30 January 2018

HSBC Global Research

European Telecoms

The FANGs are out – stock picks

EQUITIES
TELECOMS, MEDIA & TECHNOLOGY

Europe

- Prefer ORA: fibre, cost control, inexpensive, CEO stability
- Prefer DT: enlightened regulation, consolidated mobile market
- Buy rating on KPN (good execution), BT (headwinds discounted)

This report accompanies the publication of a new telecoms thematic note, *The FANGs are out* (30 January 2018) that looks at the interface of telecoms and technology regulation. After years of being on the receiving end of onerous rules imposed at the behest of Silicon Valley (i.e., net neutrality), there is now a tectonic shift underway for telecoms. The FANGs (Facebook, Amazon, Netflix, Google) have fallen from grace, and telecoms operators are looking to capitalise on this. We very much doubt operators can seize the role of 'innovation dynamo' from the technology giants, and even net neutrality regulation is secure for the present (at least in Europe). However, one advantage of the new climate is that regulators now have, in the form of the FANGs, a fresh set of targets with a far higher media profile than that of the stolid telecoms operators. The appeal/urgency of regulating the FANGs could displace resource that might otherwise have been directed at loading further burdens on telecoms.

To challenge on the global stage, European players will need scale, and the European Commission has two modest opportunities to signal its support here. The first is with its review of the proposed Dutch mobile merger. Aspects of this deal look more feasible than recent predecessors, but the task of securing approval will be extremely challenging given the stance of DG COMPETITION. The second is with the ongoing negotiation of the European Electronic Communications Code (EECC), which contains some positive elements but has been overshadowed by the topic of tight oligopoly regulation. The measures proposed here remain a risk but we are hopeful that their impact will likely be mitigated. Meanwhile, the sector as a whole continues to benefit from factors like regulatory fibre pricing flexibility and the fact that in-country mobile consolidation was permitted in a number of markets (note this has *not* meant higher consumer prices). Indeed, the industry's revenue growth is much healthier than a few years ago, when regulation was at its nadir and revenues rapidly contracting. That said, progress is presently of the slow but steady variety, and catalysts are wanting (barring a surprise in the Netherlands). Our preferred names are **Orange**, which is well advanced with fibre, relatively inexpensive and likely to see its CEO reconfirmed, and **DT**, which is well positioned both strategically and in terms of regulation. We update some estimates and TPs (see page 7), but make no changes to ratings.

Stephen Howard*
Analyst
HSBC Bank plc
stephen.howard@hsbcib.com
+44 20 7991 6820

Nicolas Cote-Colisson*
Analyst
HSBC Bank plc
nicolas.cote-colisson@hsbcib.com
+44 20 7991 6826

Luigi Minerva*
Analyst
HSBC Bank plc
luigi.minerva@hsbcib.com
+44 20 7991 6928

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Ratings and target prices

Company	Ticker	Currency	Current price	TP Old	TP New	Rating Old	Rating New	Upside/ downside	Market cap (EURm)	EV/EBITDA 2018e	EV/EBITDA 2019e	D/Y 2018e	D/Y 2019e
BT Group*	BT/A LN	GBP	2.63	3.60	3.60	Buy	Buy	36.9%	29,755	6.2x	6.0x	6.1%	6.2%
Deutsche Telecom	DTE GR	EUR	14.58	18.50	18.50	Buy	Buy	26.9%	69,399	7.1x	6.7x	5.0%	5.1%
KPN	KPN NA	EUR	2.89	3.70	3.70	Buy	Buy	28.2%	12,125	7.2x	6.9x	4.8%	5.3%
Orange	ORA FP	EUR	14.85	17.00	17.00	Buy	Buy	14.5%	39,489	5.2x	5.0x	4.4%	4.4%

Source: HSBC estimates, Thomson Reuters. Priced as of close at 26 January 2018 * for BT 2018e column shows FY19e metric

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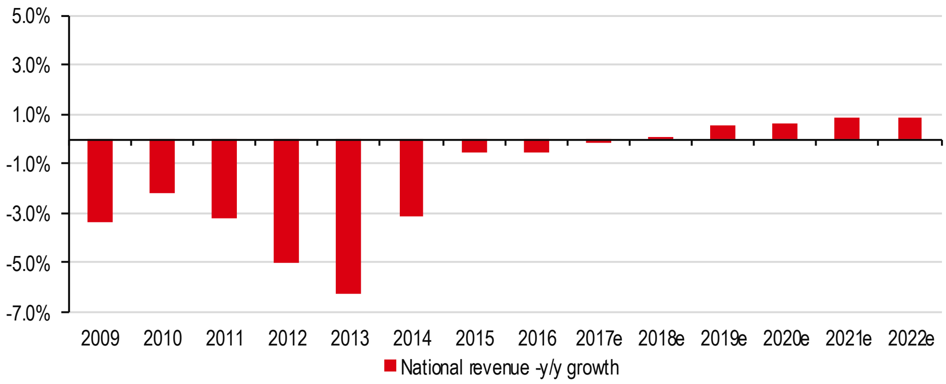
- Prefer ORA: fibre, cost control, inexpensive, CEO stability
- Prefer DT: enlightened regulation, consolidated mobile market
- Buy rating on KPN (good execution), BT (headwinds discounted)

Surprise: The sector is showing steady, if modest, improvement

Operational conditions for the major European telecoms players have been improving, though admittedly from a low base. This may come as a something of a surprise, given the sector's poor stock performance relative to the broader market over the past couple of years. There have certainly been headwinds (one example being mobile roaming regulation), but overall, the telecoms industry's revenue and EBITDA lines have been moving in the right direction. We largely attribute this to the improvements in regulation seen over the past half-decade: in particular, the granting of pricing flexibility to incumbents deploying fibre (courtesy of the *non-discrimination and cost methodology recommendation*), but note also that mobile consolidation was approved in a series of markets before DG COMPETITION reversed course.

At a national level, sector revenues that were comparatively recently showing sharp declines have now stabilised. For 2017, we expect revenues to have contracted just -0.2%, and from here we anticipate a return to very modest growth in a sub 1% band going forward. We expect this ongoing modest improvement to be underpinned by the continuing shift from basic to super-fast or even ultra-fast broadband, as well as by better conditions in many mobile markets (those countries where consolidation did secure approval should benefit – including via the better investment that can be supported as a result). Note that current mobile revenue growth rates have been depressed by roaming regulation (though this should fade from H2 2018), as well as MTR cuts in Germany.

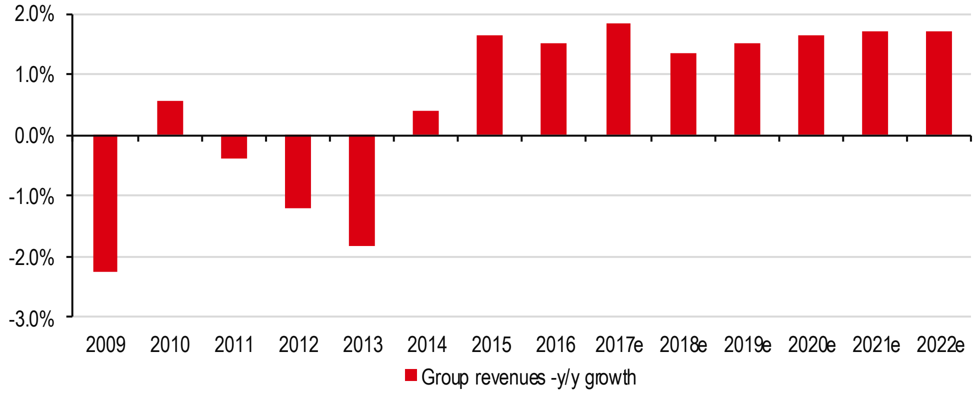
Incumbent domestic revenue trend (% change y/y)



Source: HSBC estimates, Company data

The incumbents' international activities tend to contribute faster growth than do their domestic operations (one of the issues European regulators and policy makers will need to face if they wish to see more capital invested domestically on infrastructure upgrade projects). Group revenue growth rates therefore tend to be similarly distributed but faster than those recorded in the respective home markets. DT's (DTE GR, EUR14.6, Buy) hefty exposure to T-Mobile US (TMUS, USD65, Buy) deserves special mention in this regard, given it is now as important as Germany to the group in revenue terms.

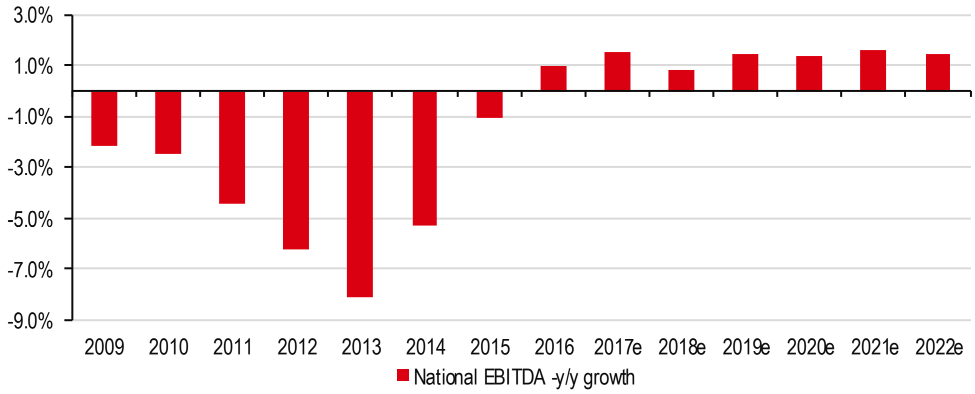
Incumbent group revenue trend (% change y/y)



Source: HSBC estimates, Company data

A similar pattern emerges when examining EBITDA developments. At a national level, the incumbents saw EBITDA contracting at mid-single digit (or worse) rates for much of the first half of the decade, from 2010. They finally returned to growth in 2016, and we continue to anticipate growth over the remainder of the decade – albeit only in the range 1-2%. This is the result of a combination of modest revenue growth combined with a relatively small measure of margin expansion (as incumbents continue with their now well-established cost efficiency programmes).

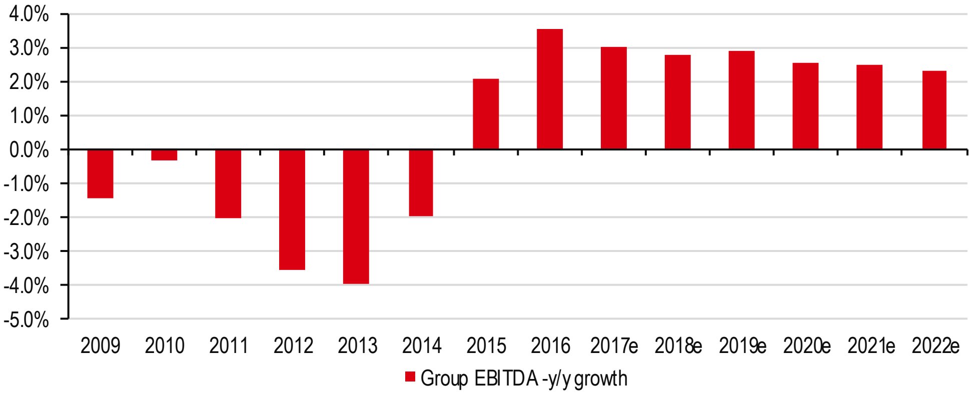
Incumbent domestic EBITDA trend (% change y/y)



Source: HSBC estimates, Company data

Just as with revenue trends, EBITDA growth at the group level has also been (and looks set to continue to be) better than that seen in the operators' respective domestic markets. We expect 3.0% for 2017 and anticipate a similar level of growth over the next couple of years. Hence it is again apparent that international activities provide superior growth – especially when outside of Europe (e.g., T-Mobile US).

Incumbent group EBITDA trend (% change y/y)

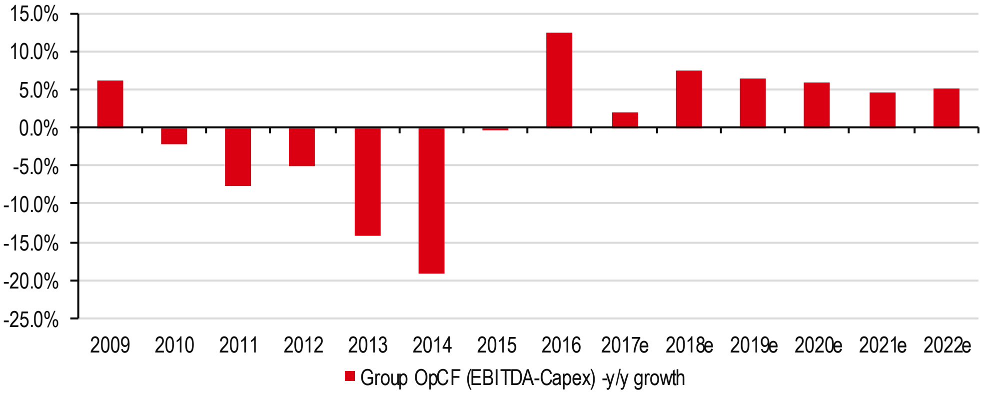


Source: HSBC estimates, Company data

Contrary to the allegations sometimes levelled against the sector, telecoms operators are investing in upgrading network infrastructure. Domestic capex/sales ratios were at their nadir in the early years of this decade, and have since risen to reach (we project) 19.5% for 2017e. We expect the level of capital intensity to remain elevated over the next few years, as operators invest in upgrading to ultra-fast broadband in particular (although we are sceptical about the need for an aggressive 5G build). This should also tend to keep the capex/sales ratio in the high teens in the early years of the next decade – albeit on a fading trend towards the mid-teens percentages that we have consistently argued represent the best assumptions for the longer term.

Capital intensity tends to be a little lower at the group level, as a function of the fact that the most capital intensive projects (e.g., fixed-line access infrastructure) tend to be domestic, whereas international activities are often tilted towards mobile (which usually exhibits a slightly lower capex/sales ratio). We expect a group capex/sales ratio of 17.3% for 2017e.

Incumbent group OpCF trend (% change y/y)



Source: HSBC estimates, Company data

We anticipate operating cash flow growth of 2.1% for 2017e, slower than the sharp improvement seen in 2016 (part of which reflected the conclusion of Vodafone's heavy Project Spring investment). Going forward, we forecast mid-single digit operating cash flow growth, given that several operators are passing peak fibre build and we expect deployment of 5G to be progressive rather than aggressive.

Anatomy of a sector

This rest of the present section focuses on reviewing the most fundamental drivers for the large cap European telecoms stocks. We group these key factors under four high-level headings: revenues, costs, balance sheet and valuation. The framework employed here is essentially that described in our report *Choose your poison* (31 March 2017). We have naturally updated the charts to incorporate the latest data. To summarise our views on the individual companies:

- Of the sector's largest names, we prefer **Orange** and **DT** (both rated Buy). Orange has continued to execute well and there are encouraging signs that conditions are starting to improve domestically. The company is also investing heavily in FTTP, which should help to ensure a stable regulatory environment. DT benefits from a relatively benign mobile market and some of Europe's most enlightened, pro-investment regulation. Meanwhile, T-Mobile US continues to perform strongly.
- **KPN** (Buy) has also executed well, especially in terms of its convergence strategy. The uncertainty generated by the proposed merger between the third and fourth mobile players in the Netherlands may also yield opportunities. Looking further out, though, any associated remedies could destabilise the market and fixed-line regulation could turn tougher, so certain caveats do apply. The lack of certainty on Belgian fixed-line regulation is the primary reason we retain a Hold rating on **Proximus**.
- Both major UK-based operators face headwinds. **Vodafone** (Hold) is delivering on cost control, but competition is a concern in Italy (due to Iliad's entry) and India (where more funds have already had to be injected). A Vodafone-Liberty Global combination has been long discussed in the press, but could prove complex. **BT** (Buy) has suffered as a result of multiple uncertainties including regulation, FTTP plans and the pension deficit. We are hopeful that a sufficient number of these can be addressed satisfactorily for the shares to show some recovery.
- The larger Scandinavian stocks appear fairly valued: we rate **Telia**, **Telenor** and **TDC** Hold. All three companies have ambitious plans to reduce their cost bases in the face, primarily, of legacy and B2B headwinds. Distinguishing between the three, we are structurally more inclined toward Telenor's geographic diversity, while Telia's medium-term competitive outlook is the most uncertain.
- **Swisscom** (Hold) has long pursued a successful strategy centred on network investment, but we think domestic conditions are likely to deteriorate – with Sunrise providing effective competition – and it remains relatively expensive.
- At the Mediterranean operators **Telefonica** and **TI** (both rated Hold), we continue to have concerns over the balance sheets. In Spain, there have been some signs of stabilisation, although concerns remain about the fourth mobile player Masmovil and the continuing parallel fibre deployment of alternative players. Meanwhile, in Italy, Open Fiber's infrastructure build (which could have profound consequences in the longer term) and Iliad's impending entry into the mobile market add to the uncertainty – though Iliad's launch date remains undefined and may be delayed until Q2 2018.

Changes in ratings/Target prices

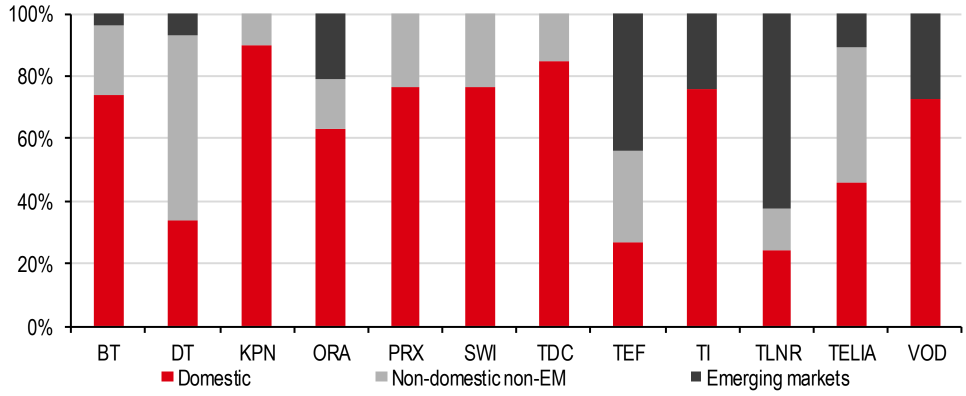
Company	Ticker	Currency	Share price	New Rating	Old Rating	New TP	Old TP	Upside/Downside
BT Group	BT/A LN	GBP	2.63	Buy	Buy	3.60	3.60	36.9%
Deutsche Telekom	DTE GR	EUR	14.58	Buy	Buy	18.50	18.50	26.9%
Elisa Oyj	ELISA FH	EUR	33.05	Reduce	Reduce	29.50	29.20	-10.7%
KPN	KPN NA	EUR	2.89	Buy	Buy	3.70	3.70	28.2%
Orange	ORA FP	EUR	14.85	Buy	Buy	17.00	17.00	14.5%
Proximus	PROX BB	EUR	28.10	Hold	Hold	32.00	32.00	13.9%
Swisscom	SCMN VX	CHF	518.80	Hold	Hold	515.00	515.00	-0.7%
TDC	TDC DC	DKK	40.07	Hold	Hold	39.80	38.00	-0.7%
Telecom Italia	TIT IM	EUR	0.72	Hold	Hold	0.85	0.85	18.0%
Telefonica	TEF SM	EUR	8.50	Hold	Hold	9.00	9.30	5.8%
Telekom Austria	TKA AV	EUR	7.93	Reduce	Reduce	7.50	7.00	-5.4%
Telenor	TEL NO	NOK	182.15	Hold	Hold	170.00	150.00	-6.7%
Telia Company	TELIA SS	SEK	38.53	Hold	Hold	37.60	42.00	-2.4%
Vodafone	VOD LN	EUR	2.26	Hold	Hold	2.30	2.30	2.0%
Telefonica Deutschland	O2D GR	EUR	3.99	Hold	Hold	4.10	4.10	2.7%

Source: HSBC estimates. Price as of 26 January 2018

Macro conditions

Our evaluation framework does not take a view as to whether it is better that an operator have more or less exposure to developed or emerging markets. That said, given exposure to emerging markets could equally be a benefit (most obviously if global macro conditions improve) or a liability (if more volatile conditions re-emerge), and given that investors will have their own preferences on this matter, we set out the relevant revenue mixes below.

Domestic/non-domestic non-EM/EM 2017e revenue contribution



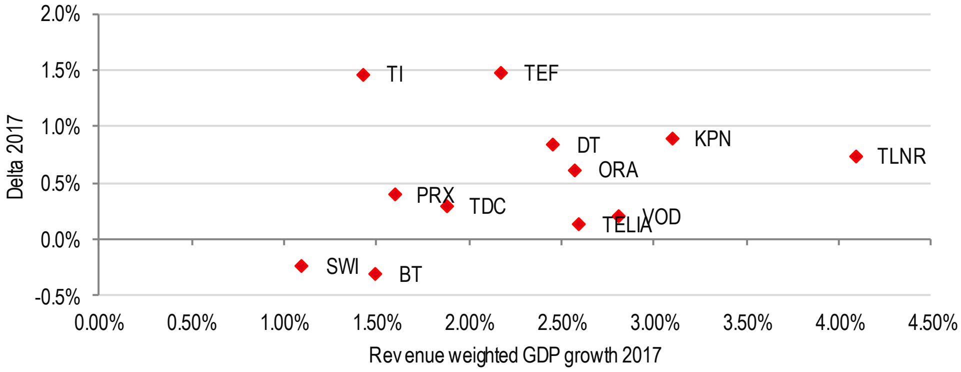
Source: HSBC estimates

The most prominent features here will not come as a great surprise. Telenor and Telefonica have the heaviest exposure to emerging markets, being considerably ahead of a second tranche of such players like Vodafone and TI. An alternative and perhaps useful way of thinking about this data is to consider which operators have the smallest exposure to their domestic market: not far behind Telenor and Telefonica in this regard is DT, thanks in part to its extensive European footprint but also to the rapid growth seen at T-Mobile US. By contrast, Proximus, Swisscom, BT, KPN and TDC are predominantly domestic operators – with Orange not far behind, despite having a presence in numerous emerging markets.

GDP growth rate exposure

GDP growth is an important driver for telecoms revenues, with the prevailing level of economic activity especially pertinent when thinking about demand from business customers. We therefore review not only the pace of economic growth seen in 2017 but also the extent to which

Revenue weighted GDP growth 2017e (x-axis) vs delta 2017e (y-axis)



Source: HSBC estimates

it is projected to change in the 12 months that follow. Note that the figures are revenue weighted, and so it is perhaps not surprising that Telenor (which has the highest emerging market focus) should enjoy the fastest rate of GDP growth. However, we would also highlight the improvement that is anticipated in the GDP growth exposure of Telefonica and TI.

Domestic fixed-line markets

The contest for lines

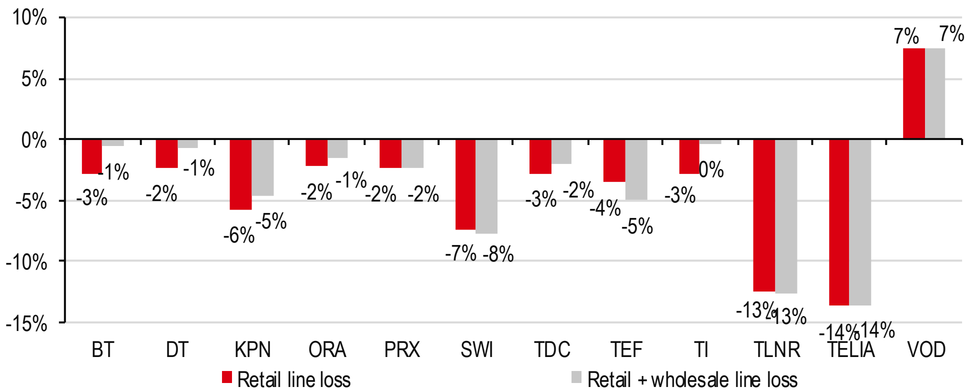
At the core of our positive thesis on the European telecoms sector has been the view that the transition to fibre-based broadband is inherently positive for revenues. This is in large part a function of the higher bills associated with upgraded platforms that are able to support more sophisticated services. However, it is also about defending market share. Operators with upgraded platforms ought to be better able to defend their customer bases from the competitive and substitutional threats from cable and mobile respectively.

We also think that the number of retail lines lost should decelerate as a result of the challenges facing the resellers escalating. When broadband was dominated by ADSL technology, resellers enjoyed a substantial arbitrage, renting copper lines at cost-orientated prices and then substantially undercutting the incumbent's retail prices. Today that process is more difficult (at least in most markets with rational regulation), as wholesale access prices are higher with the shift to fibre, with the result that the percentage size of the arbitrage is much diminished, lessening the discount that resellers can offer prospective customers.

As a result, line loss has slowed markedly, with an operator like BT now able to deliver approximately stable retail plus wholesale lines, and only a relatively modest decline of 3% in retail lines. DT represents a similar story, -0.7% and -2.4% respectively. Orange again is comparable – which we regard as a highly creditable result, given that its network upgrade is dependent on FTTP, which is much slower to deploy nationally. Nevertheless, it has restrained line loss to levels similar to those seen at DT.

In Spain, Telefonica led with a series of heavily discounted convergent offers to defend its market share, but the response from Vodafone and Orange in purchasing ONO and Jazztel respectively has resulted in a competitive environment where all three players working on sunk costs and competition has been fierce. Swisscom has experienced significant fixed-to-mobile substitution resulting in an acceleration of line losses.

Retail line loss and Retail + Wholesale line loss (LTM)



Source: HSBC estimates

For KPN, line losses are evidence of pressure on its business segment and of Vodafone-Ziggo launching a convergent product. Demand for fixed-line telephony in Norway and Sweden continues to fall very rapidly, potentially because the transition to fibre broadband (FTTP) provides customers with an option to switch off their fixed-line connections; Telenor and Telia both continue to experience heavy y-o-y line losses.

In Italy, after years of heavy line losses largely due to fixed-to-mobile substitution, TI is finally demonstrating some effectiveness in reducing the rate of line loss. This is thanks to a stronger commercial push for broadband coupled with the structural absence of a cable network alternative (while it is still too early for the parallel FTTP deployment from Open Fiber to have had an impact in terms of line losses for TI).

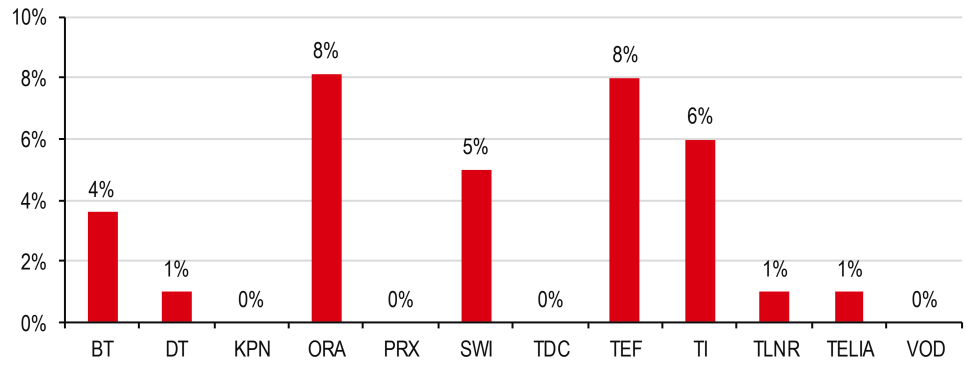
Competitor build

Infrastructure-based competition will obviously intensify in those places where the incumbent competes with operators that are extending their own network footprint. Regulation has been an important component of this story: in certain countries, wholesale fibre products have not been mandated everywhere, which has compelled rivals to build their own infrastructure if they wish to compete. Hence the large increase in rival coverage in France and Spain, impacting Orange and Telefonica respectively.

Additional competitor coverage is also a negative for TI and BT, although this build has been prompted by rather different factors. In Italy, it has been a result of the government tasking ENEL (ENEL IM, EUR5.18, Buy, Target Price EUR5.80) with launching an extensive fibre build (Open Fiber). This remains a prominent long-term risk for TI, and while sceptics will argue it is very early days, the project has been making observable progress.

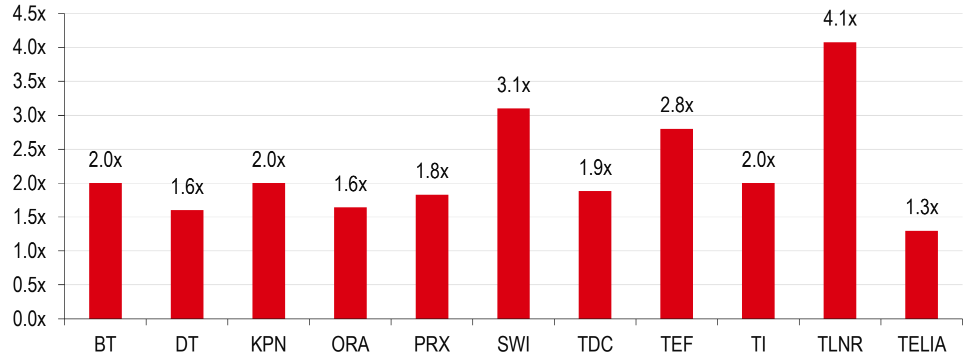
Turning to the UK, Liberty Global's plans to extend coverage comes on the back of Ofcom's willingness, since 2009, to reward infrastructure investment with pricing flexibility. However, short-sighted (in our view) proposals to cut wholesale fibre prices could now undermine the economics of this competing build. Others have also announced fibre plans, but note that such projects are comparatively modest (e.g., CityFibre, with Vodafone as an anchor tenant, is targeting 1m premises – though it could then go further if the initial build is successful).

Competitor's target fibre build per annum as a % of total lines



Source: HSBC estimates, company data

Copper ULL to wholesale fibre price multiple (September 2017)



Source: HSBC, National regulatory authorities

Unbundled local loop to wholesale fibre boost

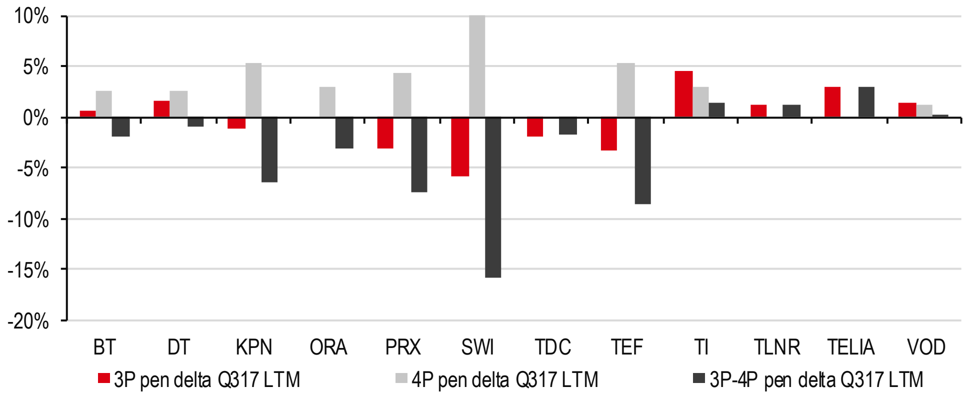
A core feature underpinning the improvement seen in most markets has been the higher cost of wholesale fibre as compared to unbundled copper. This reduces the arbitrage available to resellers, and thereby compels them to focus on an upselling model rather than concentrating on a discount-driven market share land grab model that erodes industry revenues and undermines its ability to support network upgrade investment.

The extent to which wholesale fibre pricing exceeds that of unbundled copper is therefore a useful metric to consider, with the typical range lying between 1.5x and 2.0x. We would repeat our concern that DT's wholesale prices are on the low side, and the same might be said for Orange. All things being equal, an incumbent should benefit from higher prices, but excessively high wholesale tariffs can have a similar effect to wholesale products being altogether absent – i.e., persuading competitors to build their own networks. An incumbent that loses a customer to a competitor wholesaling the line is better off than one losing a customer to a competitor with a completely independent network (because in this scenario it loses even the wholesale fee).

Triple- and quad-play

The practice of bundling telecoms services in triple- and quad-play packages has become extremely widespread. As discussed in our thematic report, *FT5G: What the telecoms sector needs is a new acronym*, 16 January 2017), bundling fixed-line, payTV and mobile has much to recommend it, in the form of producing stickier customers (thus lower churn) and generating cost synergies for those that have integrated networks. However, from a pure revenue perspective, it is worth distinguishing between its two flavours.

Penetration growth of triple-play and quad-play (LTM, y-o-y)



Source: HSBC estimates

On the whole, triple-play is a revenue-per-line accretive process, as pay TV is in Europe a relatively new product, and so bundling it with telecoms services provides a ready means of upselling customers to higher bills (for an enhanced offering). Quad-play, on the other hand, is more problematic, because the fourth service added to the bundle (i.e., mobile) is already very mature. Operators transitioning customers from triple- to quad-play therefore face the prospect of having to win customers from rivals, who will obviously resist. If those rivals lack an adequate quad-play proposition of their own (perhaps due to an inferior fixed-line infrastructure or content proposition), they will need to respond with price discounts.

This is why we would expect the transition to triple-play to generally be bill-inflationary, but see that to quad-play as potentially being price disruptive. As a consequence, **investors may prefer markets where growth in triple-play penetration (bill-inflationary) exceeds that in quad-play penetration (bill-deflationary).** This issue has been particularly prominent in Spain, where Telefonica has enthusiastically pursued quad-play bundling, but where bills have tumbled. We also see quad-play as behind many of the long-term issues that have played out in France this decade.

