4,800	4,800	4,858

Source: Company reports and Citi Investment Research and Analysis

Netherlands

Fixed

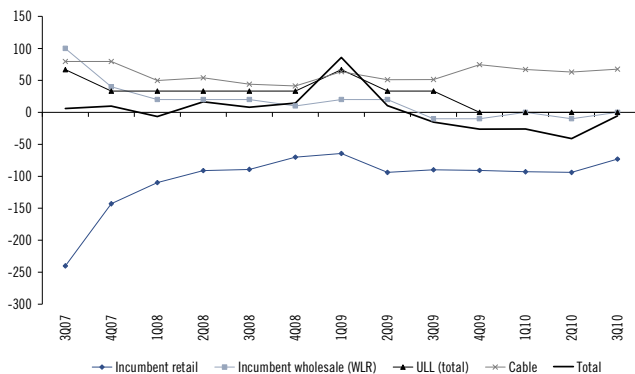
- **Small improvement from KPN** — KPN returned to positive broadband net additions but only just with 4k net adds in 3Q10. Fixed line revenue growth deteriorated slightly and is still recording around 6% revenue decline due to market share gain from cable.

Mobile

- **Vodafone gaining share, KPN improving** — KPN's mobile service revenue growth improved for the second consecutive quarter to -2.0% in 3Q10 from -2.8% 2Q10. This was done to a slight worsening trend in revenue growth at T-Mobile (up 0.8% yoy) while Vodafone continues to outperform growing revenues by 7.3% yoy in 3Q10 yoy. Mobile margins were slightly down on the back of higher SARCs following as KPN fought harder to retain market share.

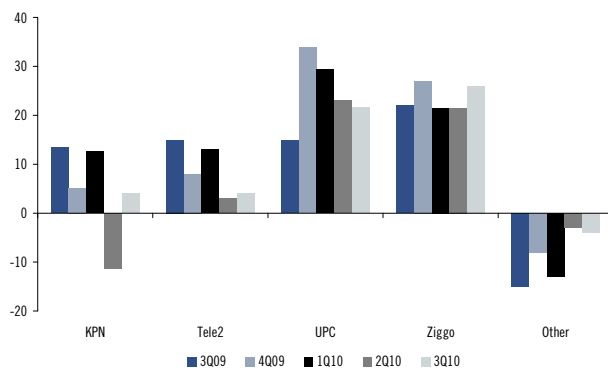
Fixed Charts

Figure 304. Telephony Net Adds



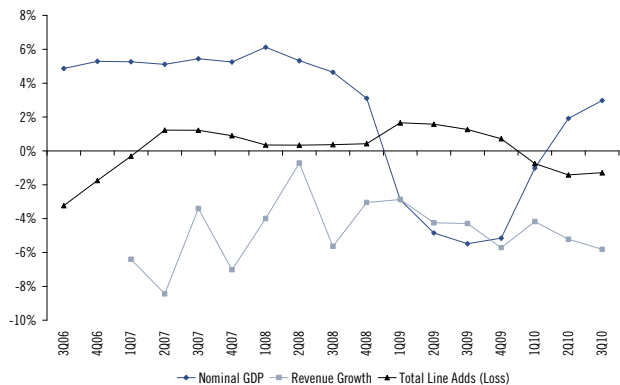
Source: Company reports and Citi Investment Research and Analysis

Figure 306. Broadband Subscriber Net Adds



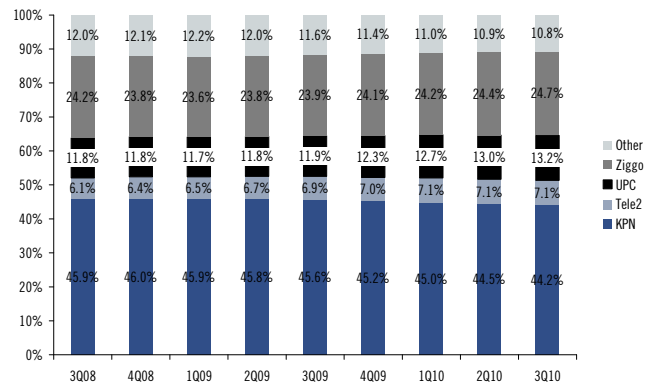
Source: Company reports and Citi Investment Research and Analysis

Figure 305. Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

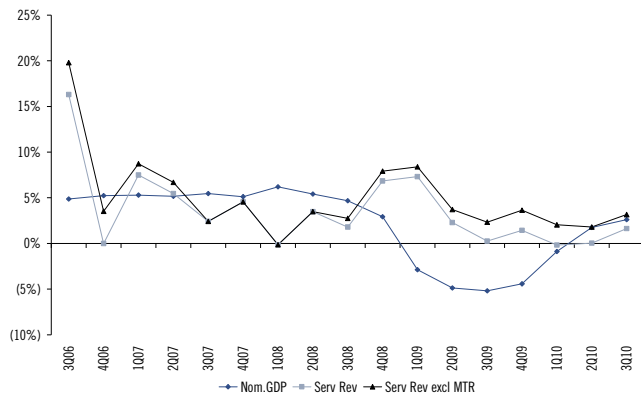
Figure 307. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

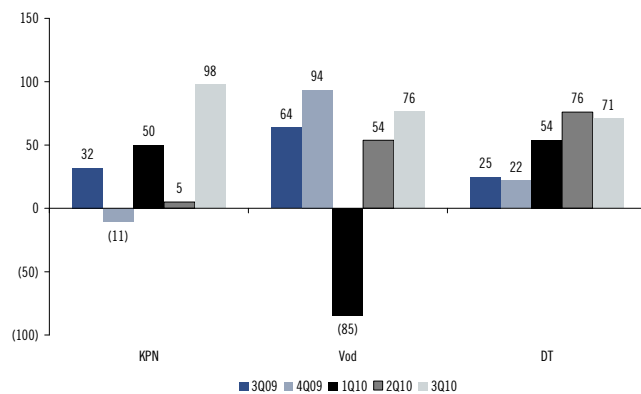
Mobile Charts

Figure 308. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



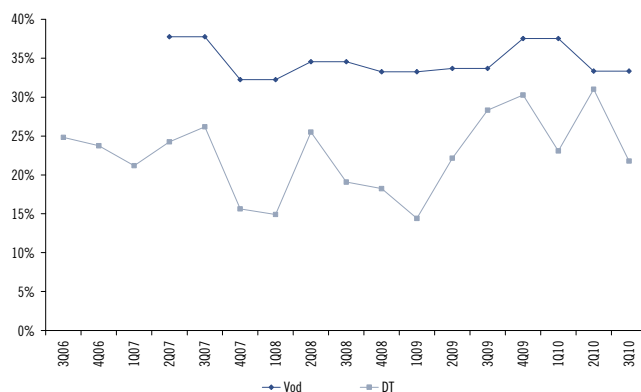
Source: Company reports, CIRA and Datastream

Figure 310. Post-Paid Net Adds



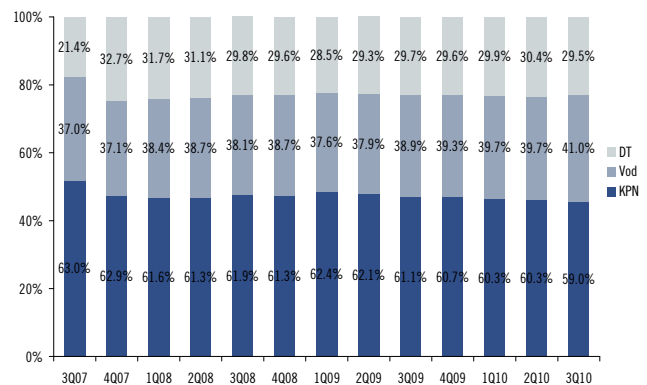
Source: Company reports and Citi Investment Research and Analysis

Figure 312. EBITDA Margin



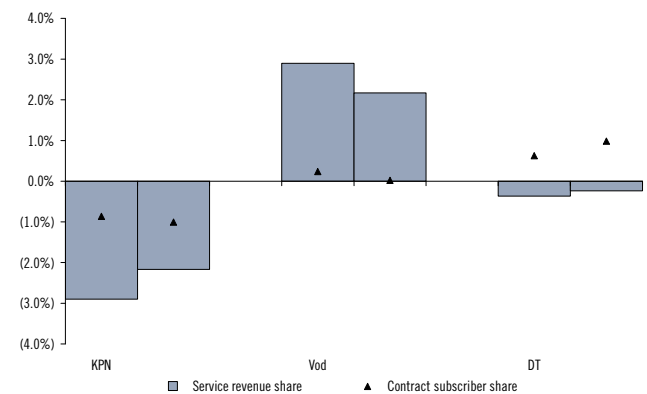
Source: Company reports and Citi Investment Research and Analysis

Figure 309. Service Revenue Market Share



Source: Company reports and Citi Investment Research and Analysis

Figure 311. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Figure 313. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 314. Netherlands Mobile Market Information

Netherlands	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
KPN	764	725	706	756	764	754	767	783	757	758	740	761	742
Vodafone	449	427	440	477	471	477	463	478	481	491	488	500	517
T-Mobile (DT)	259	377	364	383	369	365	350	370	368	370	367	383	371
Total	1,213	1,152	1,146	1,233	1,235	1,231	1,230	1,261	1,238	1,249	1,228	1,261	1,259
Service Revenue Growth, yoy													
KPN	1.6%	(1.4%)	(3.4%)	0.4%	0.0%	4.0%	8.6%	3.6%	(0.9%)	0.5%	(3.5%)	(2.8%)	(2.0%)
Vodafone	3.9%	16.4%	5.6%	8.8%	4.8%	11.7%	5.2%	0.3%	2.2%	2.9%	5.4%	4.7%	7.3%
T-Mobile (DT)	0.0%	40.8%	41.9%	42.4%	42.1%	(3.3%)	(3.8%)	(3.4%)	(0.2%)	1.4%	4.9%	3.5%	0.8%
Total	2.4%	4.6%	(0.1%)	3.5%	1.8%	6.8%	7.3%	2.3%	0.3%	1.4%	(0.2%)	0.0%	1.6%
Service Revenue Market Share													
KPN	63.0%	62.9%	61.6%	61.3%	61.9%	61.3%	62.4%	62.1%	61.1%	60.7%	60.3%	60.3%	59.0%
Vodafone	37.0%	37.1%	38.4%	38.7%	38.1%	38.7%	37.6%	37.9%	38.9%	39.3%	39.7%	39.7%	41.0%
T-Mobile (DT)	21.4%	32.7%	31.7%	31.1%	29.8%	29.6%	28.5%	29.3%	29.7%	29.6%	29.9%	30.4%	29.5%
Post-pay Customers, 000s													
KPN	4,249	4,337	4,424	4,588	4,770	4,959	5,106	5,165	5,197	5,186	5,236	5,241	5,339
Vodafone	2,226	2,302	2,432	2,498	2,575	2,658	2,725	2,756	2,820	2,914	2,829	2,883	2,959
T-Mobile (DT)	1,351	2,090	2,123	2,153	2,229	2,259	2,313	2,359	2,384	2,406	2,460	2,536	2,607
Call Volumes, mn min/qtr													
KPN	2,953	3,211	3,165	3,326	3,130	3,334	3,264	3,389	3,202	3,389	3,291	3,299	3,103
Vodafone	1,899	2,036	2,077	2,260	2,108	2,313	2,278	2,363	2,212	2,367	2,359	2,323	2,625
Deutsche Telekom	1,180	1,613	1,756	1,911	1,734	1,755	1,708	1,743	1,765	1,842	1,900	1,987	1,923
Total	6,945	7,330	6,998	7,497	6,972	7,402	7,250	7,495	7,180	7,598	7,550	7,609	7,651
Call Volume growth, yoy													
KPN	7.7%	7.9%	3.4%	5.9%	6.0%	3.8%	3.1%	1.9%	2.3%	1.7%	0.8%	(2.7%)	(3.1%)
Vodafone	11.0%	9.0%	9.3%	12.7%	11.0%	13.6%	9.7%	4.6%	4.9%	2.3%	3.6%	(1.7%)	18.7%
Deutsche Telekom	16.1%	41.0%	47.2%	52.6%	46.9%	8.8%	(2.7%)	(8.8%)	1.8%	5.0%	11.2%	14.0%	9.0%
Total	10.9%	6.9%	(0.8%)	2.0%	0.4%	1.0%	3.6%	(0.0%)	3.0%	2.7%	4.1%	1.5%	6.6%
Contract Churn, % p.a													
T-Mobile (DT)	14.4%	18.0%	19.2%	19.2%	16.8%	21.6%	18.0%	16.8%	19.2%	18.0%	15.6%	12.0%	13.2%
EBITDA, €m													
Vodafone	170	138	142	165	163	159	154	161	162	184	183	167	172
T-Mobile (DT)	77	68	62	114	91	85	64	103	128	135	102	139	98
Capex, €m													
Vodafone	30	56	56	30	30	48	48	31	31	60	60	59	59
T-Mobile (DT)	38	71	75	28	45	40	76	9	23	49	14	57	37

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 315. Netherlands Fixed Line Market Information

Netherlands	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	2,468	2,501	2,552	2,587	2,621	2,664	2,692	2,698	2,712	2,717	2,729	2,718	2,722
Incumbent wholesale	0	0	0	0	0	0	0	0	0	0	0	0	0
ULL (total)	900	933	967	1,000	1,033	1,067	1,100	1,100	1,100	1,100	1,100	1,100	1,100
Cable	1,942	1,987	2,018	2,047	2,053	2,058	2,077	2,093	2,130	2,191	2,242	2,286	2,334
Total	5,310	5,422	5,537	5,634	5,708	5,788	5,869	5,891	5,942	6,008	6,071	6,104	6,156
Broadband Subscribers (000s)													
KPN	2,468	2,501	2,552	2,587	2,621	2,664	2,692	2,698	2,712	2,717	2,729	2,718	2,722
Tele2	302	324	331	338	349	368	382	395	410	418	431	434	438
UPC	625	640	650	659	672	683	689	693	708	742	771	794	816
Ziggo	1,317	1,347	1,368	1,388	1,382	1,375	1,388	1,400	1,422	1,449	1,471	1,492	1,518
Other	598	609	636	662	684	699	718	705	690	682	669	666	662
Total	5,310	5,422	5,537	5,634	5,708	5,788	5,869	5,891	5,942	6,008	6,071	6,104	6,156
Broadband Subscribers Net Adds (000s)													
KPN	45	33	51	35	34	43	28	6	13	5	13	(11)	4
Tele2	16	22	7	7	11	19	14	13	15	8	13	3	4
UPC	24	16	10	8	13	11	7	4	15	34	29	23	22
Ziggo	30	30	21	21	(7)	(7)	13	13	22	27	22	22	26
- other	(49)	11	26	26	22	14	19	(13)	(15)	(8)	(13)	(3)	(4)
Total	65	112	115	97	74	80	80	23	50	66	63	33	52
Telephony Channels (000s)													
Incumbent retail	5,546	5,403	5,293	5,202	5,112	5,042	4,978	4,884	4,794	4,703	4,610	4,516	4,443
Incumbent wholesale (WLR)	280	320	340	360	380	390	410	430	420	410	410	400	400
ULL (total)	600	633	667	700	733	767	833	867	900	900	900	900	900
Cable	1,113	1,192	1,242	1,296	1,340	1,381	1,445	1,496	1,547	1,622	1,689	1,752	1,820
Total	7,538	7,548	7,541	7,558	7,566	7,580	7,666	7,677	7,661	7,635	7,609	7,568	7,563
Telephony Channels Net Adds (000s)													
Incumbent retail	(240)	(143)	(110)	(91)	(89)	(70)	(64)	(94)	(90)	(91)	(93)	(94)	(73)
Incumbent wholesale (WLR)	100	40	20	20	20	10	20	20	(10)	(10)	0	(10)	0
ULL (full)	67	33	33	33	33	33	67	33	33	0	0	0	0
Cable	79	79	50	54	44	41	64	51	51	75	67	63	68
Total	6	10	(7)	16	8	15	86	10	(15)	(26)	(26)	(41)	(6)
Pay TV Subscribers (000s)													
KPN	414	497	553	636	700	775	835	886	924	970	1,033	1,088	1,144
UPC	2,174	2,152	2,119	2,089	2,068	2,044	2,013	1,986	1,966	1,955	1,941	1,930	1,907
Pay TV Subscribers Net Adds (000s)													
KPN	77	83	56	83	64	75	60	51	38	46	63	55	56
UPC	(15)	(21)	(34)	(30)	(21)	(24)	(31)	(27)	(20)	(11)	(14)	(11)	(23)

Source: Company reports and Citi Investment Research and Analysis

Norway

Fixed

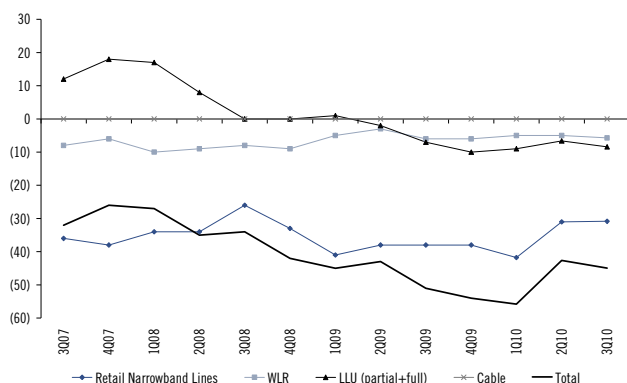
- **Line loss remains high** – Telenor's retail line loss remained high at -9.4% yoy. Telenor's domestic fixed revenue declined at a similar rate to 2Q10 at -3.8% in 3Q10. Broadband market net adds were -9k in 3Q10 a -1.2% decline yoy. This is due to market saturation and some cannibalisation from mobile broadband.