Other companies to watch carefully on this topic include KPN and Proximus. KPN has pushed bundling to defend market share and we believe that its network upgrade investments have put it in a strong position from a standpoint of service quality. For the time being, the merged Vodafone-UPC operations are struggling, while T-Mobile and Tele2 have felt compelled to attempt a merger.

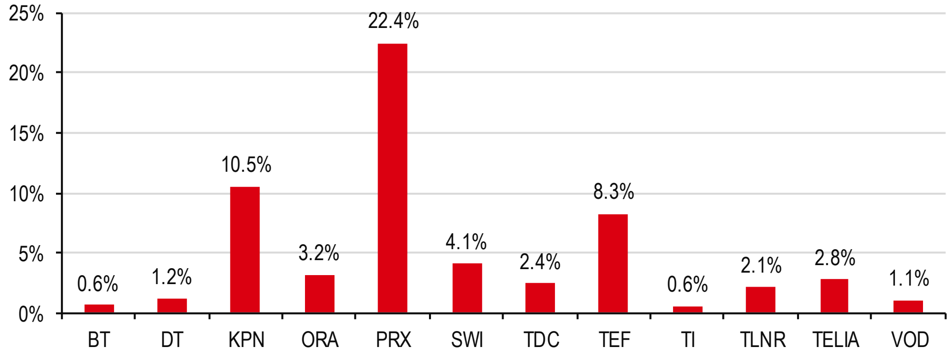
In Switzerland, Swisscom is successfully migrating customers to 4P limiting ARPU dilution. The smaller mobile operator SALT currently has no fixed-line proposition and offers its mobile services at heavily discounted prices, but it has so far proven to be a weak competitor for Swisscom due to prolonged network under-investment. Conversely, Sunrise offers a viable, but still quality oriented, alternative to Swisscom's 4P offer, and therefore its 4P offer has not destabilised the market. With respect to DT, we have previously flagged our concern that its quad-play tariffs are more aggressive than is necessary, especially in the context of the company's domestic network superiority. On the contrary, the speed of bundling so far remains relatively modest in Germany.

Competitive structure

Operators facing 'teenage' competitors are most susceptible to an aggressive pricing environment

Operators facing 'teenage' competitors (rivals with market share in the mid teens) are most susceptible to an aggressive pricing environment. Competitors that are smaller than this will tend to struggle to make an impact, lacking scale, and it will not generally be worth the incumbent cutting tariffs in order to counter such a relatively small threat. Competitors that are larger than this have to bear in mind their own need to generate an adequate return, and cutting prices for their entire base in pursuit of the relatively smaller gains in market share that are now available to them may not look so appealing. Competitors with market share in the mid teens, however, are big enough to matter but small enough to want to capture significant additional market share. Hence, for each domestic market, we measure how close the nearest competitor comes to 15% market share. **Dutch and Belgian markets look attractive on the basis of their lack of teenagers**.

Delta of Q3 2017 market share of closest fixed-line 'teenager' to 15%



Source: HSBC estimates

Domestic mobile markets

Revenue conditions stable

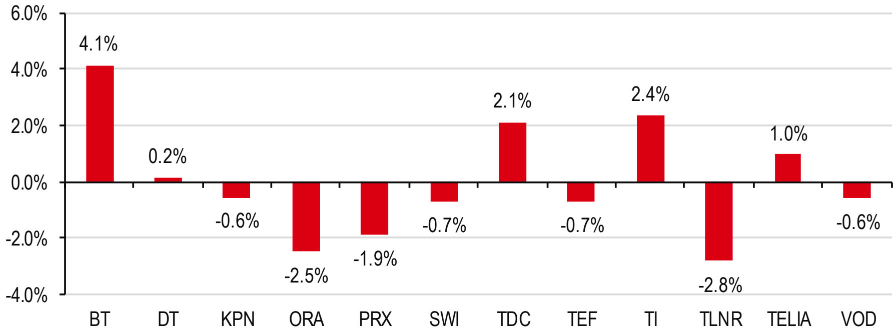
Mobile markets are healthier…

While European mobile markets are hardly displaying rapid growth, they are nonetheless in much improved condition by comparison with their state earlier in the decade. Clearly, the healthy demand seen for data capacity has been vital, although we would also add that **the degree of consolidation that the sector has been able to achieve has also made a positive contribution** (note that pricing in these markets has continued to decline at an uninterrupted pace, but customers are increasingly purchasing larger packages on improved quality networks).

…but we remain cautious in Norway, Italy and France

The above said, we are cautious on the situation in Norway, where Telenor faces what is in effect a new entrant, ICE, which displaced Tele2 in the 2012 spectrum auction, precipitating the latter's departure from the market. Meanwhile, in Italy, although current conditions are benign, bear in mind that Iliad will shortly enter as the fourth network. Historically, conditions have been extremely difficult in France, although a more rational environment emerged in the course of last year.

Mobile service revenue growth (LTM, y-o-y)

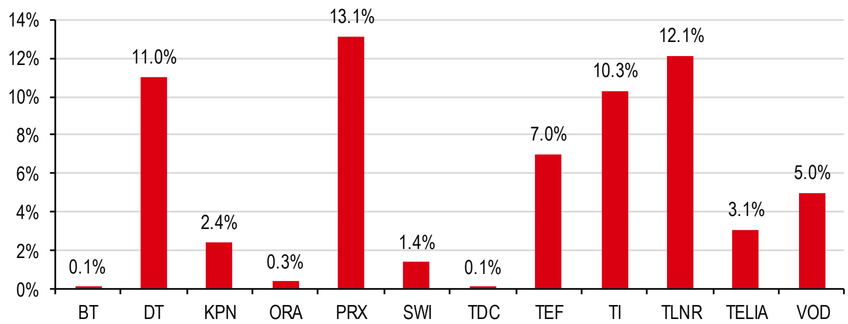


Source: HSBC estimates, company data

Competitive structure

As with the fixed-line segment, we assess mobile markets to identify those operators facing what we term 'teenager' competitors (i.e., with market share in the teens: big enough to make an impact, small enough to prioritise building market share) – the type that is structurally most likely to be disruptive to bills. A low figure on the accompanying chart indicates the presence of a 'teenager' with market share close to 15%; by contrast, a large figure indicates that competitors are considerably bigger (and so 'adult' in status) or smaller (and hence with less capability to disrupt).

Delta of Q3 2017 market share of closest mobile 'teenager' to 15%



Source: HSBC estimates, company data

With the failure of consolidation in the UK, France and Denmark (albeit for varying reasons), each of these markets incorporates at least one teenager. This is also the case in Switzerland and Sweden. Note that mobile operators combining with cable players could become more formidable competitors due to their opportunity to cross-sell. The structure of the Dutch market obviously hinges on the merger proposed between T-Mobile and Tele2.

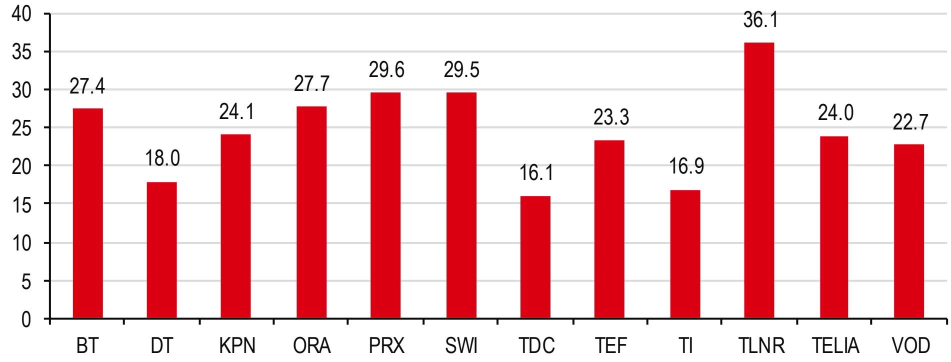
Those countries where consolidation did occur now appear in much better shape

Those countries where consolidation did occur now appear in much better shape, and should be better placed to tackle future network investment requirements. Note that the figures in the chart can be unduly flattering to certain markets, in particular Italy given Iliad's impending entry. Although the Wind/Three merger in effect replaces two teenagers with an 'adult' and an 'infant', the latter will have powerful regulatory backing (e.g., a highly attractive roaming agreement) that will likely enable it to punch well above its weight.

Pricing conditions

Mobile pricing is under continuous pressure, but it is still worth monitoring which countries have higher bills as potentially being at greater risk of disruption. We adjust our figures for PPP, as otherwise countries like Switzerland would look perennially expensive. However, even having performed this normalisation, the Norwegian market still looks potentially vulnerable.

Mobile ARPU 2016 (PPP-adjusted, USD)



Source: HSBC calculations, company data

Non-domestic market exposure

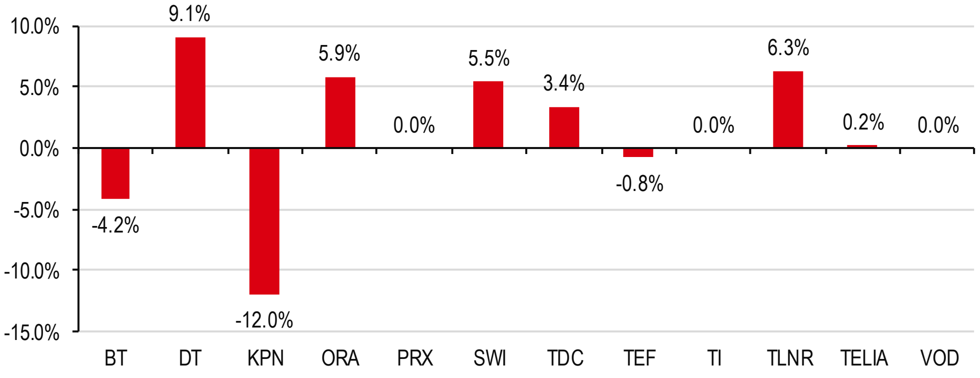
Those with exposure in Europe to integrated operations (Orange and DT) should be better placed in the long run to cope with the convergence phenomenon and the transition to 5G

Non-emerging markets

Although the incumbents' international portfolios have become more concentrated over recent years, with companies like KPN choosing to focus domestically, many of its peers retain a diverse international portfolio. We think that those with exposure in Europe to integrated operations (such as Orange and, to an increasing degree, DT) should be better placed in the long run to cope with the convergence phenomenon and the transition to 5G.

Given Europe's track record of regulation that is unsupportive of investment, it is perhaps not surprising that the stand-out non-domestic developed market lies outside of Europe altogether, i.e., the US. Here DT's T-Mobile US unit continues to grow at an impressive rate.

Non-domestic, non-EM 2017e revenue growth (y-o-y)



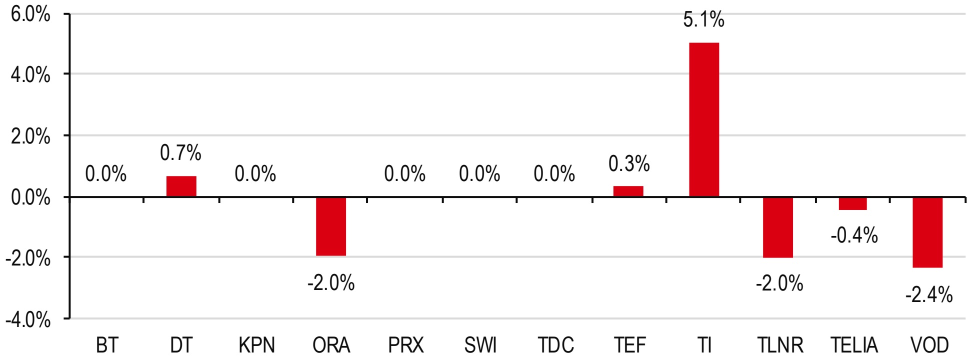
Source: HSBC estimates

Emerging markets

Historically, emerging markets have contributed a vital element of growth to European operators. They have also been volatile though, with Vodafone's difficulties in India as a result of Jio's entry there providing a recent example of how a market that was formerly a consistent contributor to growth can swiftly and sharply reverse.

We are anticipating better growth from Brazil helping TI, while Telefonica's LatAm-heavy emerging market activities should also generate some growth. Elsewhere, Telenor has in the past reported robust emerging market revenue growth but is presently seeing more subdued growth rates in the face of heightened competition. Telia is in the process of selling its non-Baltic/Nordic assets, reverting to a pure European operator.

Emerging market 2017e revenue growth (y-o-y)

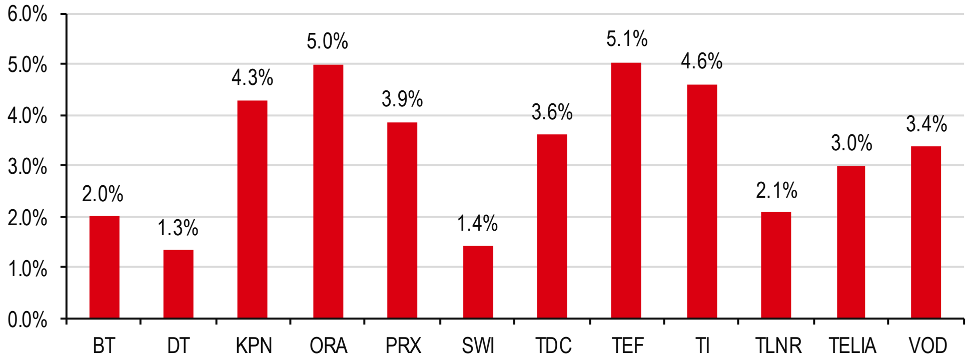


Source: HSBC estimates

Cost cutting programmes

Even though conditions have somewhat improved over the past few years (thanks to factors like better fixed-line regulation and partial consolidation), achieving top-line growth remains difficult – to say the least. Therefore cost control remains a crucial component of operators' plans, although the extent of the efficiency gains aimed at does vary materially. The accompanying chart shows targeted annual gross cost savings as a proportion of EBITDA.

Annualized gross cost savings targeted as a percentage of EBITDA



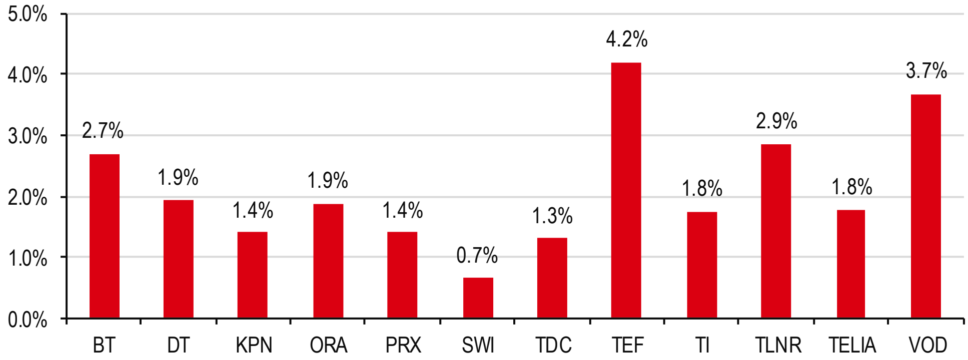
Source: HSBC estimates

TI has ambitious cost control targets, in the face of increasing competition in its domestic market. However, we remain dubious that this will be sufficient to compensate for the impact of Open Fiber's competing fibre platform plus Iliad's entry as a mobile competitor. Well-established cost cutting programmes are in place at incumbents like Orange and KPN. Much of Telenor's strong recent performance has been driven by its new-found focus on cost control.

Operators that we expect will be facing faster cost inflation include BT, Telefonica and Telenor

We also monitor inflation trends that might escalate costs and thus impede efforts to improve efficiency. Operators that we expect will be facing faster cost inflation include BT (sterling weakness), Telefonica and Telenor (emerging market exposure).

Revenue weighted inflation changes (2017e vs 2016a)

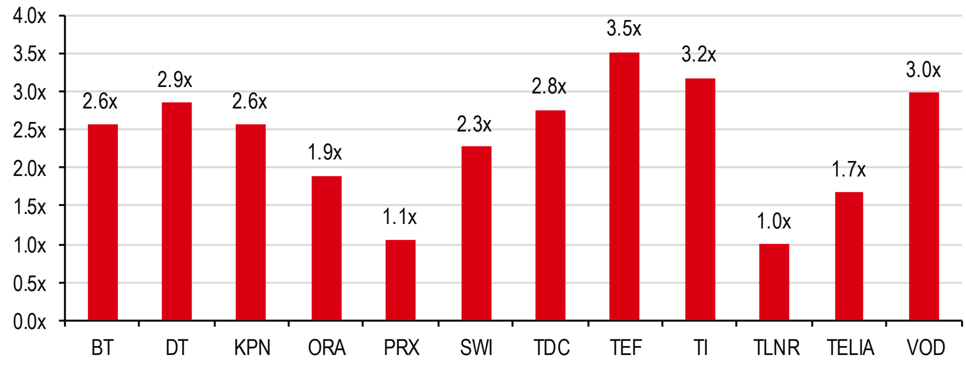


Source: HSBC estimates

Balance sheet and dividend coverage

Balance sheet strength remains a highly desirable feature of telecoms operators as investments – although admittedly players with weaker finances can represent attractive opportunities if sentiment improves and gearing leverages the resulting upside.

Net debt/EBITDA (2017e)

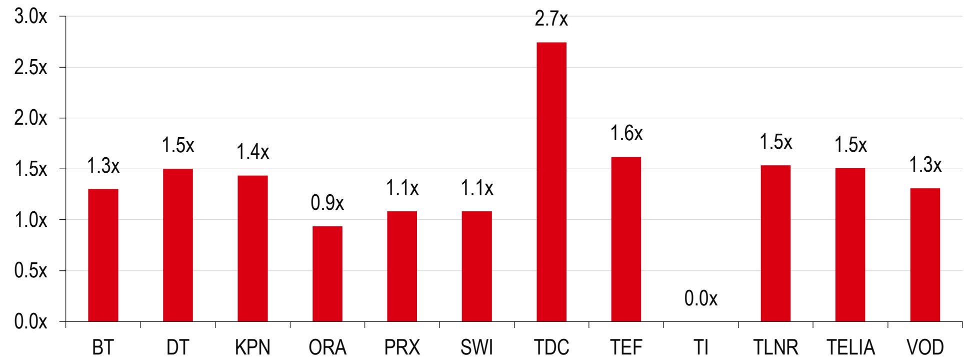


Source: HSBC estimates. Note: estimates for BT and Vodafone correspond to FY18e, Net debt definition includes contingent liabilities like spectrum, hybrid bonds, pension deficit etc

Despite the low rates environment, the more highly leveraged names have found conditions challenging in the past couple of years. Investors remain concerned about the levels of gearing seen at both TI and Telefonica. The Spanish incumbent has attempted to address this through making non-core asset disposals (although some, like the sale of O2 UK, have been frustrated). It should be noted that DT is not all that far behind taking the pension deficit fully into account, but the management is guiding to steady 10% CAGR FCF growth that should support this.

Dividend cover is another important measure of resilience. Coverage has been improving at Vodafone, now that the exceptional capex associated with Project Spring is passed. Most of the incumbents have a reasonable degree of headroom, although this has not prevented questions arising about their ability to fund dividends should additional pressures develop (for example, at BT, if there were to be additional calls on cash flows from an accelerated FTTP build and/or the pension). It is a welcome sign of confidence that an operator like Orange has recently been able to raise its floor guidance, despite the company's extensive FTTP investment.

Dividend cover (2017e)

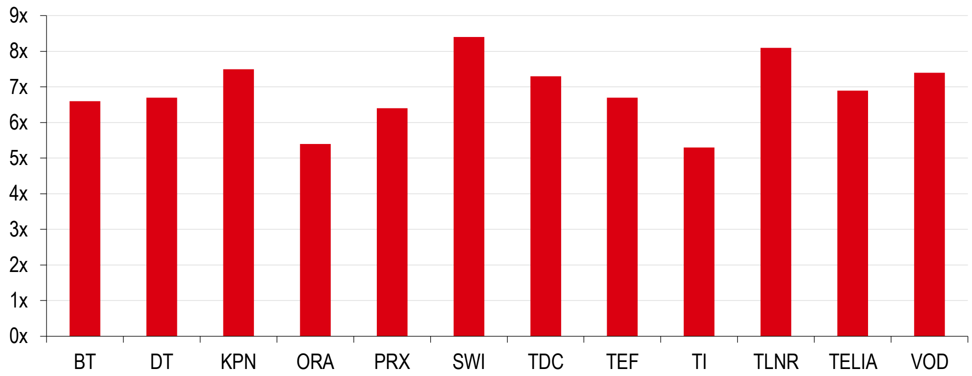


Source: HSBC estimates. Note: estimates for BT and Vodafone correspond to FY18e

Valuation

The telecoms sector's benchmark valuation measure continues (at least for the present) to be EV/EBITDA – although incoming accounting changes may lead to more emphasis being placed on FCF measures going forwards. While the deficiencies of EV/EBITDA are plain enough (it is, after all, essentially a measure of profits before costs, given the fact that it excludes capex), its ready comparability does make it extremely useful. We would highlight that Orange looks cheap on this measure – as admittedly does TI. Given its excellent strategic positioning, we would highlight that DT is hardly expensive.

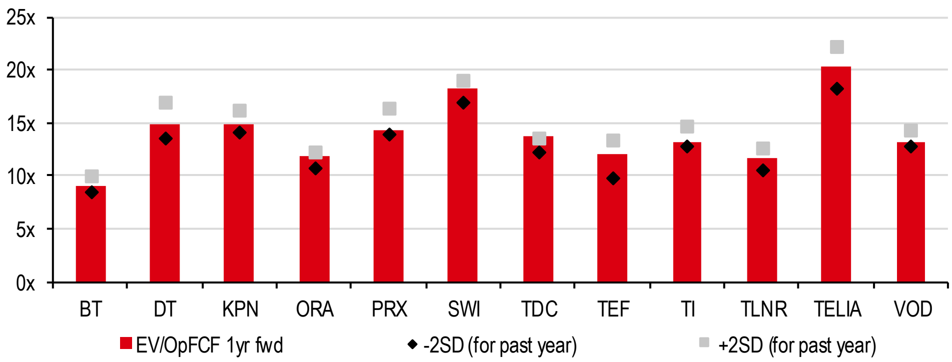
EV/EBITDA (2017e)



Source: HSBC calculations. Note: estimates for BT and Vodafone correspond to FY18e

EV/OpFCF provides a natural complement to EV/EBITDA, since it takes account of capex, although it can also be more volatile as a consequence. Note that both these sets of figures (i.e., EV/EBITDA and EV/OpFCF) tend to make KPN appear more expensive than is really the case: after the disposal of E-Plus, the company reached an agreement with the tax authorities and currently pays virtually no cash tax. As a consequence, KPN achieves a higher cash conversion ratio of EBITDA and operating FCF compared to the rest of the sector. Swisscom has also traditionally looked expensive on these measures due in part to its relatively low tax rate.

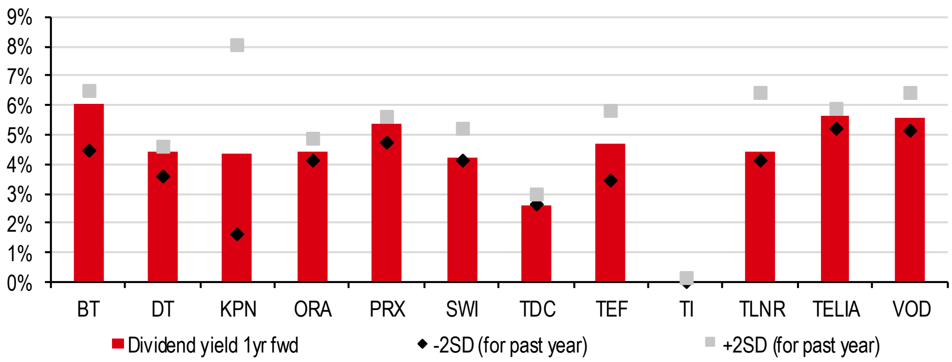
EV/OpFCF (2017e)



Source: HSBC calculations, Thomson Reuters Datastream. Note: estimates for BT and Vodafone correspond to FY18e

Turning finally to dividend yields, we would acknowledge these are arguably not a true valuation measure, but in view of the significance of dividends in driving the telecoms sector's total returns, we think this metric remains highly relevant. Again, there is considerable volatility, with certain companies cutting dividends altogether as a consequence of balance sheet strains (e.g., TI). Vodafone's dividend yield looks attractive, especially now that Project Spring coverage-related issues are behind it.

Dividend yield (2017e)



Source: HSBC calculations, Thomson Reuters Datastream. Note: estimates for BT and Vodafone correspond to FY17e. For TI the ordinary shares currently receive no dividend, while the savers shares receive the minimum level according to the company's bylaws.

Comparing the operators, we would note that Orange continues to look appealing, especially in terms of EV/EBITDA and now that it has issued robust dividend guidance. Meanwhile, we would highlight that DT is strongly positioned strategically but investors need not pay a substantial premium for this.

Looking instead at the operators against their own history (i.e., as compared to the previous year's valuation ranges, identified by the black diamonds and grey squares on the accompanying charts), we would highlight that BT is looking relatively inexpensive – albeit the UK incumbent plainly faces its fair share of challenges at present. Telefonica is also relatively inexpensive, though not to quite the same degree.

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Company profiles

Stephen Howard*
Analyst
HSBC Bank plc
stephen.howard@hsbcib.com
+44 20 7991 6820

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Q3 FY18: 2 February

BT Group (BT/A LN, 263p, Buy, TP 360p)

Investment Thesis

BT faces a catalyst-rich first half of calendar 2018. On balance we believe the net result will be positive for the shares. However the short-term path ahead may not be entirely smooth.

In order of significance to our investment case, we highlight a series of network-related decisions which will be taken – both by regulator Ofcom, and by BT itself – which will dictate the outlook for the company's returns into the medium term. The regulator will issue its final position on the 'Wholesale Local Access' Review (expected mid-February), the purpose of which is to set the regulatory environment for the wholesale pricing of copper and fibre for the next three years. The initial conclusions were unhelpful, first reversing the trajectory of copper (unbundled local loop) pricing (from stable to deflationary in real terms, in contravention of EU guidelines), and second implementing a cost-orientated pricing regime on the entry-level fibre to the cabinet product; the centre-point of Ofcom's guidance suggested a cumulative three-year price decline of 40.6%. Both these decisions undermine the investment rationale in our view and will have been facing substantial push-back from those investing in UK telecoms infrastructure (not just BT) in the past six months. The opportunity is therefore for a modestly more positive outcome than Ofcom's central case (presently incorporated into our BT forecasts).

Openreach – BT's now legally separate network division – is currently running its own consultation process, investigating demand for yet faster broadband speeds in the form of fibre-to-the-home/premise (FTTH/P). Openreach, and by extension BT, is seeking a satisfactory economic equation to allow acceptable returns on what would be a colossal private investment. The next document will discuss pricing of a potential product, and the associated conditions that would allow for greater confidence in future network cost-savings (so-called 'cutover'). There is clearly a political as well as regulatory calculation to be borne in mind when calibrating expectations.

The company's pension is currently subject to a triennial review, the result of which will be a repayment plan designed to close the deficit (expected to be c.GBP10bn). With negative real discount rates, the risk of over-committing to the pension is substantial, and so must be managed with delicate discussions with the pension Trustees. BT's CFO has discussed several levers that might moderate the deficit, including changes to actuarial assumptions, business diversification (vs. the previous assessment) and the injection of supporting assets into the scheme. We model a GBP2bn one-time cash injection, alongside GBP800m of subsequent annual payments. Despite the High Court's refusal to allow a part of the scheme to shift from RPI to CPI, we still believe a modestly positive outcome here is possible. The outcome of pension discussions and BT's fibre plans will influence future dividend options; we currently forecast 2% DPS growth; dividend yield is 6.1% (FY18e).

Beyond these two pots are a series of smaller catalysts. We think the risk around the Premier League rights auction is almost certainly over-stated. We forecast 25% inflation but note that spending this sum may deliver substantially more games as the Premier League tweaks the auction structure. While deep-pocketed new entrants are mooted, the same was true of previous auctions, and we think the price tag will be too steep. We look forward to more detail on the forthcoming integration of Consumer and EE, which we expect will lead to the opportunity for further cost synergies to be extracted. It is also integral in realising additional revenue opportunities, through the creation of a more integrated/converged portfolio. In Global Services, we expect to see small disposals over time, which while putting pressure on the Group's top line, are unlikely to impact EBITDA.

The share has a FY19e PE ratio of 9.4x, trades on a post-pension FCF yield of 6.2%, and a dividend yield of 6.0%. Despite longer-term uncertainties, we think the share undervalued.

HSBC

Valuation

We make no changes to our estimates. We derive our unchanged 360p TP using a FCFF-based DCF (details on the assumptions and risks can be read in the *Valuation and risks section*), which implies 36.9% upside and we rate the stock Buy.

FCFF based DCF valuation

in GBPm, unless specified		2018	2019	2020	2021	2022	2023	2024	2025
EBITDA (post-exceptionals)		6,870	7,357	7,488	7,596	7,769	7,950	8,147	8,325
Cash capex		-3,411	-3,850	-3,399	-3,468	-3,475	-3,498	-3,536	-3,574
Net cash interest		-549	-529	-529	-488	-444	-441	-437	-433
Cash tax paid		-635	-661	-1,003	-587	-622	-652	-684	-712
Working capital change		-270	-50	-50	-50	-50	-50	-50	-50
Equity FCF		**2,004**	**2,267**	**2,507**	**3,002**	**3,178**	**3,309**	**3,440**	**3,556**
Add back: Net interest cost		549	529	529	488	444	441	437	433
Deduct: tax shield on net interest		-93	-90	-90	-83	-75	-75	-74	-74
FCFF		**2,460**	**2,706**	**2,946**	**3,407**	**3,547**	**3,674**	**3,803**	**3,916**
TV									63,291
PV explicit cash flows		2,460	2,511	2,536	2,721	2,628	2,526	2,426	2,318
PV of terminal cash flow									37,462
PV of total explicit CF	17,666	32%							
PV of TV	37,462	68%							
Total enterprise value	**55,128**								
Net Debt (FY18e)	-11,301								
add back: FY18 interim divi cash pay-out	501								
Contingent liabilities	-7,971								
Total value of equity	**36,357**								
Shares (m)	9,903								
Price per share (GBPp)	**3.60**								

Source: HSBC estimates

Relative Valuation

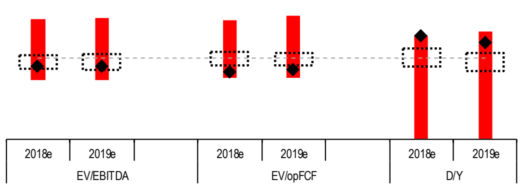
- After an year of de-rating in 2016, the company's multiples stabilised in 2017; but both EV/EBITDA and EV/OpFCF still trade at the low end of historical ranges
- Consensus earnings revisions have been very limited in past six months; the decline in OpFCF forecasts has been slightly greater than EBITDA, as capex expectations increase
- The company is cheap on both EV/EBITDA and EV/OpFCF relative to its peers. Its dividend yield is one of the highest in the sector at 6.2% (FY19e).

BT Group – Valuation benchmark chart

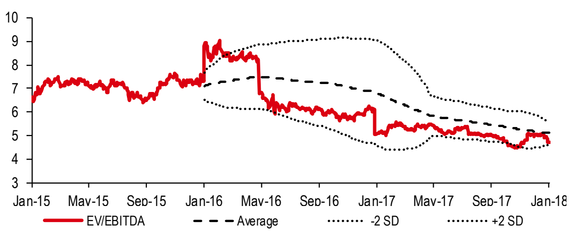
Recent performance

	1W	1M	3M	6M	12M
Price return	-0.4%	-4.1%	-0.8%	-15.4%	-13.0%
Total return	-0.5%	-2.3%	1.0%	-10.8%	-8.3%
Total return vs SXKP	-1.6%	-2.0%	0.4%	-7.5%	-11.4%
Total return vs MSCI Europe Telecom	-2.0%	-3.3%	0.4%	-8.2%	-14.5%
Total return vs FTSE 100	0.4%	-3.4%	-2.0%	-15.5%	-19.6%

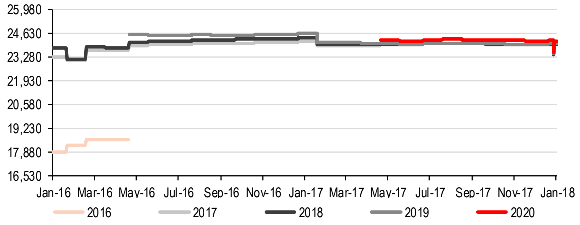
Relative valuation



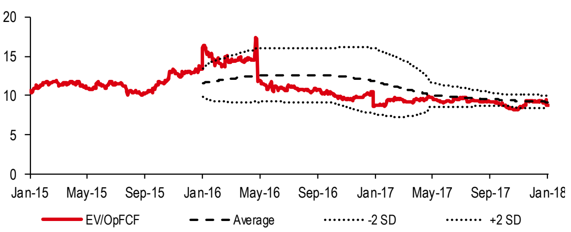
1yr fwd EV/EVITDA



Sales estimates revision

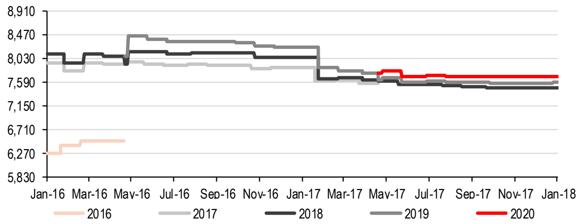


1yr fwd EV/OpFCF

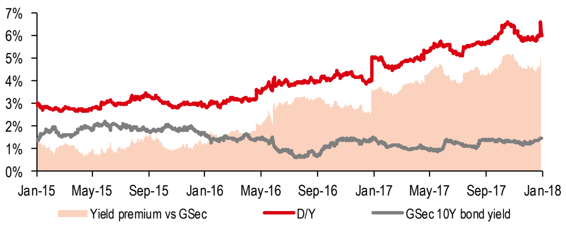


Capped at +/-50x levels

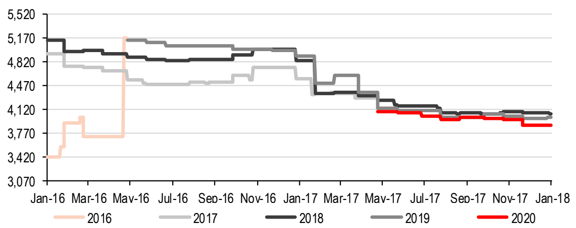
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: BT Group Plc

Buy

Financial statements

Year to	03/2017a	03/2018e	03/2019e	03/2020e
Profit & loss summary (GBPm)				
Revenue	24,082	23,876	23,849	23,947
EBITDA	6,739	6,870	7,357	7,488
Depreciation & amortisation	-3,572	-3,635	-3,578	-3,541
Operating profit/EBIT	3,167	3,235	3,779	3,946
Net interest	-804	-769	-739	-730
PBT	2,354	2,465	3,040	3,216
HSBC PBT	3,532	3,310	3,400	3,468
Taxation	-446	-545	-608	-643
Net profit	1,908	1,921	2,432	2,573
HSBC net profit	2,869	2,642	2,720	2,774
Cash flow summary (GBPm)				
Cash flow from operations	5,554	3,495	5,419	5,208
Capex	-3,145	-3,311	-3,350	-3,399
Cash flow from investment	-1,667	-5,133	-3,850	-3,399
Dividends	-1,435	-1,539	-1,566	-1,597
Change in net debt	-913	2,369	-3	-212
FCF equity	2,232	1,974	2,610	2,666
Balance sheet summary (GBPm)				
Intangible fixed assets	15,029	14,799	15,299	15,299
Tangible fixed assets	16,498	16,327	15,940	15,797
Current assets	6,875	5,424	5,477	4,639
Cash & others	2,476	818	821	-67
Total assets	42,372	40,989	41,155	40,175
Operating liabilities	8,293	8,782	8,902	8,715
Gross debt	12,713	13,299	13,299	12,199
Net debt	8,932	11,301	11,298	11,086
Shareholders' funds	8,325	7,764	8,669	9,776
Invested capital	27,633	26,950	26,993	27,087

Ratio, growth and per share analysis

Year to	03/2017a	03/2018e	03/2019e	03/2020e
Y-o-y % change				
Revenue	26.47	-0.86	-0.11	0.41
EBITDA	5.88	1.94	7.09	1.78
Operating profit	-15.21	2.14	16.82	4.44
PBT	-22.28	4.73	23.29	5.81
HSBC EPS	-13.18	-7.59	2.97	1.99
Ratios (%)				
Revenue/IC (x)	0.9	0.9	0.9	0.9
ROIC	9.1	9.6	11.3	11.8
ROE	30.7	32.8	33.1	30.1
ROA	5.6	5.7	7.0	7.4
EBITDA margin	28.0	28.8	30.8	31.3
Operating profit margin	13.2	13.5	15.8	16.5
EBITDA/net interest (x)	8.4	8.9	10.0	10.3
Net debt/equity	107.2	145.4	130.2	113.3
Net debt/EBITDA (x)	1.3	1.6	1.5	1.5
CF from operations/net debt	62.2	30.9	48.0	47.0
Per share data (GBPp)				
EPS Rep (diluted)	19.20	19.39	24.56	25.98
HSBC EPS (diluted)	28.87	26.68	27.47	28.01
DPS	15.40	15.71	16.02	16.34
Book value	83.77	78.40	87.55	98.72

Key forecast drivers

Year to	03/2017a	03/2018e	03/2019e	03/2020e
BT Adjusted revenues	24,082	23,876	23,849	23,947
BT Adjusted EBITDA	7,645	7,495	7,507	7,538
BT Adjusted PBT	3,532	3,310	3,400	3,468
BT Adjusted EPS (GBp)	29	27	27	28
BT Normalised FCF	2,782	2,735	2,917	2,557

Valuation data

Year to	03/2017a	03/2018e	03/2019e	03/2020e
EV/sales	1.8	1.9	1.9	1.9
EV/EBITDA	6.4	6.6	6.2	6.0
EV/IC	1.6	1.7	1.7	1.7
PE*	9.1	9.9	9.6	9.4
PB	3.1	3.4	3.0	2.7
FCF yield (%)	6.6	5.8	7.7	7.8
Dividend yield (%)	5.9	6.0	6.1	6.2

* Based on HSBC EPS (diluted)

Issuer information

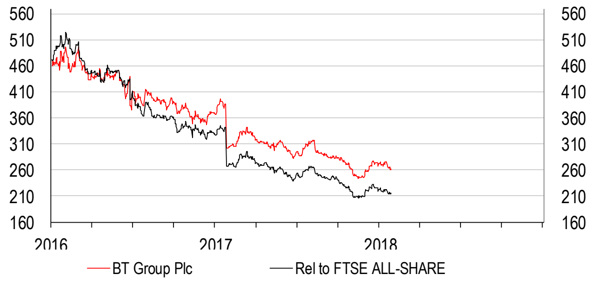
Share price (GBPp)	263	Free float	85%
Target price (GBPp)	360	Sector	Diversified Telecoms
Reuters (Equity)	BT.L	Country	United Kingdom
Bloomberg (Equity)	BT/A LN	Analyst	Stephen Howard
Market cap (USDm)	36,996	Contact	44 20 7991 6820

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.009	No. of board members	12
Energy Intensity (kWh/USD)	0.084	Average board experience (years)	4.5
CO2 reduction policy	Yes	Female board members (%)	25
Social Indicators		Board members Independence (%)	67
Employee costs as % of sales	21.5		
Employee turnover (%)	n/a		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Stephen Howard*
Analyst
HSBC Bank plc
stephen.howard@hsbcib.com
+44 20 7991 6820

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Q4 results: 22 February

Deutsche Telekom (DTE GR, EUR14.57, Buy, TP EUR18.50)

Investment Thesis

52% of DT's value stems from its German assets, and arguably sentiment towards the stock is weighted even more heavily than this. We continue to have a positive outlook on both the mobile and fixed-line markets in Germany, and think Deutsche Telekom is proving adept at managing its domestic portfolio of assets. Two deals announced late in 2017 mean the business will, pending regulatory approval, soon be able to operate as a converged player in all of its European markets, removing Austria and the Netherlands from their earlier status as outliers. Finally the 65.5% stake in T-Mobile US continues to grow in value as the business continues to strongly outperform peers.

Consolidation in the German mobile market took place in 2014, taking the market to three network operators. We think this is the ideal market structure to maximise returns on investment (for all interested parties) and we expect above-average market growth as a consequence. The segmentation of the market between premium and value brands looks to be stable despite some concerns this time last year. Some of the competition seen in the indirect channels appears to be moderating, and competitive levels in the Enterprise market also appear to have fallen. Convergent tariffs are present, but far from dominant, given a comparatively low price discount available. There is risk here, following the consolidation of Drillisch and United Internet, which will offer converged tariffs at some point in the first half of 2018. Yet at this point, while we expect these tariffs to be competitive, we do not believe they will trigger a price war from well-invested peers.

In German fixed line, we think the BNetzA's approach to regulating the sector over the last few years has been sensible, in particular the pricing arrangements surrounding the wholesale fibre market ('Kontingentmodell'). We are very supportive of Deutsche Telekom's approach to building fibre; its FTTC plans will deliver 100Mbps to 80% of German households by the end of 2018 and illustrate a sensible trade-off between rapidity of deployment and breadth of coverage. The challenge for 2018 is to convince the market (and the government) that plans for beyond 2018 are sufficiently ambitious while at the same time not allowing the domestic capex budget to balloon.

The Capital Markets Day in May 2018 will be the year's key event, providing the next four-year plan. We expect stable capex in Germany to be the key message (at or slightly above EUR4bn per year). This may allow for a greater emphasis to be placed on FTTP as other capex projects roll off, but we expect a targeted approach (eg business parks) rather than a broad-brush commitment.

The stake in T-Mobile US (TMUS US, USD65.28, Buy, Target Price USD70) (37% of DT EV) has grown in value by 69% over the past two years (equivalent to c.EUR3.00 per Deutsche Telekom share). TMUS is taking share in the US (+3.6ppt over two years), and has several options to provide sustained medium-term growth (including a more national presence thanks to 600MHz spectrum, moving in B2B and increasing selling footprints). The appreciation of the US subsidiary implies a European asset de-rating over the same time-frame; we estimate the core European business now trades of 6.2x 2018e EBITDA, 10% discount vs. sector peers.

Valuation

We make no changes to our estimates. We derive our unchanged EUR18.5 target price from a sum-of-parts (details on the assumptions and risks can be read in the *Valuation and risks section*), implying 26.9% upside and we rate the stock Buy.

Sum-of-the-parts valuation (EURm, unless stated)

Country	Valuation Method	DT stake	EV/EBITDA multiple (x) 2017	2018	prop EV	Per share	Implied value % of EV
Germany	**Multiple**	**100%**	**8.0**	**7.8**	**67,804**	**14.72**	**52%**
USA	**HSBC TP USD70**	**65.5%**	**7.9**	**7.3**	**48,227**	**10.47**	**37%**
Greece	Multiple	40%	7.8	7.8	3,539	0.77	3%
Romania	Multiple	100%	5.0	5.0	830	0.18	1%
Hungary	Multiple	59%	8.2	7.8	2,630	0.57	2%
Croatia	Multiple	51%	8.1	7.8	1,606	0.35	1%
Slovakia	Multiple	100%	7.6	7.8	2,460	0.53	2%
Poland	Multiple	100%	5.5	5.0	2,455	0.53	2%
Czech republic	Multiple	100%	5.4	5.0	2,191	0.48	2%
Austria	Multiple	100%	5.1	5.0	1,534	0.33	1%
Others	Multiple	various	0.0	0.0	0	0.00	0%
Europe	**Multiple**		**0.0**	**6.7**	**17,245**	**3.74**	**13%**
T-Systems	Multiple	100%	2.0	2.0	998	0.22	1%
GHS	Multiple	100%	4.8	5.0	-2,500	-0.54	-2%
T-Mobile Netherlands	Multiple	100%	4.7	5.0	2,096	0.45	2%
DFMG (tower business)	Multiple	100%	11.6	11.0	5,328	1.16	4%
Corporate development	Multiple	100%	0.0	8.2	7,424	1.61	6%
Elimination	Multiple		9.0	8.0	-327	-0.07	0%
NPV of restructuring charges	NPV				-7,394	-1.61	-6%
Group total			**7.4**	**7.0**	**131,476**	**28.54**	**100%**
Group net debt (YE2017e) - minorities adjustment					-42,906	-9.31	
Minorities (US, Greece, Hungary, Croatia)						0.00	
Net contingent liabilities/assets					-7,187	-1.56	
Tax asset NPV					4,898	1.06	
Total equity value					**85,100**	**18.50**	
O/S shares					4,607		

Source: HSBC estimates

Relative Valuation

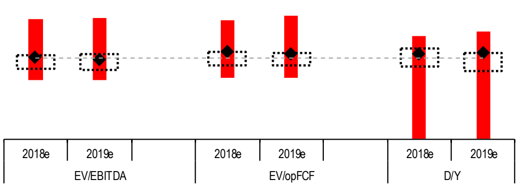
- DT has underperformed in last 6 months compared to the sector (SXKP) and its 1 year forward EV/EBITDA multiple is trading at the low-end of the two-year range. On EV/OpFCF the stock is trading close to its historical average
- Estimate revisions have been slightly negative for EBITDA, primarily driven by USD depreciation
- DT's slight premium versus the sector reflects its strong relative positioning and positive earnings outlook (8% EBITDA, 11% FCFE CAGR 2014-2018).

Deutsche Telekom – Valuation benchmark chart

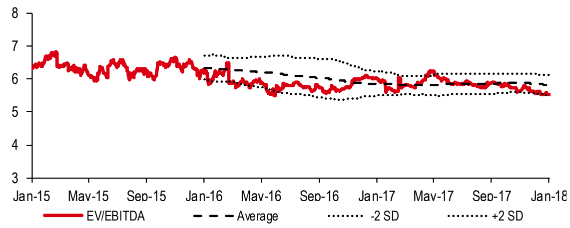
Recent performance

	1W	1M	3M	6M	12M
Price return	1.3%	-2.6%	-5.3%	-6.0%	-10.8%
Total return	1.2%	-2.6%	-5.3%	-6.0%	-7.7%
Total return vs SXKP	0.1%	-2.3%	-6.0%	-2.7%	-10.9%
Total return vs MSCI Europe Telecom	-0.3%	-3.5%	-6.0%	-3.3%	-13.9%
Total return vs DAX 30	1.9%	-4.6%	-6.9%	-14.4%	-20.3%

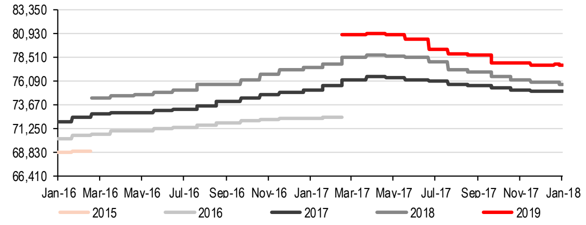
Relative valuation



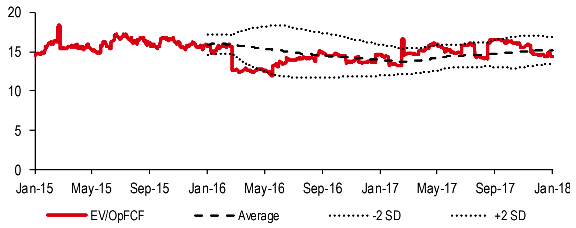
1yr fwd EV/EVITDA



Sales estimates revision

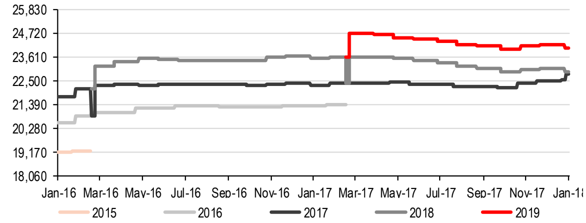


1yr fwd EV/OpFCF

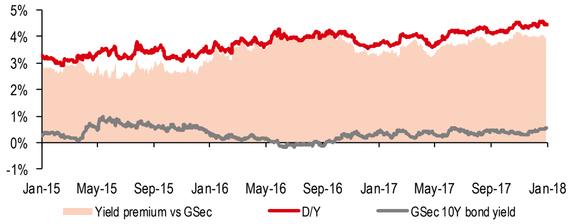


Capped at +/-50x levels

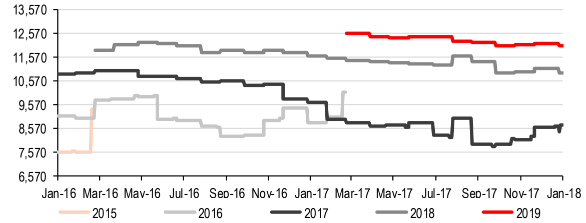
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Deutsche Telekom

Buy

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	73,095	75,469	75,999	77,600
EBITDA	22,544	23,741	22,356	23,644
Depreciation & amortisation	-13,380	-13,581	-12,198	-12,177
Operating profit/EBIT	9,164	10,159	10,159	11,467
Net interest	-2,492	-2,264	-2,438	-2,378
PBT	4,547	5,915	5,840	7,303
HSBC PBT	4,174	6,477	7,731	9,099
Taxation	-1,443	-2,099	-1,108	-1,386
Net profit	2,675	2,631	3,214	4,029
HSBC net profit	2,942	4,063	4,745	5,484
Cash flow summary (EURm)				
Cash flow from operations	15,446	17,062	16,887	17,629
Capex	-13,640	-11,043	-11,810	-12,043
Cash flow from investment	-13,736	-16,146	-11,315	-11,573
Dividends	-1,509	-2,769	-3,097	-3,406
Change in net debt	2,389	2,046	-2,476	-2,650
FCF equity	3,459	7,270	7,101	7,337
Balance sheet summary (EURm)				
Intangible fixed assets	60,599	63,169	61,955	60,788
Tangible fixed assets	46,758	45,860	46,191	46,754
Current assets	26,638	18,469	18,994	19,414
Cash & others	13,460	5,401	5,926	6,346
Total assets	148,485	139,335	138,971	138,778
Operating liabilities	18,704	18,561	18,878	18,804
Gross debt	64,650	58,637	56,686	54,456
Net debt	49,959	52,005	49,529	46,879
Shareholders' funds	29,305	26,600	26,407	26,689
Invested capital	101,831	103,537	102,336	101,805

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	5.6	3.2	0.7	2.1
EBITDA	22.6	5.3	-5.8	5.8
Operating profit	30.4	10.9	0.0	12.9
PBT	-4.8	30.1	-1.3	25.0
HSBC EPS	-18.1	35.8	16.8	15.6
Ratios (%)				
Revenue/IC (x)	0.7	0.7	0.7	0.8
ROIC	11.1	11.8	10.8	11.9
ROE	10.0	14.5	17.9	20.7
ROA	3.6	4.1	4.9	5.7
EBITDA margin	30.8	31.5	29.4	30.5
Operating profit margin	12.5	13.5	13.4	14.8
EBITDA/net interest (x)	9.0	10.5	9.2	9.9
Net debt/equity	128.6	141.8	130.5	117.0
Net debt/EBITDA (x)	2.2	2.2	2.2	2.0
CF from operations/net debt	30.9	32.8	34.1	37.6
Per share data (EUR)				
EPS Rep (diluted)	0.58	0.56	0.68	0.86
HSBC EPS (diluted)	0.64	0.87	1.01	1.17
DPS	0.60	0.66	0.73	0.80
Book value	6.35	5.67	5.63	5.69

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
DT Revenues	73,095	75,469	75,999	77,600
DT EBITDA company def	21,420	22,413	23,556	24,784
restructuring book charges	-2,013	-1,300	-1,200	-1,140
DT Net income adjusted	4,572	5,116	5,717	6,407
DT FCF definition	4,939	5,909	6,329	6,874

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	2.0	2.1	2.1	2.0
EV/EBITDA	6.6	6.7	7.1	6.7
EV/IC	1.5	1.5	1.5	1.5
PE*	22.9	16.8	14.4	12.5
PB	2.3	2.6	2.6	2.6
FCF yield (%)	3.5	6.8	6.5	6.6
Dividend yield (%)	4.1	4.5	5.0	5.5

* Based on HSBC EPS (diluted)

Issuer information

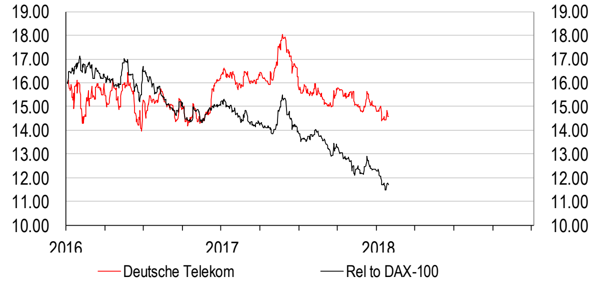
Share price (EUR)	14.57	Free float	67%
Target price (EUR)	18.50	Sector	Diversified Telecoms
Reuters (Equity)	DTEGn.DE	Country	Germany
Bloomberg (Equity)	DTE GR	Analyst	Stephen Howard
Market cap (USDm)	86,287	Contact	44 20 7991 6820

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.04	No. of board members	28
Energy Intensity (kWh/USD)	0.09	Average board experience (years)	7.68
CO2 reduction policy	Yes	Female board members (%)	36%
Social Indicators		Board members Independence (%)	64%
Employee costs as % of sales	22%		
Employee turnover (%)	4.01%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Elisa (ELISA FH, EUR33.05, Reduce, TP EUR29.50, from EUR29.20)

Investment Thesis

Elisa is a well-run and strategically well directed business, but it is expensive in the context of European telecoms peers and suffers from deteriorating earnings visibility. While it generates an outstanding return on invested capital (17.0% in 2016), this is reflected in an EV/IC of 3.7x as well as substantial trading premiums to the sector on more traditional metrics such as EV/EBITDA (+55.5% premium, 2018e) and equity FCF yield (+38.8%). Consequently operational execution must, in our view, continually provide positive surprises. Through 2017, and provisionally looking into 2018, the levels of competitive intensity in Finnish mobile have meant this has been harder to do. Consequently since the Q3 results (18 October 2017), the stock has underperformed the sector (SXKP) by 5.1ppts.

Q4 results: 18 January

Our thesis is that the market underestimates the level of competition in the Finnish mobile market. Telia, the second largest mobile operator, has underperformed the market's rate of growth for at least the last four years and has ambitions to finally catch up. As such it has recently led the market with some comparatively aggressive (though notably time-limited) promotions. Third operator DNA (DNA FH, EUR15.13, not rated) IPOed comparatively recently (30 November 2016), and consequently is under some pressure to maintain the strong performance delivered leading into, and indeed following, that event.

We see this increased competitive intensity in Elisa's churn disclosure. This metric has increased y-o-y for the last six quarters, culminating in a 5ppt q-o-q step-up in Q3 2017 (cf a five-year average q-o-q step-up of 1.5%). Management has made clear that it is not willing to cede any market share, and consequently the company's gross additions have consistently increased though 2017; in short, the cost of competing is rising. Within the mix, we have also highlighted continual pressure on consumer mobile post-paid net additions – a KPI which is not given, but can be triangulated – which makes interpreting net additions and ARPU trends increasingly difficult.

While Finland is a heavily mobile-centric telecoms market, fixed broadband is becoming incrementally important at the margins with video-based application driving increasing demand for higher (fibre-based) fixed-line broadband connections. Elisa has begun to talk about its network expansion plans slightly more, acknowledging that it needs to build some more infrastructure to satisfy this increasing customer demand, and yet detail (eg technology, locations) remains fairly limited. The country's fixed line infrastructure is something of a patchwork, and as such Elisa's network build is similarly localised. We note Telia has been acting as a source of broadband customers for the market over the last few quarters, but that it is DNA rather than Elisa that is capitalising here.

Finally we think the company could do more when it comes to disclosure of organic growth rates. Small-scale M&A is an integral part of the business given the company's strong balance sheet, and yet these additions meaningfully distort the presentation of underlying growth rates. For instance reported Q3 y-o-y revenue growth of 8.4% maps to an organic growth rate of 4.0% (Q2 was 13% reported, 4% organic). Organic growth of EBITDA for Q3 was not provided but we estimated reported growth of +6.6% was c.3% organic.

Valuation

We make no changes to our estimates. We adjust our TP to EUR29.5 (from EUR29.2) as we roll forward our valuation to the current date (refer to the *Valuation and risks section* for details of our assumptions and risks) Our revised TP implies 10.7% downside and we rate the stock Reduce, as growth offered does not justify the stock's premium valuation to the sector.

FCFF based DCF valuation

in EURm, unless stated			2018e	2019e	2020e	2021e	2022e	2023e	2024e
EBITDA			627	644	665	679	691	701	711
Less: Cash capex			-221	-224	-227	-229	-232	-234	-237
Less: Cash net interest			-17	-17	-17	-17	-17	-17	-17
Less: Cash tax paid			-70	-70	-75	-79	-82	-84	-86
Add: Working capital change			-15	-9	-10	-9	-9	-8	-8
Equity FCF			**304**	**324**	**337**	**344**	**351**	**358**	**364**
Add: Net interest costs			17	17	17	17	17	17	17
Less: Tax shield on net interest			-3	-3	-3	-3	-3	-3	-3
Free cash flow to firm			**317**	**337**	**350**	**357**	**365**	**371**	**377**
TV									6,287
PV explicit cash flows			317	315	306	291	278	264	250
PV of terminal cash flow									4,175
PV of total explicit cash flows	1,704	29%							
PV of TV	4,175	71%							
Total enterprise value	**5,879**								
Net debt (FY18e)	(1,039)								
add: Dividend payout	255								
Associates	6								
Contingent liabilities	-20								
Appraised value of equity	**5,081**								
Shares (m)	160								
Price per share	**29.5**								

Source: HSBC estimates

Relative Valuation

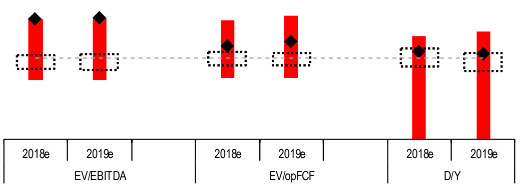
- Despite underperformance in past 6 months vs. SXKP, the stock is still trading at a significant premium to its peer group on EV/EBITDA
- Consensus earnings revisions have increased, primarily incorporating acquisitions in Estonia
- The company's stable dividend yield is substantially above the local government bond yield

Elisa – Valuation benchmark chart

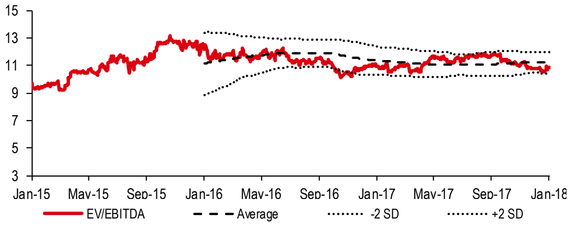
Recent performance

	1W	1M	3M	6M	12M
Price return	3.6%	0.8%	-5.6%	-5.1%	3.3%
Total return	3.6%	0.9%	-5.6%	-5.1%	8.2%
Total return vs SXKP	2.5%	1.2%	-6.3%	-1.8%	5.0%
Total return vs MSCI Europe Telecom	2.1%	-0.1%	-6.2%	-2.4%	2.0%
Total return vs OMXH	4.7%	-1.8%	-6.4%	-7.4%	-4.8%

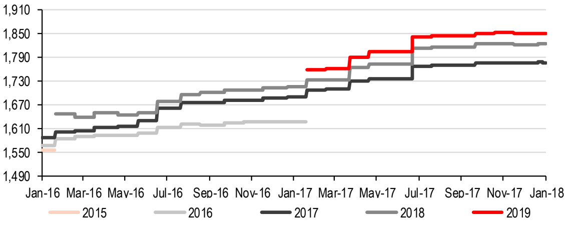
Relative valuation



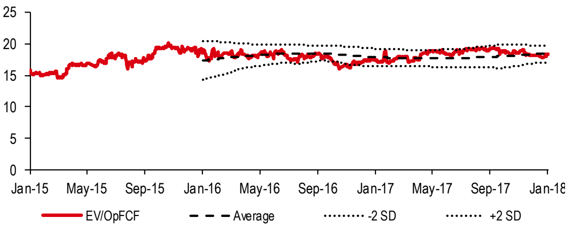
1yr fwd EV/EVITDA



Sales estimates revision

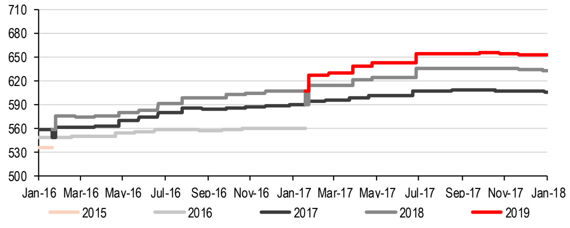


1yr fwd EV/OpFCF

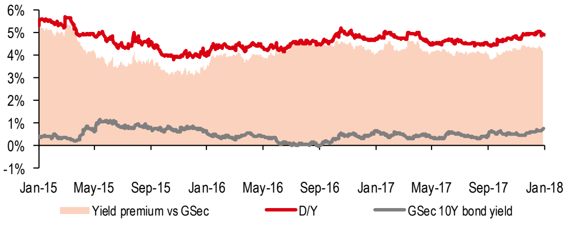


Capped at +/-50x levels

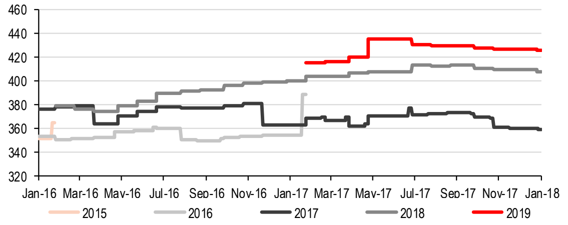
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Elisa Oyj

Reduce

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	1,636	1,773	1,808	1,829
EBITDA	563	606	627	644
Depreciation & amortisation	-224	-233	-239	-235
Operating profit/EBIT	339	373	387	409
Net interest	-18	-18	-17	-17
PBT	320	399	370	392
HSBC PBT	330	359	370	392
Taxation	-63	-70	-70	-75
Net profit	257	329	300	317
HSBC net profit	267	290	300	317
Cash flow summary (EURm)				
Cash flow from operations	487	515	525	547
Capex	-209	-241	-221	-224
Cash flow from investment	-421	-233	-221	-224
Dividends	-223	-239	-255	-270
Change in net debt	162	-37	-49	-54
FCF equity	284	271	303	319
Balance sheet summary (EURm)				
Intangible fixed assets	1,040	1,189	1,188	1,186
Tangible fixed assets	714	751	734	724
Current assets	639	631	695	758
Cash & others	45	203	252	306
Total assets	2,533	2,725	2,770	2,822
Operating liabilities	311	585	600	620
Gross debt	1,169	1,291	1,291	1,291
Net debt	1,124	1,087	1,039	985
Shareholders' funds	971	775	805	837
Invested capital	2,037	1,783	1,765	1,743

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	4.2	8.4	1.9	1.2
EBITDA	5.7	7.6	3.4	2.7
Operating profit	8.7	9.8	3.9	5.7
PBT	10.1	24.7	-7.2	5.9
HSBC EPS	5.8	8.6	3.2	5.9
Ratios (%)				
Revenue/IC (x)	0.9	0.9	1.0	1.0
ROIC	16.7	17.7	19.8	21.0
ROE	28.2	33.3	37.9	38.7
ROA	11.6	13.2	11.5	12.0
EBITDA margin	34.4	34.2	34.7	35.2
Operating profit margin	20.7	21.0	21.4	22.4
EBITDA/net interest (x)	32.0	34.4	37.6	38.7
Net debt/equity	115.7	140.2	128.9	117.5
Net debt/EBITDA (x)	2.0	1.8	1.7	1.5
CF from operations/net debt	43.3	47.4	50.5	55.5
Per share data (EUR)				
EPS Rep (diluted)	1.61	2.06	1.88	1.99
HSBC EPS (diluted)	1.68	1.82	1.88	1.99
DPS	1.50	1.60	1.69	1.79
Book value	6.08	4.86	5.05	5.24

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Finnish mobile revenues	922	974	1,008	1,040
Estonia mobile revenues	99	104	108	112
Elisa fixed business revenues	615	656	638	622
Elisa EBITDA adjusted	564	609	627	644
Elisa FCF after investments	257	271	304	324

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	4.1	3.7	3.6	3.6
EV/EBITDA	11.8	10.9	10.4	10.1
EV/IC	3.3	3.7	3.7	3.7
PE*	19.7	18.2	17.6	16.6
PB	5.4	6.8	6.6	6.3
FCF yield (%)	5.1	4.9	5.5	5.8
Dividend yield (%)	4.5	4.8	5.1	5.4

* Based on HSBC EPS (diluted)

Issuer information

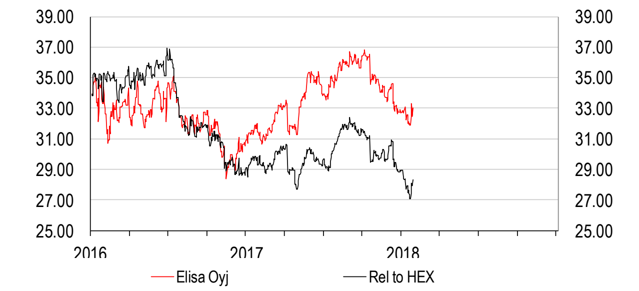
Share price (EUR)	33.05	Free float	100%
Target price (EUR)	29.50	Sector	Diversified Telecoms
Reuters (Equity)	ELISA.HE	Country	Finland
Bloomberg (Equity)	ELISA FH	Analyst	Adam Fox-Rumley, CFA
Market cap (USDm)	6,876	Contact	+44 20 7991 6819

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.08	No. of board members	7
Energy Intensity (kWh/USD)	0.16	Average board experience (years)	4.7
CO2 reduction policy	Yes	Female board members (%)	43
Social Indicators		Board members Independence (%)	100
Employee costs as % of sales	16.8		
Employee turnover (%)	NA		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Luigi Minerva*
Analyst
HSBC Bank plc
luigi.minerva@hsbcib.com
+44 20 7991 6928

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Q4 results: 31 January

KPN (KPN NA, EUR2.88, Buy, TP EUR3.70)

Investment Thesis

Strong shareholder return and FCF growth remains key to the investment case of KPN. We estimate FCF grows at a 2016-19e CAGR of 10%, and supports a growing dividend. The stock trades on 2018e EV/EBITDA of 7.1x (vs 6.7x for peer group) but benefits from very low taxes, which leads to a higher than average EBITDA to cash-flow conversion. The impact of consolidation in the Netherlands with the merger of T-Mobile and Tele2 (TEL2B SS, SEK98.64, Hold, Target Price SEK100) will depend, if approved by DG COMPETITION, on the nature of the chosen remedies.