Mobile

- **Significant worsening in growth** – The mobile market growth rate excluding the impact of MTR cuts fell from 2.9% 2Q10 to -0.9% 3Q10. This is at odds with other Northern European countries. This was driven by voice, with data staying resilient. Telenor stated it was caused by the impact from roaming and price competition in the corporate segment. Norway is one of the few European markets with worsening trends, we therefore watch this market closely to see if this is a blip or the sign of long term increase in price competition.

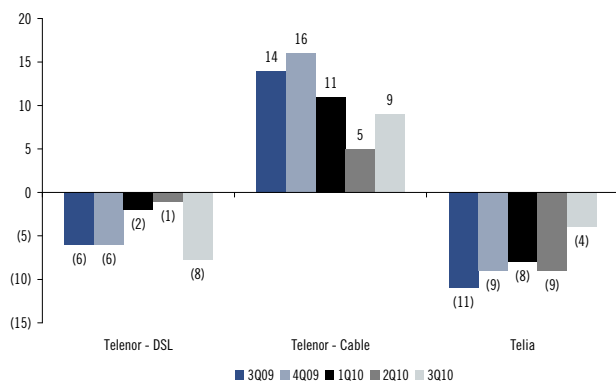
Fixed Charts

Figure 316. Telephony Net Adds



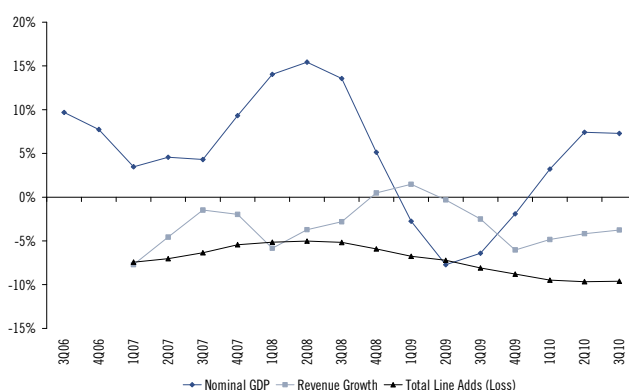
Source: Company reports and Citi Investment Research and Analysis

Figure 318. Broadband Subscriber Net Adds



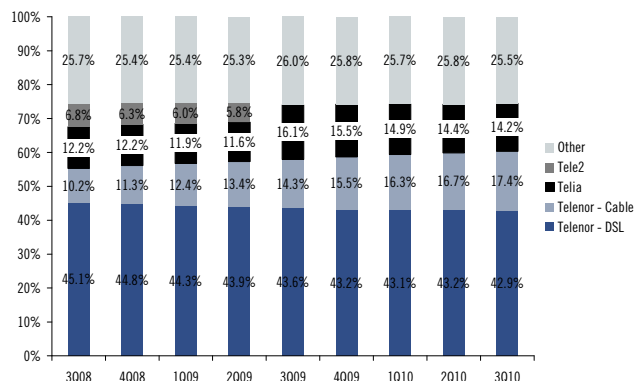
Source: Company reports and Citi Investment Research and Analysis

Figure 317. Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

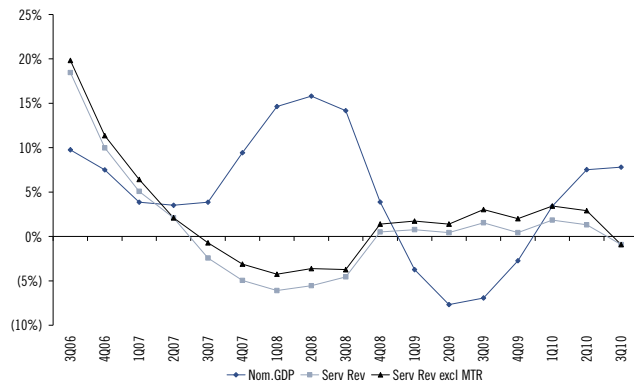
Figure 319. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

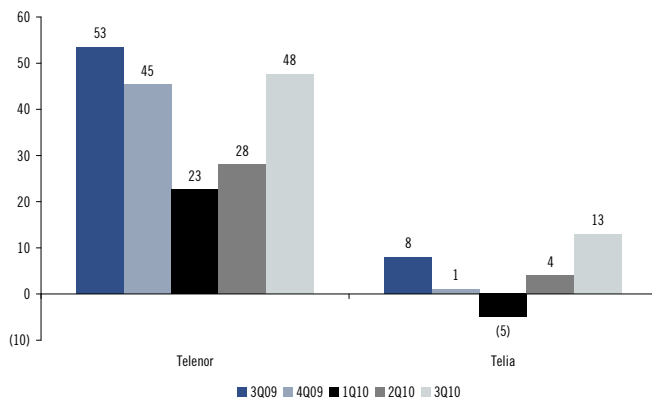
Mobile Charts

Figure 320. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



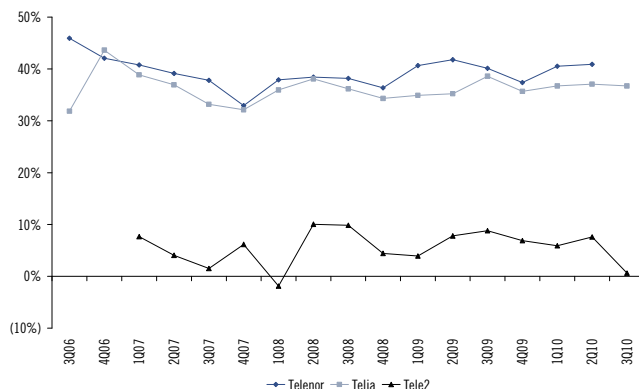
Source: Company reports, CIRA and Datastream

Figure 322. Post-Paid Net Adds



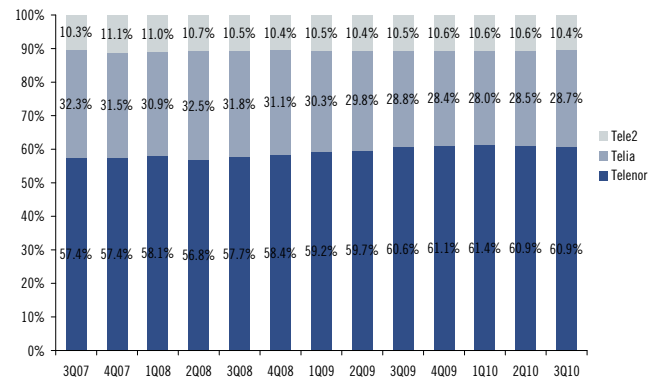
Source: Company reports and Citi Investment Research and Analysis

Figure 324. EBITDA Margin



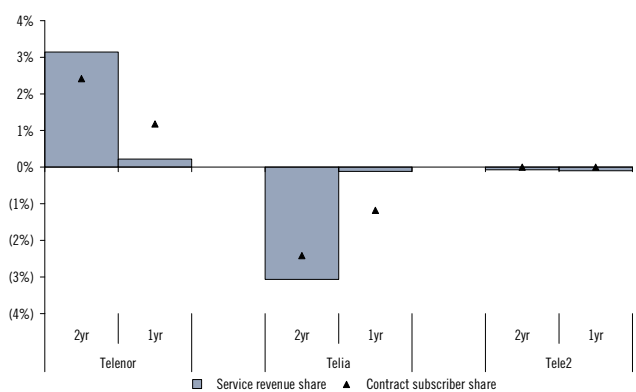
Source: Company reports and Citi Investment Research and Analysis

Figure 321. Service Revenue Market Share



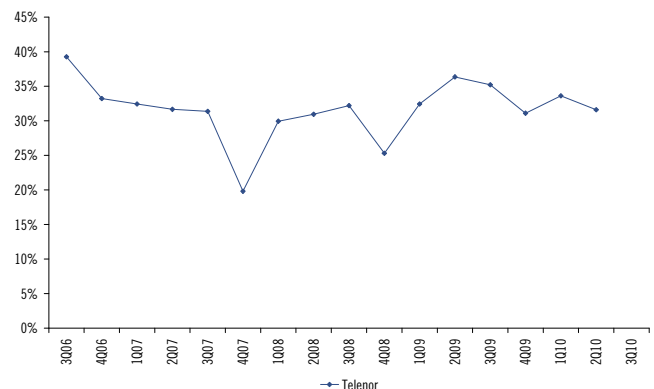
Source: Company reports and Citi Investment Research and Analysis

Figure 323. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Figure 325. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 326. Norway Mobile Market Information

Norway	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, NOK m													
Telenor	3,114	2,915	2,861	2,912	2,988	2,982	2,934	3,075	3,188	3,129	3,100	3,176	3,170
Telia	1,750	1,597	1,521	1,665	1,646	1,588	1,504	1,537	1,516	1,454	1,414	1,489	1,496
Tele2	561	564	541	550	543	532	522	537	553	541	537	552	543
Total	5,425	5,077	4,922	5,127	5,178	5,102	4,960	5,149	5,257	5,124	5,051	5,217	5,209
Service Revenue Growth, yoy													
Telenor	(1.7%)	(1.4%)	(1.7%)	(4.1%)	(4.0%)	2.3%	2.6%	5.6%	6.7%	4.9%	5.6%	3.3%	(0.6%)
Telia	(3.7%)	(10.7%)	(11.9%)	(5.9%)	(5.9%)	(0.6%)	(1.1%)	(7.7%)	(7.9%)	(8.5%)	(5.9%)	(3.1%)	(1.3%)
Tele2	(2.2%)	(5.4%)	(10.7%)	(11.7%)	(3.1%)	(5.8%)	(3.4%)	(2.3%)	1.8%	1.8%	2.9%	2.9%	(1.9%)
Total	(2.4%)	(5.0%)	(6.1%)	(5.5%)	(4.6%)	0.5%	0.8%	0.4%	1.5%	0.4%	1.8%	1.3%	(0.9%)
Service Revenue Market Share													
Telenor	57.4%	57.4%	58.1%	56.8%	57.7%	58.4%	59.2%	59.7%	60.6%	61.1%	61.4%	60.9%	60.9%
Telia	32.3%	31.5%	30.9%	32.5%	31.8%	31.1%	30.3%	29.8%	28.8%	28.4%	28.0%	28.5%	28.7%
Tele2	10.3%	11.1%	11.0%	10.7%	10.5%	10.4%	10.5%	10.4%	10.5%	10.6%	10.6%	10.6%	10.4%
Post-pay Customers, 000s													
Telenor	1,765	1,848	1,901	1,965	2,022	2,069	2,093	2,132	2,185	2,230	2,253	2,281	2,329
Telia	1,122	1,137	1,136	1,140	1,137	1,138	1,147	1,156	1,164	1,165	1,160	1,164	1,177
Tele2	0	0	0	0	0	0	0	0	0	0	0	0	0
Call Volumes, mn min/qtr													
Telenor	1,629	1,705	1,713	1,857	1,777	1,855	1,894	1,962	1,951	2,041	2,013	2,099	2,014
Telia	1,186	1,209	1,181	1,297	1,244	1,256	1,304	1,354	1,359	1,409	1,374	1,414	1,360
Tele2	370	391	383	411	390	406	423	433	429	446	439	457	443
Total	3,186	3,304	3,277	3,565	3,411	3,518	3,620	3,749	3,739	3,897	3,827	3,971	3,817
Call Volume growth, yoy													
Telenor	13.8%	15.4%	12.0%	15.2%	9.1%	8.8%	10.5%	5.6%	9.8%	10.0%	6.3%	7.0%	3.2%
Telia	3.5%	1.7%	0.7%	9.3%	4.9%	4.0%	10.4%	4.4%	9.3%	12.2%	5.4%	4.4%	0.1%
Tele2			14.9%	16.0%	5.2%	4.0%	10.5%	5.3%	10.1%	9.8%	3.7%	5.6%	3.2%
Total			8.0%	13.1%	7.1%	6.5%	10.5%	5.1%	9.6%	10.8%	5.7%	5.9%	2.1%
EBITDA, NOK m													
Telenor	1,224	1,009	1,127	1,166	1,182	1,135	1,249	1,339	1,369	1,270	1,359	1,376	0
Telia	646	593	675	766	731	672	630	639	706	625	627	657	677
Tele2	8	35	(10)	55	54	24	21	42	49	37	32	42	3

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 327. Norway Fixed Line Market Information

Norway	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	714	741	766	776	797	811	822	828	836	846	855	859	860
Incumbent wholesale	153	144	132	123	116	106	98	90	87	85	84	82	80
ULL (total)	313	331	348	356	356	356	357	355	348	338	329	322	314
Cable	172	172	172	172	172	172	172	172	172	172	172	172	172
Total	1,352	1,388	1,418	1,427	1,441	1,445	1,449	1,445	1,443	1,441	1,440	1,435	1,426
Broadband Subscribers (000s)													
Telenor - DSL	619	633	645	646	650	647	642	635	629	623	621	620	612
Telenor - Cable	95	108	121	130	147	164	180	193	207	223	234	239	248
Telia	176	177	178	176	176	176	172	168	232	223	215	206	202
Tele2	116	112	107	104	98	91	87	84	0	0	0	0	0
- other	346	358	367	371	370	367	368	365	375	372	370	370	364
Total	1,352	1,388	1,418	1,427	1,441	1,445	1,449	1,445	1,443	1,441	1,440	1,435	1,426
Broadband Subscribers Net Adds (000s)													
Telenor - DSL	13	14	12	1	4	(3)	(5)	(7)	(6)	(6)	(2)	(1)	(8)
Telenor - Cable	6	13	13	9	17	17	16	13	14	16	11	5	9
Telia	1	1	1	(2)	0	0	(4)	(4)	(11)	(9)	(8)	(9)	(4)
Tele2	2	(4)	(5)	(3)	(6)	(7)	(4)	(3)	0	0	0	0	0
- other	10	12	9	4	(1)	(3)	1	(3)	10	(3)	(2)	0	(6)
Total	32	36	30	9	14	4	4	(4)	(2)	(2)	(1)	(5)	(9)
Telephony Channels (000s)													
Incumbent retail	1,783	1,745	1,711	1,677	1,651	1,618	1,577	1,539	1,501	1,463	1,421	1,390	1,359
Incumbent wholesale (WLR)	263	257	247	238	230	221	216	213	207	201	196	191	185
ULL (total)	313	331	348	356	356	356	357	355	348	338	329	322	314
Cable													
Total	2,359	2,333	2,306	2,271	2,237	2,195	2,150	2,107	2,056	2,002	1,946	1,904	1,859
Telephony Channels Net Adds (000s)													
Incumbent retail	(36)	(38)	(34)	(34)	(26)	(33)	(41)	(38)	(38)	(38)	(42)	(31)	(31)
Incumbent wholesale (WLR)	(8)	(6)	(10)	(9)	(8)	(9)	(5)	(3)	(6)	(6)	(5)	(5)	(6)
ULL (total)	12	18	17	8	0	0	1	(2)	(7)	(10)	(9)	(7)	(8)
Cable	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	(32)	(26)	(27)	(35)	(34)	(42)	(45)	(43)	(51)	(54)	(56)	(43)	(45)

Source: Company reports and Citi Investment Research and Analysis

Portugal

Fixed

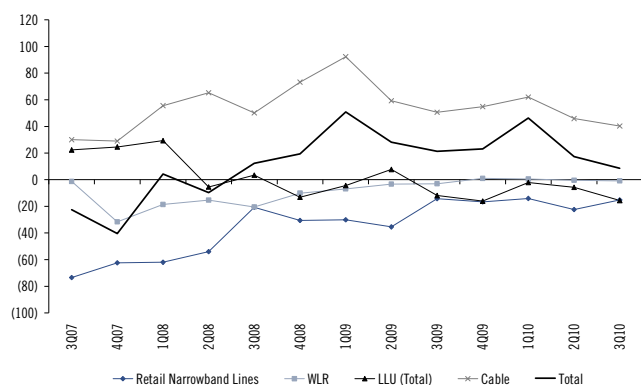
- **Stable trends in fixed** – PT's retail line loss was slightly better than last quarter helped by strong TV additions. Trends in broadband net additions remain very constant, though the absolute decline in Sonaecom's base is improving as the base shrinks.

Mobile

- **Tribal tariffs hurting larger players** – PT reported -8.8% service revenue growth in a market context of -6.3%. PT's growth (and VOD's to a lesser extent) has been affected by responding to changes in Sonaecom's tariffs. Sonaecom is outperforming as a consequence.
- **Price rises coming in 2011** – Sonaecom has announced that it has price rises scheduled for early in the new year – we expect PT and VOD to follow.

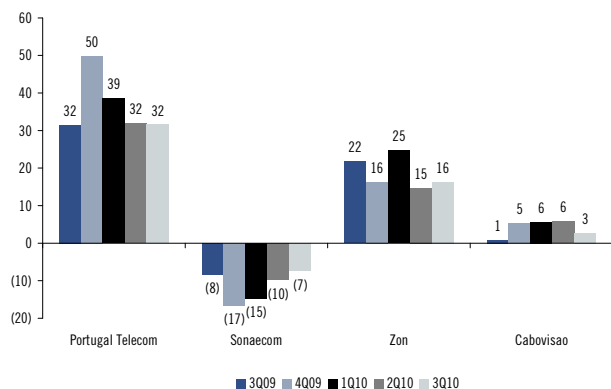
Fixed Charts

Figure 328. Telephony Net Adds



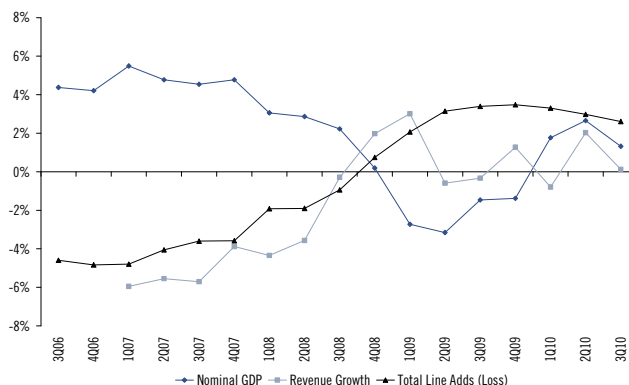
Source: Company reports and Citi Investment Research and Analysis

Figure 330. Broadband Subscriber Net Adds



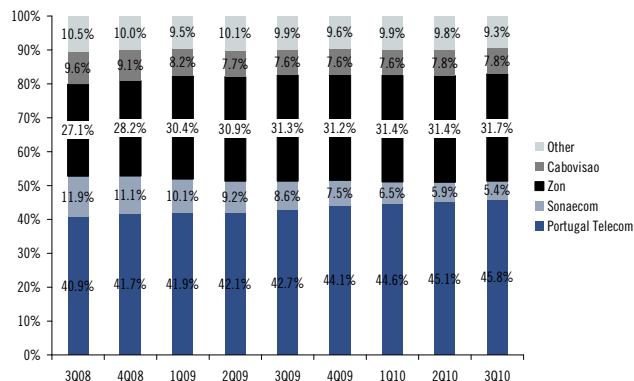
Source: Company reports and Citi Investment Research and Analysis

Figure 329. Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

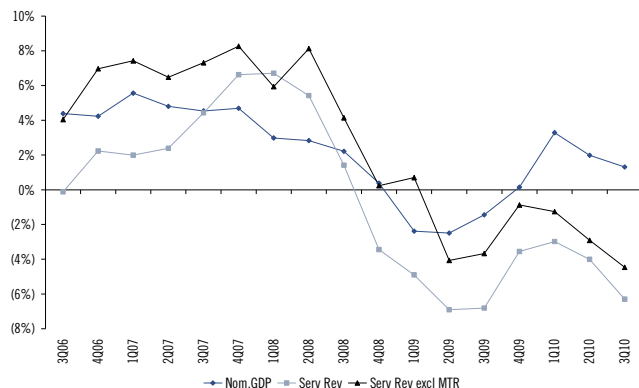
Figure 331. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

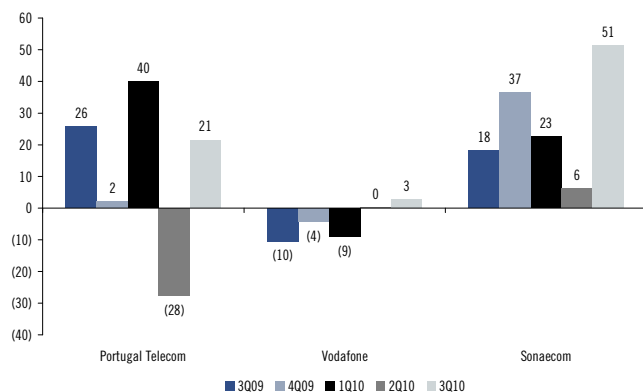
Mobile Charts

Figure 332. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



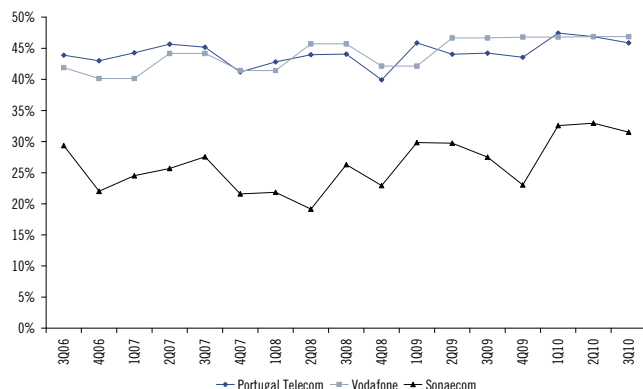
Source: Company reports, CIRA and Datastream

Figure 334. Post-Paid Net Adds



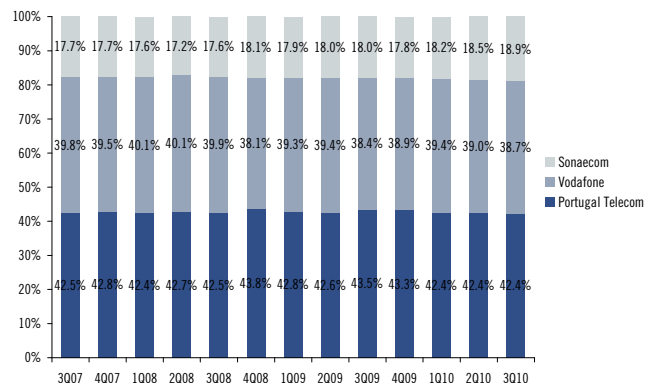
Source: Company reports and Citi Investment Research and Analysis

Figure 336. EBITDA Margin



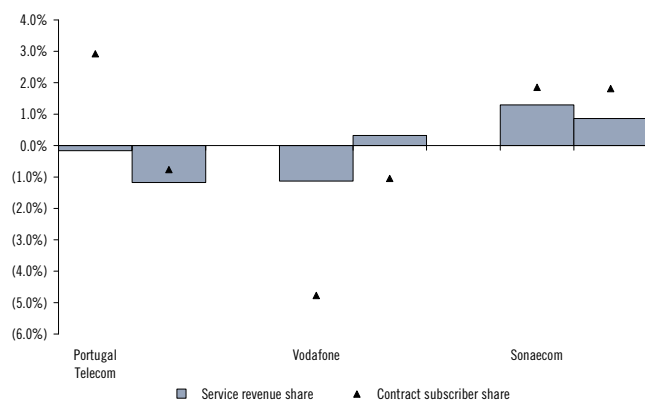
Source: Company reports and Citi Investment Research and Analysis

Figure 333. Service Revenue Market Share



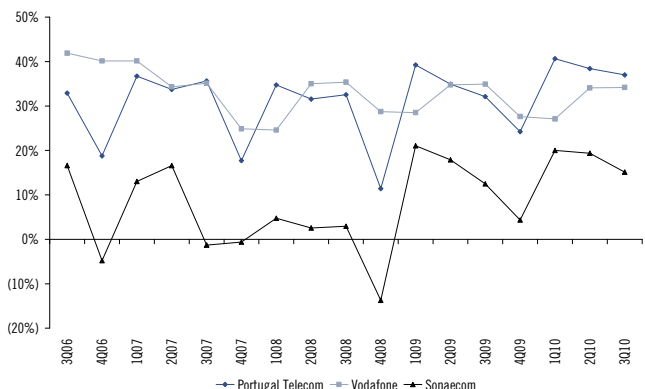
Source: Company reports and Citi Investment Research and Analysis

Figure 335. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Figure 337. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 338. Portugal Mobile Market Information

Portugal	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
Portugal Telecom	365	362	347	358	370	357	333	333	353	340	321	318	322
Vodafone	342	334	328	336	347	311	306	307	312	306	298	293	295
Sonae	152	149	144	144	153	148	139	141	146	140	137	139	144
Total	859	845	819	839	871	816	779	781	811	787	756	749	760
Service Revenue Growth, yoy													
Portugal Telecom	2.5%	4.6%	5.9%	5.7%	1.5%	(1.3%)	(3.9%)	(7.1%)	(4.6%)	(4.7%)	(3.8%)	(4.4%)	(8.8%)
Vodafone	7.8%	9.7%	7.6%	7.0%	1.7%	(6.8%)	(6.6%)	(8.6%)	(10.2%)	(1.7%)	(2.8%)	(4.9%)	(5.5%)
Sonae	1.8%	5.1%	6.7%	1.3%	0.6%	(1.3%)	(3.3%)	(2.6%)	(4.5%)	(4.8%)	(1.4%)	(1.2%)	(1.8%)
Total	4.4%	6.6%	6.7%	5.4%	1.4%	(3.4%)	(4.9%)	(6.9%)	(6.8%)	(3.6%)	(3.0%)	(4.0%)	(6.3%)
Service Revenue Market Share													
Portugal Telecom	42.5%	42.8%	42.4%	42.7%	42.5%	43.8%	42.8%	42.6%	43.5%	43.3%	42.4%	42.4%	42.4%
Vodafone	39.8%	39.5%	40.1%	40.1%	39.9%	38.1%	39.3%	39.4%	38.4%	38.9%	39.4%	39.0%	38.7%
Sonae	17.7%	17.7%	17.6%	17.2%	17.6%	18.1%	17.9%	18.0%	18.0%	17.8%	18.2%	18.5%	18.9%
Post-pay Customers, 000s													
Portugal Telecom	1,321	1,377	1,623	1,744	1,824	1,951	2,081	2,206	2,231	2,234	2,274	2,246	2,267
Vodafone	1,041	1,089	1,130	1,164	1,188	1,201	1,201	1,190	1,180	1,176	1,167	1,167	1,170
Sonae	697	608	855	880	921	961	992	1,026	1,045	1,081	1,104	1,110	1,161
Call Volumes, mn min/qtr													
Portugal Telecom	2,223	2,226	2,157	2,207	2,351	2,324	2,252	2,432	2,595	2,602	2,504	2,627	2,719
Vodafone	1,836	1,764	1,763	1,839	2,049	2,075	2,143	2,206	2,373	2,343	2,367	2,572	2,931
Sonae	984	1,023	1,029	1,144	1,221	1,231	1,249	1,278	1,324	1,384	1,387	1,401	1,394
Total	5,043	5,013	4,949	5,190	5,622	5,630	5,645	5,916	6,292	6,329	6,259	6,600	7,044
Call Volume growth, yoy													
Portugal Telecom	10.5%	10.2%	9.0%	6.3%	5.8%	4.4%	4.4%	10.2%	10.4%	12.0%	11.2%	8.0%	4.8%
Vodafone	14.3%	11.2%	9.4%	11.0%	11.6%	17.6%	21.6%	20.0%	15.8%	12.9%	10.5%	16.6%	23.5%
Sonae	13.6%	13.5%	12.7%	25.5%	24.1%	20.3%	21.4%	11.7%	8.4%	12.4%	11.1%	9.6%	5.3%
Total	12.5%	11.2%	9.9%	11.7%	11.5%	12.3%	14.0%	14.0%	11.9%	12.4%	10.9%	11.6%	12.0%
EBITDA, €m													
Portugal Telecom	182	170	167	172	180	164	170	162	176	167	164	161	163
Vodafone	151	138	136	154	159	131	129	143	145	143	139	137	138
Sonae	45	36	33	29	44	37	44	45	43	35	46	48	48

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 339. Portugal Fixed Line Market Information

Portugal	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	741	652	657	667	679	710	752	781	812	862	901	933	964
Incumbent wholesale	63	62	60	57	55	53	50	51	54	54	53	53	52
ULL (total)	267	291	320	315	318	305	301	309	297	281	278	273	257
Cable	597	606	582	595	610	633	693	715	738	760	790	811	830
Total	1,667	1,611	1,619	1,634	1,662	1,701	1,796	1,856	1,901	1,956	2,022	2,068	2,103
Broadband Subscribers (000s)													
PT	741	652	657	667	679	710	752	781	812	862	901	933	964
Sonaecom	182	218	202	202	198	188	180	171	163	146	132	122	114
Zon	387	400	416	431	451	479	546	573	594	611	635	650	666
Cabovisao	210	206	166	164	159	154	147	143	144	149	155	160	163
- other	147	135	179	169	175	169	171	188	188	188	199	203	195
Total	1,667	1,611	1,619	1,634	1,662	1,701	1,796	1,856	1,901	1,956	2,022	2,068	2,103
Broadband Subscribers Net Adds (000s)													
PT	26	(90)	5	11	12	31	42	29	32	50	39	32	32
Sonaecom	39	36	(16)	0	(4)	(10)	(8)	(9)	(8)	(17)	(15)	(10)	(7)
Zon	6	13	16	15	20	28	67	27	22	16	25	15	16
Cabovisao	10	(4)	(40)	(2)	(5)	(5)	(7)	(4)	1	5	6	6	3
- other	(17)	(12)	43	(9)	5	(5)	1	18	(0)	(0)	11	4	(8)
Total	63	(57)	8	15	28	38	95	60	45	55	66	47	35
Telephony Channels (000s)													
Incumbent retail	3,073	3,010	2,948	2,894	2,873	2,843	2,813	2,777	2,763	2,746	2,732	2,710	2,695
Incumbent wholesale (WLR)	172	140	122	106	86	76	69	66	62	63	64	64	63
ULL (total)	267	291	320	315	318	305	301	309	297	281	278	273	257
Cable	54	83	139	204	254	327	419	479	529	584	646	692	732
Total	3,565	3,524	3,529	3,519	3,531	3,551	3,602	3,630	3,651	3,674	3,721	3,738	3,747
Telephony Channels Net Adds (000s)													
Incumbent retail	(74)	(62)	(62)	(54)	(21)	(31)	(30)	(35)	(14)	(17)	(14)	(22)	(15)
Incumbent wholesale (WLR)	(1)	(32)	(19)	(15)	(21)	(10)	(7)	(3)	(3)	1	1	(0)	(1)
ULL (full)	22	25	29	(6)	3	(13)	(4)	8	(12)	(16)	(2)	(6)	(16)
Cable	30	29	56	65	50	73	92	59	51	55	62	46	40
Total	(23)	(40)	4	(10)	12	19	51	28	21	23	46	17	9
Pay TV Subscribers (000s)													
PT	6	21	47	116	211	312	384	443	505	581	646	702	769
Zon	1,521	1,547	1,561	1,557	1,539	1,525	1,595	1,591	1,595	1,595	1,588	1,576	1,573
Pay TV Subscribers Net Adds (000s)													
PT	6	15	26	70	95	101	72	59	62	76	65	57	67
Zon	26	26	14	(4)	(18)	(14)	70	(4)	3	0	(6)	(12)	(3)

Source: Company reports and Citi Investment Research and Analysis

Spain

Fixed

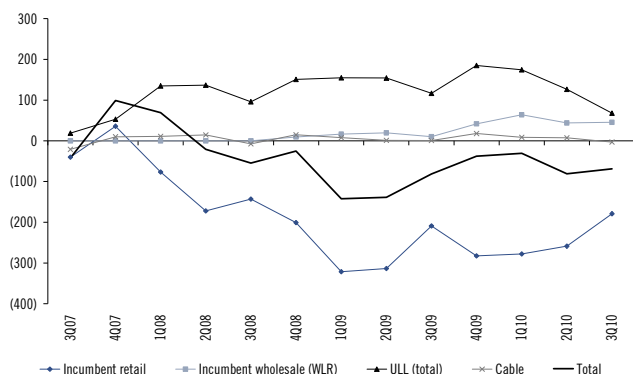
- **ULL connections falling** – In the third quarter Telefonica has seen a significant improvement in retail line loss, as migrations to ULL lines fell to end-2007 levels. The total broadband market was strong with connections up 9.1% YoY: TEF and Jazztel posted strong net adds during the quarter.
- **Fixed revenue still in negative territory** – Telefonica's organic fixed revenue growth continued to deteriorate despite an easy comp in the quarter. Fixed revenues were down 3.3% yoy (-5.6% in comparable terms) compared to -4.3% in 2Q10 and -9.4% in 3Q09. This is mainly due to the lower contribution from traditional access (-9.6% YoY) and traffic (-10.6% YoY).

Mobile

- **One step back for mobile service revenues** – Service revenue growth deteriorated QoQ and the market was down 4.8% YoY. We remain cautious on the prospects for the Spanish mobile market given the weak macro-economic environment. In addition, in our view the telecom industry remains an easy target for an indebted government in search of cash.