Shareholder return: KPN's shares continue to give strong return to shareholders in the form of a regular dividend plus distribution of dividends received from Telefonica Deutschland. Our forecasts incorporate the regular dividend growing at a 2016-19 CAGR of 10.4%, translating into 2018e dividend yield of 4.8% (including TEF-D dividend). Additionally, the 9.5% stake in Telefonica Deutschland remains a financial asset, which, if sold, could further enhance shareholder return. We note the shareholder distribution is not at the expense of balance sheet strength. We estimate the leverage ratio declines to 2.2x by 2019e (compared to 2.8x in 2016).

FCF growth: We estimate FCF grows at a 2016-19e CAGR of 10% and supports a growing dividend. The key drivers of a growing 2016-19e FCF are EBITDA growth and normalization of capex. The company continues to make good progress in its simplification programme, leading to improvement in EBITDA. In terms of capex, we believe 2016 marked the end of an intensive capex cycle with 2017 the first year of a new normalized capex phase (we expect a Netherlands capex/sales ratio in the 18-19% range during 2018e-20e, above company guidance).

Consolidation in the Netherlands: We continue to be strong believers that in-market mobile consolidation is the most effective way to boost network investment, which in turn should drive unit prices lower and bandwidths higher. Indeed, it is our view that a market like the Netherlands would benefit from less fragmentation and therefore we would consider a 3-player market structure proportionate and sufficient. For our detailed treatment of the merit of consolidation see our thematic reports *Supercollider* (5 February 2014) and *Supersonic* (13 April 2015).

We expect a full Phase Two review by DG competition for the Tele2-DT deal (see our note *Dutch Telecoms: Tele2 and DT announce merger of Dutch operations*, 18 December 2017 for more details). If DG COMPETITION is consistent with the approach adopted in the case of the UK or Italy, structural remedies could go as far as demanding a new entrant in the Dutch market. If this were the case, T-Mobile and Tele2 would improve their scale, but the overall impact on the market would depend on the nature of the chosen remedies. As we discuss in the companion report *The FANGs are out,* also published today, if the EC demands a fourth MNO as a remedy, then – given the relatively small size of the market opportunity – it may be difficult for DT/Tele2 to find a willing candidate to take a set of merger remedies so as to maintain the Netherlands' four-operator status. Without a change in the EC's stance on merger control, it is therefore hard to see how a deal could be feasible.

For a further review of the approach of the current DG COMPETITION to in-market consolidation, see our reports:

- *Prohibition era?* (12 May 2016) for our review of the proposed O2UK 3UK merger, which was blocked by the EC, and
- *EC approves Italian deal but only alongside Iliad's entry* (2 September 2016) on the merger between Wind and 3Italia, which was approved by the EC with structural remedies, leading to a new entrant in the Italian market.

Valuation

We make no changes to our estimates. We derive our unchanged EUR3.7 target price from a DCF methodology (details on the assumptions and risks can be read in the *Valuation and risks section*), implying 28.2% upside and we rate the stock Buy.

KPN: SOTP valuation

(In EURm)	EV	Proportion of total operating EV	Method	Implied EV/sales 2017	Implied EV/EBITDA 2017	EBITDA margin
Netherlands	20,627	99%	DCF	3.5	8.6	41.1%
iBasis	116	1%	EV multiple	0.2	5.0	3.1%
EV	**20,742**	100%		3.2	8.5	37.2%
Adjusted Net debt (2017e)	-6,043					
Non Core assets	35					
TEF-D stake	1,133					
Tax assets	816					
Hybrid issue	-1,012					
Contingent liabilities	-320					
Equity value	**15,352**					
Number of shares	4,188					
Target price/share	**3.7**					

Source: HSBC estimates

Relative Valuation

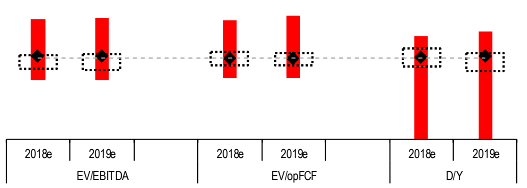
- KPN is currently trading at the mid-level of the EV/EBITDA and EV/OpCF 1 yr forward multiple range (defined by 2 standard deviations)
- It is trading broadly in line of the peer group on EV/OpCF
- KPN continues to be at the higher end of the dividend yield range compared to the peer group

KPN – Valuation benchmark chart

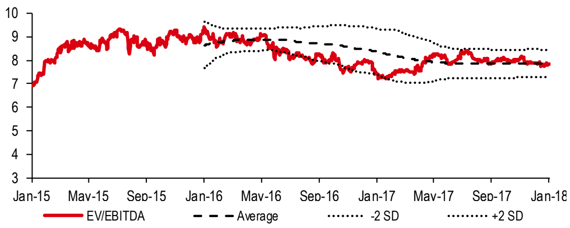
Recent performance

	1W	1M	3M	6M	12M
Price return	1.9%	-0.8%	-3.3%	-6.0%	6.2%
Total return	1.9%	-0.8%	-3.4%	-5.0%	10.7%
Total return vs SXKP	0.8%	-0.5%	-4.1%	-1.7%	7.6%
Total return vs MSCI Europe Telecom	0.4%	-1.7%	-4.0%	-2.3%	4.6%
Total return vs AEX INDEX	2.3%	-4.2%	-7.2%	-13.6%	-9.7%

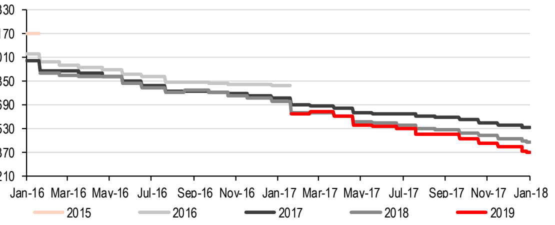
Relative valuation



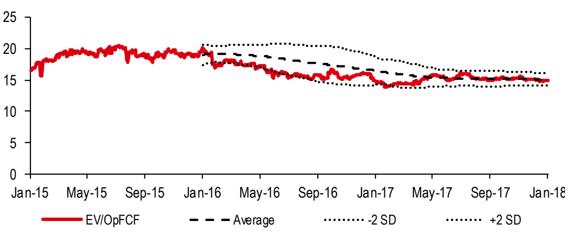
1yr fwd EV/EVITDA



Sales estimates revision

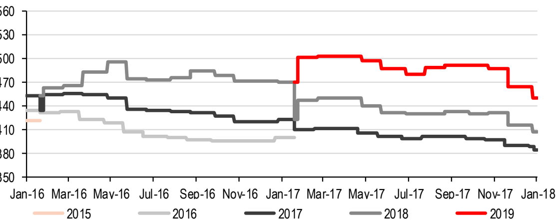


1yr fwd EV/OpFCF

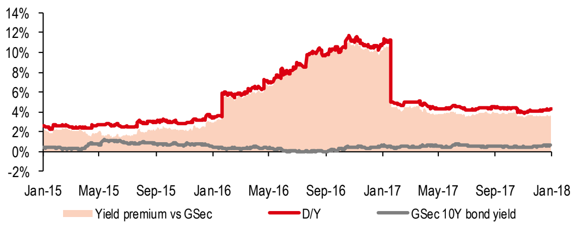


Capped at +/-50x levels

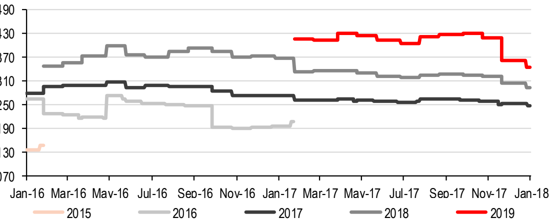
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: KPN

Buy

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	6,806	6,528	6,478	6,497
EBITDA	2,429	2,337	2,384	2,450
Depreciation & amortisation	-1,545	-1,441	-1,405	-1,360
Operating profit/EBIT	884	895	979	1,089
Net interest	-417	-262	-348	-329
PBT	466	632	628	757
HSBC PBT	625	722	700	824
Taxation	-96	-116	0	0
Net profit	793	513	618	747
HSBC net profit	458	535	511	603
Cash flow summary (EURm)				
Cash flow from operations	1,924	1,954	2,026	2,115
Capex	-1,193	-1,147	-1,139	-1,126
Cash flow from investment	336	-569	-1,139	-1,126
Dividends	-1,747	-581	-598	-644
Change in net debt	240	-717	-289	-345
FCF equity	602	720	887	990
Balance sheet summary (EURm)				
Intangible fixed assets	3,250	3,220	3,066	2,920
Tangible fixed assets	5,969	5,801	5,687	5,599
Current assets	2,134	2,091	2,083	2,086
Cash & others	1,179	1,000	1,000	1,000
Total assets	14,736	13,705	13,428	13,193
Operating liabilities	1,893	2,111	2,139	2,201
Gross debt	8,829	8,043	7,754	7,408
Net debt	6,760	6,043	5,754	5,408
Shareholders' funds	3,601	3,249	3,223	3,262
Invested capital	8,281	8,000	7,698	7,404

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-2.9	-4.1	-0.8	0.3
EBITDA	4.5	-3.8	2.0	2.8
Operating profit	24.9	1.3	9.3	11.3
PBT	-23.0	35.7	-0.6	20.5
HSBC EPS	-8.5	18.8	-4.5	18.0
Ratios (%)				
Revenue/IC (x)	0.8	0.8	0.8	0.9
ROIC	11.7	12.2	13.5	14.9
ROE	10.7	15.6	15.8	18.6
ROA	5.3	6.0	7.1	8.1
EBITDA margin	35.7	35.8	36.8	37.7
Operating profit margin	13.0	13.7	15.1	16.8
EBITDA/net interest (x)	5.8	8.9	6.8	7.5
Net debt/equity	187.7	185.8	177.8	164.7
Net debt/EBITDA (x)	2.8	2.6	2.4	2.2
CF from operations/net debt	28.5	32.3	35.2	39.1
Per share data (EUR)				
EPS Rep (diluted)	0.19	0.12	0.15	0.18
HSBC EPS (diluted)	0.11	0.13	0.12	0.14
DPS	0.27	0.13	0.14	0.15
Book value	0.85	0.78	0.77	0.78

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Netherlands revenue	6,025	5,867	5,843	5,883
I-basis revenue	867	750	721	699
Revenue	6,779	6,530	6,478	6,497

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	2.7	2.7	2.7	2.6
EV/EBITDA	7.5	7.5	7.2	6.9
EV/IC	2.2	2.2	2.2	2.3
PE*	26.8	22.6	23.6	20.0
PB	3.4	3.7	3.7	3.7
FCF yield (%)	5.2	6.3	7.7	8.6
Dividend yield (%)	9.5	4.4	4.8	5.3

* Based on HSBC EPS (diluted)

Issuer information

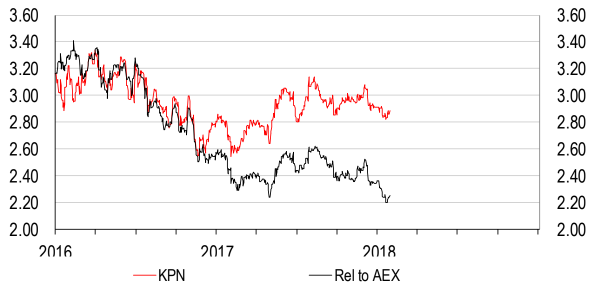
Share price (EUR)	2.88	Free float	100%
Target price (EUR)	3.70	Sector	Diversified Telecoms
Reuters (Equity)	KPN.AS	Country	Netherlands
Bloomberg (Equity)	KPN NA	Analyst	Luigi Minerva
Market cap (USDm)	15,076	Contact	44 20 7991 6928

ESG metrics

Environmental Indicators		**Governance Indicators**	
GHG Intensity (kg/USD)	0.04	No. of board members	7
Energy Intensity (kWh/USD)	0.12	Average board experience (years)	3.1
CO2 reduction policy	Yes	Female board members (%)	29%
Social Indicators		Board members Independence (%)	86%
Employee costs as % of sales	16.8%		
Employee turnover (%)	9.7%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC
Note: Priced at close of 26 Jan 2018

Nicolas Cote-Colisson*
Analyst
HSBC Bank plc
nicolas.cote-colisson@hsbcib.com
+44 20 7991 6826

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Orange (ORA FP, EUR14.85, Buy, TP EUR17.00)

Q4 results: 21 February

Investment Thesis

Orange starts 2018 with a positive outlook. The company is growing (revenue were up 1% in the first 9 months of 2017, EBITDA up 2.2%) and management successfully presented its medium-term strategic plan to investors just before Christmas. In addition, on 22 January 2018, the French Ministry of finances, Bruno Le Maire closed the debate around the re-election for a third mandate of Stéphane Richard at the head of Orange. The Minister, who represents the State and its 29% voting rights in Orange, said that "the CEO did a good job and that he should be re-elected" (Radio Classique, 22 January 2018). Pending the AGM vote, we see this re-election as a positive for Orange shares, with management now fully dedicated to delivering the strategic plan.

Orange's investor day (7 December 2017) succeeded, in our view, in convincing investors that the high capex intensity at Orange (17% capex/sales in 2017e, 17.9% in 2018e) is already paying off and will continue to do so (read *Music to our ears*, 8 December 2017). The company explained in detail how upgraded networks (fibre, 4G) and systems (digitisation, convergence) are generating higher revenue per customer and lower churn. As an example, Orange calculates a EUR6.1 ARPU uplift for FTTH customers in France (compared to ADSL) and a growing market share in fixed broadband driven by fibre. On operational costs, Orange also announced a EUR1bn additional gross saving initiative (after a EUR2.6bn opex reduction target in 2015-18). Management concluded, and our forecasts reflect the same, that the company is in a position to deliver substantial EBITDA growth from 2017 ("around 2% in 2017e, acceleration in 2018 and continued growth in 2019 and 2020"). This, combined with a capex budget reaching a peak in 2018, should lead to growing operating cash flow in 2017-2020, according to Orange guidance.

Our analysis concludes that Orange is well positioned to defend its position in France in 2018 (44% of FY18e revenue). Note we expect the French retail market to remain very competitive: the presence of two subscale players in each of the mobile (Iliad, ILD FP, EUR212.7, Buy) and fixed broadband (Bouygues Telecom, EN FP, EUR45.48, Hold) subsectors maintains strong pressure on prices, while SFR (not rated) needs to stop the customer base erosion, in fixed broadband in particular. But Orange's lead on fibre should protect the incumbent (network differentiation): the company has so far deployed 70% (85% outside the low dense area) of the 9.5m FTTH lines at the end of Q3 17 (of a total of c27m homes) and is therefore is a strong position to maintain its lead. We also expect Iliad to launch a new fixed broadband box, which in the past has been a good recruitment tool for the alternative operator. But this could also be the occasion for Iliad to introduce a richer and more expensive offering that could help Orange in better monetising its network (Orange targets EUR8 ARPU uplift on FTTH in the longer term).

French regulation will also be a key trigger for Orange in 2018. The year started favourably after French operators struck a deal with telecom regulator ARCEP on 12 January: operators will spend EUR3-4bn (albeit not all incremental) collectively in the next five years to improve 4G coverage, in the lower density area in particular, but in exchange operators will not face auctions for the renewal of their 2G and 3G licences (which have to be renewed from 2021). More negatively, ARCEP still intends to increase the level of competition in the B2B market by helping the development of wholesalers, which could limit Orange's capacity to retail its newly built fibre, in particular to SMEs; however we do not expect a rapid change in this market (Orange B2B revenue in France represented 14% of FY17e Group revenue). 2018 should also be a test year to measure the traction of Orange Bank, launched in France in Q4 2017: Orange intends to leverage its large retail presence in telecoms and to generate commissions and fees, but could face losses of around EUR100m in 2018 as a start-up year on our estimates.

Forecast changes

We have made minor changes to our 2017-19 forecasts. For 2017, we increase our EBITDA forecasts to align with company guidance of c2% EBITDA growth. We also increase our capex forecasts for 2018, in line with the company's guidance for peak capex this year. Our higher reported EBITDA forecasts are essentially driven by lower restructuring charges expectations. Changes to estimates are described in the table below.

Orange: Changes to estimates

	New			Old			Changes		
EURm	2017e	2018e	2019e	2017e	2018e	2019e	2017e	2018e	2019e
Sales	41,032	41,377	41,971	41,054	41,493	42,028	-0.1%	-0.3%	-0.1%
EBITDA restated	12,785	13,085	13,477	12,709	13,058	13,593	0.6%	0.2%	-0.9%
EBITDA reported	12,435	12,736	13,129	12,180	12,227	12,870	2.1%	4.2%	2.0%
Net profit HSBC	2,985	3,080	3,271	2,913	3,070	3,344	2.5%	0.3%	-2.2%
Capex	-7,240	-7,404	-7,213	-7,193	-7,265	-7,193	0.6%	1.9%	0.3%

Source: HSBC estimates

We are mostly in line with the consensus estimates collected by Orange (January 2018):

Forecasts vs consensus

	HSBCe			Consensus			Changes		
EURm	2017e	2018e	2019e	2017e	2018e	2019e	2017e	2018e	2019e
Sales	41,032	41,377	41,971	41,035	41,348	41,841	0.0%	0.1%	0.3%
EBITDA restated	12,785	13,085	13,477	12,785	13,099	13,417	0.0%	-0.1%	0.4%
EBITDA reported	12,435	12,736	13,129	12,456	12,882	13,246	-0.2%	-1.1%	-0.9%
Net profit	2,287	2,708	2,896	2,315	2,789	3,053	-1.2%	-2.9%	-5.2%
Capex	-7,240	-7,404	-7,213	-7,206	-7,402	-7,242	0.5%	0.0%	-0.4%

Source: HSBC estimates, Company provided consensus

Valuation

We derive our unchanged EUR17 target price for Orange shares from a DCF-based sum-of-parts (details on the assumptions and risks can be read in the *Valuation and risks section*). Our TP implies 14.5% upside and we rate the stock Buy as we expect the company to keep capitalising on its lead in fibre in France.

SOTP Valuation

EURm	EV	% EV	Implied EV/EBITDA 18e	Method
Orange France	42,186	57.6%	6.1	DCF (LT EBITDA margin 40%, WACC 8.1%)
Orange Polska (Poland)	3,841	5.2%	5.4	HSBC Target price (PLN5.9)(OPL PW, PLN6.1, Hold, covered by Hervé Drouet)
Spain	10,370	14.2%	6.3	DCF (LT EBITDA margin 29%,WACC 8.4%)
Belgium & Luxembourg	1,936	2.6%	6.4	HSBC Target price for Orange Belgium (EUR26) (OBEL BB, EUR17.02, Buy)
Other European countries	4,069	5.6%	6.7	DCF (LT EBITDA margin 36%,WACC 8.1%)
Africa & Middle East	8,261	11.3%	5.2	DCF (LT EBITDA margin 35%,WACC 10%)
Orange Business Services (B2B)	8,048	11.0%	6.4	DCF (LT EBITDA margin 20%, WACC 8.7%)
ICSS (wholesale)	-5,657	-7.7%		DCF (WACC 8.6%)
Orange Bank	170	0.2%		Acquisition cost of Groupama Banque
Orange Group EV	**73,225**	**100.0%**		
Associates	1,292			BT Group stake (2.66%), Orange Tunisia, Korek (Iraq), Dailymotion, etc.
Minorities	-4,799			Sonatel, Orange Polska, Orange Belgium Jordan Telecom, etc.
Net debt (Dec 18)	**-24,110**			
Minority net debt	1,121			
Tax asset NPV & others	1,146			Discount rate 9.5%, includes 10% of unrecognised tax assets
provision for litigations	-506			As in the balance sheet adjusted for the Competition authority's fine in France (B2B)
Equity value	**47,369**			
outstanding shares	2,686			Assumes 50% probability of TDIRA conversion (26m extra shares
Unpaid portion of the dividend	0.65			in net debt (2017 Final of EURc40 to be paid in 2018)
Equity value Dec 18	18.3			
Target price (equity value NPV)	**17.0**			

Source: HSBC estimates

Relative Valuation

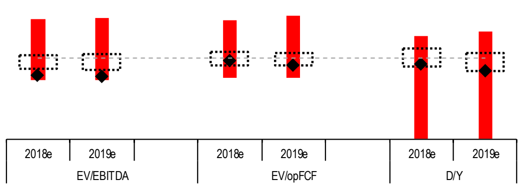
- Orange shares trade close to medium term average on both EV/EBITDA and EV/OFCF metrics
- Orange trades at a discount to peers on all metrics, reflecting the risk of a French government stake placement (BFMBusiness, 6 November 2017) and the stiff and durable competition in the French telecom market
- Dividend yield at 4.4% (2018e), is in line with the peer average. On 7 December 2017 management announced a new floor for the dividend at EUR0.65 for 2017-2020 earlier guidance was EUR0.65 for 2017 after EUR0.60 in 2016)

Orange – Valuation benchmark chart

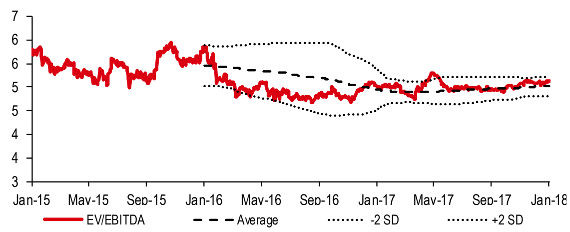
Recent performance

	1W	1M	3M	6M	12M
Price return	2.9%	1.5%	8.1%	3.6%	2.0%
Total return	2.7%	1.4%	9.9%	5.4%	6.5%
Total return vs SXKP	1.6%	1.7%	9.3%	8.7%	3.4%
Total return vs MSCI Europe Telecom	1.2%	0.5%	9.3%	8.0%	0.4%
Total return vs CAC 40	2.7%	-1.7%	8.3%	-1.6%	-10.7%

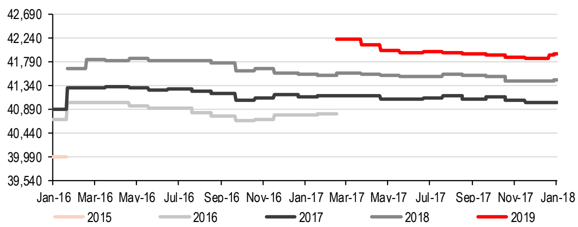
Relative valuation



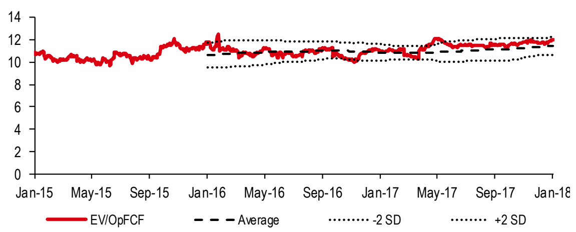
1yr fwd EV/EVITDA



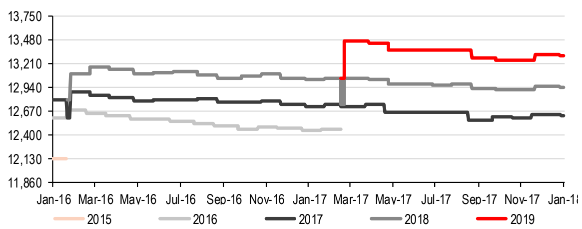
Sales estimates revision



1yr fwd EV/OpFCF

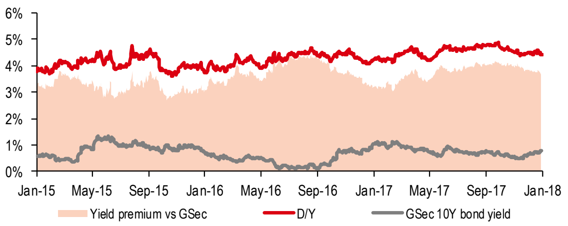


EBITDA estimates revision

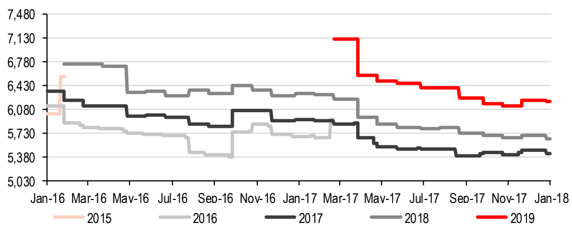


Capped at +/-50x levels

Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Orange

Buy

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	40,918	41,032	41,377	41,971
EBITDA	11,719	12,435	12,736	13,129
Depreciation & amortisation	-7,596	-6,647	-6,734	-6,826
Operating profit/EBIT	4,123	5,788	6,002	6,303
Net interest	-2,097	-1,748	-1,442	-1,388
PBT	1,980	4,043	4,560	4,915
HSBC PBT	3,507	4,882	5,052	5,407
Taxation	-970	-1,473	-1,550	-1,671
Net profit	2,935	2,287	2,708	2,896
HSBC net profit	4,275	2,985	3,080	3,271
Cash flow summary (EURm)				
Cash flow from operations	8,491	10,011	9,685	10,007
Capex	-6,971	-7,240	-7,404	-7,213
Cash flow from investment	-4,879	-7,416	-7,637	-7,213
Dividends	-1,596	-2,261	-1,729	-1,726
Change in net debt	-2,108	-16	-319	-1,068
FCF equity	1,681	1,975	2,323	2,841
Balance sheet summary (EURm)				
Intangible fixed assets	41,758	41,779	42,012	42,012
Tangible fixed assets	25,912	26,778	27,448	27,836
Current assets	18,824	17,101	16,118	17,177
Cash & others	6,355	4,980	3,977	5,000
Total assets	94,668	92,634	92,362	93,611
Operating liabilities	23,496	22,272	22,277	22,297
Gross debt	30,799	29,408	28,086	28,042
Net debt	24,444	24,428	24,110	23,042
Shareholders' funds	30,688	31,269	32,249	33,418
Invested capital	56,643	58,406	59,325	59,728

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	1.7	0.3	0.8	1.4
EBITDA	3.9	6.1	2.4	3.1
Operating profit	-13.7	40.4	3.7	5.0
PBT	-37.3	104.2	12.8	7.8
HSBC EPS	43.1	-30.2	3.2	6.2
Ratios (%)				
Revenue/IC (x)	0.7	0.7	0.7	0.7
ROIC	5.6	6.7	6.8	7.1
ROE	13.9	9.6	9.7	10.0
ROA	2.1	3.7	4.2	4.4
EBITDA margin	28.6	30.3	30.8	31.3
Operating profit margin	10.1	14.1	14.5	15.0
EBITDA/net interest (x)	5.6	7.1	8.8	9.5
Net debt/equity	73.7	72.3	69.2	63.8
Net debt/EBITDA (x)	2.1	2.0	1.9	1.8
CF from operations/net debt	34.7	41.0	40.2	43.4
Per share data (EUR)				
EPS Rep (diluted)	1.11	0.86	1.02	1.09
HSBC EPS (diluted)	1.61	1.12	1.16	1.23
DPS	0.60	0.65	0.65	0.65
Book value	11.55	11.77	12.14	12.58

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Orange revenue	40,918	41,032	41,377	41,971
Orange EBITDA	12,682	12,785	13,085	13,477
Orange EBIT	4,123	5,789	6,002	6,303
Orange Net Income	2,935	2,288	2,708	2,896
Orange FCF	5,711	5,545	5,680	6,264

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	1.6	1.6	1.6	1.6
EV/EBITDA	5.7	5.4	5.2	5.0
EV/IC	1.2	1.1	1.1	1.1
PE*	9.2	13.2	12.8	12.1
PB	1.3	1.3	1.2	1.2
FCF yield (%)	4.0	4.6	5.4	6.6
Dividend yield (%)	4.0	4.4	4.4	4.4

* Based on HSBC EPS (diluted)

Issuer information

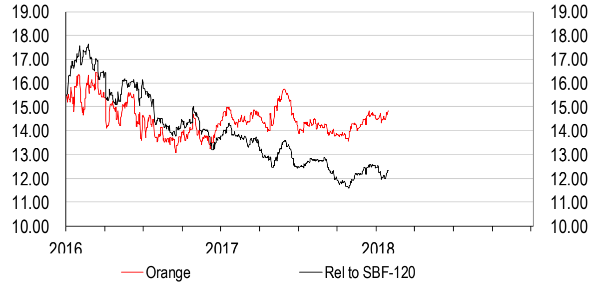
Share price (EUR)	14.85	Free float	73%
Target price (EUR)	17.00	Sector	Diversified Telecoms
Reuters (Equity)	ORAN.PA	Country	France
Bloomberg (Equity)	ORA FP	Analyst	Nicolas Cote-Colisson
Market cap (USDm)	49,098	Contact	44 20 7991 6826

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.03	No. of board members	15
Energy Intensity (kWh/USD)	0.13	Average board experience (years)	4.6
CO2 reduction policy	Yes	Female board members (%)	47%
Social Indicators		Board members Independence (%)	47%
Employee costs as % of sales	20%		
Employee turnover (%)	4%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Nicolas Cote-Colisson*
Analyst
HSBC Bank plc
nicolas.cote-colisson@hsbcib.com
+44 20 7991 6826

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Q4 results: 2 March

Proximus (PROX BB, EUR28.1, Hold, TP EUR32.00)

Investment Thesis

Proximus should benefit in theory from an attractive market structure compared with the majority of its European peers, with three operators competing regionally (Proximus and Orange Belgium at the national level, cable operator Telenet (TNET BB, EUR61.55 Hold) in Flanders for fixed services and nationally in mobile, cable operator Voo (not rated) in Wallonia). But as discussed below, the changes in regulation have allowed Orange Belgium to enter the fixed broadband market, whose low market share in fixed broadband (3% Dec 17e) means price pressure will remain in the fixed broadband and the mobile market in the coming quarters (as Orange Belgium sells quad-play offers).

Every Belgian telcos confirmed at the time of their Q3 17 results that the level of competition was stronger than usual. Proximus's fixed broadband internet market share was slightly down at 46.5% in Q3 17 versus 46.6% in Q2 (but higher than the 46.4% reached in Q3 16). Our view is that higher competition was triggered by Orange Belgium taking share from cable operators with its quad-play LOVE offers. Cable operators in turn defended their positions in both regions of the country with promotions, hitting Proximus at the same time. To some extent the incumbent can defend itself with its dual-brand strategy: Scarlett for price-conscious clients and the Proximus brand for higher-end customers. Quad-play offers (Tuttimus, a combination of fixed broadband, TV and mobile) are also proving an efficient way for Proximus to defend its market share, despite minimal discount being attached to this 4-play package compared to its sum-of-the-parts value. Proximus has reiterated its strategy to protect value rather than chasing volumes in such markets (and also put forward a few price increases at the beginning of the year).

The main question for Proximus's investment case in 2018 relates to the regulatory environment in Belgium, as this will define the level of competition intensity that should be expected in the coming years. Belgium, with its track record of benign regulation, is now looking to establish a more open fixed market. To foster competition, Belgian telecoms and media regulators are currently working on new cable wholesale tariffs, which will define the price at which Orange Belgium can access cable networks and become a significant fixed broadband player. Under the current regulatory framework, we estimate Orange Belgium pays cEUR24 per month to cable operators to resell the same on the retail market. We calculate it makes no profit (content costs, extra services such as speed), which brings into question its capacity to remain a competitor in the long term. Hence the regulator is conducting a new market analysis, with a decision on tariffs by 30 April 2018. This implicit deadline was set on 25 October, after a Belgian appeals court cancelled the initial decision of 2013 (and the follow-up in 2016) to regulate cable, setting the current wholesale tariffs. As detailed in our report *Still optimistic for regulatory change*, 24 October 2017, we expect a EUR5 cut to wholesale access fees via the introduction of a cost-oriented model, as opposed to the retail-minus model currently in place.

Pending this regulatory change, Proximus continues to deliver a sound network strategy. An earlier adopter of VDSL, the technology now covers 94% of Belgian homes (83% with vectoring), delivering 100Mbps to more than half the population. But with cable operators also upgrading their networks, a year ago (December 2016), Proximus announced a EUR3bn fibre plan over a decade (we expect total Group capex budget of around EUR1bn in 2018). The target is to cover more than 85% of businesses and more than 50% of homes with FTTH by 2026, with a priority for businesses (65% after five years vs 18% for households). This programme should secure Proximus's position in the fixed broadband market. On the cost side, has taken continuous steps to reduce headcount: the early retirement plan set in 2016 identified almost 1.9k employees (13.1k Group employees in Q3 17) leaving by 2019, excluding natural attrition. This contributes to the EUR150m cost reduction plan.

Forecast changes

We have adjusted the charge for the early leave plan, impacting reported EBITDA. Our 2017 capex estimate also rises after adding the cost of football rights (EUR66m). The adjusted net profit difference in 2018 is driven by a higher tax rate than our initial assumptions. These forecasts assume that Proximus is in line to achieve most of its cost saving plan by 2019. The company targets a reduction of domestic opex of EUR150m in 2015-19: we forecast EUR142m.

Changes to estimates

	New			Old			Change		
(EURm)	2017e	2018e	2019e	2017e	2018e	2019e	2017e	2018e	2019e
Revenue	5,775	5,786	5,805	5,809	5,868	5,928	-0.6%	-1.4%	-2.1%
EBITDA adjusted	1,817	1,848	1,903	1,842	1,882	1,923	-1.4%	-1.8%	-1.1%
EBITDA reported	1,771	1,808	1,873	1,842	1,882	1,923	-3.9%	-3.9%	-2.6%
HSBC Net profit	510	501	534	528	542	562	-3.4%	-7.6%	-4.9%
Capex	-1,063	-1,001	-1,004	-999	-1,009	-1,020	6.4%	-0.8%	-1.5%

Source: HSBC estimates

Operational forecasts vs consensus

	HSBC estimates			Company consensus			Variance		
(EURm)	2017e	2018e	2019e	2017e	2018e	2019e	2017e	2018e	2019e
Revenue	5,775	5,786	5,805	5,786	5,792	5,807	-0.2%	-0.1%	0.0%
EBITDA adjusted	1,817	1,848	1,903	1,817	1,843	1,877	0.0%	0.3%	1.4%
EBITDA reported	1,771	1,808	1,873	1,764	1,804	1,856	0.4%	0.2%	0.9%
Capex (excl. Football)	-997	-1,001	-1,004	-1,009	-1,004	-1,008	-0.1%	-0.3%	-0.4%

Source: HSBC estimates

Valuation

We value Proximus with a DCF approach. We roll forward our forecasts by 12 months, which combined with our new forecasts returns an unchanged target price of EUR32 (details on assumptions and risks in the *Valuation and risks section*. Despite 13.9% upside implied by our TP, we retain a Hold rating given the uncertainties surrounding the regulatory environment and the consequent market structure from 2018 onward.