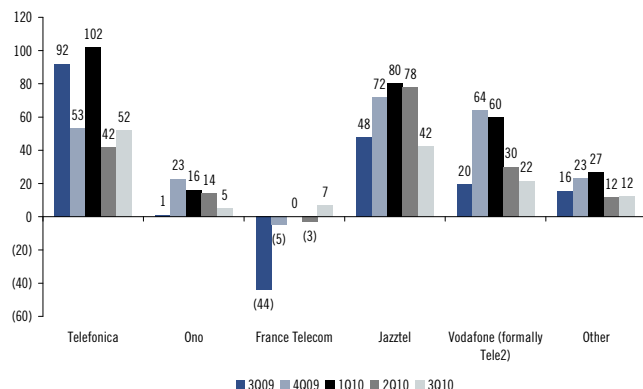
Fixed Charts

Figure 340. Telephony Net Adds



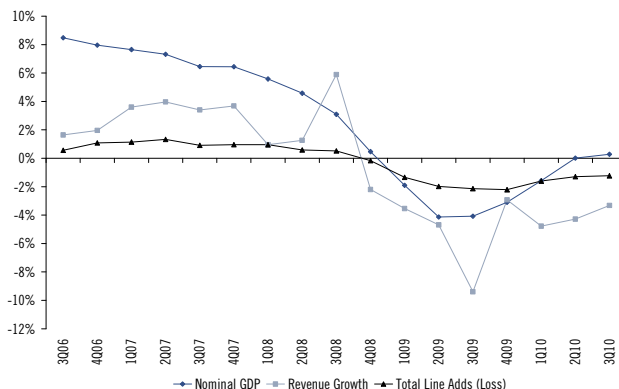
Source: Company reports and Citi Investment Research and Analysis

Figure 342. Broadband Subscriber Net Adds



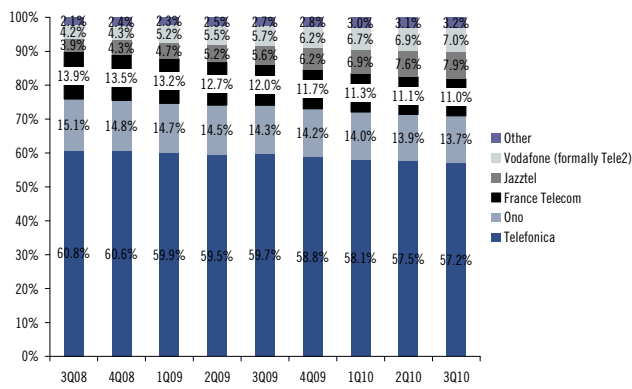
Source: Company reports and Citi Investment Research and Analysis

Figure 341. Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

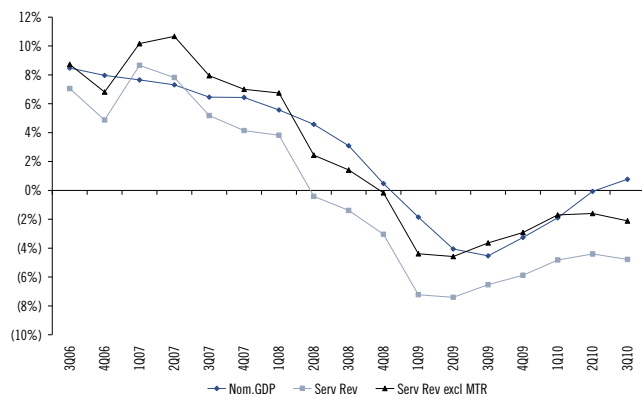
Figure 343. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

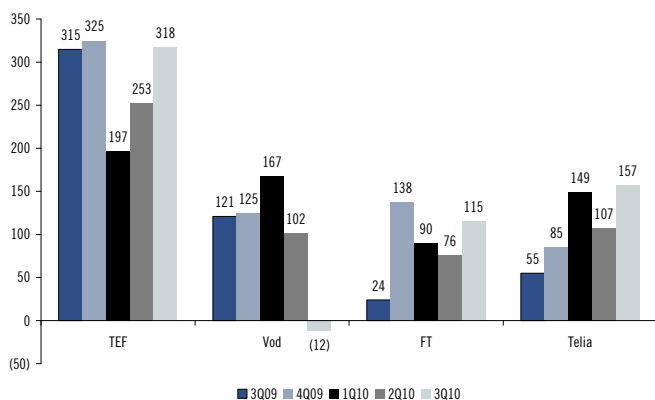
Mobile Charts

Figure 344. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



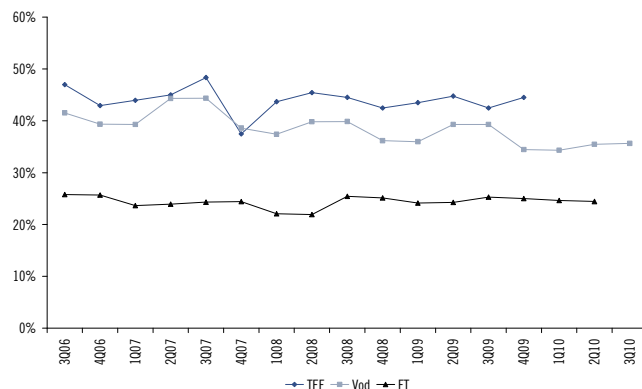
Source: Company reports, CIRA and Datastream

Figure 346. Post-Paid Net Adds



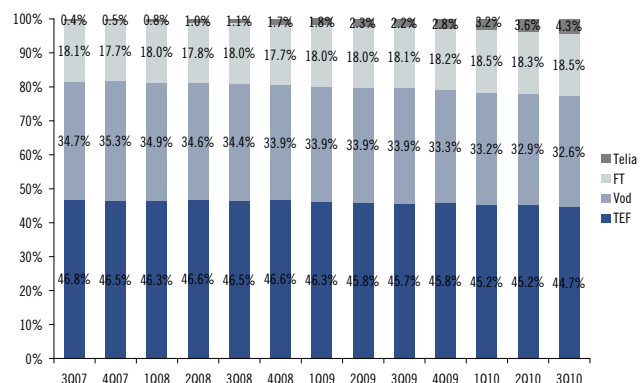
Source: Company reports and Citi Investment Research and Analysis

Figure 348. EBITDA Margin



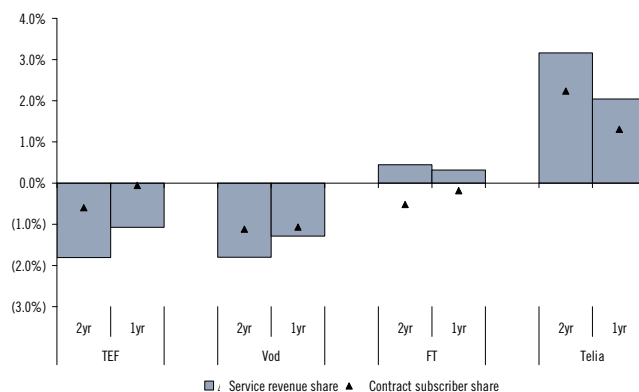
Source: Company reports and Citi Investment Research and Analysis

Figure 345. Service Revenue Market Share



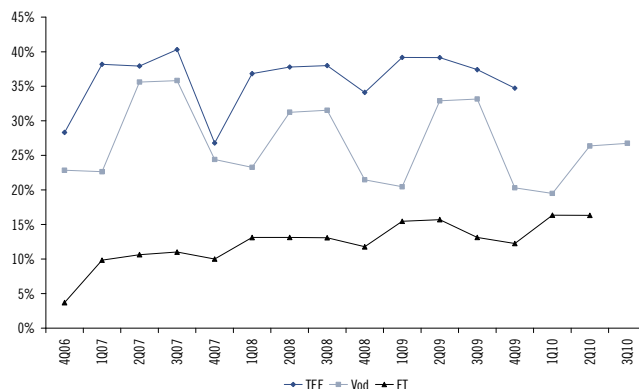
Source: Company reports and Citi Investment Research and Analysis

Figure 347. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Figure 349. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 350. Spanish Mobile Market Information

Spain	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, €m													
Telefonica	2,245	2,111	2,072	2,132	2,198	2,055	1,921	1,940	2,022	1,898	1,785	1,829	1,880
Vodafone	1,666	1,603	1,560	1,582	1,629	1,495	1,409	1,436	1,500	1,379	1,311	1,334	1,374
Orange (FT)	869	805	806	815	852	779	747	762	802	755	729	740	777
Telia	17	24	35	44	52	77	73	97	98	114	126	146	180
Total	4,797	4,543	4,473	4,573	4,731	4,406	4,150	4,235	4,422	4,146	3,950	4,048	4,210
Service Revenue Growth, yoy													
Telefonica	3.3%	2.6%	2.0%	0.5%	(2.1%)	(2.7%)	(7.3%)	(9.0%)	(8.0%)	(7.6%)	(7.1%)	(5.7%)	(7.0%)
Vodafone	8.5%	7.1%	5.4%	(3.0%)	(2.2%)	(6.8%)	(9.7%)	(9.2%)	(7.9%)	(7.7%)	(7.0%)	(7.1%)	(8.4%)
Orange (FT)	2.0%	(0.2%)	2.3%	(1.7%)	(2.0%)	(3.2%)	(7.3%)	(6.5%)	(5.9%)	(3.1%)	(2.4%)	(2.9%)	(3.1%)
Telia													
Total	5.2%	4.1%	3.8%	(0.4%)	(1.4%)	(3.0%)	(7.2%)	(7.4%)	(6.5%)	(5.9%)	(4.8%)	(4.4%)	(4.8%)
Service Revenue Market Share													
Telefonica	46.8%	46.5%	46.3%	46.6%	46.5%	46.6%	46.3%	45.8%	45.7%	45.8%	45.2%	45.2%	44.7%
Vodafone	34.7%	35.3%	34.9%	34.6%	34.4%	33.9%	33.9%	33.9%	33.9%	33.3%	33.2%	32.9%	32.6%
Orange (FT)	18.1%	17.7%	18.0%	17.8%	18.0%	17.7%	18.0%	18.0%	18.1%	18.2%	18.5%	18.3%	18.5%
Telia	0.4%	0.5%	0.8%	1.0%	1.1%	1.7%	1.8%	2.3%	2.2%	2.8%	3.2%	3.6%	4.3%
Post-pay Customers, 000s													
Telefonica	13,262	13,645	13,950	14,261	14,458	14,568	14,553	14,694	15,009	15,334	15,531	15,784	16,101
Vodafone	8,758	9,059	9,303	9,531	9,701	9,824	9,977	10,052	10,173	10,298	10,466	10,567	10,555
Orange (FT)	5,790	5,956	6,079	6,220	6,311	6,434	6,485	6,495	6,519	6,657	6,747	6,823	6,938
Telia	109	181	219	248	290	370	463	550	605	690	839	946	1,103
Call Volumes, mn min/qtr													
Telefonica	11,220	10,588	10,408	10,991	11,441	10,727	10,038	10,499	11,007	10,495	10,051	10,562	10,675
Vodafone	8,886	8,800	8,815	9,226	9,059	8,827	8,457	8,759	9,035	8,980	8,769	9,124	9,259
France Telecom	4,582	4,678	4,890	4,908	5,062	5,028	5,119	5,094	5,264	5,276	5,401	5,357	5,637
Telia	121	194	286	353	414	496	571	643	725	802	947	1,116	1,327
Total	24,809	24,259	24,398	25,478	25,977	25,078	24,185	24,995	26,032	25,552	25,168	26,160	26,898
Call Volume growth, yoy													
Telefonica	13.6%	5.9%	0.2%	4.9%	2.0%	1.3%	(3.6%)	(4.5%)	(3.8%)	(2.2%)	0.1%	0.6%	(3.0%)
Vodafone	18.0%	15.0%	6.9%	8.2%	1.9%	0.3%	(4.1%)	(5.1%)	(0.3%)	1.7%	3.7%	4.2%	2.5%
France Telecom	11.9%	6.3%	4.8%	4.2%	10.5%	7.5%	4.7%	3.8%	4.0%	4.9%	5.5%	5.2%	7.1%
Telia			681.1%	356.1%	242.7%	155.5%	100.0%	82.1%	75.1%	61.6%	65.7%	73.6%	82.9%
Total	15.4%	10.0%	4.6%	7.1%	4.7%	3.4%	(0.9%)	(1.9%)	0.2%	1.9%	4.1%	4.7%	3.3%
Contract Churn, % p.a													
Telefonica			13.2%	13.2%	13.2%	15.6%	16.8%	15.6%	14.4%	15.6%	18.0%	16.8%	16.8%
Vodafone	14.6%	15.2%	16.6%	16.4%	16.1%	18.3%	18.3%	19.9%	20.6%	21.7%	21.2%	18.9%	19.5%
Orange (FT)	27.6%	27.4%	23.8%	22.9%	22.7%	23.1%	23.5%	24.1%	24.5%	24.2%	23.6%	22.8%	21.5%
Data Revenue (excl messaging) % Service Revenue													
Telefonica	7.2%	7.5%	8.8%	8.7%	9.4%	10.3%	11.4%	11.2%	11.9%	12.7%	13.5%	13.4%	14.5%
Vodafone	7.1%	7.0%	7.1%	7.3%	7.3%	8.1%	10.2%	9.3%	9.3%	9.8%	10.9%	11.3%	11.9%
Orange (FT)	5.2%	4.6%	5.0%	5.7%	5.7%	6.3%	7.3%	6.8%	7.2%	8.9%	8.9%	9.1%	9.2%
EBITDA, €m													
Telefonica	1,226	902	1,048	1,099	1,106	1,012	945	980	988	1,014			
Vodafone	742	629	612	660	680	570	537	599	625	506	481	507	522
Orange (FT)	218	201	182	185	224	204	189	193	212	200	187	190	
Capex, €m													
Telefonica	204	257	165	185	162	199	94	123	118	223			
Vodafone	143	231	231	142	142	232	232	98	98	208	208	130	130
Orange (FT)	119	119	74	74	109	109	68	68	102	102	63	63	

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 351. Spanish Fixed Line Market Information

Spain	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	4,381	4,614	4,836	5,005	5,117	5,246	5,292	5,331	5,424	5,477	5,579	5,620	5,672
Incumbent wholesale	509	496	480	463	445	424	406	369	337	359	419	464	508
ULL (total)	1,238	1,354	1,467	1,533	1,585	1,698	1,835	1,951	2,021	2,154	2,261	2,332	2,372
Cable	1,160	1,203	1,241	1,272	1,272	1,283	1,295	1,302	1,303	1,326	1,342	1,356	1,361
Total	7,288	7,666	8,024	8,272	8,419	8,651	8,828	8,953	9,085	9,315	9,600	9,772	9,913
Broadband Subscribers (000s)													
Telefonica	4,381	4,614	4,836	5,005	5,117	5,246	5,292	5,331	5,424	5,477	5,579	5,620	5,672
Ono	1,160	1,203	1,241	1,272	1,272	1,283	1,295	1,302	1,303	1,326	1,342	1,356	1,361
France Telecom	1,156	1,177	1,186	1,192	1,174	1,164	1,165	1,135	1,091	1,086	1,086	1,083	1,090
Jazztel	240	255	277	300	327	375	416	462	510	582	662	740	782
Vodafone (formally Tele2)	258	273	300	326	350	373	456	497	516	581	641	671	692
Other	94	145	184	178	179	210	204	225	241	264	291	303	315
Total	7,288	7,666	8,024	8,272	8,419	8,651	8,828	8,953	9,085	9,315	9,600	9,772	9,913
Broadband Subscribers Net Adds (000s)													
Telefonica	149	233	222	169	112	129	45	40	92	53	102	42	52
Ono	(9)	43	38	31	0	11	13	7	1	23	16	14	5
France Telecom	458	21	9	6	(18)	(10)	1	(30)	(44)	(5)	0	(3)	7
Jazztel	4	15	23	23	27	48	42	46	48	72	80	78	42
Vodafone (formally Tele2)	0	15	27	25	24	24	83	41	20	64	60	30	22
Other	(670)	51	40	(6)	1	31	(6)	21	16	23	27	12	12
Total	191	378	358	248	147	232	177	125	132	230	285	172	140
Telephony Channels (000s)													
Incumbent retail	15,883	15,919	15,842	15,670	15,527	15,326	15,005	14,691	14,483	14,200	13,923	13,664	13,485
Incumbent wholesale (WLR)	0	0	0	0	0	10	26	45	56	97	161	205	251
ULL (total)	524	578	713	849	945	1,096	1,251	1,405	1,521	1,706	1,881	2,007	2,075
Cable	1,595	1,605	1,616	1,631	1,623	1,638	1,646	1,647	1,648	1,666	1,675	1,682	1,679
Total	18,002	18,101	18,171	18,150	18,095	18,070	17,927	17,789	17,707	17,670	17,639	17,558	17,489
Telephony Channels Net Adds (000s)													
Incumbent retail	(40)	36	(77)	(172)	(143)	(201)	(321)	(314)	(209)	(282)	(278)	(259)	(179)
Incumbent wholesale (WLR)	0	0	0	0	0	10	16	20	10	42	64	44	45
ULL (full)	19	53	135	137	96	151	155	154	117	185	174	127	68
Cable	(21)	10	11	14	(8)	15	8	1	1	18	9	7	(3)
Total	(42)	99	69	(21)	(55)	(25)	(142)	(139)	(81)	(38)	(31)	(81)	(69)
Pay TV Subscribers (000s)													
TEF	469	511	554	577	590	613	605	610	654	703	733	748	773
ONO	909	960	1,011	1,052	1,057	1,039	1,016	991	977	975	970	966	948
Orange	18	54	75	92	86	87	99	92	86	84	79	75	72
Total	1,396	1,525	1,640	1,721	1,733	1,739	1,720	1,693	1,717	1,762	1,782	1,789	1,793
Pay TV Subscribers Net Adds (000s)													
TEF	18	42	43	23	13	23	(8)	5	45	49	30	15	26
ONO	(13)	51	51	41	5	(18)	(23)	(25)	(14)	(2)	(5)	(4)	(18)
Orange	2	36	21	17	(6)	1	12	(7)	(6)	(2)	(5)	(4)	(3)
Total	7	129	115	81	12	6	(18)	(28)	25	45	20	7	4

Source: Company reports and Citi Investment Research and Analysis

Sweden

Fixed

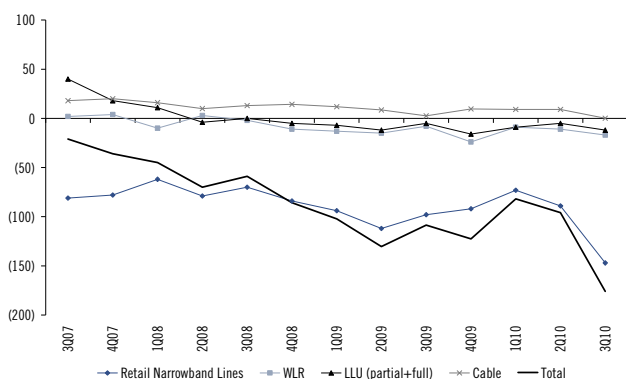
- **Worsening KPI trends** – Total market line loss worsened to -176k in 3Q10 vs -96k 2Q10, this is a -8.5% yoy decline. In addition fixed broadband declined by -15k, a 1% decline yoy. This is due to the increasing cannibalisation of fixed by mobile.
- **Cable gaining share** – The decline in fixed broadband customers was mainly from Telenor and Telia with the cable operator Com Hem achieving +4k net adds.

Mobile

- **Continued high growth** – The Swedish mobile market remained the highest growing in Europe at +8.6% (excl MTR cuts), flat on 2Q10 +8.7%. This is being driven by high data growth as well as benign pricing on voice.
- **Market shares stabilizing** – After a period of change market shares have now been broadly stable for the last few quarters.

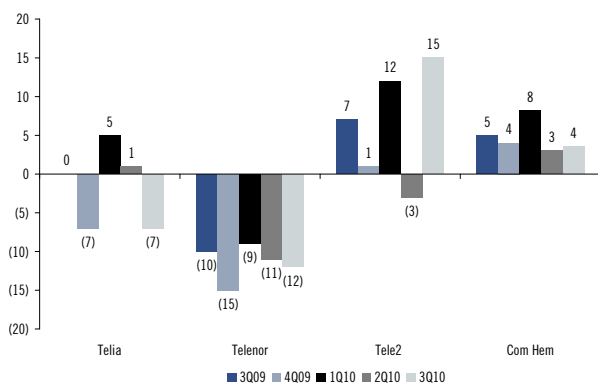
Fixed Charts

Figure 352. Telephony Net Adds



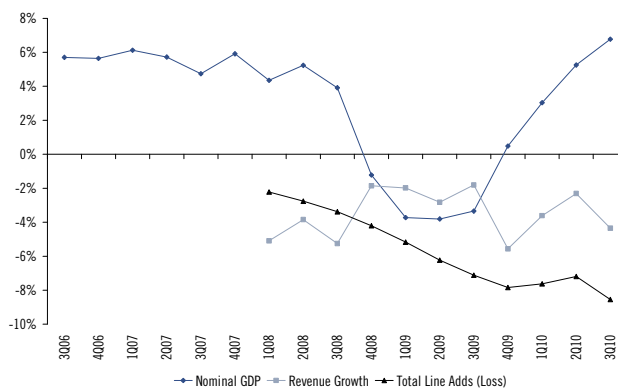
Source: Company reports and Citi Investment Research and Analysis

Figure 354. Broadband Subscriber Net Adds



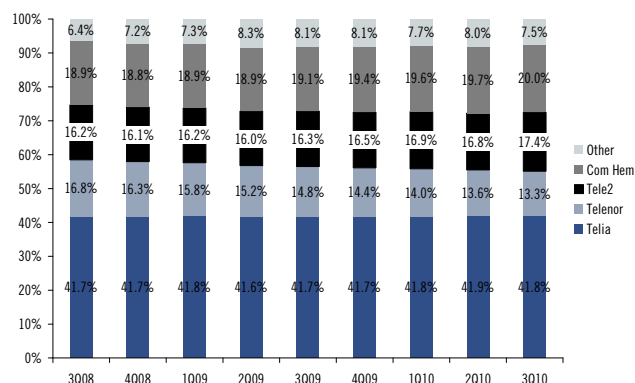
Source: Company reports and Citi Investment Research and Analysis

Figure 353. Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

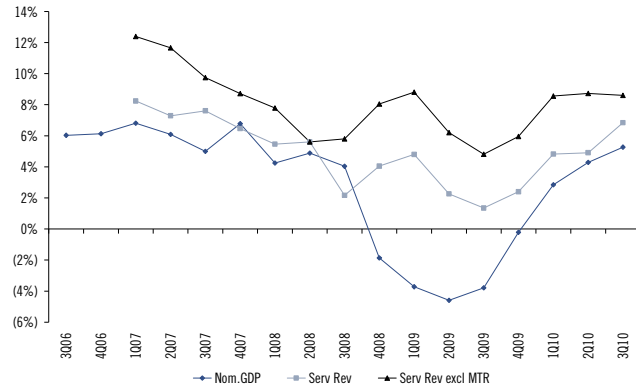
Figure 355. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

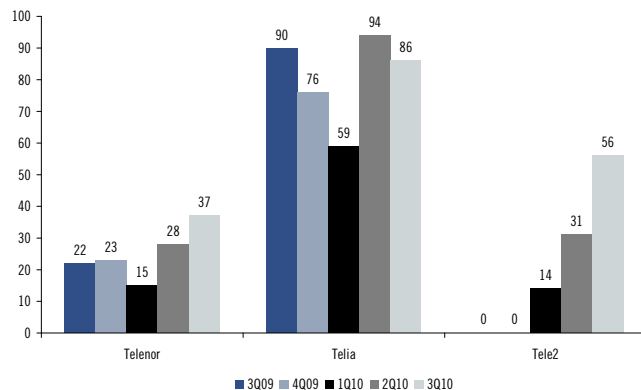
Mobile Charts

Figure 356. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



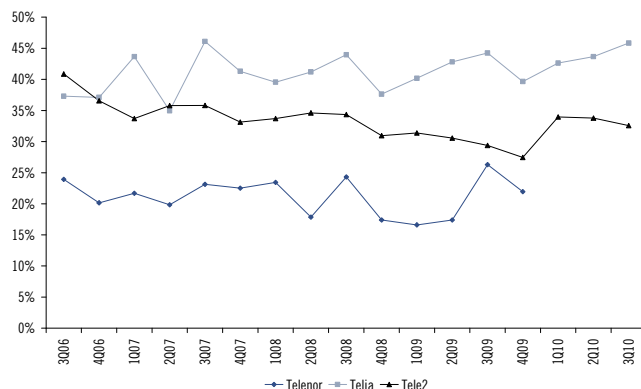
Source: Company reports, CIRA and Datastream

Figure 358. Post-Paid Net Adds



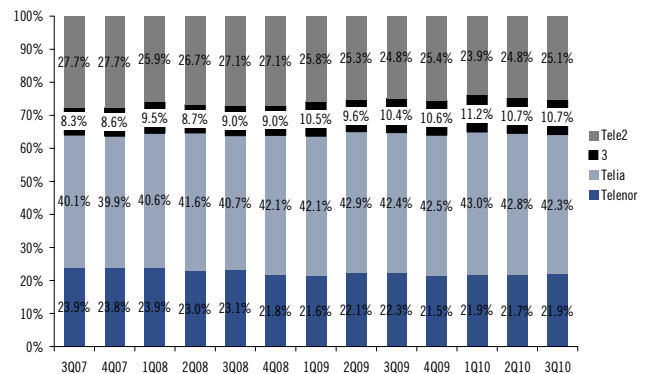
Source: Company reports and Citi Investment Research and Analysis

Figure 360. EBITDA Margin



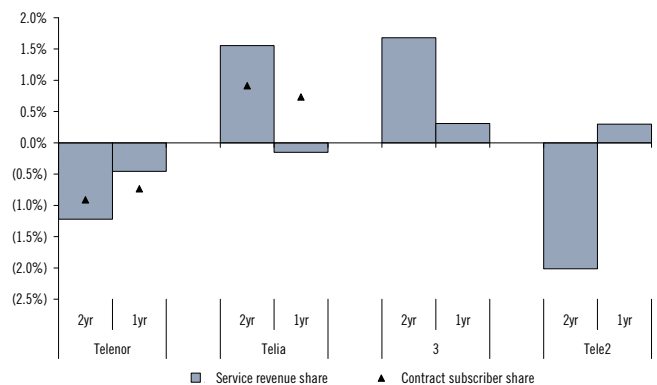
Source: Company reports and Citi Investment Research and Analysis

Figure 357. Service Revenue Market Share



Source: Company reports and Citi Investment Research and Analysis

Figure 359. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 361. Swedish Mobile Market Information

Sweden	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, SEK m													
Telenor	1,715	1,693	1,650	1,721	1,694	1,617	1,562	1,693	1,660	1,629	1,662	1,739	1,738
Telia	2,882	2,846	2,805	3,113	2,988	3,121	3,046	3,280	3,155	3,230	3,262	3,436	3,359
Tele2	1,986	1,977	1,790	1,994	1,991	2,006	1,870	1,935	1,845	1,931	1,810	1,988	1,996
Total	7,181	7,126	6,904	7,476	7,336	7,415	7,235	7,645	7,435	7,592	7,583	8,020	7,944
Service Revenue Growth, yoy													
Telenor	6.9%	5.3%	4.5%	(0.5%)	(1.2%)	(4.5%)	(5.4%)	(1.6%)	(2.0%)	0.7%	6.4%	2.7%	4.7%
Telia	2.6%	(0.0%)	4.0%	7.6%	3.7%	9.7%	8.6%	5.4%	5.6%	3.5%	7.1%	4.8%	6.5%
Tele2	0.0%	0.0%	0.0%	3.6%	0.3%	1.5%	4.4%	(2.9%)	(7.3%)	(3.7%)	(3.2%)	2.7%	8.1%
Total	7.6%	6.5%	5.5%	5.6%	2.2%	4.1%	4.8%	2.3%	1.3%	2.4%	4.8%	4.9%	6.8%
Service Revenue Market Share													
Telenor	23.9%	23.8%	23.9%	23.0%	23.1%	21.8%	21.6%	22.1%	22.3%	21.5%	21.9%	21.7%	21.9%
Telia	40.1%	39.9%	40.6%	41.6%	40.7%	42.1%	42.1%	42.9%	42.4%	42.5%	43.0%	42.8%	42.3%
Tele2	27.7%	27.7%	25.9%	26.7%	27.1%	27.1%	25.8%	25.3%	24.8%	25.4%	23.9%	24.8%	25.1%
Post-pay Customers, 000s													
Telenor	1,325	1,358	1,383	1,421	1,476	1,536	1,571	1,609	1,631	1,654	1,669	1,697	1,734
Telia	2,404	2,398	2,546	2,708	2,863	2,952	3,012	3,099	3,189	3,265	3,324	3,418	3,504
Tele2	0	0	0	0	0	0	0	0	0	0	0	0	0
Call Volumes, mn min/qtr													
Telenor	1,094	1,140	1,107	1,239	1,161	1,222	1,206	1,314	1,294	1,296	1,327	1,435	1,407
Telia	2,687	2,801	2,835	3,233	3,189	3,533	3,385	3,608	3,605	3,788	3,874	4,137	3,999
Tele2	1,720	1,827	1,832	2,067	2,028	2,212	2,128	2,218	2,156	2,233	2,285	2,469	2,439
Total	5,771	6,096	6,146	7,007	6,875	7,546	7,314	7,816	7,761	8,067	8,269	8,925	8,755
Call Volume growth, yoy													
Telenor	17.1%	13.3%	7.9%	10.8%	6.1%	7.2%	9.0%	6.0%	11.5%	6.1%	9.9%	9.2%	8.7%
Telia	19.5%	16.4%	15.2%	20.3%	18.7%	26.2%	19.4%	11.6%	13.1%	7.2%	14.4%	14.7%	10.9%
Tele2	(6.7%)	(6.3%)	(7.1%)	6.6%	18.0%	21.1%	16.1%	7.3%	6.3%	1.0%	7.4%	11.3%	13.1%
Total	11.6%	10.3%	8.9%	17.3%	19.1%	23.8%	19.0%	11.5%	12.9%	6.9%	13.1%	14.2%	12.8%
EBITDA, SEK m													
Telenor	441	428	426	335	456	324	296	336	512	434			
Telia	1,386	1,216	1,123	1,291	1,388	1,197	1,252	1,424	1,490	1,360	1,472	1,580	1,682
Tele2	700	645	632	707	708	611	595	620	600	560	664	722	748

Source: Company reports and Citi Investment Research and Analysis

Sweden Fixed Data

Figure 362. Swedish Fixed Line Market Information

Sweden	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	1,027	1,067	1,089	1,099	1,107	1,122	1,132	1,132	1,132	1,125	1,130	1,131	1,124
Incumbent wholesale	0	0	0	0	0	0	0	0	0	0	0	0	0
ULL (total)	591	609	620	616	616	611	604	592	587	571	562	557	545
Cable	466	479	490	495	503	506	512	513	518	522	530	533	537
Other	428	435	406	411	430	453	459	483	480	480	480	480	480
Total	2,512	2,590	2,605	2,621	2,656	2,692	2,706	2,720	2,717	2,698	2,702	2,701	2,686
Broadband Subscribers (000s)													
Telia	1,027	1,067	1,089	1,099	1,107	1,122	1,132	1,132	1,132	1,125	1,130	1,131	1,124
Telenor	475	475	468	456	446	438	427	413	403	388	379	368	356
Tele2	365	386	416	418	430	433	439	436	443	444	456	453	468
Com Hem	466	479	490	495	503	506	512	513	518	522	530	533	537
- other	179	183	142	153	170	193	197	226	221	219	207	216	201
Total	2,512	2,590	2,605	2,621	2,656	2,692	2,706	2,720	2,717	2,698	2,702	2,701	2,686
Broadband Subscribers Net Adds (000s)													
Telia	24	40	22	10	8	15	10	0	0	(7)	5	1	(7)
Telenor	5	0	(7)	(12)	(10)	(8)	(11)	(14)	(10)	(15)	(9)	(11)	(12)
Tele2	20	21	30	2	12	3	6	(3)	7	1	12	(3)	15
Com Hem	19	13	11	5	8	3	6	1	5	4	8	3	4
- other	10	4	(40)	11	18	23	3	30	(5)	(2)	(12)	9	(15)
Total	78	78	16	16	36	36	14	14	(3)	(19)	4	(1)	(15)
Telephony Channels (000s)													
Incumbent retail	4,373	4,295	4,233	4,154	4,084	4,000	3,906	3,794	3,696	3,604	3,531	3,442	3,295
Incumbent wholesale (WLR)	1,003	1,007	997	1,000	998	987	974	959	951	927	918	907	890
ULL (total)	591	609	620	616	616	611	604	592	587	571	562	557	545
Cable	241	261	277	287	300	314	326	335	337	347	356	365	365
Total	6,208	6,172	6,127	6,057	5,998	5,912	5,810	5,680	5,571	5,449	5,367	5,271	5,095
Telephony Channels Net Adds (000s)													
Incumbent retail	(81)	(78)	(62)	(79)	(70)	(84)	(94)	(112)	(98)	(92)	(73)	(89)	(147)
Incumbent wholesale (WLR)	2	4	(10)	3	(2)	(11)	(13)	(15)	(8)	(24)	(9)	(11)	(17)
ULL (total)	40	18	11	(4)	0	(5)	(7)	(12)	(5)	(16)	(9)	(5)	(12)
Cable	18	20	16	10	13	14	12	9	3	10	9	9	0
Total	(21)	(36)	(45)	(70)	(59)	(86)	(102)	(130)	(109)	(123)	(82)	(96)	(176)
Pay TV Subscribers (000s)													
Telia	216	304	318	320	320	324	333	350	367	396	411	418	431
Telenor	242	242	235	235	233	235	231	226	223	217	212	202	203
Com Hem	485	501	514	524	542	552	564	565	573	576	592	600	610
Pay TV Subscribers Net Adds (000s)													
Telia	58	88	14	2	0	4	9	17	17	29	15	7	13
Telenor	0	0	(7)	0	(2)	2	(4)	(5)	(3)	(6)	(5)	(10)	1
Com Hem	15	16	13	10	18	10	12	1	8	3	16	8	10

Source: Company reports and Citi Investment Research and Analysis

Switzerland

Fixed

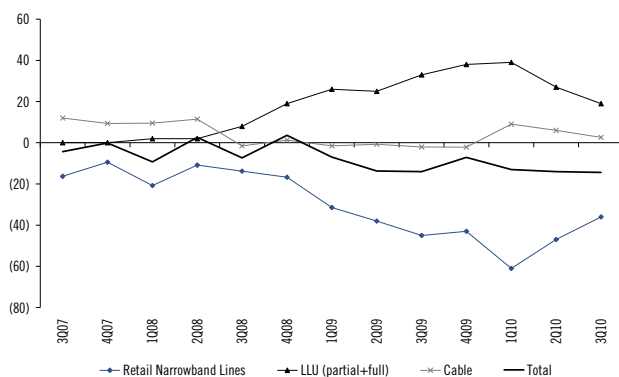
- **Competition appears to be falling back as Swisscom improves** – Swisscom continues to see material improvements in its retail line loss as growth in ULL connections drops off. Broadband net adds were in-line QoQ.

Mobile

- **A better quarter for contract net adds** – Both Swisscom and FT materially improved QoQ. Service revenue growth of 2.5% is ahead of GDP growth.
- **No longer see Sunrise** – Following the acquisition of Sunrise by CVC from TDC, we no longer have access to data on the company.