Proximus DCF Valuation

		2015a	2016a	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e	2025e
Revenues		6,012	5,871	5,775	5,786	5,805	5,837	5,876	5,919	5,966	6,018	6,074
Pre Tax NOPLAT		777	816	827	895	944	966	991	1,012	1,040	1,075	1,111
Tax		-194	-204	-207	-265	-236	-242	-248	-253	-260	-269	-278
NOPLAT		583	612	620	630	708	725	743	759	781	806	833
Depreciation		869	917	940	954	958	964	966	971	966	959	951
Capex		-926	-949	-1,063	-1,001	-1,004	-992	-999	-971	-953	-944	-940
Free cash flow		526	580	497	583	662	697	711	759	794	821	844
Terminal Value												
Terminal growth rate	1.5%											
WACC	7.3%											
Discount Factors												
PV of Cash Flow	3,951											
PV of continuing Value	8,870											
Enterprise Value	**12,821**											
Net Debt end-2018	1,940											
Minority Interests	-147											
Tax assets, Pension liabilities	-473											
Market Value	**10,554**											
No. of Shares	321											
Price Per share (end-2018)	32.8											
Price per share NPV	30.5											
Unpaid portion of dividend	1.5											
Target price	**32.0**											

Source: HSBC estimates

Relative Valuation

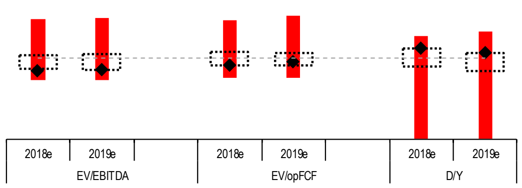
- Proximus looks cheap on both EV/EBITDA and EV/OFCF metrics, possibly due to the uncertainty regarding the regulatory decision on cable wholesale access prices, which could impact the overall market
- Shares could also reflect the risk of the Belgian State selling down some of its 53.5% stake (Le Soir, 7 October 2017)
- Dividend yield is higher than peers at 5.4%, reflecting the company's policy to return most of its annual free cash flow on the back of its low leverage (2018e Net debt/EBITDA of 1.1x)

Proximus – Valuation benchmark chart

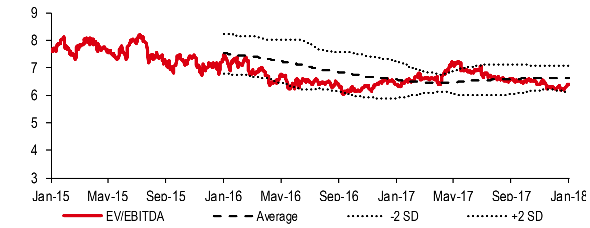
Recent performance

	1W	1M	3M	6M	12M
Price return	2.6%	1.3%	-2.2%	-11.6%	4.3%
Total return	2.6%	1.3%	-1.0%	-10.6%	8.1%
Total return vs SXKP	1.5%	1.6%	-1.7%	-7.3%	5.0%
Total return vs MSCI Europe Telecom	1.1%	0.4%	-1.7%	-7.9%	2.0%
Total return vs BEL 20	2.5%	-3.2%	-3.6%	-17.5%	-10.8%

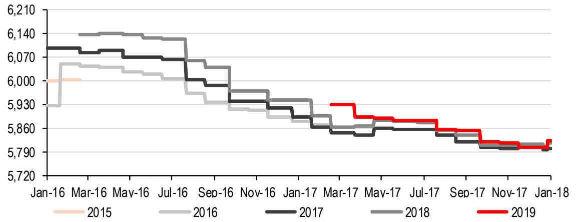
Relative valuation



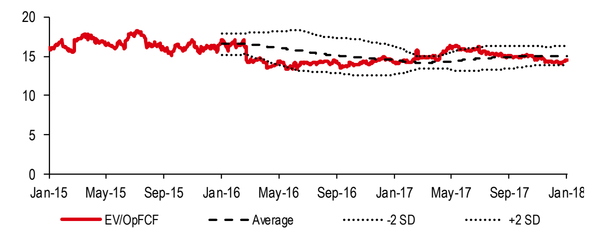
1yr fwd EV/EVITDA



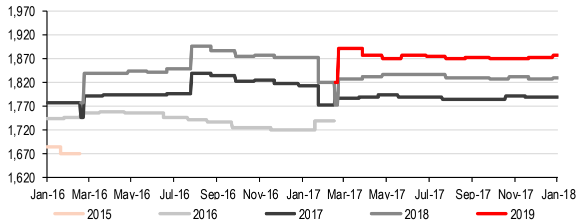
Sales estimates revision



1yr fwd EV/OpFCF

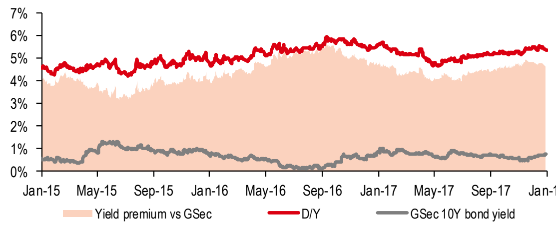


EBITDA estimates revision

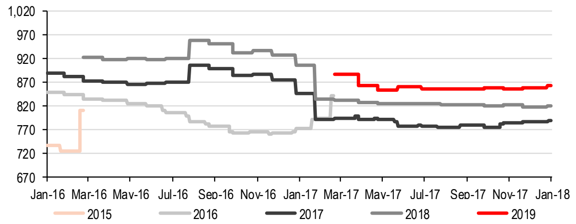


Capped at +/-50x levels

Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

HSBC

Financials & valuation: Proximus

Hold

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	5,871	5,775	5,786	5,805
EBITDA	1,733	1,771	1,808	1,873
Depreciation & amortisation	-917	-940	-954	-958
Operating profit/EBIT	816	831	855	914
Net interest	-101	-72	-98	-98
PBT	715	759	757	817
HSBC PBT	778	805	797	847
Taxation	-167	-226	-231	-246
Net profit	523	511	501	547
HSBC net profit	489	510	501	534
Cash flow summary (EURm)				
Cash flow from operations	1,495	1,529	1,474	1,518
Capex	-962	-1,073	-1,001	-1,004
Cash flow from investment	-960	-1,279	-1,001	-1,004
Dividends	-485	-327	-484	-483
Change in net debt	-58	68	12	-31
FCF equity	502	399	479	525
Balance sheet summary (EURm)				
Intangible fixed assets	3,378	3,623	3,623	3,623
Tangible fixed assets	2,910	3,010	3,057	3,103
Current assets	1,745	1,903	1,904	1,907
Cash & others	309	500	500	500
Total assets	8,117	8,626	8,674	8,722
Operating liabilities	2,032	2,396	2,413	2,437
Gross debt	2,170	2,429	2,440	2,410
Net debt	1,861	1,929	1,940	1,910
Shareholders' funds	2,819	2,687	2,703	2,752
Invested capital	5,692	5,640	5,671	5,695

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-2.3	-1.6	0.2	0.3
EBITDA	5.3	2.2	2.1	3.6
Operating profit	5.0	1.8	2.9	7.0
PBT	9.1	6.1	-0.3	7.9
HSBC EPS	3.5	4.3	-1.6	6.6
Ratios (%)				
Revenue/IC (x)	1.0	1.0	1.0	1.0
ROIC	9.5	9.7	10.0	10.6
ROE	17.4	18.5	18.6	19.6
ROA	7.5	6.9	6.8	7.3
EBITDA margin	29.5	30.7	31.3	32.3
Operating profit margin	13.9	14.4	14.8	15.8
EBITDA/net interest (x)	17.1	24.6	18.5	19.2
Net debt/equity	62.4	68.8	68.8	66.6
Net debt/EBITDA (x)	1.1	1.1	1.1	1.0
CF from operations/net debt	80.3	79.3	75.9	79.5
Per share data (EUR)				
EPS Rep (diluted)	1.62	1.59	1.56	1.70
HSBC EPS (diluted)	1.52	1.58	1.56	1.66
DPS	1.50	1.50	1.50	1.54
Book value	8.75	8.34	8.40	8.55

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Proximus Revenues	5,871	5,775	5,786	5,805
Proximus EBITDA adjusted	1,796	1,817	1,848	1,903
Proximus EBIT adjusted	879	877	895	944
Proximus Net income adjusted	586	557	541	577
Proximus FCF definition	559	308	499	540

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	1.9	2.0	2.0	1.9
EV/EBITDA	6.5	6.4	6.3	6.0
EV/IC	2.0	2.0	2.0	2.0
PE*	18.5	17.8	18.0	16.9
PB	3.2	3.4	3.3	3.3
FCF yield (%)	5.4	4.2	5.1	5.6
Dividend yield (%)	5.3	5.3	5.3	5.5

* Based on HSBC EPS (diluted)

Issuer information

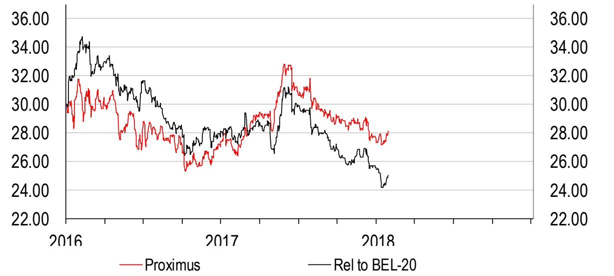
Share price (EUR)	28.10	Free float	42%
Target price (EUR)	32.00	Sector	Diversified Telecoms
Reuters (Equity)	PROX.BR	Country	Belgium
Bloomberg (Equity)	PROX BB	Analyst	Nicolas Cote-Colisson
Market cap (USDm)	11,810	Contact	44 20 7991 6826

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.01	No. of board members	14
Energy Intensity (kWh/USD)	0.09	Average board experience (years)	4.2
CO2 reduction policy	Yes	Female board members (%)	43%
Social Indicators		Board members Independence (%)	43%
Employee costs as % of sales	20%		
Employee turnover (%)	2%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Luigi Minerva*
Analyst
HSBC Bank plc
luigi.minerva@hsbcib.com
+44 20 7991 6928

** Employed by a non-US affiliate of HSBC Securities (USA) Inc, and is not registered/ qualified pursuant to FINRA regulations*

Q4 results: 1 February

Swisscom (SCMN VX, CHF518.80, Hold, TP CHF515.0)

Investment Thesis

The Swiss telecoms market is one of the most ideally structured in Europe, in our view. In mobile there are three players: Swisscom (the market leader), Sunrise (SRCG SW, CHF89.70, Buy, the challenger) and Salt (not listed) the potential market disrupter). In fixed-line: Swisscom, cable operators (essentially UPC, owned by Liberty Global, LBTYA US, USD38.19, Buy) and Sunrise. A regulatory framework designed to incentivize infrastructure investments has shaped the nature of competition over time, with a marked bias towards quality. All this with consumers' propensity to pay for a high quality service and macro conditions creating a broadly stable and defensive backdrop.

We summarize the investment case for Swisscom in the following five points:

1. Swisscom has high market shares across every segment and this makes it a natural target for competition. However, we think Swisscom has so far been defending its market position well.
2. We expect the entry of Salt in fixed-line (which we expect for H1 2018) to be more negative for Swisscom compared to Sunrise's presence. Further, a potential fixed-mobile consolidation (see our latest report *Swiss Telecoms - Hypothesis Now: Fixed-mobile consolidation scenario*, 11 January 2018), especially in the case of a Sunrise-UPC merger, could create a strong second converged operator in Switzerland, thus relatively weakening Swisscom. However, in this scenario, we expect Salt to be the real loser, as a small third operator in a concentrated market. A risk here is that remedies imposed by the competition authority could involve more intrusive regulation of fixed-line access to allow Salt to compete better as a converged fixed-mobile player.
3. Capex is likely to continue at a high run-rate (~19% capex/sales). We believe this is the best way to preserve the high quality market position while effectively using sub-brands in the low-end market segments. After having championed VDSL (alongside Proximus), Swisscom is now well ahead of its peer group on FTTS/G.fast which, given the characteristics of the Swiss network, is a much more efficient solution than FTTH, in our view.
4. In Italy, we believe Fastweb has missed a significant opportunity to gain more scale by not purchasing the remedies assets from the Wind-Tre merger (won by Iliad). Moreover, the FTTH deployment by Open Fiber (see *Telecom Italia: Iliad and OF, key challenges ahead*, 22 May 2017), if successful, will reduce the scarcity value of Fastweb's infrastructure.
5. The stock is up 4.0% in the last three months (vs the index at 0.3% over the same period) and continues to look fairly valued. Even in the absence of growth, it still offers what we expect to remain a stable dividend with an attractive yield (c4% in 2018e). It remains a good option for those investors seeking income with a more defensive exposure (low leverage and no M&A ambitions).

Valuation

We make no changes to our estimates. We derive our unchanged CHF515 target price from a DCF-based sum-of-parts (details on the assumptions and risks can be read in the *Valuation and risks section*), implying 0.7% downside and we rate the stock Hold against a backdrop of increasing competition balanced by an attractive dividend yield.

Swisscom valuation summary

	(In CHFm)
Switzerland	31,902
Italy	4,624
Enterprise value	**36,526**
Net debt (end-2018e)	7,968
Non-core assets	136
Minorities	105
Contingent liabilities	1,774
Equity value	**26,815**
Shares	51.8
Equity value/share (CHF, as of Dec-18)	518
Equity value/share (CHF, as of Jan-18)	**493**
Dividend to be paid in 2018e (CHF)	22
Target value/share (CHF, as of Jan-18)	**515**

Source: HSBC estimates

Relative Valuation

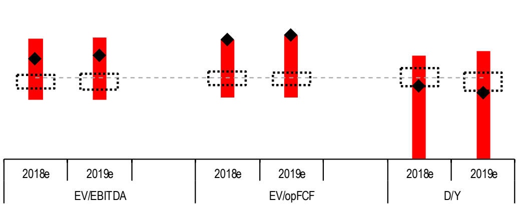
- Swisscom trades at a high EV/EBITDA vs the European peer incumbents. A large part of the premium is due to the lower effective tax rate (21% in Switzerland compared to 25-35% in the rest of the Europe) and to lower interest rates in Switzerland, which result in higher conversion to FCF
- Consensus estimates a flat revenue growth for Swisscom for the period 2017-19, while the EBITDA estimates have been revised upwards for the same period in last few months
- Historically, Swisscom seems to trade within the 4-5% dividend yield range. It is currently trading close to the lower end of the range, with an implied dividend yield of 4.2%.

Swisscom – Valuation benchmark chart

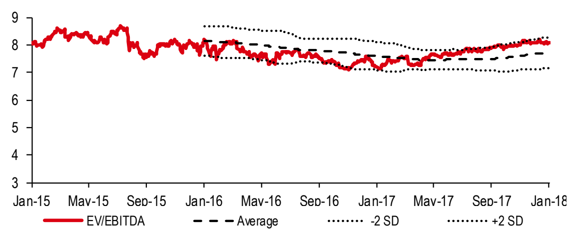
Recent performance

	1W	1M	3M	6M	12M
Price return	-0.2%	-0.1%	4.0%	9.9%	18.7%
Total return	-0.2%	-0.1%	4.0%	9.8%	24.6%
Total return vs SXKP	-1.4%	0.2%	3.3%	13.1%	21.4%
Total return vs MSCI Europe Telecom	-1.7%	-1.1%	3.4%	12.5%	18.4%
Total return vs SMI	-0.3%	-1.4%	0.6%	3.9%	7.7%

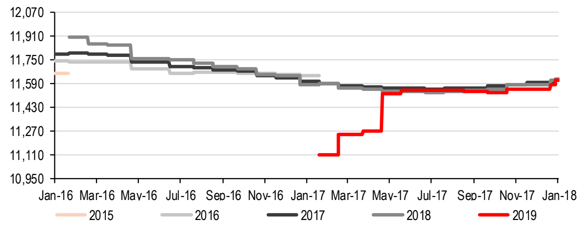
Relative valuation



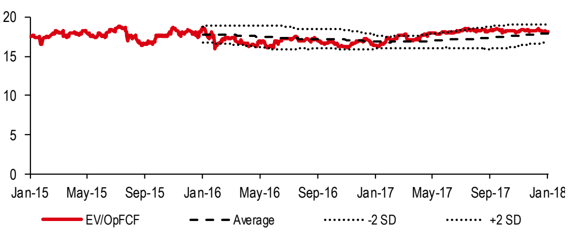
1yr fwd EV/EVITDA



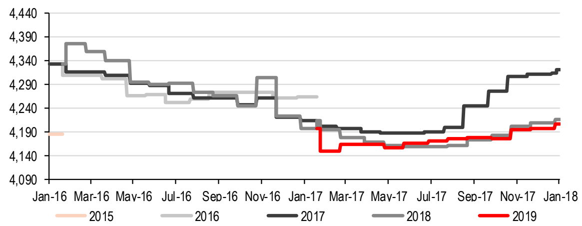
Sales estimates revision



1yr fwd EV/OpFCF

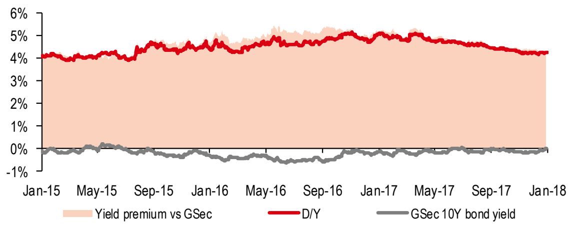


EBITDA estimates revision

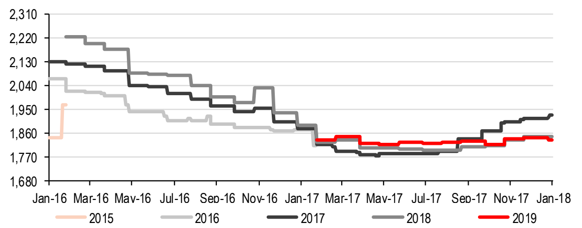


Capped at +/-50x levels

Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Swisscom

Hold

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (CHFm)				
Revenue	11,643	11,627	11,661	11,633
EBITDA	4,293	4,344	4,229	4,244
Depreciation & amortisation	-2,145	-2,123	-2,177	-2,206
Operating profit/EBIT	2,148	2,221	2,052	2,039
Net interest	-155	-157	-154	-156
PBT	1,990	2,055	1,887	1,872
HSBC PBT	1,970	1,953	1,887	1,872
Taxation	-386	-460	-399	-395
Net profit	1,604	1,593	1,488	1,476
HSBC net profit	1,555	1,539	1,488	1,476
Cash flow summary (CHFm)				
Cash flow from operations	3,714	3,699	3,495	3,519
Capex	-2,416	-2,431	-2,455	-2,386
Cash flow from investment	-2,448	-2,275	-2,455	-2,386
Dividends	-1,140	-1,140	-1,140	-1,139
Change in net debt	-196	22	100	5
FCF equity	1,343	1,299	1,224	1,308
Balance sheet summary (CHFm)				
Intangible fixed assets	6,912	6,897	6,777	5,195
Tangible fixed assets	10,177	10,744	11,142	11,443
Current assets	3,535	3,492	3,494	3,492
Cash & others	650	500	500	500
Total assets	21,454	21,894	22,163	20,551
Operating liabilities	2,853	2,888	2,878	2,875
Gross debt	8,496	8,368	8,468	8,473
Net debt	7,846	7,868	7,968	7,973
Shareholders' funds	6,514	7,481	7,830	8,167
Invested capital	17,121	17,745	18,034	16,755

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-0.3	-0.1	0.3	-0.2
EBITDA	4.8	1.2	-2.7	0.4
Operating profit	6.8	3.4	-7.6	-0.6
PBT	12.9	3.2	-8.1	-0.8
HSBC EPS	-1.9	-1.0	-3.3	-0.8
Ratios (%)				
Revenue/IC (x)	0.7	0.7	0.7	0.7
ROIC	10.6	10.6	9.6	9.8
ROE	26.5	22.0	19.4	18.4
ROA	8.1	7.9	7.3	7.5
EBITDA margin	36.9	37.4	36.3	36.5
Operating profit margin	18.4	19.1	17.6	17.5
EBITDA/net interest (x)	27.7	27.7	27.5	27.2
Net debt/equity	120.3	105.3	102.0	97.9
Net debt/EBITDA (x)	1.8	1.8	1.9	1.9
CF from operations/net debt	47.3	47.0	43.9	44.1
Per share data (CHF)				
EPS Rep (diluted)	30.99	30.78	28.75	28.51
HSBC EPS (diluted)	30.05	29.74	28.75	28.51
DPS	22.00	22.00	22.00	22.00
Book value	125.86	144.54	151.29	157.80

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Swisscom Revenues	11,643	11,627	11,661	11,633
Swisscom EBITDA adjusted	4,273	4,242	4,229	4,244
Swisscom EBIT adjusted	2,128	2,119	2,052	2,039
Swisscom Net income adjusted	1,584	1,491	1,488	1,476
Swisscom FCF definition (OpFCF)	1,791	1,825	1,606	1,688

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	3.1	3.1	3.1	3.1
EV/EBITDA	8.5	8.4	8.7	8.6
EV/IC	2.1	2.1	2.0	2.2
PE*	17.3	17.4	18.0	18.2
PB	4.1	3.6	3.4	3.3
FCF yield (%)	4.7	4.5	4.3	4.6
Dividend yield (%)	4.2	4.2	4.2	4.2

* Based on HSBC EPS (diluted)

Issuer information

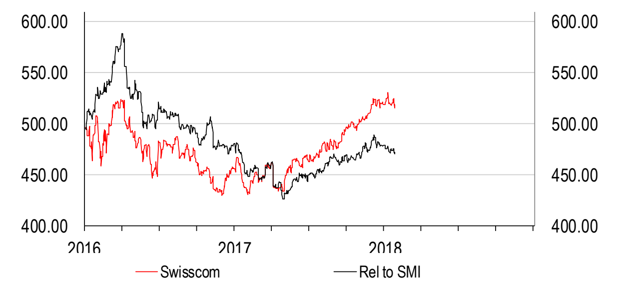
Share price (CHF)	518.80	Free float	42%
Target price (CHF)	515.00	Sector	Diversified Telecoms
Reuters (Equity)	SCMN.S	Country	Switzerland
Bloomberg (Equity)	SCMN SW	Analyst	Luigi Minerva
Market cap (USDm)	28,735	Contact	44 20 7991 6928

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.00	No. of board members	9
Energy Intensity (kWh/USD)	0.05	Average board experience (years)	4.7
CO2 reduction policy	Yes	Female board members (%)	33%
Social Indicators		Board members Independence (%)	56%
Employee costs as % of sales	11%		
Employee turnover (%)	9%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Q4 results: 2 February

TDC (TDC DC, DKK40.07, Hold, TP DKK39.80 from DKK38.00)

Investment Thesis

TDC is now more than half-way through a substantial restructuring which, to-date, has not suffered from some of the pitfalls that had initially caused us some unease. The share has rallied strongly from September 2017 lows (+12%) but we think valuation is now up with events. For longer-term sustained growth to be assured, we need to see evidence of a turnaround in B2B (especially when it comes to closing legacy products) and think that management needs to take some difficult decisions in the Consumer business.

Our view remains that Danish mobile – which DG Competition prevented from consolidating to three mobile network operators in 2015 – remains a tricky market, and one for which we think market enthusiasm has a tendency to get ahead of itself. Following the effective block on consolidation of Telia and Telenor's businesses, all mobile operators put through price rises. Nevertheless, the challenger brand of fourth operator Three – Oister – remains very competitively priced *and* continues to take market share. Without Oister shifting its prices upward, there appears to be a competitive constraint on broader price moves. Additionally 2018 will see a lapping of 2017 tariffs adjustments that stemmed from roam-like-at-home regulation. These were well received (indeed better than expected) but the challenge is to find a similar more-for-more story.

In fixed line the company has merged its consumer brands, and is now working exclusively under the YouSee banner (the old cable business). This helps marketing and product consistency, which is important given TDC operates both cable and copper networks. Consumers are now offered the best network available, which for 55% of households is cable. This network is being rapidly upgraded by Huawei to full DOCSIS 3.1, which should provide both a degree of future-proofing, and a quality of service boost to existing customers. TDC has agreed to a voluntary regulatory regime whereby wholesale access to its cable network is granted (in return for forbearance on wider regulation). These offers are in the early stages, and while we are cautious, initial take-up does not seem particularly problematic.

The area that does require attention is TV. We think the annual prices rises traditionally applied to TV tariffs are intrinsically unsustainable given the very real competitive pressure from OTT services. A bold option would be to announce substantial investment in set-top boxes (currently in less than 33% of TV homes) to increase access to the extra services (on-demand, catch-up etc) that are typically provided by a cable platform, and yet are absent for the bulk of Danish homes.

Finally in Denmark, the B2B market remains difficult, and we are yet to see the ambitious large-scale decommissioning of products that was promised as part of the company's restructuring plan. At the end of 2017, the government telecoms framework agreements (SKI) were largely successfully held. This should ease some of the earlier pressure on the B2B segment, but we would caution that this is typically a deflationary environment and end customers are hardly ramping up telecoms budgets.

The focus for 2018 will be on the company's ability to drive additional costs out of the business: as restructuring efforts come to an end, the output must be delivered. Structural headwinds remain in some divisions (eg Business), and yet consensus now expects EBITDA growth to be delivered in 2018. This, combined with falling capex from H2 2018e onward, is likely to support FCF growth, where consensus of DKK2.4bn is already ahead of guidance (DKK2.3bn). As leverage continues to fall, discussions will at some point turn to the outlook for the dividend, which after its earlier reset, means the stock presently yields just 2.9% (2018e).

Forecast changes

We make only very modest changes to the forecasts in our model as we update our forecasts after recent results, outlined in the table below.

Forecast changes

	New			Old			Delta (%)		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Revenue	20,423	20,136	20,098	20,518	20,174	20,128	-0.5%	-0.2%	-0.2%
Adjusted EBITDA	8,305	8,292	8,386	8,364	8,308	8,409	-0.7%	-0.2%	-0.3%
EFCF	2,200	2,331	2,561	2,216	2,317	2,556	-0.7%	0.6%	0.2%
DPS	1.05	1.10	1.16	1.05	1.10	1.16	0.0%	0.0%	0.0%

Source: HSBC estimates

Valuation

We adjust our FFCF-based DCF target price to DKK39.8 (from DKK38.0) (details on the assumptions and risks can be read in the *Valuation and risks section*), as a result of changes in forecasts and roll forward of our valuation. Our new TP implies 0.7% downside and we rate the stock Hold.

Free cash to the firm DCF valuation model

DKKm		2018e	2019e	2020e	2021e	2022e	2023e	2024e
EBITDA company		8,292	8,386	8,488	8,594	8,702	8,812	8,923
Cash Capex		-4,108	-4,011	-3,943	-3,896	-3,864	-3,845	-3,835
Cash tax		-706	-749	-799	-835	-912	-975	-1,045
tax rate		28.7%	27.7%	27.2%	26.9%	26.5%	26.3%	26.1%
Working Capital changes		0	0	0	0	0	0	0
Restructuring		-360	-288	-259	-233	-210	-189	-170
FCFF		**3,119**	**3,337**	**3,486**	**3,630**	**3,716**	**3,804**	**3,873**
Terminal Value								59,492
Discount Factor		1.00	0.94	0.88	0.83	0.78	0.73	0.68
Present value		3,119	3,133	3,073	3,004	2,888	2,775	2,653
PV of cash flows	17,525							
PV of TV	40,749							
Enterprise Value	**58,275**		Terminal growth rate		0.0%			
Net debt (FY18e)	-18,560		Cost of Capital		6.5%			
Adjust for hybrid capital (100%)	-5,552		Cost of equity		9.1%			
Contingent liability	-215							
Value of minorities	-157							
add back: dividend	843							
Appraised value of the equity	**34,634**							
Number of shares	803							
Fair Value per share	**39.80**							

Source: HSBC estimates

Relative Valuation

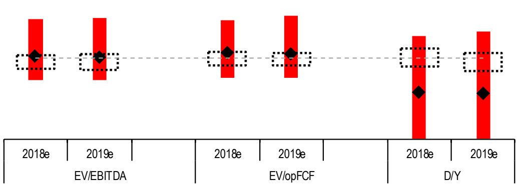
- The stock has seen continued re-rating in past 6 months; thus is currently trading above its historical levels
- Consensus revisions has been very modest in the past 6 months
- Compared to the peer group, TDC is trading in-line on EBITDA and OpFCF multiples; but its dividend yield is below the sector average.

TDC – Valuation benchmark chart

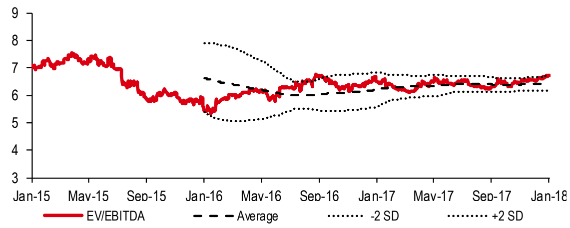
Recent performance

	1W	1M	3M	6M	12M
Price return	1.8%	4.5%	4.2%	2.9%	4.7%
Total return	1.8%	4.5%	4.1%	2.9%	7.6%
Total return vs SXKP	0.7%	4.8%	3.4%	6.1%	4.4%
Total return vs MSCI Europe Telecom	0.3%	3.6%	3.5%	5.5%	1.4%
Total return vs OMXC20	2.7%	3.2%	3.7%	-1.8%	-10.7%

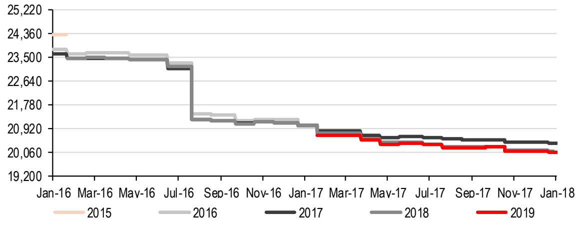
Relative valuation



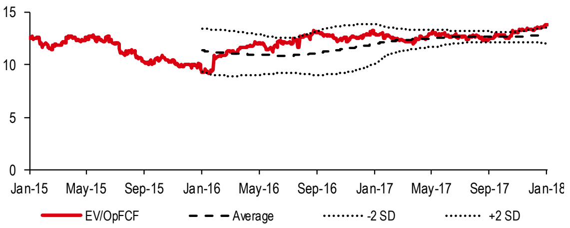
1yr fwd EV/EVITDA



Sales estimates revision

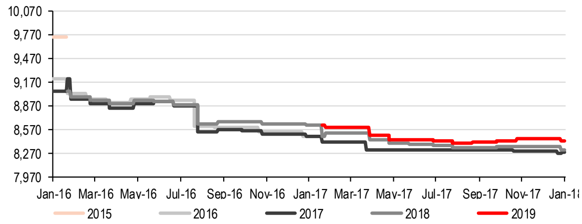


1yr fwd EV/OpFCF

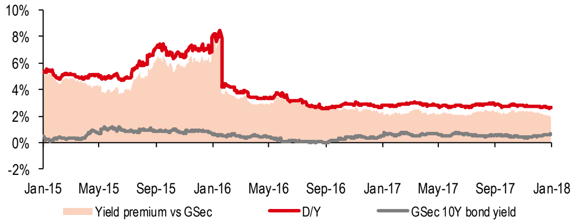


Capped at +/-50x levels

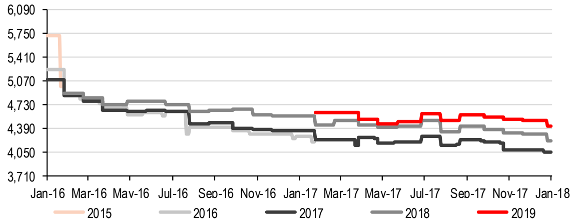
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: TDC A/S

Hold

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (DKKm)				
Revenue	21,031	20,423	20,136	20,098
EBITDA	8,207	8,005	7,932	8,098
Depreciation & amortisation	-4,940	-4,914	-4,806	-4,736
Operating profit/EBIT	3,267	3,091	3,126	3,361
Net interest	-765	-658	-658	-649
PBT	3,566	2,426	2,463	2,707
HSBC PBT	2,548	2,300	2,463	2,707
Taxation	-529	-606	-616	-677
Net profit	2,868	1,659	1,688	1,870
HSBC net profit	1,917	1,729	1,852	2,034
Cash flow summary (DKKm)				
Cash flow from operations	6,642	6,484	6,534	6,669
Capex	-4,454	-4,187	-4,108	-4,011
Cash flow from investment	-4,581	-3,758	-4,108	-4,011
Dividends	-802	-802	-843	-885
Change in net debt	-3,898	-1,939	-1,634	-1,822
FCF equity	2,610	2,554	2,551	2,760
Balance sheet summary (DKKm)				
Intangible fixed assets	34,208	32,827	32,047	31,315
Tangible fixed assets	18,041	17,989	18,021	17,979
Current assets	5,743	4,971	6,459	8,136
Cash & others	1,687	1,670	3,158	4,835
Total assets	64,332	62,472	63,208	64,104
Operating liabilities	10,170	10,101	10,053	10,026
Gross debt	24,186	21,998	21,852	21,706
Net debt	22,133	20,194	18,560	16,737
Shareholders' funds	24,206	24,319	24,926	25,672
Invested capital	46,135	44,016	43,316	42,569

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-13.7	-2.9	-1.4	-0.2
EBITDA	-12.2	-2.5	-0.9	2.1
Operating profit		-5.4	1.2	7.5
PBT		-32.0	1.6	9.9
HSBC EPS	-20.0	-9.9	7.1	9.9
Ratios (%)				
Revenue/IC (x)	0.5	0.5	0.5	0.5
ROIC	5.4	5.2	5.4	5.9
ROE	8.6	7.1	7.5	8.0
ROA	5.6	3.7	3.7	4.0
EBITDA margin	39.0	39.2	39.4	40.3
Operating profit margin	15.5	15.1	15.5	16.7
EBITDA/net interest (x)	10.7	12.2	12.1	12.5
Net debt/equity	91.4	83.0	74.0	64.4
Net debt/EBITDA (x)	2.7	2.5	2.3	2.1
CF from operations/net debt	30.0	32.1	35.2	39.8
Per share data (DKK)				
EPS Rep (diluted)	3.58	2.07	2.10	2.33
HSBC EPS (diluted)	2.39	2.15	2.31	2.53
DPS	1.00	1.05	1.10	1.16
Book value	30.18	30.30	31.06	31.99

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Adjusted EBITDA	8,474	8,305	8,292	8,386
Adj Net profit post Hybrid adjustment	2,064	1,901	1,958	2,086
Adj EPS post Hybrid adjustment	2.6	2.4	2.4	2.6
FCFE company definition	2,082	2,200	2,331	2,561
Adj Net Debt(incl Hybrid bond)	24,909	22,970	21,336	19,513
Adj Net Debt/EBITDA (x)	2.9	2.8	2.6	2.3

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	2.9	2.9	2.8	2.8
EV/EBITDA	7.4	7.3	7.2	6.8
EV/IC	1.3	1.3	1.3	1.3
PE*	16.8	18.6	17.4	15.8
PB	1.3	1.3	1.3	1.3
FCF yield (%)	6.8	6.7	6.6	7.1
Dividend yield (%)	2.5	2.6	2.8	2.9

* Based on HSBC EPS (diluted)

Issuer information

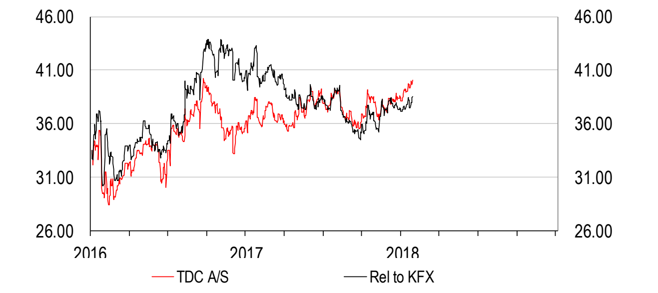
Share price (DKK)	40.07	Free float	100%
Target price (DKK)	39.80	Sector	Diversified Telecoms
Reuters (Equity)	TDC.CO	Country	Denmark
Bloomberg (Equity)	TDC DC	Analyst	Adam Fox-Rumley, CFA
Market cap (USDm)	5,435	Contact	+44 20 7991 6819

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.023	No. of board members	11
Energy Intensity (kWh/USD)	0.108	Average board experience (years)	4.3
CO2 reduction policy	Yes	Female board members (%)	36
Social Indicators		Board members Independence (%)	55
Employee costs as % of sales	18.1		
Employee turnover (%)	NA		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

HSBC

Luigi Minerva*
Analyst
HSBC Bank plc
luigi.minerva@hsbcib.com
+44 20 7991 6928

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Q4 results: 6 March

Telecom Italia (TIT IM, EUR0.72, Hold, TP EUR0.85)

Investment Thesis

The investment case of Telecom Italia remains challenging primarily due to two factors: the entrance of Iliad (which we expect in first half of 2018) and the ongoing parallel deployment of Open Fiber. Additionally, in Brazil, where TI has a c67% stake in TIM Participaçoes, in-market consolidation seems unlikely until Oi's restructuring is completed. We believe all these specific factors increase the level of risk embedded in the investment case, making overall the risk-reward profile still relatively unattractive.

Entry of Iliad: In our note *Telecom Italia – Hold: Iliad and OF, key challenges ahead*, 22 May 2017 we identify two tariffs Iliad could use to enter the Italian market: EUR2 (voice centric) and EUR12 (data centric). In our most recent tariff tracker (see *Italian Telecoms – Tariff tracker #4: 'below-the-line' and 'more-for-less'*, 27 November 2017) we conclude those tariff plans would represent, respectively, a 65%+ and 25%+ discount to comparable tariffs currently available in the market. We also highlight that price adjustments continue before Iliad's launch, with TI and Wind lowering the entry level with 'pay-as-you-go' plans. The companies are also targeting a specific group of customers proactively using 'below-the-line' promotions. Our TI valuation base case includes a 'normally disruptive' entry from Iliad, driving a TI mobile service revenue decline of 3.3% in FY18e, after growth in FY16 and FY17e. We expect around 11% market share (SIM ex M2M) by 2020 for Iliad. We also run 'Jio style' scenario analyses, should Iliad decide to launch its services for free initially: with TIM's 2018e ARPU declining by -10% and Iliad reaching 11% market share by 2019e, the impact on TI's equity value could be as high as 14c/share (see next page).

Open Fiber and the network spin-off debate: OF's plans are ambitious, aiming for a national FTTH deployment using existing civil infrastructure (largely made available by ENEL) as much as possible and, where possible, by-passing TI's local exchanges. OF's progress is slower than expected but we continue to consider it a credible threat. We expect it to cover 7.8m homes in the Clusters A and B by 2021 (compared to guidance of 9.5m). Regulation remains key: AGCOM should avoid cutting wholesale fibre prices and TI's SMP status should be revisited to take into account the emergence of a parallel fibre network. In recent months the possibility that TI may consider spinning off its fixed-line network has become again topical (see, for instance, *IlSole24Ore*, 24 November 2017). Amos Genish, TI's CEO, stated during the Q3 2017 conference call that the network remains a strategic asset and that giving up control is not an option for TI. In the meantime the government continues to apply some pressure with the Minister of Economic Development Carlo Calenda asking TI, as recently as December 2017 (see *IlSole24Ore*), to consider all options on the network, including a spin-off. We have a cautious view on the network spin-off as a viable, value-generating option; we believe the market tends to overestimate the impact that such a development may have on TI's value.

Brazil: we think TIM Brasil's postpaid subscriber, mobile services revenue and ARPU growth assumptions released in its 2017-19 Industrial Plan are too aggressive. The implied c6% revenue CAGR (c8% excluding MTRs) over the next three years looks possible in the very short term because of comps, but maintaining such a growth pace through 2019 seems unlikely to us, for no other reason than the competitive dynamics in Brazil, unless TIM captures a disproportionate amount of macro-fuelled telecom growth. Mr Genish stated in the Q3 2017 results conference call that TIM Brazil remains a core strategic asset. We see remote possibility of in-market consolidation in the short term. In fact, the potential interest for Oi (OIBR3 BZ BRL3.77, Reduce) from China Telecom (728 HK, HKD3.90, Buy – see *China Telcos*, 25 January 2018) could perpetuate the 4-player mobile market structure and enhance Oi's ability to be price disruptive.

A bear case: Iliad launches in the "Jio style"

In our note *Telecom Italia – Hold: Iliad and OF, key challenges ahead*, 22 May 2017 we ran two versions of our bear case scenario assuming a "Jio style" of entry by Iliad into the Italian market.

In scenario A, we assume a -5% y-o-y decline in TIM's ARPU in 2018 (compared to a base case of -1.8%).

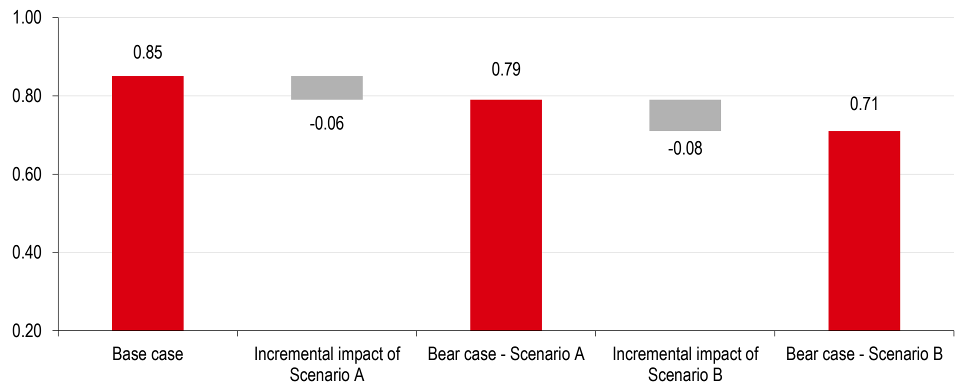
In scenario B, we assume a -10% y-o-y decline in TIM's ARPU in 2018 and a faster market share take-up with Iliad reaching 11% by 2019. In our base case we assume Iliad gains 11% market share by 2020 with TI's mobile ARPU declining by -1.8% in FY18e.

Refer to the waterfall chart below for the likely impact of such scenarios on our Telecom Italia's valuation.

Valuation

We derive our unchanged EUR0.85 target price from a DCF method (details on the assumptions and risks can be read in the *Valuation and risks section*), implying 18.0% upside and we rate the stock Hold as we expect TI to face increasing competitive pressures in the Italian market, with the entry of Iliad as a new mobile operator and the ongoing parallel deployment of Open Fiber.

Impact of bear case scenarios on Telecom Italia's fair value (EUR/share)



Source: HSBC

Relative Valuation

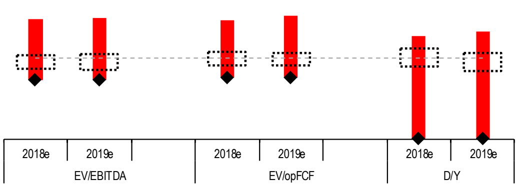
- TI continues to trade at a significant discount to peers on EV/EBITDA and on EV/OpCF.
- TI pays no dividend to the ordinary shareholders. We expect the dividend not to resume before 2020
- The company is trading in the lower half of the EV/EBITDA and EV/OpCF 1 yr forward multiple range (defined by 2 standard deviations) indicating the stock is currently relatively cheap compared to its historical multiples range.

Telecom Italia – Valuation benchmark chart

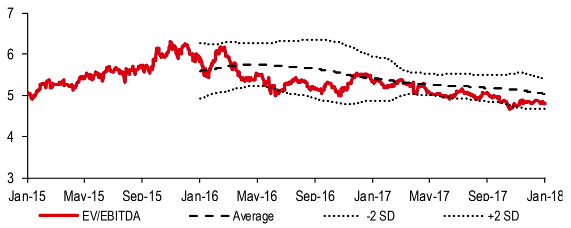
Recent performance

	1W	1M	3M	6M	12M
Price return	-0.2%	-2.4%	-4.4%	-16.9%	-11.1%
Total return	-0.1%	-2.4%	-4.3%	-16.8%	-11.1%
Total return vs SXKP	-1.2%	-2.0%	-5.0%	-13.6%	-14.2%
Total return vs MSCI Europe Telecom	-1.6%	-3.3%	-4.9%	-14.2%	-17.2%
Total return vs FTSE MIB INDEX	-0.8%	-10.1%	-9.5%	-28.3%	-37.8%

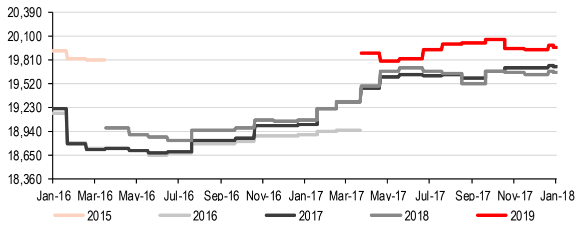
Relative valuation



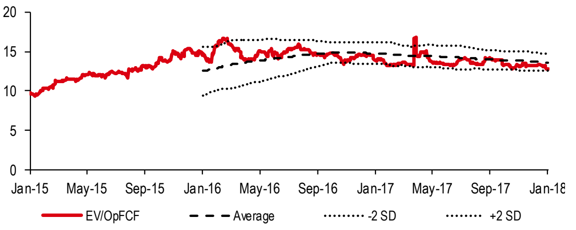
1yr fwd EV/EVITDA



Sales estimates revision

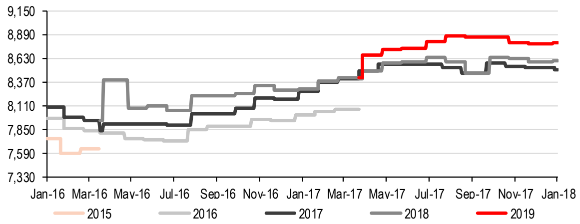


1yr fwd EV/OpFCF

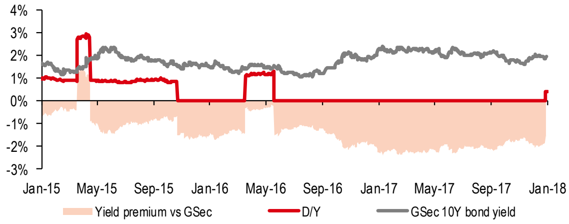


Capped at +/-50x levels

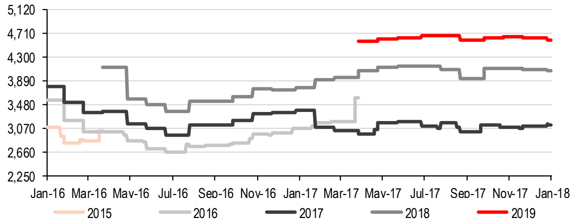
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Telecom Italia

Hold

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	19,025	19,868	19,848	19,921
EBITDA	8,002	8,526	8,562	8,554
Depreciation & amortisation	-4,291	-4,471	-4,595	-4,570
Operating profit/EBIT	3,722	4,058	3,966	3,984
Net interest	-907	-1,442	-1,412	-1,347
PBT	2,846	2,600	2,537	2,619
HSBC PBT	2,965	2,620	2,537	2,619
Taxation	-880	-1,046	-945	-976
Net profit	1,808	1,157	1,156	1,155
HSBC net profit	1,702	1,247	1,156	1,155
Cash flow summary (EURm)				
Cash flow from operations	6,111	5,980	6,224	6,190
Capex	-5,108	-6,338	-4,425	-4,221
Cash flow from investment	-4,414	-6,103	-4,425	-4,221
Dividends	-227	0	-166	-166
Change in net debt	-2,159	529	-1,633	-1,804
FCF equity	1,009	-501	1,821	2,008
Balance sheet summary (EURm)				
Intangible fixed assets	36,563	37,894	38,475	38,961
Tangible fixed assets	16,360	17,144	16,392	15,557
Current assets	11,662	10,126	10,657	10,668
Cash & others	3,964	2,466	3,000	3,000
Total assets	70,446	70,866	71,222	70,880
Operating liabilities	8,283	8,610	8,649	8,657
Gross debt	34,525	33,030	31,930	30,127
Net debt	25,119	25,648	24,014	22,211
Shareholders' funds	21,207	22,346	23,337	24,326
Invested capital	52,338	54,088	53,876	53,529

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-3.5	4.4	-0.1	0.4
EBITDA	14.2	6.5	0.4	-0.1
Operating profit	33.9	9.0	-2.3	0.4
PBT	224.5	-8.6	-2.4	3.2
HSBC EPS	943.4	-26.7	-7.3	-0.1
Ratios (%)				
Revenue/IC (x)	0.4	0.4	0.4	0.4
ROIC	5.5	5.7	5.5	5.6
ROE	8.8	5.7	5.1	4.8
ROA	4.3	3.6	3.6	3.6
EBITDA margin	42.1	42.9	43.1	42.9
Operating profit margin	19.6	20.4	20.0	20.0
EBITDA/net interest (x)	8.8	5.9	6.1	6.4
Net debt/equity	106.6	102.3	90.8	79.6
Net debt/EBITDA (x)	3.1	3.0	2.8	2.6
CF from operations/net debt	24.3	23.3	25.9	27.9
Per share data (EUR)				
EPS Rep (diluted)	0.09	0.05	0.05	0.05
HSBC EPS (diluted)	0.08	0.06	0.05	0.05
DPS	0.00	0.00	0.00	0.00
Book value	1.01	1.06	1.11	1.16

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Domestic business	15,006	15,144	15,057	14,937
Brazilian mobile	4,047	4,756	4,823	5,016
Others/Elimination	-28	-32	-32	-32
Group Revenues	19,025	19,868	19,848	19,921

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	2.4	2.3	2.2	2.1
EV/EBITDA	5.6	5.3	5.1	4.9
EV/IC	0.9	0.8	0.8	0.8
PE*	8.9	12.2	13.1	13.1
PB	0.7	0.7	0.6	0.6
FCF yield (%)	5.1	-2.5	9.3	10.2
Dividend yield (%)	0.0	0.0	0.0	0.0

* Based on HSBC EPS (diluted)

Issuer information

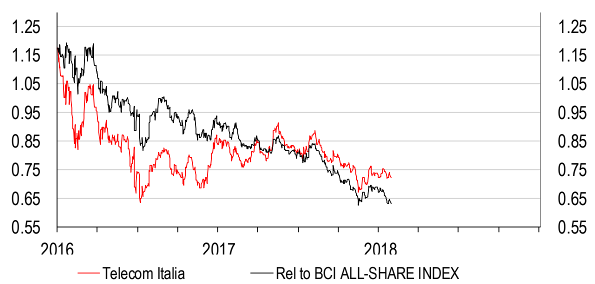
Share price (EUR)	0.72	Free float	78%
Target price (EUR)	0.85	Sector	Diversified Telecoms
Reuters (Equity)	TLIT.MI	Country	Italy
Bloomberg (Equity)	TIT IM	Analyst	Luigi Minerva
Market cap (USDm)	18,206	Contact	44 20 7991 6928

ESG metrics

Environmental Indicators		**Governance Indicators**	
GHG Intensity (kg/USD)	0.04	No. of board members	15
Energy Intensity (kWh/USD)	0.14	Average board tenure (years)	2.6
CO2 reduction policy	Yes	Female board members (%)	40%
Social Indicators		Board members Independence (%)	60%
Employee costs as % of sales	16.3%		
Employee turnover (%)	11%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC
Note: Priced at close of 26 Jan 2018

Luigi Minerva*
Analyst
HSBC Bank plc
luigi.minerva@hsbcib.com
+44 20 7991 6928

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Q4 results: 22 February

Telefónica (TEF SM, EUR8.50, Hold, TP EUR9.0 from EUR9.3)

Investment Thesis

Telefonica's presence in key European markets (Spain and Germany, which combined contribute over 40% of group EBITDA) makes it a beneficiary of improved regulation and consolidation (with the notable exception of the UK) in Europe. However, in Brazil (Telefonica's key international market), we see remote possibilities of in-market consolidation in the short term. In fact, the potential interest for Oi from China Telecom (728 HK, Buy, HKD3.90 – see *China Telcos*, 25 January 2018) may perpetuate the 4-player mobile market structure and enhance Oi's ability to be price disruptive. Performance in the rest of LatAm remains very much mixed: The Mexican operation is chronically sub-scale with profitability under pressure, Chile and Peru are experiencing disruptive competition, which also affects profitability, while Colombia and Argentina are performing relatively well.

Spain: In its domestic market Spain, our key concern continues to be the existence of parallel networks. As we discussed in *Choose your poison* (31 March 2017), in markets where alternative operators have deployed their own network, they face no recurrent wholesale cost, and have therefore more freedom to be disruptive for the sake of gaining market share. In fact, ongoing wholesale costs are an important factor in determining a market's orderliness: they represent a marginal cost that must be covered month by month, quarter by quarter and therefore reflected in retail tariffs; they are rather different from the industry's bête noir, namely, sunk costs, which are cost associated with a parallel network deployment.

Brazil: We see limited scope for consolidation in fixed-line following the acquisition of GVT by Telefonica Brasil (VIVT4 BZ, BRL52.94, Hold). Any combination with Oi, in our view, is unlikely in the short term, as we expect the incumbent coming out of the reorganisation to be recapitalised to operate on its own for a while in 'proof of concept' mode. Another milestone required for consolidation would be the concession regime becoming an authorisation one, an uncertain 2018 event because of elections.

At the **group** level, we expect the focus to remain on deleveraging both organically and with a possible IPO of UK operations (see *Financial Times*, 27 June 2017). We estimate a 2018 leverage ratio of 3.1x, treating the hybrids as 100% debt. We expect the dividend to remain flat at 40c/share (implying a 4.7% dividend yield) also in 2018e-19e, which would imply a comfortable ~40% FCF payout ratio (2018e-19e)

HSBC

Forecast changes

We have reduced our estimates with the main impact from the depreciation of LatAm currencies vs EUR. As such, we estimate the weighted average basket of non-EUR currencies (in countries where TEF has operations) has depreciated by 4% since we last published (in September 2017). In the table below, we summarise our changes in estimates.

Telefonica – Changes in estimates

(In EURm)	2017e	2018e	2019e
Revenue			
New	52,432	51,137	52,340
Old	52,647	52,847	54,416
% Change	-0.4%	-3.2%	-3.8%
Adjusted EBITDA			
New	16,653	16,405	17,084
Old	16,902	17,098	17,918
% Change	-1.5%	-4.1%	-4.7%
Capex			
New	8,160	7,878	7,939
Old	8,188	8,060	8,223
% Change	-0.3%	-2.3%	-3.5%
EPS			
New	0.69	0.75	0.90
Old	0.70	0.73	0.93
% Change	-1.8%	3.3%	-3.4%

Source: HSBC estimates

Valuation

We adjust our TP to EUR9 from EUR9.3 as we reduce our estimates, partially offset by rolling forward of our valuation to Feb-18. We use a DCF-based SOTP method to derive our new TP (details on the assumptions and risks can be read in the *Valuation and risks section*), which implies 5.8% upside and we rate the stock Hold as concerns remain on the competitive environment in its domestic market Spain and LatAm region.

Telefonica Valuation summary

(EURm)	EV	Proportion of total EV	Method	Implied EV/Sales (2018e)	Implied EV/EBITDA (2018e)	EBITDA Margin (2018e)
Telefonica de España	41,508	38%	DCF	3.3	7.9	41%
LatAm	43,492	39%		1.8	5.8	31%
HispanoAmerica	21,918	20%	DCF	1.9	6.4	30%
Brazil	21,574	20%	Spot price	1.8	5.4	33%
Europe (Germany and UK)	25,546	23%	DCF + TP	1.9	7.2	26%
Total EV	**110,546**					
Group net debt (2018e)	-42,750					
Deferred tax assets/liabilities	4,357					
Hybrid (100%)	-7,469					
Minorities	-12,266					
Investment and other assets	631					
Contingent Liability	-5,702					
Dividend still to be paid	2,077					
Equity value (Dec-18)	49,425					
Equity value (Feb-18)	46,662					
Number of Shares (m)	5,192					
Target price (Feb-18)	**9.0**					

Source: HSBC estimates

Relative Valuation

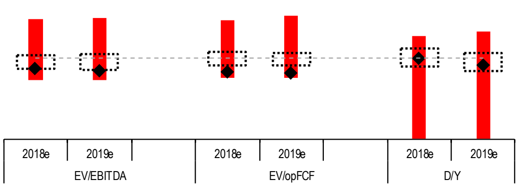
- TEF is currently trading at the average of the EV/EBITDA and EV/OpCF 1 yr forward multiple range (defined by 2 standard deviation)
- Telefonica is trading at a 2018e dividend yield of 4.7% broadly in line with the peer average
- The recent downward revision in the consensus revenue and EBITDA estimates could be explained, in our view, by the depreciation of LatAm currencies vs EUR.

Telefónica – Valuation benchmark chart

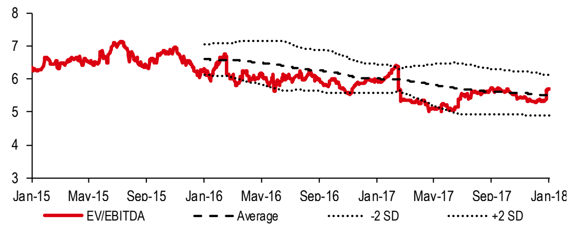
Recent performance

	1W	1M	3M	6M	12M
Price return	3.0%	3.0%	-3.4%	-10.1%	-6.8%
Total return	3.0%	3.0%	-1.5%	-8.4%	-3.4%
Total return vs SXKP	1.8%	3.3%	-2.2%	-5.1%	-6.6%
Total return vs MSCI Europe Telecom	1.4%	2.1%	-2.1%	-5.8%	-9.6%
Total return vs IBEX 35	1.8%	-1.4%	-4.9%	-10.0%	-18.6%

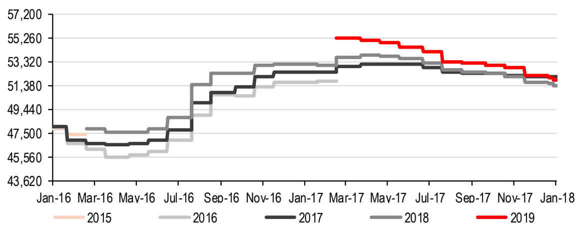
Relative valuation



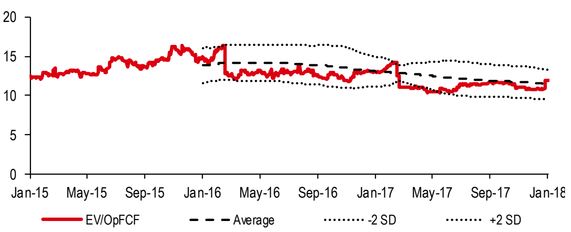
1yr fwd EV/EVITDA



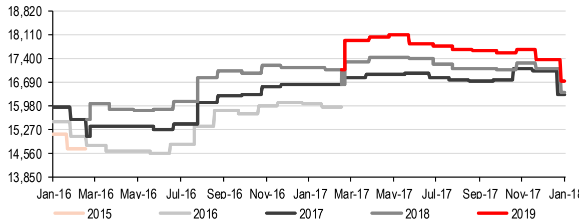
Sales estimates revision



1yr fwd EV/OpFCF

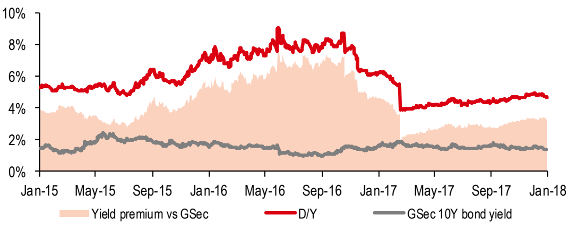


EBITDA estimates revision

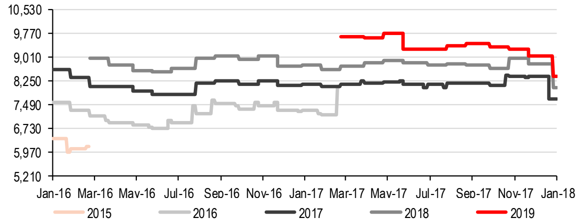


Capped at +/-50x levels

Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Telefonica

Hold

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	52,035	52,432	51,137	52,340
EBITDA	15,118	16,519	16,405	17,084
Depreciation & amortisation	-9,649	-9,482	-8,904	-8,602
Operating profit/EBIT	5,469	7,037	7,502	8,481
Net interest	-2,219	-2,154	-1,638	-1,550
PBT	3,246	4,886	5,867	6,934
HSBC PBT	4,622	4,927	5,468	6,535
Taxation	-847	-1,219	-1,407	-1,663
Net profit	2,369	3,487	4,195	4,967
HSBC net profit	3,482	3,565	3,893	4,664
Cash flow summary (EURm)				
Cash flow from operations	12,827	13,810	13,187	13,502
Capex	-8,846	-9,162	-7,878	-7,939
Cash flow from investment	-10,098	-9,007	-7,978	-8,039
Dividends	-2,906	-2,527	-2,476	-2,476
Change in net debt	-566	-3,113	-2,732	-2,987
FCF equity	4,673	4,351	5,695	6,012
Balance sheet summary (EURm)				
Intangible fixed assets	49,204	46,336	46,436	46,536
Tangible fixed assets	36,393	33,344	32,318	31,654
Current assets	19,974	19,930	19,634	19,815
Cash & others	3,736	4,601	4,500	4,500
Total assets	123,641	116,154	114,936	114,556
Operating liabilities	20,702	19,743	19,459	19,418
Gross debt	60,361	56,573	53,740	50,752
Net debt	48,595	45,482	42,750	39,762
Shareholders' funds	18,157	17,449	19,568	22,458
Invested capital	81,133	75,265	74,429	74,088

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-5.2	0.8	-2.5	2.4
EBITDA	14.3	9.3	-0.7	4.1
Operating profit	55.1	28.7	6.6	13.1
PBT	258.7	50.5	20.1	18.2
HSBC EPS	19.7	-0.2	9.2	19.8
Ratios (%)				
Revenue/IC (x)	0.7	0.7	0.7	0.7
ROIC	5.3	6.8	7.6	8.7
ROE	20.5	20.0	21.0	22.2
ROA	3.4	4.6	5.1	5.7
EBITDA margin	29.1	31.5	32.1	32.6
Operating profit margin	10.5	13.4	14.7	16.2
EBITDA/net interest (x)	6.8	7.7	10.0	11.0
Net debt/equity	171.2	170.1	149.8	127.8
Net debt/EBITDA (x)	3.2	2.8	2.6	2.3
CF from operations/net debt	26.4	30.4	30.8	34.0
Per share data (EUR)				
EPS Rep (diluted)	0.47	0.67	0.81	0.96
HSBC EPS (diluted)	0.69	0.69	0.75	0.90
DPS	0.55	0.40	0.40	0.40
Book value	3.59	3.36	3.77	4.33

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
T. Espana	12,816	12,640	12,679	12,823
T. UK	6,860	6,540	6,565	6,663
T.Brasil	11,090	12,598	12,263	12,760
T. HispanoAmerica	12,579	12,486	11,581	11,994
T. Deutschland	7,504	7,242	7,145	7,175
Total Group Revenue	52,035	52,432	51,137	52,340

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	2.2	2.1	2.1	2.0
EV/EBITDA	7.5	6.7	6.5	6.1
EV/IC	1.4	1.5	1.4	1.4
PE*	12.4	12.4	11.3	9.5
PB	2.4	2.5	2.3	2.0
FCF yield (%)	7.2	6.7	8.8	9.3
Dividend yield (%)	6.5	4.7	4.7	4.7

* Based on HSBC EPS (diluted)

Issuer information

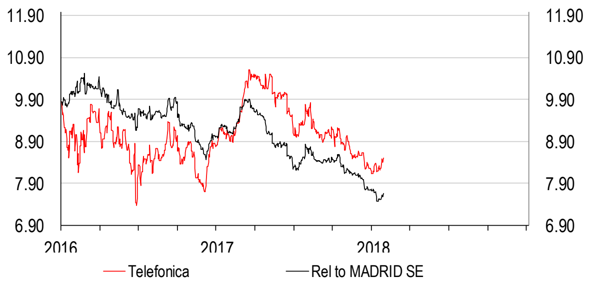
Share price (EUR)	8.50	Free float	100%
Target price (EUR)	9.00	Sector	Diversified Telecoms
Reuters (Equity)	TEF.MC	Country	Spain
Bloomberg (Equity)	TEF SM	Analyst	Luigi Minerva
Market cap (USDm)	54,893	Contact	44 20 7991 6928

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.04	No. of board members	18
Energy Intensity (kWh/USD)	0.10	Average board experience (years)	10
CO2 reduction policy	Yes	Female board members (%)	11%
Social Indicators		Board members Independence (%)	50%
Employee costs as % of sales	15.6%		
Employee turnover (%)	6.8%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

HSBC

Luigi Minerva*
Analyst
HSBC Bank plc
luigi.minerva@hsbcib.com
+44 20 7991 6928

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Telefónica Deutschland (O2D GR, EUR3.99, Hold, TP EUR4.10)

Investment Thesis

Telefonica Deutschland (O2D) is Telefonica's German subsidiary (69.2%-owned by TEF, 9.5%-owned by KPN, 21.3% free float) and is a pure German telecom operator benefiting from a healthy three-player market structure. O2D faces mobile service revenue pressure as its customer mix changes, with wholesale gaining more weight. Combined with roaming and termination revenue losses we see reported service revenue growth deteriorate in 2017 and slight negative growth in 2018 as well. However, we believe the impact on gross profits from the change in customer mix should be limited given the gross profit per wholesale customer is not necessarily lower than that of a retail customer given no direct commercial costs for a wholesale customer. We expect FCF to grow strongly and cover dividends by 2020. With an underleveraged balance sheet, we believe O2D's commitment to grow dividends is credible.

Q4: 21 February

Forecast changes

The changes to our forecasts, as summarised in the table below, are primarily explained by our incorporating the Q3 2017 results into our model. Overall, the impact on valuation is not meaningful.