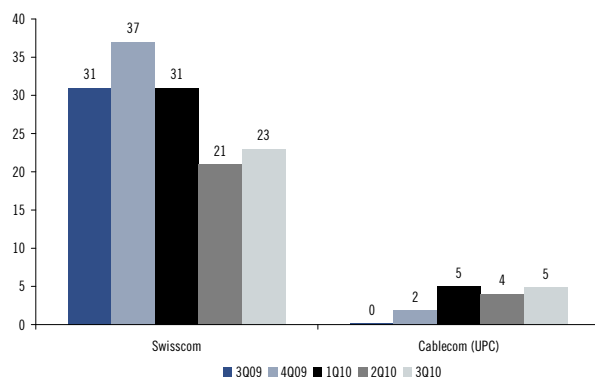
Fixed Charts

Figure 363. Telephony Net Adds



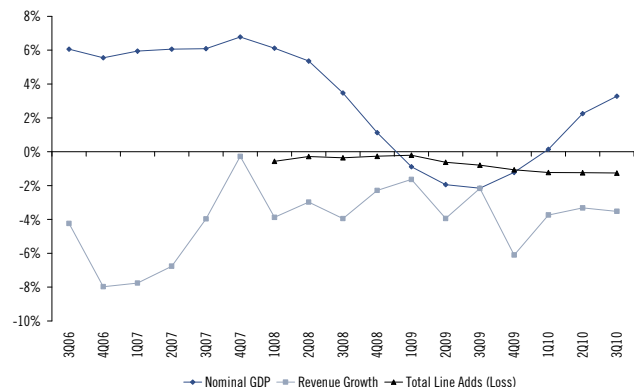
Source: Company reports and Citi Investment Research and Analysis

Figure 365. Broadband Subscriber Net Adds



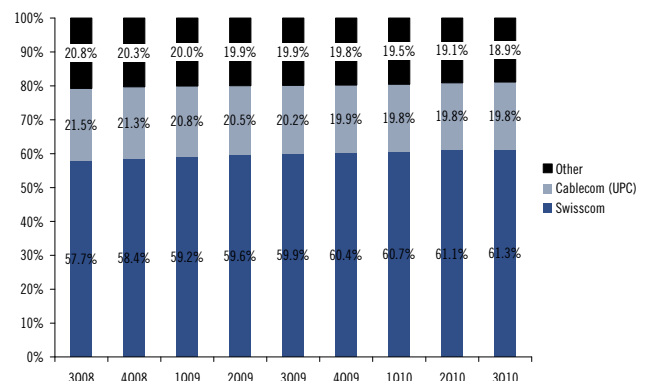
Source: Company reports and Citi Investment Research and Analysis

Figure 364. Line Loss, Incumbent Revenue Growth and GDP



Source: Company reports, CIRA and Datastream

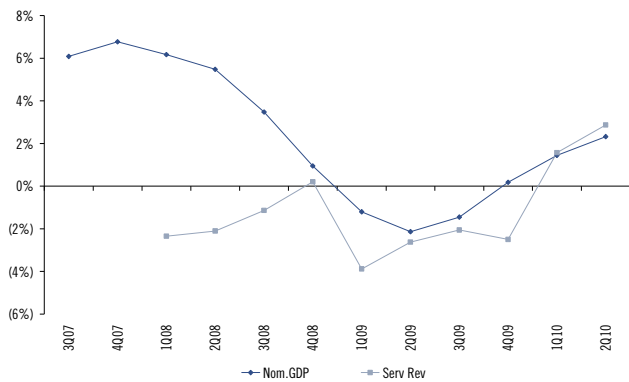
Figure 366. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

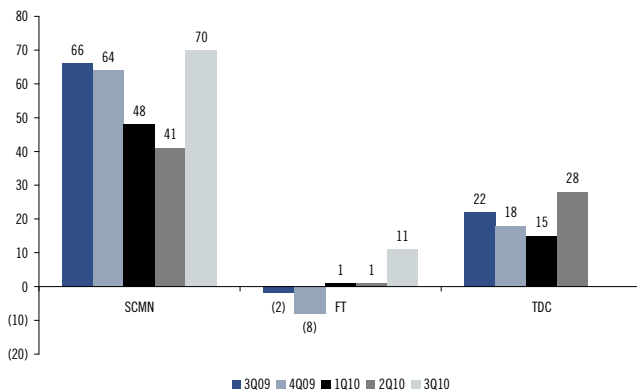
Mobile Charts

Figure 367. Revenue and GDP



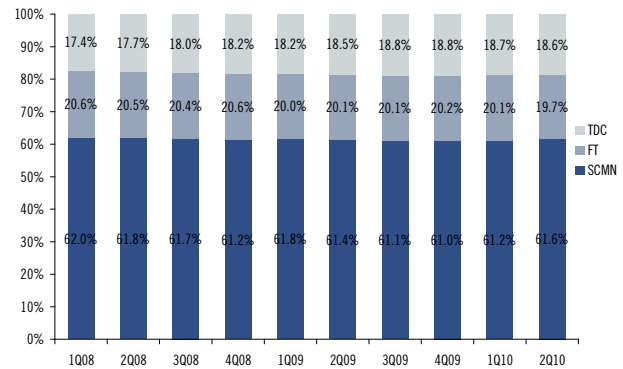
Source: Company reports, CIRA and Datastream

Figure 369. Post-Paid Net Adds



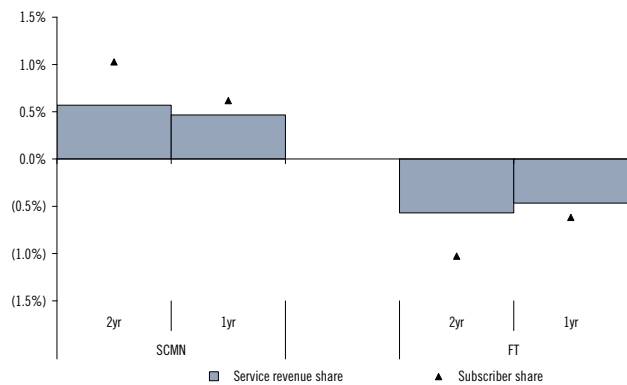
Source: Company reports and Citi Investment Research and Analysis

Figure 368. Service Revenue Market Share



Source: Company reports and Citi Investment Research and Analysis

Figure 370. Change in Service Revenue and Contract Sub Share (comparison excludes TDC)



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 371. Swiss Mobile Market Information

Switzerland	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, CHFm													
Swisscom	903	844	847	871	899	862	820	851	882	844	830	880	910
Orange (FT)	307	305	282	289	297	290	265	279	290	279	272	282	292
Total	1,211	1,149	1,129	1,160	1,197	1,152	1,085	1,130	1,172	1,123	1,102	1,162	1,202
Service Revenue Growth, yoy													
Swisscom			2.4%	0.9%	(0.4%)	2.1%	(3.2%)	(2.3%)	(1.9%)	(2.1%)	1.2%	3.4%	3.2%
Orange (FT)			(14.3%)	(10.2%)	(3.2%)	(5.1%)	(5.9%)	(3.5%)	(2.5%)	(3.7%)	2.7%	1.2%	0.6%
Total			(2.3%)	(2.1%)	(1.1%)	0.2%	(3.9%)	(2.6%)	(2.1%)	(2.5%)	1.6%	2.9%	2.5%
Customers, 000s													
Swisscom	4,894	5,007	5,100	5,181	5,284	5,370	5,411	5,472	5,538	5,602	5,650	5,691	5,761
Orange (FT)	1,473	1,510	1,529	1,527	1,530	1,543	1,558	1,568	1,566	1,558	1,559	1,560	1,571
Customer Net Adds, 000s													
Swisscom	118	113	93	81	103	86	41	61	66	64	48	41	70
Orange (FT)	32	37	19	(2)	3	13	15	10	(2)	(8)	1	1	11

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 372. Swiss Fixed Line Market Information

Switzerland	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	1,123	1,169	1,221	1,254	1,279	1,331	1,379	1,410	1,441	1,478	1,509	1,530	1,553
Incumbent wholesale	440	438	439	450	448	431	410	390	363	331	293	260	240
ULL (total)	0	0	2	4	12	31	57	82	115	153	192	219	238
Cable	444	455	468	480	477	486	485	485	485	487	492	496	501
Total	2,007	2,062	2,130	2,188	2,216	2,278	2,331	2,367	2,404	2,449	2,486	2,505	2,532
Broadband Subscribers (000s)													
Swisscom	1,123	1,169	1,221	1,254	1,279	1,331	1,379	1,410	1,441	1,478	1,509	1,530	1,553
Cablecom (UPC)	444	455	468	480	477	486	485	485	485	487	492	496	501
- other	440	438	441	454	460	462	467	472	478	484	485	479	478
Total	2,007	2,062	2,130	2,188	2,216	2,278	2,331	2,367	2,404	2,449	2,486	2,505	2,532
Broadband Subscribers Net Adds (000s)													
Swisscom	53	46	52	33	24	52	48	31	31	37	31	21	23
Cablecom (UPC)	12	11	13	12	(2)	8	(0)	(0)	0	2	5	4	5
- other	(1)	(2)	3	13	6	2	5	5	6	6	1	(6)	(1)
Total	64	55	68	58	28	62	53	36	37	45	37	19	27
Telephony Channels (000s)													
Incumbent retail	3,620	3,611	3,590	3,579	3,565	3,548	3,517	3,479	3,434	3,391	3,330	3,283	3,247
Incumbent wholesale (WLR)	0	0	0	0	0	0	0	0	0	0	0	0	0
ULL (total)	0	0	2	4	12	31	57	82	115	153	192	219	238
Cable	279	289	298	310	308	309	308	307	305	303	312	318	321
Total	3,899	3,899	3,890	3,892	3,885	3,889	3,882	3,868	3,854	3,847	3,834	3,820	3,806
Telephony Channels Net Adds (000s)													
Incumbent retail	(16)	(9)	(21)	(11)	(14)	(17)	(31)	(38)	(45)	(43)	(61)	(47)	(36)
Incumbent wholesale (WLR)	0	0	0	0	0	0	0	0	0	0	0	0	0
ULL (total)	0	0	2	2	8	19	26	25	33	38	39	27	19
Cable	12	9	10	12	(2)	1	(2)	(1)	(2)	(2)	9	6	3
Total	(4)	(0)	(9)	3	(7)	4	(7)	(14)	(14)	(7)	(13)	(14)	(14)
Pay TV Subscribers (000s)													
Swisscom	52	59	64	80	95	118	139	165	186	232	275	317	358
Cablecom (UPC)	1,554	1,551	1,557	1,562	1,567	1,556	1,557	1,552	1,554	1,546	1,541	1,539	1,537
Pay TV Subscribers Net Adds (000s)													
Swisscom	12	7	5	16	15	23	21	26	21	46	43	42	41
Cablecom (UPC)	(2)	(3)	6	4	5	(10)	1	(5)	2	(8)	(5)	(2)	(2)

Source: Company reports and Citi Investment Research and Analysis

UK

Fixed

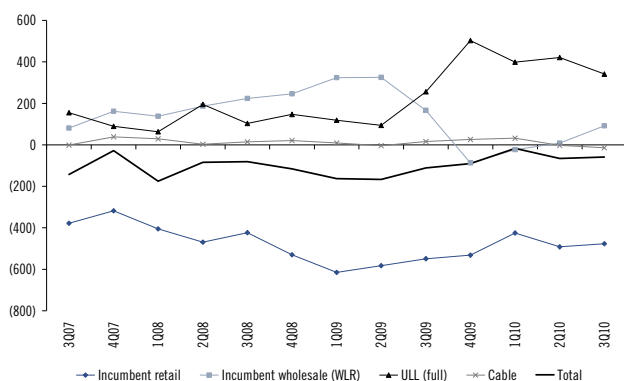
- **Incumbent retail line loss remains severe** – With BSkyB migrating its base to full ULL, BT Retail's line base continues to fall. It is unlikely that either fibre or BT Vision will be able to drive a turnaround of this trend in the near term.
- **Promotions drive strong broadband quarter** – Market broadband net additions were up 11% as the market was stimulated by promotions from BSkyB and BT ahead of the start of the Premier League football season. BSkyB added 178k subs, its best since 2Q08. Most other operators performed in line with recent trends but we saw deterioration at TalkTalk where churn at Tiscali remains high through the network migration.

Mobile

- **Best growth found at the biggest operators** – Contract net additions remained similar to previous quarters albeit with a slight deterioration at Everything Everywhere. We calculate mobile service revenue market growth in the quarter of +2.6% with +6.5% YoY at O2, VOD at 5.2% and H3G falling at -5.6%. However, Vodafone overtook O2 in post pay revenue growth.

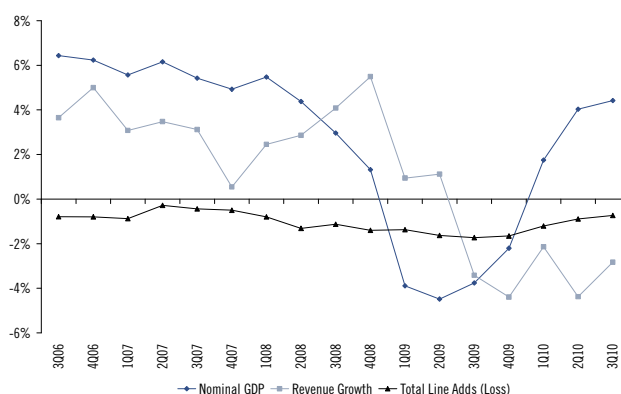
Fixed Charts

Figure 373. Telephony Net Adds



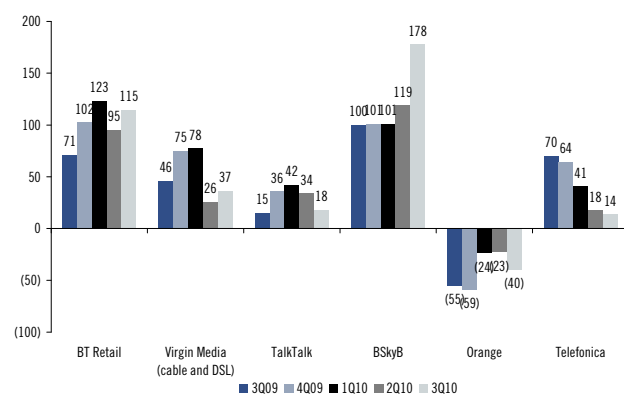
Source: Company reports and Citi Investment Research and Analysis

Figure 374. Line Loss, Incumbent Revenue Growth and GDP



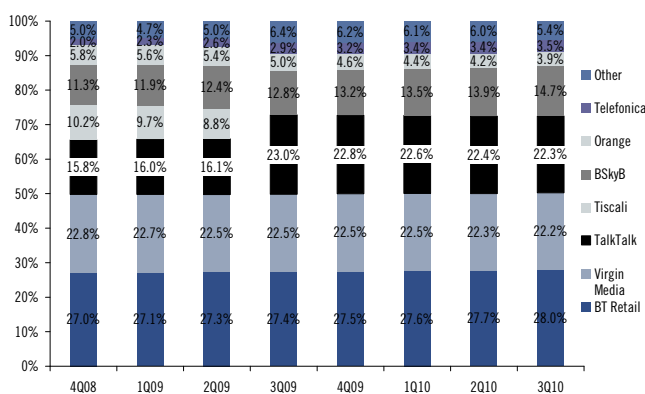
Source: Company reports, CIRA and Datastream

Figure 375. Broadband Subscriber Net Adds



Source: Company reports and Citi Investment Research and Analysis

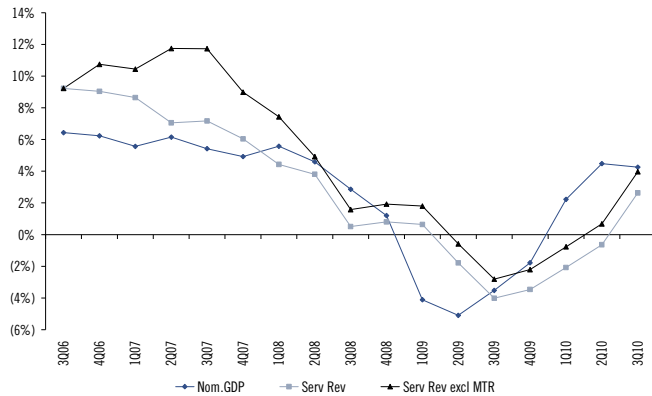
Figure 376. Broadband Subscriber Market Share



Source: Company reports and Citi Investment Research and Analysis

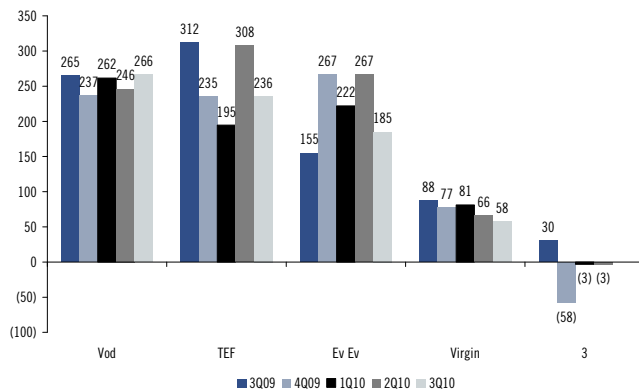
Mobile Charts

Figure 377. Service revenue growth incl. & excl. MTR impact. YoY GDP growth



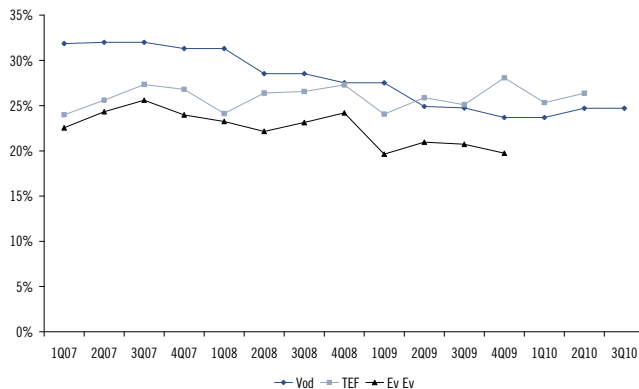
Source: Company reports, CIRA and Datastream

Figure 379. Post-Paid Net Adds



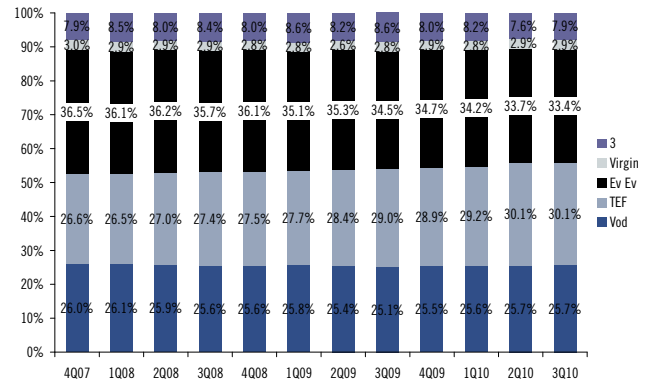
Source: Company reports and Citi Investment Research and Analysis