Telefónica Deutschland – Changes in estimates

	New			Old			Delta		
(In EURm)	2017e	2018e	2019e	2017e	2018e	2019e	2017e	2018e	2019e
Wireless Service revenue	5,259	5,239	5,302	5,212	5,226	5,292	0.9%	0.2%	0.2%
Revenue	7,242	7,145	7,175	7,076	7,047	7,090	2.3%	1.4%	1.2%
EBITDA clean	1,813	1,858	1,901	1,807	1,832	1,886	0.3%	1.4%	0.8%
Y-o-Y growth	-0.8%	2.5%	2.4%	-1.0%	1.4%	2.9%			
EBITDA margin	25.0%	26.0%	26.5%	25.5%	26.0%	26.6%	-2.0%	0.0%	-0.4%
FCFE	358	692	765	359	720	742	-0.2%	-3.9%	3.0%
Dividends paid	-744	-781	-803	-744	-781	-803	0.0%	0.0%	0.0%

Source: HSBC estimates

Valuation

We derive our unchanged EUR4.10 target price from a DCF method (details on the assumptions and risks can be read in the *Valuation and risks section*), implying 2.7% upside and we rate the stock Hold based on an attractive dividend yield supported by strong cash conversion but limited valuation upside.

DCF – Telefonica Deutschland

	EURm		
EV (Germany)	13,562	**WACC**	
Value non-core assets	0	RFR	2.5%
Contingent liabilities	0	Kd	3.0%
Dividends to be paid	781	Beta	1.0
Net debt 2018e	-1,295	MRP	6.0%
Equity Value	13,048	Ke	8.5%
Shares (in m)	2,975	D/(D+E)	18.0%
Value per share	**4.1**	E/(D+E)	82.0%
current share price	3.99	tax rate	12.8%
upside	2.7%	**WACC**	**7.4%**
		TGR	0.5%

Source: HSBCe

Financials & valuation: Telefonica Deutschland

Hold

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	7503.0	7241.8	7144.9	7175.0
EBITDA	2068.9	1760.7	1857.7	1901.4
Depreciation & amortisation	-2118.5	-1915.1	-1879.3	-1835.0
Operating profit/EBIT	-49.7	-154.4	-21.6	66.4
Net interest	-35.8	-38.1	-42.1	-42.2
PBT	-85.4	-192.5	-63.7	24.2
HSBC PBT	-391.5	-186.4	-114.2	-30.7
Taxation	-90.1	0.0	0.0	0.0
Net profit	-175.5	-192.5	-63.7	21.1
HSBC net profit	-391.5	-186.4	-114.2	-30.7
Cash flow summary (EURm)				
Cash flow from operations	2283.3	1610.7	1799.3	1848.2
Capex	-1101.5	-1030.5	-1107.5	-1083.4
Cash flow from investment	-990.6	-1145.5	-1107.5	-1083.4
Dividends	-713.9	-744.0	-780.9	-803.3
Change in net debt	-426.1	407.3	89.1	38.5
FCF equity	1078.5	570.3	691.8	764.7
Balance sheet summary (EURm)				
Intangible fixed assets	8146.1	7389.8	6500.8	5611.8
Tangible fixed assets	4216.7	4114.7	4231.9	4369.3
Current assets	2245.7	1975.0	1965.3	1968.3
Cash & others	612.8	700.0	700.0	700.0
Total assets	15300.8	14146.4	13364.9	12616.4
Operating liabilities	3218.4	3441.1	3437.4	3462.3
Gross debt	1757.7	2141.7	2230.9	2269.4
Net debt	798.5	1205.7	1294.9	1333.4
Shareholders' funds	9408.4	7707.6	6840.6	6028.7
Invested capital	10777.3	9338.3	8560.5	7787.0

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-4.9	-3.5	-1.3	0.4
EBITDA	14.7	-14.9	5.5	2.4
Operating profit				
PBT				
HSBC EPS				
Ratios (%)				
Revenue/IC (x)	0.7	0.7	0.8	0.9
ROIC	7.3	7.3	9.7	11.7
ROE	-4.0	-2.2	-1.6	-0.5
ROA	-0.9	-1.0	-0.2	0.5
EBITDA margin	27.6	24.3	26.0	26.5
Operating profit margin	-0.7	-2.1	-0.3	0.9
EBITDA/net interest (x)	57.8	46.2	44.1	45.1
Net debt/equity	8.5	15.6	18.9	22.1
Net debt/EBITDA (x)	0.4	0.7	0.7	0.7
CF from operations/net debt	286.0	133.6	139.0	138.6
Per share data (EUR)				
EPS Rep (diluted)	-0.06	-0.06	-0.02	0.01
HSBC EPS (diluted)	-0.13	-0.06	-0.04	-0.01
DPS	0.25	0.26	0.27	0.28
Book value	3.16	2.59	2.30	2.03

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Service revenues reported	5,437	5,259	5,239	5,302
Mobile Revenues	6,498	6,361	6,338	6,413
Fixed Line Revenues	981	866	793	748
EBITDA clean	1,828	1,813	1,858	1,901
EBITDA reported	2,068	1,761	1,858	1,901

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	1.7	1.8	1.8	1.8
EV/EBITDA	6.1	7.4	7.1	6.9
EV/IC	1.2	1.4	1.5	1.7
PB	1.3	1.5	1.7	2.0
FCF yield (%)	9.1	4.8	5.8	6.4
Dividend yield (%)	6.3	6.6	6.8	7.0

* Based on HSBC EPS (diluted)

Issuer information

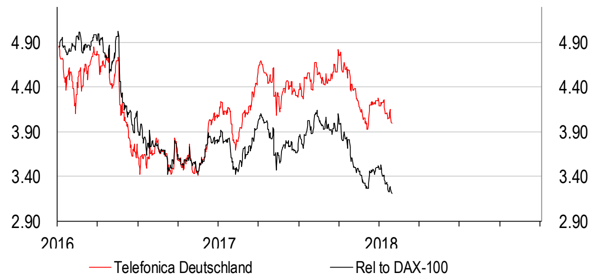
Share price (EUR)	3.99	Free float	21%
Target price (EUR)	4.10	Sector	Diversified Telecoms
Reuters (Equity)	O2Dn.F	Country	Germany
Bloomberg (Equity)	O2D GR	Analyst	Luigi Minerva
Market cap (USDm)	14764.2	Contact	44 20 7991 6928

ESG metrics

Environmental Indicators		**Governance Indicators**	
GHG Intensity (kg/USD)	0.05	No. of board members	24
Energy Intensity (kWh/USD)	0.1	Average board experience (years)	3.94
CO2 reduction policy	Yes	Female board members (%)	29%
Social Indicators		Board members Independence (%)	33%
Employee costs as % of sales	9%		
Employee turnover (%)	17.9%		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC
Note: Priced at close of 26 Jan 2018

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Q4 results: 13 February

Telekom Austria (TKA AV, EUR7.93, Reduce, TP EUR7.50, from EUR7.00)

Investment Thesis

The biggest threat that Telekom Austria faces in the medium term is an increasingly converged domestic market. While Austrian telecoms services remain comparatively skewed towards mobile connectivity (certainly versus European peers), there are signs that commercial directions may be poised to change. Three has bought the broadband base of Tele2, representing its first European foray into fixed line. Three's local management has unsurprisingly made some forthright statements of intent about the opportunity that a broader business offers it, highlighting areas where it sees opportunities to take market share.

This would be noteworthy by itself, but at the end of 2017, Deutsche Telekom announced it was seeking to acquire Liberty Global's Austrian business, UPC Austria. This increases the likelihood that a far more significant converged market strategy is likely to be followed by Telekom Austria's competitors.

We are not arguing that TKA is unable to compete in this space (the company's domestic business has been converged since 2010, orchestrated by current Vodafone Germany CEO Hannes Ametsreiter), but that its 59% broadband market share may be vulnerable. TKA has taken mobile subsidies to very low levels in Austria (and indeed more widely), but this is an area that could see upward pressure. Additionally, TKA's target to get 40Mbps fixed broadband to 70% of the country by the end of 2018, may require something of an upgrade, especially if UPC Austria gets a quick boost to DOCSIS3.1. This strategy would allow Deutsche Telekom to compete on quality rather than price (as we imagine it would prefer), but could nevertheless open a substantial gap to the incumbent.

We have one further structural concern in Austria; the set-up of mobile tariffs. These are split into three tiers – premium, optimiser and value (TKA's terms), and TKA has three brands that it deploys across the segments. Our concern is that the premium brand, 'A1', which is also used for the convergent portfolio, is simultaneously being used for SIM only tariffs at prices that overlap with unsuitable rival brands (in particular the MVNO from supermarket chain Hofer), suggesting that there is a risk of spin-down.

Telekom Austria's Group growth profile shows substantial differences between the reported figures and like-for-like measures. 2017's financial performance has been flattered by M&A, currency benefits and one-offs, while operationally, sales growth has been substantially assisted by growth in handset sales (which are low margin). The company's fixed line performance has been good, helped by sales of fixed line broadband across the portfolio, but growth in core mobile service revenue (50% of Group sales) has been negative in the majority of markets (including Austria).

We have argued that given persistent ongoing restructuring costs (related to reducing the size of the active workforce), it is imperative to look at the business on an equity FCF yield, rather than an OpFCF multiple. On this basis, and taking into account the financial characteristics described above, following a dramatic re-rating since mid-2016, the stock screens as being at the expensive end of the sector at below 6%.

We note that the company tends to guide conservatively, and we expect the same for 2018.

Forecast changes

We make small operational changes to our forecasts as we update our model after Q3 results, detailed in the table below.

Forecast changes

	New			Old			Delta		
	2017	2018	2019	2017	2018	2019	2017	2018	2019
Revenue	4,336	4,318	4,307	4,326	4,324	4,324	0.2%	-0.1%	-0.4%
Clean EBITDA	1,385	1,395	1,413	1,369	1,383	1,410	1.2%	0.9%	0.2%
Clean Net Income	319	322	340	298	323	352	7.0%	-0.4%	-3.3%
Capex	721	728	724	727	733	731	-0.9%	-0.6%	-1.0%
Op CF	664	667	689	641	651	679	3.6%	2.5%	1.5%

Nb: clean adjusts for exceptional items
Source: HSBC estimates

Valuation

We adjust our TP to EUR7.50 from EUR7.0 following upward revision in forecasts and roll forward of valuation to current date. We use a FCFF-based DCF method to derive our new TP (details on the assumptions and risks can be read in the *Valuation and risks section*), which implies 5.4% downside and we rate the stock Reduce given competition concerns.

Free cash to the firm DCF valuation model

EURm			2018e	2019e	2020e	2021e	2022e	2023e
Adjusted EBITDA			1,395	1,413	1,422	1,425	1,424	1,421
Cash Capex			-768	-754	-742	-729	-721	-722
Cash tax			-34	-36	-38	-39	-40	-40
Net cash interest			-113	-121	-121	-121	-121	-121
Interest paid on Hybrid			-34	0	0	0	0	0
WC changes			-25	-23	-20	-18	-16	-15
Dividends received			1	1	1	1	1	1
Cash cost of restructuring			-96	-91	-87	-82	-78	-30
FCF to equity			**326**	**390**	**416**	**437**	**449**	**494**
Add: Net interest costs & Hybrid divi			147	121	121	121	121	121
Less: Tax shield			-34	-28	-28	-28	-28	-28
Free cash flow to firm			**439**	**482**	**509**	**529**	**542**	**587**
Continuity Value								8,733
Discount Factor			1.00	0.93	0.87	0.81	0.76	0.70
PV of FCFF			439	450	443	429	409	413
PV of Continuity Value								6,154
PV of total explicit cash flows	2,144	25.8%						
PV of TV	6,154	74.2%						
Enterprise Value	**8,298**							
Value of non-core assets	45							
Contingent liability	-361							
Net Debt YE2018	-2,624							
Hybrid Bonds	0							
Equity Value	5,358							
NOS	664							
Value per share	**7.50**							

Financial summary & valuation		2016	2017e	2018e	2019e	2020e	2021e	2022e
EBITDA margin		31.7%	32.1%	32.3%	32.8%	33.1%	33.3%	33.4%
Capex/sales		18.1%	16.6%	16.9%	16.8%	16.8%	16.8%	16.9%
At current price (EUR)	**8.10**							
Equity FCF yield		3.1%	5.6%	6.1%	7.2%	7.7%	8.1%	8.3%
Dividend yield		2.5%	2.5%	2.6%	4.9%	4.9%	4.9%	4.9%
EV/EBITDA		6.2x	6.0x	6.0x	5.9x	5.8x	5.8x	5.8x
EV/(EBITDA-Capex)		15.9x	13.6x	13.3x	12.6x	12.2x	12.0x	11.8x
At target price (EUR)	**7.50**							
Equity FCF yield		3.3%	6.0%	6.5%	7.8%	8.3%	8.7%	8.9%
Dividend yield		2.6%	2.6%	2.8%	5.3%	5.3%	5.3%	5.3%
EV/EBITDA		6.2x	6.0x	5.9x	5.9x	5.8x	5.8x	5.8x
EV/(EBITDA-Capex)		15.8x	13.5x	13.2x	12.6x	12.2x	11.9x	11.8x

Source: HSBC estimates

Relative Valuation

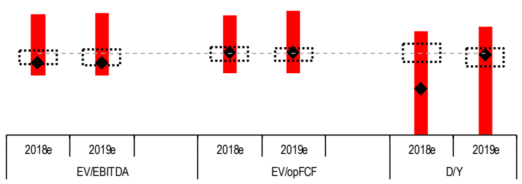
- Telekom Austria was one of the strongest performers in the sector in 2017, returning 36%.
- Despite this appreciation the company is approximately on the 25th centile on EV/EBITDA, though more centrally valued using EV/OpFCF. We have stressed the importance of looking at the company's valuation on an equity FCF basis
- Rising consensus estimates have helped support this return to sector-level trading multiples, though much of this has been driven by acquisitions

Telekom Austria – Valuation benchmark chart

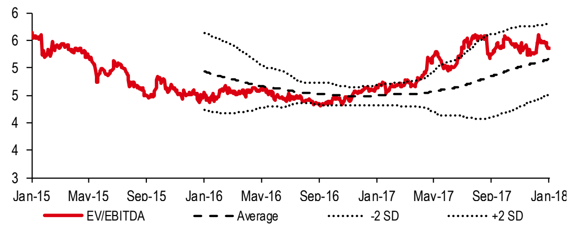
Recent performance

	1W	1M	3M	6M	12M
Price return	-2.7%	2.3%	-1.5%	7.8%	40.8%
Total return	-2.7%	2.3%	-1.5%	7.8%	44.9%
Total return vs SXKP	-3.8%	2.7%	-2.1%	11.0%	41.7%
Total return vs MSCI Europe Telecom	-4.2%	1.4%	-2.1%	10.4%	38.7%
Total return vs ATX	-3.1%	-4.0%	-10.2%	-5.2%	7.3%

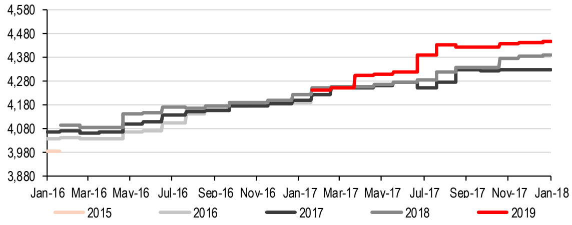
Relative valuation



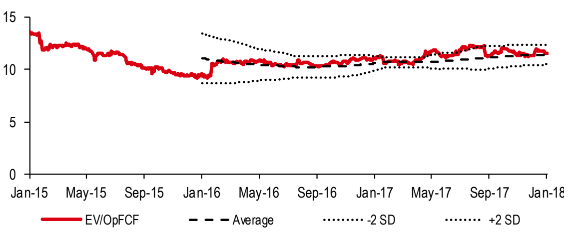
1yr fwd EV/EVITDA



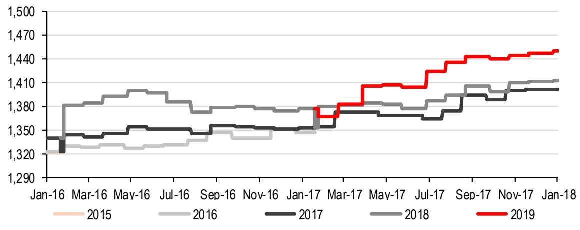
Sales estimates revision



1yr fwd EV/OpFCF

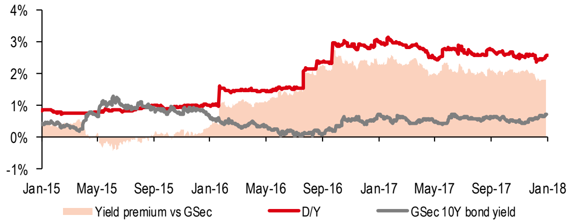


EBITDA estimates revision

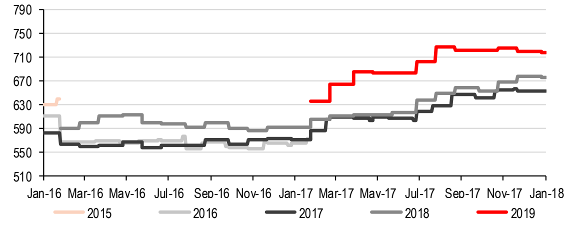


Capped at +/-50x levels

Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Telekom Austria

Reduce

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (EURm)				
Revenue	4,211	4,336	4,318	4,307
EBITDA	1,354	1,395	1,385	1,403
Depreciation & amortisation	-868	-867	-858	-849
Operating profit/EBIT	487	528	527	554
Net interest	-138	-103	-118	-147
PBT	360	422	409	407
HSBC PBT	329	405	409	407
Taxation	54	-36	-34	-34
Net profit	387	360	373	373
HSBC net profit	302	372	375	373
Cash flow summary (EURm)				
Cash flow from operations	997	1,082	1,084	1,110
Capex	-817	-771	-768	-754
Cash flow from investment	-825	-841	-768	-754
Dividends	-33	-133	-139	-139
Change in net debt	-144	-100	384	-216
FCF equity	329	336	344	355
Balance sheet summary (EURm)				
Intangible fixed assets	3,563	3,442	3,283	3,143
Tangible fixed assets	2,551	2,612	2,642	2,656
Current assets	1,439	2,043	1,682	1,919
Cash & others	464	1,044	660	876
Total assets	7,943	8,485	7,993	8,104
Operating liabilities	1,348	1,448	1,412	1,537
Gross debt	2,804	3,284	3,284	3,283
Net debt	2,339	2,240	2,624	2,408
Shareholders' funds	2,769	2,833	2,468	2,576
Invested capital	5,741	5,605	5,534	5,306

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	-0.4	2.9	-0.4	-0.3
EBITDA	-1.0	3.0	-0.7	1.3
Operating profit	-14.8	8.6	-0.3	5.1
PBT	-13.6	17.4	-3.2	-0.5
HSBC EPS	-17.2	23.1	0.9	-0.5
Ratios (%)				
Revenue/IC (x)	0.7	0.8	0.8	0.8
ROIC	13.0	13.8	13.7	14.2
ROE	11.6	13.3	14.1	14.8
ROA	6.8	6.0	6.0	6.5
EBITDA margin	32.2	32.2	32.1	32.6
Operating profit margin	11.6	12.2	12.2	12.9
EBITDA/net interest (x)	9.8	13.5	11.8	9.6
Net debt/equity	84.4	79.0	106.2	93.4
Net debt/EBITDA (x)	1.7	1.6	1.9	1.7
CF from operations/net debt	42.6	48.3	41.3	46.1
Per share data (EUR)				
EPS Rep (diluted)	0.58	0.54	0.56	0.56
HSBC EPS (diluted)	0.45	0.56	0.56	0.56
DPS	0.20	0.20	0.21	0.40
Book value	4.17	4.27	3.72	3.88

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Adjusted Revenues	4,230	4,316	4,318	4,307
Adjusted EBITDA	1,340	1,385	1,395	1,413
Adjusted EBIT	475	518	537	564
Adjusted net profit	258	319	322	320
FCFE clean	165	311	326	366
Net Debt/EBITDA adjusted for 100% Hybrid	1.7	1.6	1.9	1.7

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	1.8	1.7	1.8	1.7
EV/EBITDA	5.4	5.2	5.6	5.3
EV/IC	1.3	1.3	1.4	1.4
PE*	17.4	14.2	14.0	14.1
PB	1.9	1.9	2.1	2.0
FCF yield (%)	6.5	6.6	6.8	7.0
Dividend yield (%)	2.5	2.5	2.6	5.0

* Based on HSBC EPS (diluted)

Issuer information

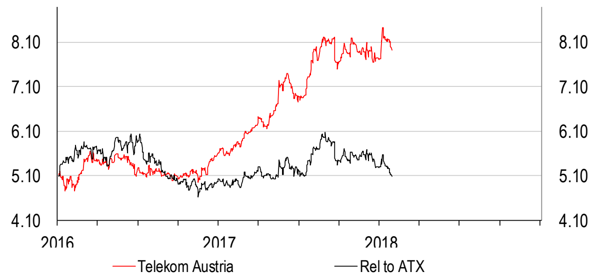
Share price (EUR)	7.93	Free float	21%
Target price (EUR)	7.50	Sector	Diversified Telecoms
Reuters (Equity)	TELA.VI	Country	Austria
Bloomberg (Equity)	TKA AV	Analyst	Adam Fox-Rumley, CFA
Market cap (USDm)	6,552	Contact	+44 20 7991 6819

ESG metrics

Environmental Indicators		**Governance Indicators**	
GHG Intensity (kg/USD)	0.04	No. of board members	17
Energy Intensity (kWh/USD)	0.16	Average board experience (years)	4.77
CO2 reduction policy	Yes	Female board members (%)	12%
Social Indicators		Board members Independence (%)	88%
Employee costs as % of sales	19%		
Employee turnover (%)	NA		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

HSBC

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

** Employed by a non-US affiliate of HSBC Securities (USA) Inc, and is not registered/ qualified pursuant to FINRA regulations*

Q4 results: 31 January

Telenor (TEL NO, NOK182.15, Hold, TP NOK170.0 from NOK150.0)

Investment Thesis

Telenor in the most international company in European telecoms. On our sum-of-the-parts, almost 50% of the company's enterprise value comes from its Asian operations, and the domestic Norwegian business accounts for just 27% of the total. This is despite the fact that the company has sold some international operations in 2017, with a disposal of its Indian business (23 February 2017), and the structuring of a complete withdrawal from Veon (21 September 2017). In our view, the market should be looking for this geographical exposure to provide above-sector average revenue growth; current medium-term guidance is for 'low single-digit organic revenue growth'.

The 2017 Capital Markets Day (2 February 2017) emphasised a deep focus on cost reduction, with an explicit target for *net* opex reductions of 1-3% per year 2018-2020. This should be a very appealing narrative to investors, and appears to be being delivered on; by Q3 2017 the company had already reached its NOK1bn target. These cost savings, combined with a capex/sales ratio of 15-16% should deliver strong FCF growth (pre-spectrum), which will supports the company's aspiration to grow DPS y-o-y.

Spectrum spend will be a big focus in 2018, in particular in Thailand, which has a history of expensive auctions. Clarity remains relatively limited, with recent suggestions (*see Bangkok post, 19 January 2018*) that a planned auction of 900MHz spectrum will be suspended, and larger amounts of 1800MHz sold; irrespective of this we expect a competitive auction (with N-1 bidding methodology applied) and one in which DTAC really needs to succeed. Allocation of spectrum in Malaysia and Bangladesh has historically been at comparatively low prices and is probably not something for stakeholders to worry about. An award of 700MHz spectrum in Sweden by the end of 2018 may be more costly.

Fibre build in the Nordic countries continues, with a focus on Norway, where the company looks to roll network out once c.50% of homes in an area have expressed an interest. We expect there to be another three or four years of steady construction to be done. In contrast, Sweden remains in land-grab mode, but this is increasingly in more rural (and therefore economically challenging) sites. Telenor consequently appears to be comfortable relying largely on third-party networks rather than extensive own-build.

Competition in the Nordic consumer markets requires continued monitoring. In Norwegian mobile, third operator ICE (Not listed) is focussed on the lowest price points and is outspending peers on commissions, while TDC's Get (an MVNO) appears to be selling largely into its cable base; to date a meaningful threat to Telenor has not materialised. Convergence has not begun in Norway, however Telia spoke of its active hunt for fixed broadband assets in the market (Q4 conference call), and the introduction of quad-play raises the possibility that some form of discounting might follow. Convergence is increasingly the story in Sweden, where Telia has taken tentative first steps, but the market may be accelerated should the proposed merger of Tele2 and Com Hem go ahead as planned. Telenor would be comparatively out-positioned should this deal go ahead.

On valuation Telenor trades a premium to the sector on FCF yield (7.7% vs. peers on 9%, 2018e) but this is somewhat supported by the cost savings that are being delivered. The company's 4.4% dividend yield is in line with the sector average. It is hard therefore, to find substantial additional upside to the current share price.

Forecast changes

We have updated our model for Sep 17 results. Our EBITDA forecasts increase c.2% as we increase cost savings forecasts. Our capex forecasts have reduced, in line with management commentary and recent trends. This leads to increase in our cash flow forecasts. Our 2017e cash forecasts are benefitted by one-off cash inflow from Veon stake disposal.

Forecast changes table

	New			Old			Delta		
NOKm	FY2017e	FY2018e	FY2019e	FY2017e	FY2018e	FY2019e	FY2017e	FY2018e	FY2019e
Revenue	125,881	125,844	127,860	126,946	127,567	129,332	-0.8%	-1.4%	-1.1%
EBITDA clean	49,393	49,935	51,548	48,242	48,977	50,347	2.4%	2.0%	2.4%
margin	*39.2%*	*39.7%*	*40.3%*	*38.0%*	*38.4%*	*38.9%*			
opFCF	30,447	30,032	32,412	27,608	29,003	30,878	10.3%	3.5%	5.0%

Source: HSBC estimates

Valuation

We adjust our TP to NOK170.0 from NOK150.0 as a result of increases in our EBITDA estimates. We use a FCFF-based DCF method (from SOTP earlier to bring our assessment of the equity value in-line with the bulk of our coverage) to derive our new TP (details on the assumptions and risks can be read in the *Valuation and risks section*), which implies 6.7% downside and we rate the stock Hold as we believe current share price is supported by sector leading cost performance.

FCFF based DCF valuation

NOKm, unless stated	2017e	2018e	2019e	2020e	2021e	2022e	2023e	2024e
Adjusted EBITDA	49,040	50,135	51,848	52,541	53,422	54,310	55,209	56,120
Cash Capex	-20,043	-19,903	-19,137	-19,438	-19,760	-20,101	-20,459	-20,832
Cash tax	-6,134	-7,783	-8,084	-8,572	-8,860	-9,170	-9,457	-9,727
Net cash interest	-1,226	-1,196	-1,080	-1,259	-1,046	-841	-643	-454
WC changes	-548	-143	-248	-130	-143	-132	-123	-116
FCFF	**21,111**	**21,109**	**23,299**	**23,143**	**23,613**	**24,067**	**24,526**	**24,991**
Add: Net interest costs	1,226	1,196	1,080	1,259	1,046	841	643	454
Less: Tax shield	-328	-320	-289	-337	-280	-225	-172	-121
Free cash flow to firm	**22,010**	**21,986**	**24,090**	**24,066**	**24,380**	**24,683**	**24,997**	**25,323**
Terminal value								413,996
Discount Factor	1.00	1.00	0.93	0.87	0.81	0.76	0.71	0.66
PV of FCFF	22,010	21,986	22,477	20,950	19,802	18,706	17,675	16,706
PV of Terminal Value								273,126
PV of total explicit cash flows	116,316	29.9%						
PV of TV	273,126	70.1%						
Enterprise Value	**389,443**							
Value of non-core assets	3,823							
Minorities	-73,192							
Pension deficit	-2,411							
Contingent liability (proportionate)	-12,128							
Net Debt YE2018	-38,719							
add back: ND attributable to minority	4,943							
Equity Value	**271,759**							
NOSH (m)	1,501							
Value per share (NOK)	**170**							

Source: HSBC estimates

Relative Valuation

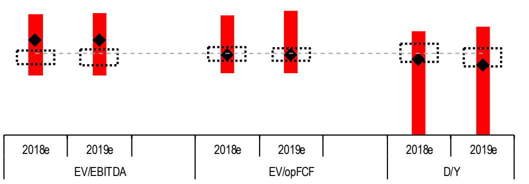
- Telenor is richly valued, trading at the upper end of EV/EBITDA multiples and the lower end of the peer group on dividend yield
- The company is currently trading at the higher end of EV/EBITDA 1yr forward multiple range (defined by 2 standard deviations). Thus justifying the hold rating of the stock
- The recent positive momentum in EBITDA estimates are driven by cost reduction, with an explicit target for net opex reductions of 1-3% per year 2018-2020

Telenor – Valuation benchmark chart

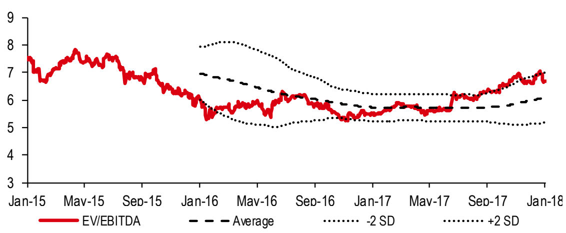
Recent performance

	1W	1M	3M	6M	12M
Price return	-3.7%	2.0%	5.1%	14.5%	37.2%
Total return	-3.8%	2.0%	7.2%	16.9%	44.4%
Total return vs SXKP	-4.9%	2.4%	6.6%	20.1%	41.3%
Total return vs MSCI Europe Telecom	-5.3%	1.1%	6.6%	19.5%	38.3%
Total return vs OBX OSLO	-2.5%	0.1%	4.1%	3.3%	27.0%

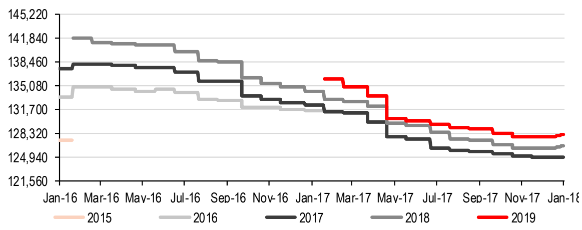
Relative valuation



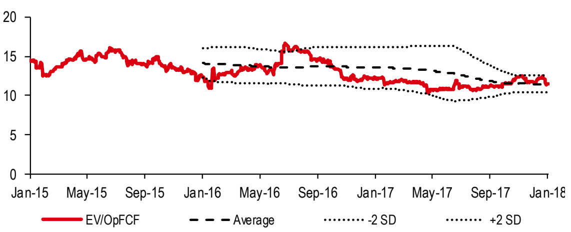
1yr fwd EV/EVITDA



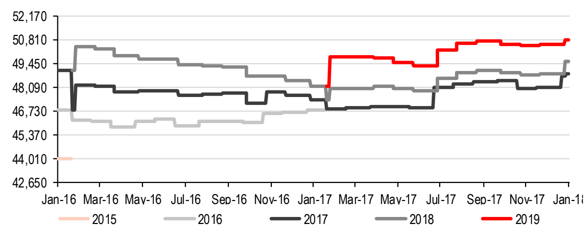
Sales estimates revision



1yr fwd EV/OpFCF

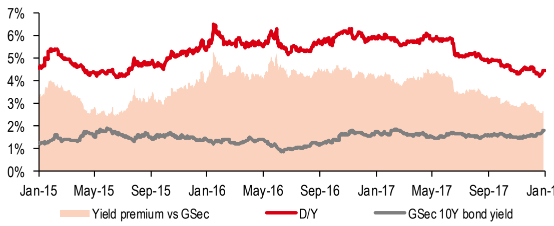


EBITDA estimates revision

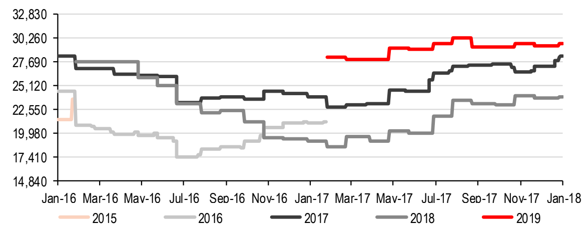


Capped at +/-50x levels

Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

HSBC

Financials & valuation: Telenor

Hold

Financial statements

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Profit & loss summary (NOKm)				
Revenue	125,395	125,881	125,844	127,860
EBITDA	45,049	49,393	49,935	51,548
Depreciation & amortisation	-20,742	-20,703	-19,862	-19,821
Operating profit/EBIT	24,307	28,691	30,073	31,728
Net interest	-2,509	-2,280	-1,719	-1,549
PBT	11,995	23,693	28,609	30,433
HSBC PBT	27,721	25,995	28,609	30,433
Taxation	-5,924	-7,783	-8,084	-8,572
Net profit	3,097	12,932	17,445	18,590
HSBC net profit	16,649	15,838	17,945	19,090
Cash flow summary (NOKm)				
Cash flow from operations	36,639	38,989	38,104	39,373
Capex	-21,840	-18,946	-18,311	-17,606
Cash flow from investment	-21,105	-11,492	-19,903	-17,606
Dividends	-11,246	-11,961	-11,824	-11,943
Change in net debt	281	-10,330	-6,376	-8,294
FCF equity	15,749	19,837	21,678	23,573
Balance sheet summary (NOKm)				
Intangible fixed assets	57,575	56,162	50,951	46,705
Tangible fixed assets	72,016	74,106	79,359	82,920
Current assets	52,991	45,257	51,628	60,224
Cash & others	26,313	20,682	27,058	35,352
Total assets	206,319	191,432	198,100	206,267
Operating liabilities	51,648	61,908	62,178	62,840
Gross debt	86,361	65,777	65,777	65,777
Net debt	54,381	44,051	37,675	29,381
Shareholders' funds	50,879	48,003	54,028	61,025
Invested capital	104,622	92,935	92,701	91,658

Ratio, growth and per share analysis

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Y-o-y % change				
Revenue	2.3	0.4	0.0	1.6
EBITDA	3.8	9.6	1.1	3.2
Operating profit	2.8	18.0	4.8	5.5
PBT	-6.0	97.5	20.8	6.4
HSBC EPS	36.7	-4.8	13.3	6.4
Ratios (%)				
Revenue/IC (x)	1.2	1.3	1.4	1.4
ROIC	17.0	21.3	23.8	25.3
ROE	30.5	32.0	35.2	33.2
ROA	4.0	9.1	11.4	11.6
EBITDA margin	35.9	39.2	39.7	40.3
Operating profit margin	19.4	22.8	23.9	24.8
EBITDA/net interest (x)	18.0	21.7	29.1	33.3
Net debt/equity	98.2	83.7	63.8	44.1
Net debt/EBITDA (x)	1.2	0.9	0.8	0.6
CF from operations/net debt	67.4	88.5	101.1	134.0
Per share data (NOK)				
EPS Rep (diluted)	2.06	8.62	11.62	12.39
HSBC EPS (diluted)	11.09	10.55	11.96	12.72
DPS	7.80	7.88	7.96	8.04
Book value	33.89	31.98	36.00	40.66

Key forecast drivers

Year to	12/2016a	12/2017e	12/2018e	12/2019e
Telenor revenue	125,395	125,881	125,844	127,860
Telenor EBITDA adjusted	46,059	49,040	50,135	51,848
Telenor PBT adjusted	28,731	25,642	28,809	30,733
Telenor Net income adjusted	19,834	14,884	17,734	18,928
Telenor OCF definition	24,220	30,094	30,232	32,712

Valuation data

Year to	12/2016a	12/2017e	12/2018e	12/2019e
EV/sales	3.3	3.2	3.1	3.0
EV/EBITDA	9.0	8.1	7.9	7.5
EV/IC	3.9	4.3	4.2	4.2
PE*	16.4	17.3	15.2	14.3
PB	5.4	5.7	5.1	4.5
FCF yield (%)	4.5	5.6	6.1	6.6
Dividend yield (%)	4.3	4.3	4.4	4.4

* Based on HSBC EPS (diluted)

Issuer information

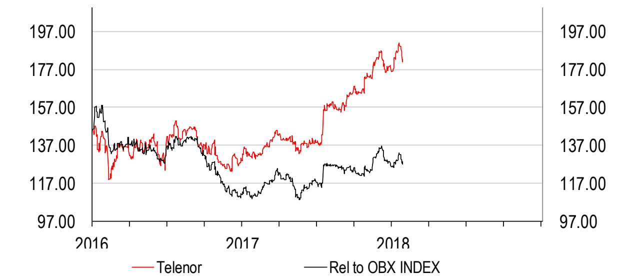
Share price (NOK)	182.15	Free float	46%
Target price (NOK)	170.00	Sector	Diversified Telecoms
Reuters (Equity)	TEL.OL	Country	Norway
Bloomberg (Equity)	TEL NO	Analyst	Adam Fox-Rumley, CFA
Market cap (USDm)	35,611	Contact	+44 20 7991 6819

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.09	No. of board members	21
Energy Intensity (kWh/USD)	0.26	Average board experience (years)	3
CO2 reduction policy	Yes	Female board members (%)	38%
Social Indicators		Board members Independence (%)	29%
Employee costs as % of sales	10%		
Employee turnover (%)	NA		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Telia Company (TELIA SS, SEK38.53, Hold, TP SEK37.6, from SEK42.0)

Investment Thesis

Telia is a company hunkering down to its core; by the end of 2018 it should be exclusively operating in the Nordic and Baltic regions (aside from a global Carrier business), having also substantially reduced its holdings in associate companies in 2017.