Figure 381. EBITDA Margin



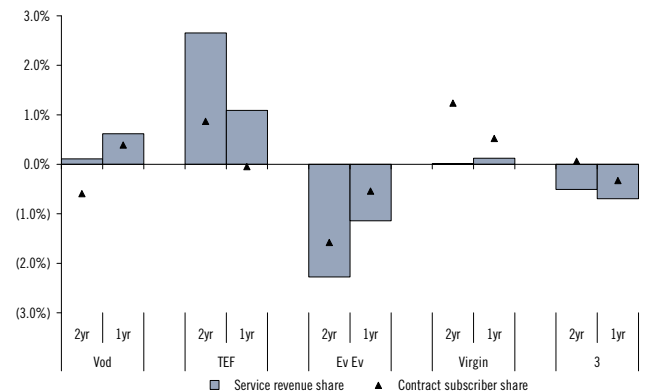
Source: Company reports and Citi Investment Research and Analysis

Figure 378. Service Revenue Market Share



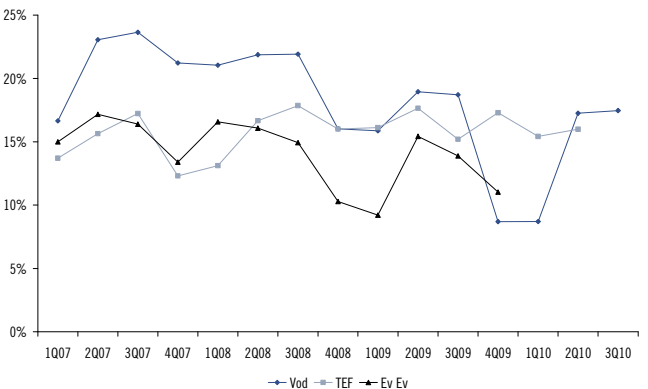
Source: Company reports and Citi Investment Research and Analysis

Figure 380. Change in Service Revenue and Contract Sub Share



Source: Company reports and Citi Investment Research and Analysis

Figure 382. OpFCF margin



Source: Company reports and Citi Investment Research and Analysis

Mobile Data

Figure 383. UK Mobile Market Information

UK	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Service Revenue, £m													
Vodafone	1,287	1,229	1,208	1,226	1,235	1,218	1,202	1,179	1,162	1,169	1,170	1,187	1,222
O2 (Telefonica)	1,247	1,253	1,226	1,277	1,322	1,307	1,293	1,322	1,342	1,329	1,333	1,390	1,429
Ev Ev	1,711	1,721	1,671	1,712	1,720	1,715	1,638	1,643	1,598	1,594	1,562	1,557	1,586
Virgin Mobile	147	142	135	139	140	135	129	121	129	133	128	132	139
3 (Hutch)	405	374	394	378	405	382	401	383	398	367	374	353	375
Total	4,797	4,719	4,634	4,732	4,822	4,757	4,664	4,648	4,629	4,592	4,567	4,618	4,751
Service Revenue Growth, yoy													
Vodafone	8.3%	5.9%	3.6%	1.8%	(4.0%)	(0.9%)	(0.5%)	(3.8%)	(5.9%)	(4.0%)	(2.7%)	0.7%	5.2%
O2 (Telefonica)	9.7%	8.7%	8.0%	6.7%	6.1%	4.3%	5.4%	3.5%	1.5%	1.7%	3.1%	5.1%	6.5%
Ev Ev	6.7%	8.2%	6.0%	5.2%	0.5%	(0.3%)	(2.0%)	(4.0%)	(7.1%)	(7.0%)	(4.7%)	(5.2%)	(0.8%)
Virgin Mobile	11.2%	0.1%	(1.1%)	(2.1%)	(5.0%)	(5.2%)	(3.8%)	(13.0%)	(7.6%)	(1.3%)	(1.3%)	8.8%	7.2%
3 (Hutch)	(2.7%)	(7.2%)	(6.7%)	(2.9%)	0.0%	2.1%	1.9%	1.1%	(1.9%)	(3.8%)	(6.7%)	(7.8%)	(5.6%)
Total	7.2%	6.0%	4.4%	3.8%	0.5%	0.8%	0.6%	(1.8%)	(4.0%)	(3.5%)	(2.1%)	(0.6%)	2.6%
Service Revenue Market Share													
Vodafone	26.8%	26.0%	26.1%	25.9%	25.6%	25.6%	25.8%	25.4%	25.1%	25.5%	25.6%	25.7%	25.7%
O2 (Telefonica)	26.0%	26.6%	26.5%	27.0%	27.4%	27.5%	27.7%	28.4%	29.0%	28.9%	29.2%	30.1%	30.1%
Ev Ev	35.7%	36.5%	36.1%	36.2%	35.7%	36.1%	35.1%	35.3%	34.5%	34.7%	34.2%	33.7%	33.4%
Virgin Mobile	3.1%	3.0%	2.9%	2.9%	2.9%	2.8%	2.8%	2.6%	2.8%	2.9%	2.8%	2.9%	2.9%
3 (Hutch)	8.4%	7.9%	8.5%	8.0%	8.4%	8.0%	8.6%	8.2%	8.6%	8.0%	8.2%	7.6%	7.9%
Post-pay Customers, 000s													
Vodafone	7,148	7,287	7,415	7,552	7,711	7,896	7,767	7,909	8,174	8,410	8,672	8,918	9,184
O2 (Telefonica)	6,533	6,809	7,687	7,868	8,189	8,412	8,699	9,011	9,324	9,559	9,754	10,061	10,297
Ev Ev	9,345	9,490	9,583	9,769	10,026	10,229	10,407	10,552	10,707	10,974	11,196	11,463	11,648
Virgin Mobile	329	376	436	492	579	649	712	785	873	950	1,031	1,097	1,155
3 (Hutch)	2,529	2,662	2,801	3,051	3,278	3,474	3,657	3,711	3,741	3,683	3,679	3,676	4,019
Call Volumes, mn min/qtr													
Vodafone	9,112	9,434	9,508	9,650	9,597	9,762	10,195	9,784	10,259	10,379	10,870	10,704	10,569
Telefonica	10,331	10,721	11,069	12,002	12,240	12,816	12,798	13,304	13,579	14,176	14,155	14,346	14,565
Ev Ev	15,298	15,808	15,867	16,357	16,384	16,509	16,434	16,056	15,995	16,260	16,166	16,609	15,994
Virgin Mobile	1,200	1,234	1,236	1,261	1,216	1,177	1,178	1,178	1,205	1,227	1,261	1,316	1,365
3 Hutch	1,821	1,913	1,974	2,142	2,256	2,385	2,498	2,569	2,668	2,794	2,935	3,097	3,323
Total	37,761	39,110	39,653	41,411	41,693	42,650	43,104	42,891	43,706	44,836	45,388	46,071	45,817
Call Volume growth													
Vodafone	20.2%	15.6%	8.2%	7.7%	5.3%	3.5%	7.2%	1.4%	6.9%	6.3%	6.6%	9.4%	3.0%
Telefonica	15.2%	13.5%	16.5%	19.1%	18.5%	19.5%	15.6%	10.8%	10.9%	10.6%	10.6%	7.8%	7.3%
Ev Ev	11.6%	10.1%	8.5%	9.3%	7.1%	4.4%	3.6%	(1.8%)	(2.4%)	(1.5%)	(1.6%)	3.4%	(0.0%)
Virgin Mobile	10.8%	7.6%	6.2%	6.2%	1.3%	(4.6%)	(4.7%)	(6.6%)	(0.9%)	4.2%	7.1%	11.7%	13.3%
3 Hutch	20.7%	19.3%	18.7%	22.4%	23.9%	24.7%	26.6%	19.9%	18.2%	17.1%	17.5%	20.6%	24.6%
Total	15.0%	12.7%	11.0%	12.1%	10.4%	9.1%	8.7%	3.6%	4.8%	5.1%	5.3%	7.4%	4.8%
Contract Churn, % p.a													
Vodafone	15.3%	15.6%	17.3%	18.0%	17.5%	17.3%	21.9%	18.0%	18.5%	18.1%	16.2%	15.5%	16.1%
O2 (Telefonica)	20.4%	19.2%	18.0%	16.8%	15.6%	15.6%	14.4%	14.4%	14.4%	12.0%	13.2%	13.2%	14.4%
Ev Ev	22.7%	24.2%	22.4%	21.0%	21.5%	23.5%	24.7%	22.9%	23.3%	21.9%	21.6%	18.9%	19.2%
Data Revenue (excl messaging) % Service Revenue													
Vodafone	6.9%	7.6%	8.1%	9.0%	9.4%	10.1%	10.1%	11.6%	12.5%	12.8%	13.8%	14.7%	15.1%
O2 (Telefonica)	4.7%	5.2%	6.3%	6.2%	7.1%	7.9%	8.7%	9.7%	11.0%	11.6%	12.3%	13.5%	13.2%
Ev Ev	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
EBITDA, £m													
Vodafone	412	385	378	350	352	335	331	294	289	279	279	295	304
O2 (Telefonica)	361	357	320	363	381	401	342	371	366	418	367	401	0
Ev Ev	479	461	425	416	435	457	352	379	364	356	0	0	0
Capex, £m													
Vodafone	108	125	125	82	82	141	141	71	71	177	177	89	89
O2 (Telefonica)	133	193	146	134	125	166	113	118	144	160	144	158	133
Ev Ev	173	204	122	114	154	263	187	100	120	157	0	0	0

Source: Company reports and Citi Investment Research and Analysis

Fixed Data

Figure 384. UK Fixed Line Market Information

UK	3Q07	4Q07	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Broadband Subscribers (000s)													
Incumbent retail	4,074	4,251	4,402	4,505	4,574	4,658	4,757	4,835	4,906	5,008	5,132	5,227	5,342
Incumbent wholesale	4,405	4,205	3,983	3,756	3,622	3,416	3,305	3,191	3,124	3,036	2,926	2,785	2,629
ULL (total)	3,195	3,729	4,300	4,756	5,084	5,501	5,750	5,957	6,121	6,352	6,620	6,906	7,143
Cable	3,308	3,414	3,502	3,563	3,625	3,682	3,730	3,735	3,774	3,837	3,910	3,936	3,969
Total	14,982	15,599	16,187	16,580	16,905	17,257	17,542	17,718	17,925	18,234	18,587	18,854	19,083
Broadband Subscribers (000s)													
BT Retail	4,074	4,251	4,402	4,505	4,574	4,658	4,757	4,835	4,906	5,008	5,132	5,227	5,342
Virgin Media	3,590	3,701	3,782	3,836	3,885	3,934	3,977	3,981	4,027	4,102	4,180	4,206	4,242
TalkTalk	2,486	2,604	2,713	2,754	2,788	2,732	2,806	2,853	4,119	4,155	4,197	4,231	4,249
Tiscali	1,820	1,829	1,875	1,838	1,774	1,768	1,710	1,551					
BSkyB	939	1,199	1,428	1,628	1,792	1,955	2,085	2,203	2,303	2,404	2,505	2,624	2,802
Orange	1,142	1,138	1,107	1,063	1,023	1,000	977	954	899	840	816	793	753
Telefonica	38	71	131	194	267	341	405	457	527	592	632	650	664
- other	892	806	749	762	802	869	826	884	1,144	1,133	1,126	1,123	1,031
Total	14,982	15,599	16,187	16,580	16,905	17,257	17,542	17,718	17,925	18,234	18,587	18,854	19,083
Broadband Subscribers Net Adds (000s)													
BT Retail	240	177	151	103	69	84	99	78	71	102	123	95	115
Virgin Media (cable and DSL)	124	111	81	54	49	49	43	4	46	75	78	26	37
TalkTalk	89	118	109	41	34	36	74	47	15	36	42	34	18
Tiscali	270	9	46	(37)	(64)	(6)	(58)	(77)	0	0	0	0	0
BSkyB (incl. UK Online)	223	260	229	200	164	163	130	118	100	101	101	119	178
Orange	52	(4)	(31)	(44)	(40)	(23)	(23)	(23)	(55)	(59)	(24)	(23)	(40)
Telefonica	8	32	61	63	73	74	64	52	70	64	41	18	14
- other	(411)	(86)	(57)	13	40	67	(44)	59	260	(11)	(7)	(2)	(92)
Total	595	617	588	393	325	352	285	176	207	309	354	267	229
Telephony Channels (000s)													
Incumbent retail	23,266	22,948	22,543	22,074	21,651	21,121	20,506	19,924	19,375	18,843	18,418	17,926	17,449
Incumbent wholesale	4,366	4,528	4,666	4,853	5,077	5,323	5,647	5,972	6,138	6,051	6,028	6,036	6,128
ULL (total)	998	1,087	1,150	1,345	1,448	1,595	1,714	1,808	2,064	2,567	2,966	3,387	3,728
Cable	3,993	4,031	4,060	4,064	4,078	4,099	4,108	4,104	4,120	4,146	4,178	4,175	4,161
Total	32,622	32,594	32,419	32,336	32,254	32,138	31,975	31,808	31,697	31,607	31,590	31,524	31,466
Telephony Channels Net Adds (000s)													
Incumbent retail	(378)	(318)	(405)	(469)	(423)	(530)	(615)	(582)	(549)	(532)	(425)	(492)	(477)
Incumbent wholesale (WLR)	81	162	138	187	224	246	324	325	166	(87)	(23)	8	92
ULL (total)	155	89	63	195	103	147	119	94	256	503	399	421	341
Cable	(1)	39	29	3	15	21	9	(4)	16	26	32	(3)	(14)
Total	(143)	(28)	(175)	(84)	(82)	(116)	(163)	(167)	(111)	(90)	(17)	(66)	(58)
Pay TV Subscribers (000s)													
BT IPTV	46	120	214	282	320	376	423	433	436	451	467	481	505
Sky	8,665	8,832	8,888	8,980	9,067	9,238	9,318	9,442	9,536	9,708	9,770	9,860	9,956
Virgin Media	3,368	3,429	3,466	3,490	3,527	3,572	3,602	3,623	3,660	3,694	3,730	3,752	3,767
Total	12,079	12,381	12,568	12,752	12,914	13,186	13,343	13,498	13,632	13,853	13,967	14,093	14,228
Pay TV Subscribers Net Adds (000s)													
BT IPTV	31	74	94	68	38	56	47	10	3	15	16	14	24
Sky	83	167	56	92	87	171	80	124	94	172	62	90	96
Virgin Media	20	61	37	24	37	45	30	20	37	34	36	22	15
Total	134	302	187	184	162	272	157	154	134	221	114	126	135

Source: Company reports and Citi Investment Research and Analysis

Additional companies discussed: Freenet (FNTGn.DE; €7.78; 1H); Virgin Media (VMED.O; US\$27.27; 1M); Kabel Deutschland (KD8Gn.DE; €36.35; 1M); Eutelsat Communications (ETL.PA; €26.91; 1M)

Belgacom SA

Valuation

Our valuation on Belgacom and our 24 euros target price are based on our ROIC fade DCF method. We model Belgacom to 2016, then fade ROIC in that year to cost-of-capital over the next 25 years. We use a WACC of 8.0% (in line with our companies under coverage, with only exposure to Western markets), beta of 0.8 and an average growth rate in invested capital of 1% over 40 years.

Risks

We rate Belgacom Low Risk. The risk rating on the stock is derived after consideration of a number of factors that may affect the achievement of our target price. These factors include an assessment of industry-specific risks, financial risk and management risk. In addition, we consider historical share price volatility, based on the input of the Citi quantitative research team, as a possible indicator of future stock-specific risk:

Upside risks include an increase in dividends if no sizeable acquisition target emerges, and faster-than-expected headcount cuts.

Downside risks include handset subsidies, faster migration to VOIP, stronger impact from fixed to mobile substitution and regulatory cuts (mobile termination, roaming, leased lines) than expected. These risks could impede the share price from reaching our target price.

Bouygues SA

Valuation

We derive our €40 target price using a blended average of our DCF and SOTP valuations. We use CAPM to drive cost of capital between 8% and 10.5% (9% in Bouygues' case) and a terminal growth rates of 2%. We expect the conglomerate discount to close and possibly move to a premium in any restructuring scenario. Our target price of €40 is set equal to our fair value.

Risks

We rate Bouygues as High Risk. Bouygues has low gearing and is a mid-cycle, not late-cycle, player in construction businesses. Industry-specific risks for mobile and construction companies include economic sensitivity and voice pricing pressure. We believe Bouygues also has particular risks that may prevent it from achieving our target price: it is rolling out the mobile aggressively and it has exposure to large capital projects. The arrival of a new mobile operator in France in 2012 and risk of cuts in public spending in road building could weight on the shares. However, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target.

BT Group PLC

Valuation

Our target price of £2.10 is set by reference to a DCF with returns fading close to the cost of capital in the long term, SOTP analysis and reference market multiples. The DCF uses a WACC of 8.7% and due to the returns fade, in the long term cash flow is expected to decline in nominal terms.

Risks

We rate BT Group Medium Risk. The risk rating on the stock is derived after consideration of a number of factors. Principle among these is the presence of the sizeable pension fund along with historic stock volatility and exposure to both one-country and regulatory risk. If the impact of these risk factors is more or less negative than we currently anticipate, then the share price could fail to reach or rise above our target price.

Deutsche Telekom AG

Valuation

We base our €11.0/share target price on our ROCE fade DCF and we sense check with a SOTP based on industry multiples.

Risks

We rate Deutsche Telecom Low Risk based on our assessment of industry and company-specific risk factors. There are industry-specific risks to achieving our target price for all telecom companies. These include concerns about competition, demand, regulation and technological obsolescence. The government remains a significant shareholder and will probably look to recommence reducing its shareholding at some stage. Nonetheless the company's commitment to minimum returns on capital and cash returns to shareholders provides a solid basis for valuation.

Elisa Oyj

Valuation

Our €13.0 target price on Elisa is based on a 40-year ROCE fade DCF model. We assume a 7.6% WACC and a 1.5% perpetuity growth.

Risks

We rate Elisa Low Risk based on our assessment of industry and company-specific risk factors. Elisa has stable operations and macro environment. 95% of Elisa's value is from Finland. There is upside risk from higher capital returns and Elisa may become an M&A target.

France Telecom

Valuation

We set our target price of €17 in line with our SOTP fair value. TPSA Poland, Mobistar and Mobinil are valued at market value. All other assets are valued based on equivalent EV/EBITDA multiples. In our SOTP model, we apply a 5% discount to our resulting fair value to reflect fibre and M&A risk.

Risks

We rate France Telecom Low Risk based on our assessment of industry and company-specific risk factors. The following risks could cause the share price to deviate significantly from our target price. On the positive side, we see three reasons why FT's share price could outperform. These include: a better performance from RoW assets after the recent slowdown in growth, rising French DSL market share and a turnaround of Orange UK.

On the downside, corporate pricing remains under pressure and may deteriorate faster than we anticipate. The risk of disruptive pricing from a fourth mobile entrant is high. In addition, there are still concerns about capitalisation, weak demand, and the risk of new technology establishing cost advantages over current technology. Finally, there is still a risk that regulation and austerity measures continue to hit domestic wireline and mobile revenues. If the impact of these risk factors is more/less negative than we anticipate, then the share price might fail to reach/rise above our target price.

KPN NV

Valuation

We have a target price of €13.5. We base our target price on a combination of: 1) a simple DCF/EVA model; and 2) and cross-check with a multiple-based approach. We ignore buybacks in setting our targets. Our DCF assumptions are 8.0% cost of capital, 2.5% terminal growth rate. Our target price is then set at a 5% discount to the second approach to reflect the probability of reaching fair value within 12 months.

Risks

We rate KPN Low Risk after an assessment of industry and company-specific risk factors. There are industry-specific risks to achieving our target price for all telecom companies. These include concerns about over capitalisation, weak demand, regulatory risks and the risk of new technology establishing cost advantages over current technology. For KPN we see several particular risks that could impede the shares from achieving fair value: notably that E-Plus is immature with limited free cash flow and has very aggressive, possibly irrational competitors; the company is heavily exposed to mobile, which we believe is going through increasing technological risks; and competition in the Dutch market is fierce. If the impact on the company from any of these factors proves to be greater than we anticipate, the stock will likely have difficulty achieving our financial and price targets. Likewise, if any of these factors proves to have less of an effect than we anticipate, the stock could materially outperform our target price.

Mobistar SA

Valuation

As for all mobile companies, and at a time of multiple convergence across the market, DCF and Fade DCF are our basic valuation approaches. We use a common set of assumptions for subscriber growth, ARPUs, margins and capex for the European mobile companies to build a 15-year DCF. We use CAPM to drive cost of capital between 8.0% and 10.5% (in Mobistar's case close to 8.5%) and terminal growth rates of 1.5%. Our €39 target price is based on our FADE DCF, but does not reflect a buy-in premium by France Telecom. We also use relative valuation approaches and ROIC/WACC for reference.

Risks

We rate Mobistar Low Risk based on our assessment of industry and company specific risks. The following risks may prevent the achievement of our target price. Upside risks include higher consumer usage, heavier penetration of the SME market or stronger uptake of mobile data. Downside risks include the possibility that consumer usage of new services may disappoint and the potential proliferation of mobile handset subsidies. Regulatory risk on termination and roaming revenues is significant. The company is struggling to implement DSL.

OTE

Valuation

As we do for all integrated telecoms companies, we use a combination of DCF and market-based multiples in a sum of the parts. In both our mobile and fixed-line models, we use consistent long-term assumptions on operating data and use a local market WACC (9.5%), based on a CAPM. Rather than using a terminal growth multiple, we adopt a return on capital fade approach to deriving our terminal value beyond the end of the explicit modeling period. Our 8 euros target price is based on our DCF model.

Risks

We rate OTE as High Risk based on our assessment of industry- and company-specific risk factors. Industry-specific risks to achieving our target price for all telecom companies include concerns about over-capitalisation, weak demand, regulatory risks and the risk of new technology establishing cost advantages over current technology. Upside risk to our target would result from better-than-expected news on restructuring, more regulatory clarity or operational out-performance at Rom-Telecom. Downside risks would include impact of economic slowdown in South East Europe, increased competition from ULL operators, slow cost management, and country risk due to the macro-economic conditions. The entry of Deutsche Telekom adds integration risk (e.g. strike actions). If the impact on the company from any of these factors proves to be greater than we anticipate, the stock may deviate significantly from our target price.

Portugal Telecom

Valuation

Our €8.5 ex-div target price is based on a sum of the parts valuation. For the domestic wireline operations we use 4.7x 2011e EBITDA and 4.2x for mobile. The difference reflects the divergent revenue trends expected. We include PT's expected stake in Telemar at 4.8x 2011e EBITDA, using a peer multiple, adjusted for shared control.

Risks

We rate PT Medium Risk. We see the following risks to our target price. Post M&A, the market expects details of the company's plans for capital returns. Should these expectations not be met, the PT share price could fall. Additionally there are reinvestment risks associated with any funds not dedicated to capital returns. Operationally, competition in Portugal may become tougher than we expect. In Brazil assuming the Telemar transaction proceeds, PT will not have complete control of Telemar and so risks of poor performance exist outside of PT management's control. If the impact on the company from any of these factors proves to be greater or less than we anticipate, the stock will either likely have difficulty achieving our financial and target prices or materially outperform our target.

Swisscom AG

Valuation

Our SFr440 target price is set at a discount to fair value since we do not think fair value can be reached in the next 12 months under current market conditions. It also reflects reduced visibility of Fastweb's mid-term performance. Our SFR500 fair value estimate is derived using a combination of 35-year DCF (for domestic Fixed and Mobile) and relative valuation metrics. Our valuation of Swisscom's 82% Fastweb stake is set at 6.5x 08E EV/EBITDA based on comparable peer multiples. This derives a value of SFr4.5bn, which compares to the SFr5.7bn Swisscom paid for the asset.

At our fair value Swisscom would trade at c.7.3x 10E EV/EBITDA. This is a 20% premium to the sector, which we believe can be justified by:

Low Swiss tax rates - we model 21% in perpetuity from 2008 (vs. sector average c.30%).

Cheap borrowing rates - when Swisscom refinanced Fastweb's debt it secured a rate of just 3.75% (vs. sector average 5.2%).

Risks

We rate Swisscom Low Risk and see its domestic operations as among the lowest risk assets in the European telecom sector. However, Fastweb contributes a slightly more risky income stream, the regulatory environment is less certain and there is tougher competition than in Switzerland. Additionally the company may engage in M&A which could be risky. Nonetheless, Swisscom has a strong Group balance sheet, and in Switzerland faces moderate competition and a fairly benign regulatory environment.

Tele2 AB

Valuation

Our SKr150 target price is based on a DCF valuation. We assume a 11.3% WACC and 1.5% perpetuity growth. We cross check this with a SOTP valuation with Russia on 7.2x 2011 EV/EBITDA, the other operations on 4.0-5.5x 2011E EV/EBITDA.

Risks

We rate Tele2 as Medium Risk based on our assessment of industry and company-specific risk factors. Tele2 has a high exposure to Russia, 45% of our SOTP. Operational trends in Russia remain strong, however the lack of a data network may create longer term problems. An upside risk in Russia is a possible acquisition by Svyazinvest, which is looking to expand further into mobile.

Telecom Italia SpA

Valuation

We base our €1.1/share on our ROCE fade DCF valuation methodology and we sense check with a SOTP based on industry multiples.

Risks

We rate TI ordinary shares as Medium Risk based on our assessment of industry and company-specific risk factors. TI has relatively high financial leverage, ownership uncertainty remains through the Telco holding company, and turnaround of its domestic mobile business remains a key risk. If the impact of these risk factors is more or less negative than we currently anticipate, then the share price could fail to reach or exceed our target price.

Telecom Italia SpA

Valuation

Our €0.88 target price for TI saving shares is derived by applying a 20% discount to the current ordinary share €1.10 target price to reflect the lack of voting rights, consistent with its recent trading level in the market.

Risks

We rate the TI Savings shares as Medium Risk for the same reasons as the Ordinary shares, namely the risks from the controlling shareholders seeking to transfer value from TI to themselves and risk around the turnaround of its domestic mobile business.

Telefonica SA

Valuation

Our target price of €17.5 is set by reference to a DCF, with returns fading close to the cost of capital in the long term, SOTP analysis, and reference market multiples. The DCF uses a WACC of 8.5% and due to the returns fade in the long term, cash flow is expected to decline in nominal terms, with a perpetual fall in FCF from 2014 of 0.8% pa implied by the model assumptions.

Risks

We rate Telefónica Low Risk based on our assessment of industry and company-specific risk factors. Downside risks that could impede the share price from reaching our target price include: acquisitions, changes in regulation, macro issues including currency fluctuations. Growth rates in the many different Latin American markets may diverge markedly from our expectations. Telefónica's strong domestic position attracts broadband competition and the pace of this is likely to increase. On the other hand, if the impact of these risk factors is less negative than we anticipate, then the share price might rise above our target price.

Telekom Austria

Valuation

Our €10.5 target price is based on a SOTP fade DCF valuation model. We use a 40-year fade ROCE DCF for the individual business units. In wireline, we assume ROCE falls to our 8% WACC by 2030. For domestic mobile, we assume ROCE/WACC convergence in 2030 on an 8% WACC. For Belarus, Bulgaria and Croatia we use a 11.5% WACC. For the remaining units, we use relative multiple valuation. At our target price, Telekom Austria would trade at 5.1x EV/EBITDA and 12x P/E in FY11E.

Risks

We rate Telekom Austria as Medium Risk, based on a number of factors, including input from the CIRA quantitative research team. The biggest risk to the stock is the uncertainty surrounding the emerging market economies (35% of group value). With cheap finance and exports dwindling, TKA's emerging market economies are stalling. Bulgaria and Belarus continue to suffer from macro pressure into 2010 with no let up in competitive pressure from aggressive third players. Croatian roaming regulatory pain annualises in 2010 and data roaming regulation is a further risk. The length and extent of the economic problems and their impact on mobile telephony is far from certain. In Austria, on top of economic deterioration fixed to mobile substitution continues to be a net negative for Telekom Austria. Slowing overall telecom market growth and regulation (encouraging new fixed-line and mobile entrants) present further downside risk to financial forecasts. On the other hand, if the impact of these risk factors is less negative than we currently anticipate, then the share price could rise above our target price.

Telenor ASA

Valuation

Our Telenor target price of NOK120 is set at fair value based on conservative underlying expectations. This is DCF based with a WACC of 9.9% and 1.0% perpetuity growth. We cross-check this with valuation multiples and a SOTP.

Risks

We rate Telenor Medium Risk and see the following risks that could prevent the shares from reaching our target price. Firstly, we estimate that c40% of Telenor's value is generated from emerging markets. Secondly, uncertainty remains around Indian operations and the current investigation into the 2008 2G auction. Thirdly Telenor's underleveraged balance sheet increases the risk of value destructive M&A.

TeliaSonera AB

Valuation

Our target price of SEK55 is based on a SOTP. Multiples range from 7.0x 2011E EV/EBITDA for Eurasia to 4.8x for Wholesale. We do not use a DCF because of the lack of a dividend from Megafon which is c.20% EV. Turkcell is included at market value.

Risks

We rate TeliaSonera as Medium Risk, based on our assessment of industry and company-specific risk factors. Telia operates in 15 countries from the Nordic region to the Baltics to Central Asia, this creates macro and FX risk. Domestically Telia is exposed to the increasing cannibalisation of fixed by mobile due to its relatively higher market share in fixed. In addition a 35% of Telia's EV on our SOTP valuation comes from associate holdings where there are ownership disputes.

Vodafone Group PLC

Valuation

Our target price of £1.95 is set by reference to a DCF with returns fading close to the cost of capital in the long term, SOTP analysis, and reference to market multiples. The DCF uses a WACC of 7.9% and due to the returns fade in the long term, FCF is expected to remain approximately flat in nominal terms from 2014/15.

Risks

We rate Vodafone Low Risk based on our assessment of industry and company-specific risk factors. Risks include: competition, regulation, technological obsolescence translation impacts from exchange rates, M&A and spectrum costs. In addition, the increase in dividends that we expect from Verizon Wireless may come later or in smaller amounts than we have forecast. Nonetheless, the company's commitment to cash returns provides important support for the shares, in our view.

Notes

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Appendix A-1

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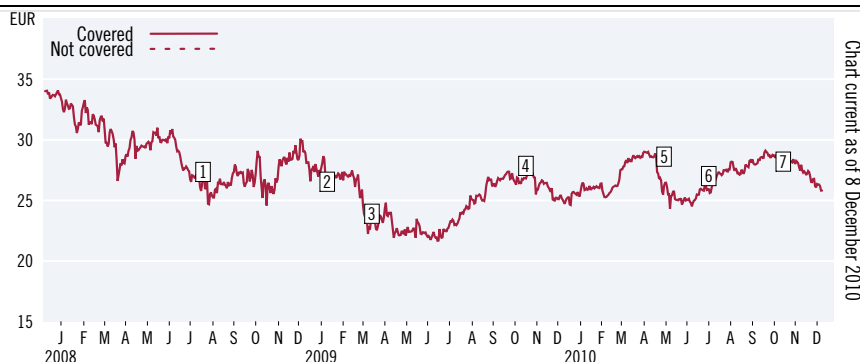
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Ratings and Target Price History Fundamental Research

Analyst: Dimitri Y Kallianiotis, CFA
Covered since July 21 2008



	Date	Rating	Target Price	Closing Price
1	18-Jul-08	2M	*27.50	27.11
2	9-Jan-09	*3M	*25.00	27.23
3	13-Mar-09	*2M	*24.00	23.30

	Date	Rating	Target Price	Closing Price
4	16-Oct-09	2M	*27.00	26.81
5	29-Apr-10	*1M	*29.00	26.20
6	1-Jul-10	*2M	*27.00	25.97

	Date	Rating	Target Price	Closing Price
7	14-Oct-10	*2L	27.00	28.52

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Elisa Oyj (ELI1V.HE)

Ratings and Target Price History Fundamental Research

Analyst: Laurie Fitzjohn-Sykes, CFA
Covered since June 25 2010



	Date	Rating	Target Price	Closing Price
1	12-Feb-08	*2M	14.14	16.97
2	18-Apr-08	2M	*15.62	15.61
3	25-Apr-08	2M	*13.78	13.06

	Date	Rating	Target Price	Closing Price
4	24-Oct-08	2M	*11.02	9.82
5	16-Oct-09	2M	*12.40	13.25
6	27-Nov-09	2M	*12.40	13.57

	Date	Rating	Target Price	Closing Price
7	15-Feb-10	*3M	*12.28	14.52
8	23-Apr-10	3M	*12.07	14.70
9	14-Oct-10	*3L	12.07	16.73

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

OTE (OTEr.AT)

Ratings and Target Price History Fundamental Research

Analyst: Dimitri Y Kallianiotis, CFA
Covered since May 22 2008



Chart current as of 5 December 2010

	Date	Rating	Target Price	Closing Price
1	14-May-08	*2H	*23.00	20.40
2	30-May-08	2H	*20.00	18.00
3	18-Jul-08	2H	*16.50	14.92

	Date	Rating	Target Price	Closing Price
4	28-Oct-08	*1H	*15.00	8.98
5	20-Jul-09	*2H	*12.00	10.45
6	6-Nov-09	*1H	*14.00	11.53

	Date	Rating	Target Price	Closing Price
7	22-Feb-10	1H	*12.00	9.30
8	12-May-10	1H	*10.00	7.89
9	1-Jul-10	1H	*8.00	6.28

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Swisscom AG (SCMN.VX)

Ratings and Target Price History Fundamental Research

Analyst: Simon Weeden
Covered since June 25 2010



Chart current as of 8 December 2010

	Date	Rating	Target Price	Closing Price
1	7-May-08	1M	*450.00	359.50

	Date	Rating	Target Price	Closing Price
2	18-Jul-08	1M	*410.00	327.25

	Date	Rating	Target Price	Closing Price
3	14-Oct-10	*1L	410.00	396.80

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Vodafone Group PLC (VOD.L)

Ratings and Target Price History Fundamental Research

Analyst: Simon Weeden
Covered since December 16 2009



Chart current as of 9 December 2010

	Date	Rating	Target Price	Closing Price
1	10-Dec-07	1M	*2.25	1.84
2	11-Jul-08	1M	*2.00	1.47
3	11-Nov-08	1M	*1.60	1.15
4	15-Jan-09	1M	*1.80	1.32

	Date	Rating	Target Price	Closing Price
5	22-Jan-10	1M	*1.65	1.36
6	20-Apr-10	1M	*1.70	1.50
7	20-May-10	1M	*1.60	1.29
8	26-Jul-10	1M	*1.65	1.52

	Date	Rating	Target Price	Closing Price
9	10-Sep-10	1M	*1.70	1.60
10	14-Oct-10	*1L	1.70	1.67
11	11-Nov-10	1L	*1.85	1.72

* Indicates change

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