It has now been two years since the company's Eurasian assets were classified as 'held for sale', yet effecting disposals has not been straightforward despite management confidence a year ago. Most recently, Geocell has been disposed of (100% owned by Fintur) while Kazakhtelecom has permission from Kazakhstan's antitrust committee to buy 75% of Kcell which would be both Telia's direct 24% stake and Fintur's 51%. A piece-by-piece disposal of Fintur Holdings (owned alongside Turkcell) is now plainly on the agenda; smaller companies may be more digestible by local players. Following the settlement with the US DoJ (USD965m, c. SEK7.9bn), Ucell is probably in a more saleable state. We note a tax dispute in Nepal has surfaced (see *The Kathmandu Post*, 4 January 2018), well after Ncell was sold (Telia denies any liability), highlighting the sale of these assets may not entirely end the company's involvement in the region.

Domestically, there are several items on the agenda in Sweden. Most pressing is the outlook for fibre network expansion. This has been problematic in 2017, not from a demand perspective, but rather the company is running into practical issues associated with a progressively rural build-out (eg securing relevant permits). The market remains in land-grab mode, as overbuild is limited; we still think Telia is likely to build more than peers. But recent Swedish sales growth has seen a meaningful contribution from the substantial connection fees paid and a slower network build adds pressure here. The next challenge is the convergence of fixed and mobile tariffs. This is not in evidence today in Sweden, but Tele2's bid for Com Hem can be expected to change this should it successfully conclude. Telia's management wishes to reduce the threat of discounting by offering more-for-more, but market dynamics are not entirely in its control.

Outside Sweden, the company is pushing to achieve better growth rates in Finland, which the market should be able to support. In Norway, the consumer mobile market is comparatively quiet; commercial pressure may come from either third operator ICE or TDC's Get (an MVNO) but neither is especially active at present. More significantly the integration of B2B mobile provider Phonero is set to complete in early 2018, doubling Telia's size. Potentially this is a flash point for more competition. Denmark is treading water and being managed for cash, while the Baltic countries get little attention, given their scale within the Group.

The company had to instigate special cost-saving measures at its H1 2017 results in order to achieve the full year EBITDA targets. Mostly savings came from headcount reductions, and as such the impact was visible in both Q3 and Q4. There will be a benefit to flow through into the first half of 2018 from these changes. Given the ongoing pressures in the B2B market, the company may need to find further savings as the year develops.

On valuation, the stock trades roughly in-line with sector peers at 6.9x 2018e EBITDA. The company raised its dividend to SEK2.30 from SEK2.0, thus implying an attractive yield of 6.0% compared to 4.7% average of peers. This and the prospect of more cost savings should provide some support, but the increasingly competitive domestic market is a medium-term concern.

Forecast changes

We make small changes to our operational forecasts post FY17 results, primarily raising EBITDA estimates in Finland and Denmark, partly offset by negative revisions in Sweden. The 13-14% reductions in EPS are a consequence of the sale of associate stakes in Megafon and Turkcell at the end of 2017, and the consequent removal (respectively full and partial) of associate income.

Forecast changes (in SEKm, except EPS in SEK)

	New			Old			Delta		
in SEKm	**2018e**	**2019e**	**2020e**	**2018e**	**2019e**	**2020e**	**2018e**	**2019e**	**2020e**
Revenue	80,053	80,150	80,491	78,605	78,712	79,026	1.8%	1.8%	1.9%
Adj EBITDA*	26,016	26,188	26,411	25,826	25,996	26,210	0.7%	0.7%	0.8%
Adj EPS*	2.31	2.44	2.59	2.68	2.83	3.03	-13.8%	-13.9%	-14.4%
Capex**	-14,031	-13,296	-13,172	-13,527	-12,889	-12,785	3.7%	3.2%	3.0%

*Adjusted is before restructuring costs
** Accrued capex including capex on intangible assets
Source: HSBC estimates

Valuation

Our fair value target price is reduced to SEK37.6 from SEK42.0, primarily driven by c.25% lower realisation from associate stake sale in Turkcell and Megafon than our estimates (details on the assumptions and risks can be read in the *Valuation and risks section*). Our new TP implies 2.4% downside and we rate the stock Hold.

Free cash to the firm DCF valuation model

SEKm			**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**
EBITDA reported			25,516	25,988	26,251	26,539	26,845	27,164	27,495
Cash capex			-14,214	-13,479	-13,355	-13,290	-13,272	-13,441	-13,611
Cash net interest			-1,611	-1,520	-1,514	-1,504	-1,495	-1,478	-1,456
Cash tax paid			-1,405	-1,671	-1,946	-2,487	-2,546	-2,609	-2,673
Change in WC + Provisions			-106	500	250	0	0	0	0
Equity FCF			**8,179**	**9,818**	**9,686**	**9,257**	**9,532**	**9,636**	**9,755**
add back: Net cash interest			1,611	1,520	1,514	1,504	1,495	1,478	1,456
Less:			-337	-318	-316	-314	-313	-309	-304
FCFF			**9,454**	**11,020**	**10,884**	**10,447**	**10,715**	**10,805**	**10,907**
TV									**191,309**
PV explicit cash flows			9,454	10,323	9,549	8,586	8,249	7,792	7,367
PV of terminal cash flow									129,219
PV of total explicit cash flows	51,865	28.6%							
PV of TV	129,219	71.4%							
Total EV – continuing business	**181,085**								
EV of discontinued business	**6,335**								
Net debt (FY18e)	-35,353		Includes 50% of Hybrid						
add back: FY18 Dividend pay-out	9,959		Interim paid in April, Final in October						
Associates	25,810								
Minorities	-2,335								
Contingent liabilities	-8,992		Adj for 50% of Hybrid + 25% of Ncell CGT liability						
Appraised value of equity	**176,509**								
Shares (m)	4,330								
Price per share (SEK) - Dec 18	**40.8**								
Target price (SEK/share) - Jan 18	**37.6**								

Source: HSBC estimates

Relative Valuation

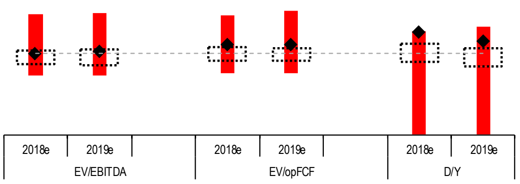
- Cost saving program lead to upward revisions of consensus EBITDA forecasts
- Stock trades in line with peers on EBITDA metrics; but D/Y of 6% is at the upper end of the peer group.
- We believe outperformance vs SXKP in past 3 months is driven by group's recent successful exits from non-core business/regions

Telia Company – Valuation benchmark chart

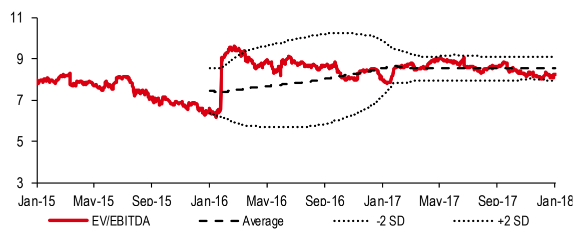
Recent performance

	1W	1M	3M	6M	12M
Price return	3.5%	4.0%	1.8%	0.7%	5.4%
Total return	3.5%	3.9%	1.7%	3.4%	11.1%
Total return vs SXKP	2.4%	4.2%	1.0%	6.7%	8.0%
Total return vs MSCI Europe Telecom	2.0%	2.9%	1.0%	6.0%	5.0%
Total return vs OMXS30	4.6%	3.5%	4.2%	0.9%	3.6%

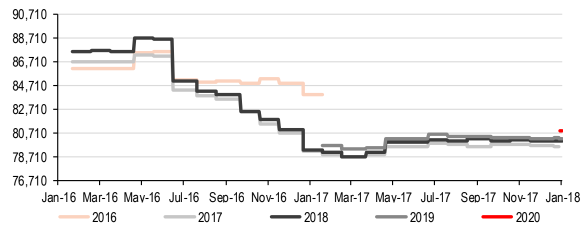
Relative valuation



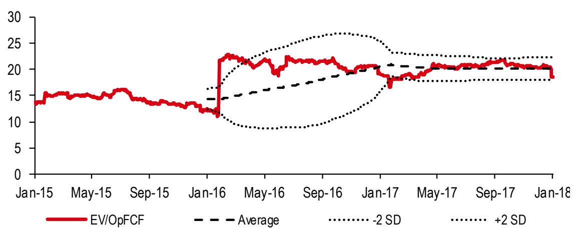
1yr fwd EV/EVITDA



Sales estimates revision

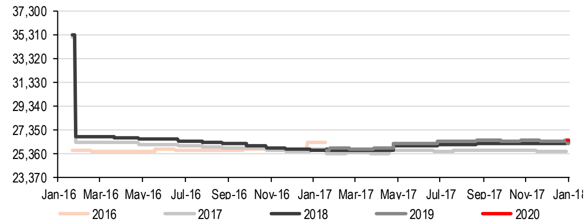


1yr fwd EV/OpFCF

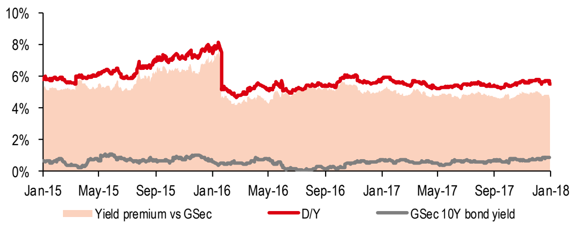


Capped at +/-50x levels

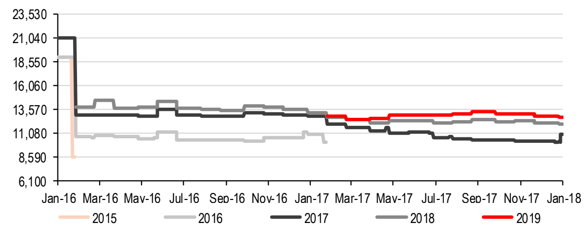
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

Financials & valuation: Telia Company AB

Hold

Financial statements

Year to	12/2017a	12/2018e	12/2019e	12/2020e
Profit & loss summary (SEKm)				
Revenue	79,867	80,053	80,150	80,491
EBITDA	25,806	25,516	25,988	26,251
Depreciation & amortisation	-12,893	-12,334	-12,431	-12,442
Operating profit/EBIT	12,913	13,181	13,557	13,809
Net interest	-2,154	-2,479	-2,338	-2,329
PBT	11,186	12,378	13,289	14,040
HSBC PBT	12,846	12,878	13,489	14,200
Taxation	-1,041	-2,354	-2,468	-2,526
Net profit	9,608	9,489	10,285	10,975
HSBC net profit	11,268	10,002	10,566	11,228
Cash flow summary (SEKm)				
Cash flow from operations	23,569	22,678	23,852	23,973
Capex	-11,525	-10,834	-10,267	-10,171
Cash flow from investment	-10,115	-14,249	-13,479	-13,355
Dividends	-8,660	-9,959	-9,959	-9,959
Change in net debt	-16,933	1,530	-413	-659
FCF equity	6,422	9,742	11,415	11,476
Balance sheet summary (SEKm)				
Intangible fixed assets	74,627	75,211	75,628	76,017
Tangible fixed assets	60,024	61,319	61,950	62,475
Current assets	69,342	61,391	61,391	61,391
Cash & others	32,951	25,000	25,000	25,000
Total assets	241,821	236,291	238,005	239,695
Operating liabilities	19,659	20,503	21,800	22,630
Gross debt	91,487	85,066	84,653	83,994
Net debt	33,823	35,353	34,940	34,281
Shareholders' funds	99,970	99,500	99,825	100,842
Invested capital	151,383	152,419	152,170	152,253

Ratio, growth and per share analysis

Year to	12/2017a	12/2018e	12/2019e	12/2020e
Y-o-y % change				
Revenue	-5.1	0.2	0.1	0.4
EBITDA	-13.4	-1.1	1.9	1.0
Operating profit	-29.4	2.1	2.9	1.9
PBT	20.1	10.7	7.4	5.7
HSBC EPS	-4.6	-11.2	5.6	6.3
Ratios (%)				
Revenue/IC (x)	0.5	0.5	0.5	0.5
ROIC	9.0	8.5	8.7	8.9
ROE	11.9	10.0	10.6	11.2
ROA	4.8	5.0	5.4	5.6
EBITDA margin	32.3	31.9	32.4	32.6
Operating profit margin	16.2	16.5	16.9	17.2
EBITDA/net interest (x)	12.0	10.3	11.1	11.3
Net debt/equity	32.1	33.6	32.9	31.8
Net debt/EBITDA (x)	1.3	1.4	1.3	1.3
CF from operations/net debt	69.7	64.1	68.3	69.9
Per share data (SEK)				
EPS Rep (diluted)	2.22	2.19	2.38	2.53
HSBC EPS (diluted)	2.60	2.31	2.44	2.59
DPS	2.30	2.30	2.30	2.30
Book value	23.09	22.98	23.05	23.29

Key forecast drivers

Year to	12/2017a	12/2018e	12/2019e	12/2020e
Adjusted EBITDA	25,438	26,016	26,188	26,411
Adjusted net income	11,268	10,002	10,566	11,228
Net debt incl 100% Hybrid	41,493	43,023	42,610	41,951
Dividend from associates	2,851	1,135	1,404	1,781
Operational FCF	9,687	9,554	9,579	9,496

Valuation data

Year to	12/2017a	12/2018e	12/2019e	12/2020e
EV/sales	2.1	2.1	2.1	2.1
EV/EBITDA	7.1	6.9	6.9	6.9
EV/IC	1.1	1.1	1.1	1.1
PE*	14.8	16.7	15.8	14.9
PB	1.7	1.7	1.7	1.7
FCF yield (%)	4.8	7.3	8.5	8.5
Dividend yield (%)	6.0	6.0	6.0	6.0

* Based on HSBC EPS (diluted)

Issuer information

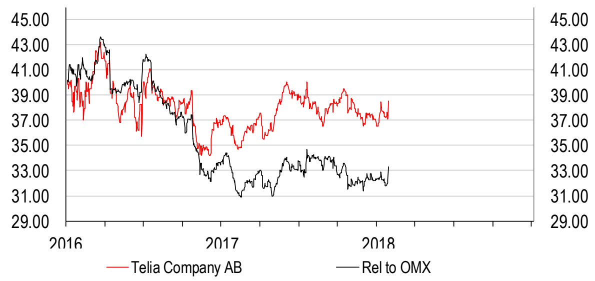
Share price (SEK)	38.53	Free float	53%
Target price (SEK)	37.60	Sector	Diversified Telecoms
Reuters (Equity)	TELIA.ST	Country	Sweden
Bloomberg (Equity)	TELIA SS	Analyst	Adam Fox-Rumley, CFA
Market cap (USDm)	21,200	Contact	+44 20 7991 6819

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.034	No. of board members	12
Energy Intensity (kWh/USD)	0.177	Average board experience (years)	4.6
CO2 reduction policy	Yes	Female board members (%)	50
Social Indicators		Board members Independence (%)	67
Employee costs as % of sales	NA		
Employee turnover (%)	NA		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

HSBC

Stephen Howard*
Analyst
HSBC Bank plc
stephen.howard@hsbcib.com
+44 20 7991 6820

Adam Fox-Rumley*, CFA
Analyst
HSBC Bank plc
adam.fox-rumley@hsbcib.com
+44 20 7991 6819

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Q3 IMS: 1 February

Vodafone Group (VOD LN, 226p, Hold, TP 230p)

Investment Thesis

Vodafone increasingly defies too tight a categorisation; it is certainly no longer simply a wireless telecoms provider. Almost 25% of service revenue is from fixed line and the company has 15m broadband customers and 10m TV subscribers. Cut the business a different way and virtually a third of its service revenue comes from the Corporate sector. The structural demand for mobile services continues and can be illustrated by 88% y-o-y growth in data traffic in H1 FY18. Contract ARPU is stable in most European markets after years of decline. The Group's Global portfolio remains largely intact, though it is unarguably more European than in (say) 2010.

Mobile inevitably remains at the core of the company. We think the German market is one of Europe's best following consolidation, and Vodafone has a strong number two position here. Competitive levels appear to be somewhat lower than a year ago, though we are watching the convergent market carefully following the merger of Drillisch and United Internet. The Spanish mobile pricing environment has been very supportive over the last year, but recently competition at the low-end has begun to pick up, though Vodafone has comparatively little exposure. Our greatest concerns are with Italy, where below-the-line marketing is aggressive in advance of Iliad's entry later in 2018. As a largely pre-paid market, any tariff war is likely to lead to rapid cuts to estimates. Low starting tariffs provide us with little comfort, given Iliad's need to gain market share rapidly.

The fixed line network is an interlinking patchwork of networks, which allow Vodafone to provide high-speed broadband services to its mobile base. It has mixed outright acquisitions (eg Germany, Spain) with own-build (eg Germany), partnerships (eg Portugal, UK) and wholesale agreements (eg UK, Spain). This strategy reflects active capital allocation and we think is suited to the comparatively difficult task of selling fixed line services into an existing mobile base.

Vodafone's three year 'Fit for Growth' programme has come to a close, delivering more centralised spending, increased use of shared service centres and lowering the cost of Group support functions, but cost control remains central to the company's investment case. With a growing top line, absolute cost reductions are not straightforward to achieve, but the company has pointed to an opex base of EUR8bn which could be optimised via 'Digital' means. Opportunities exist to simplify and automate standard processes, use data analytics for better network management, through to AI-enabled customer support. There is certainly a significant opportunity for Vodafone here, though questions remain on whether savings will simply be competed away, and the extent to which they are able to capture a meaningful competitive advantage. Concerns aside, the company is promising to deliver EBITDA growth at a faster pace than revenue growth which is a tantalising medium term prospect.

From a valuation perspective, the company is currently trading in line with peers. While reported growth is high (eg EBITDA growth of 9.3% in H1 FY18), the deconsolidation of problem assets (specifically the Netherlands and India into JVs, though economic ownership is comparatively unchanged) means that owned growth is flattered. The company's return on invested capital is one of the lowest in the sector (3.0%), though with falling capex (relative to the Spring high-point) and improving profits, returns may reach the cost of capital by FY22. The saving grace is the dividend yield, presently 5.9%. A re-rating to 5% would take the share to 265p.

Finally we do not expect the suggestion of a Vodafone-Liberty Global tie-up to disappear in 2018. Indeed the noise levels may increase (eg *Telegraph*, 28 November 2017). Liberty Global's recent divestment of UPC Austria and the finalisation of the Liberty Latin America (formerly known as LiLAC) spin-off, removes some of the non-overlapping countries; as such a greater portion of the assets would provide some operating synergies.

Forecast changes

We have incorporated the latest forecasts from our colleague Ziyad Joosub for Vodacom group (VOD SJ, ZAR163, Hold; see his 21 December 2017 report *FCF yield attractive but still cautious on SA consumer growth and regulations*) in our model. This lead to 0.8-1.4% cuts to our adjusted EBITDA forecasts. Our forecasts for rest of the group are unchanged.

Forecast changes table

(in EURm, unless stated)	NEW 2018e	NEW 2019e	NEW 2020e	OLD 2018e	OLD 2019e	OLD 2020e	Δ (%) 2018e	Δ (%) 2019e	Δ (%) 2020e
Sales	46,015	46,451	47,377	46,030	46,513	47,484	0.0%	-0.1%	-0.2%
Adjusted EBITDA	14,346	14,519	14,935	14,462	14,690	15,149	-0.8%	-1.2%	-1.4%
EPS* (EURc)	8.9	9.1	10.5	9.2	9.6	11.1	-3.4%	-4.8%	-5.2%
FCF	5,213	5,532	5,837	5,312	5,658	5,989	-1.9%	-2.2%	-2.5%

Source: HSBC estimates
* company definition of adjusted earnings

Valuation

We derive our unchanged 230p TP using a SOTP method (details on the assumptions and risks can be read in the *Valuation and risks section*), which implies 2.0% upside and we rate the stock Hold.

Vodafone sum of the parts valuation

	FY18 sales (EURbn)	FY18 EBITDA (EURbn)	FY18 EV/sales	FY18 EV/EBITDA	EV	Ownership	Stake (EURbn)	EUR/share	% EV
Germany	10.8	3.9	3.0x	8.3x	32.6	91.6%	29.9	1.12	26.2%
Italy	6.2	2.3	2.2x	6.0x	13.6	100%	13.6	0.51	11.9%
UK	6.7	1.5	1.4x	6.0x	9.1	100%	9.1	0.34	8.0%
Spain	5.0	1.5	2.3x	8.0x	11.7	100%	11.7	0.44	10.3%
Portugal	1.0	0.4	2.5x	7.0x	2.5	100%	2.5	0.09	2.2%
Greece	0.9	0.3	1.7x	5.5x	1.5	99.9%	1.5	0.06	1.3%
Others	3.0	0.9	1.6x	5.5x	4.7	100%	4.7	0.18	4.2%
Europe	**33.4**	**10.7**	**2.3x**	**7.1x**	**75.8**	**96%**	**73.0**	**2.73**	**64.0%**
Vodacom	5.3	2.0	2.9x	7.7x	17.9	64.5%	9.8	0.37	8.6%
Turkey	2.9	0.7	2.0x	8.5x	5.6	100%	5.6	0.21	4.9%
Egypt	1.0	0.4	2.4x	5.5x	2.5	54.9%	1.3	0.05	1.2%
Others	2.1	0.6	1.5x	5.5x	3.1	78.7%	2.5	0.09	2.1%
AMAP	**11.3**	**3.7**	**2.3x**	**7.2x**	**26.4**	**72.8%**	**19.3**	**0.78**	**16.9%**
Eliminations	1.3	0.0	0.0x	0.0x	0.0	100%	0.0	0.00	0.0%
Consolidated Group	**46.0**	**14.3**	**2.2x**	**7.1x**	**102.2**	**90%**	**92.3**	**3.45**	**80.9%**
India	5.1	1.1	1.4x	6.4x	7.1	100%	7.1	0.27	6.3%
Associate & Investments									
Safaricom		0.9		10.5x	9.7	5%	0.5	0.02	0.4%
Indus towers		1.1		7.2x	7.7	42%	3.2	0.12	2.8%
Netherlands		1.8		10.0x	17.6	50%	8.8	0.33	7.6%
Australia		0.5		8.0x	4.1	50%	2.1	0.08	1.8%
Enterprise value (EURbn)							**114.0**	**4.26**	**100%**
Net debt (end FY18) (EURbn)							(29.8)	-1.11	-26.2%
Verizon loan notes							2.1	0.08	1.9%
shareholder loans to NL JV							1.0	0.04	0.9%
Contingent liabilities							(9.3)	-0.35	-8.0%
Adjustment to ND for Associates/Minorities							(7.9)	-0.29	-6.9%
Adjustment to Indian ND							(9.2)	-0.34	-8.1%
NPV of deferred tax assets							7.0	0.26	6.0%
Interim dividend adjustment							1.3	0.05	1.2%
Market cap (EURbn)							69.3	2.60	
Market cap (GBPbn)							**60.8**	**2.30**	
Shares in issue (bn)							26.78		

Source: HSBC estimates

Relative Valuation

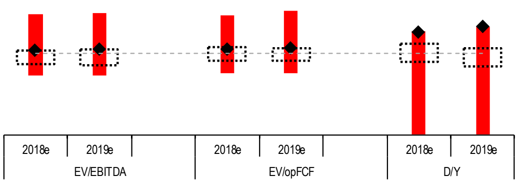
- Despite its slight outperformance vs. SXKP over past 12 months, the stock is trading in-line with its historical multiples as well as peer group on EBITDA and OpFCF
- Strong EBITDA performance in H1 18 has driven slight upward consensus revisions
- Dividend yield is one of the highest among peers at 6.1% (FY19e)

Vodafone – Valuation benchmark chart

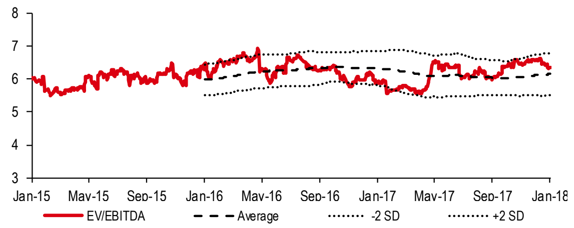
Recent performance

	1W	1M	3M	6M	12M
Price return	-0.1%	-4.4%	4.9%	2.9%	17.2%
Total return	-0.1%	-4.4%	6.9%	4.8%	24.3%
Total return vs SXKP	-1.2%	-4.0%	6.2%	8.1%	21.2%
Total return vs MSCI Europe Telecom	-1.6%	-5.3%	6.2%	7.5%	18.2%
Total return vs FTSE 100	0.8%	-5.4%	3.9%	0.2%	13.0%

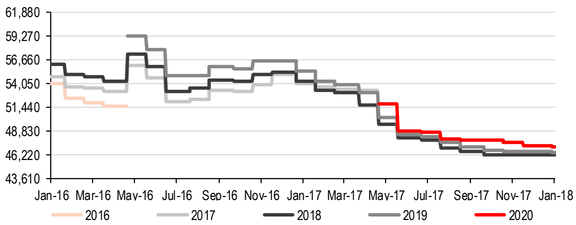
Relative valuation



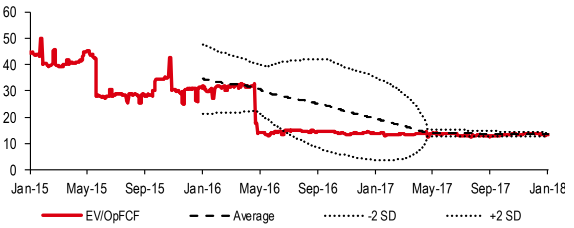
1yr fwd EV/EVITDA



Sales estimates revision

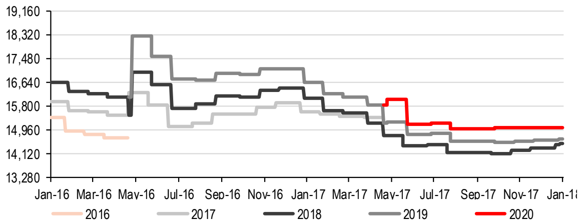


1yr fwd EV/OpFCF

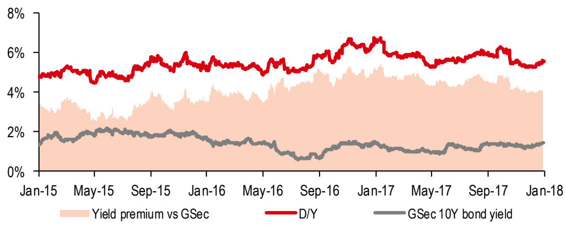


Capped at +/-50x levels

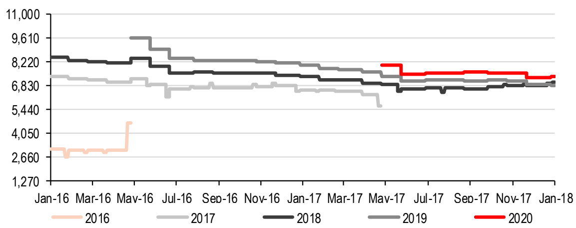
EBITDA estimates revision



Dividend yield and corresponding Gsec 10yr bond yield



OpFCF estimates revision



* Total return includes share price appreciation plus any dividend
Source: Thomson Reuters Datastream and HSBC calculations. Dated as of 26 January 2018

HSBC

Financials & valuation: Vodafone Group

Hold

Financial statements

Year to	03/2017a	03/2018e	03/2019e	03/2020e
Profit & loss summary (EURm)				
Revenue	47,631	46,015	46,451	47,377
EBITDA	13,734	13,931	14,104	14,520
Depreciation & amortisation	-11,225	-10,963	-9,763	-9,633
Operating profit/EBIT	2,509	2,968	4,341	4,887
Net interest	-932	-389	-862	-884
PBT	2,792	2,679	3,561	4,126
HSBC PBT	3,272	3,818	3,976	4,541
Taxation	-4,764	-646	-891	-1,028
Net profit	-2,190	1,614	2,216	2,607
HSBC net profit	2,249	2,462	2,525	2,916
Cash flow summary (EURm)				
Cash flow from operations	10,451	11,967	12,214	12,540
Capex	-8,387	-7,178	-7,098	-7,118
Cash flow from investment	-8,358	-6,915	-7,923	-7,943
Dividends	-3,714	-3,981	-4,061	-4,142
Change in net debt	-5,728	-1,328	-231	-455
FCF equity	-2,155	5,520	5,215	5,482
Balance sheet summary (EURm)				
Intangible fixed assets	46,220	45,110	43,990	42,895
Tangible fixed assets	30,204	29,432	28,712	28,117
Current assets	42,737	42,519	42,069	42,318
Cash & others	14,955	14,541	14,051	14,292
Total assets	154,684	152,163	149,371	147,433
Operating liabilities	30,338	30,311	30,428	30,587
Gross debt	46,574	45,548	44,827	44,613
Net debt	31,169	29,841	29,611	29,155
Shareholders' funds	72,200	69,113	67,075	65,343
Invested capital	73,868	72,210	70,292	68,450

Ratio, growth and per share analysis

Year to	03/2017a	03/2018e	03/2019e	03/2020e
Y-o-y % change				
Revenue	-14.8	-3.4	0.9	2.0
EBITDA	-11.5	1.4	1.2	2.9
Operating profit	30.9	18.3	46.3	12.6
PBT		-4.1	32.9	15.9
HSBC EPS	16.5	10.6	2.5	15.5
Ratios (%)				
Revenue/IC (x)	0.6	0.6	0.7	0.7
ROIC	6.6	7.8	8.2	9.0
ROE	2.9	3.5	3.7	4.4
ROA	-0.8	1.5	2.2	2.5
EBITDA margin	28.8	30.3	30.4	30.6
Operating profit margin	5.3	6.5	9.3	10.3
EBITDA/net interest (x)	14.7	35.8	16.4	16.4
Net debt/equity	42.3	41.7	42.7	43.2
Net debt/EBITDA (x)	2.3	2.1	2.1	2.0
CF from operations/net debt	33.5	40.1	41.2	43.0
Per share data (EUR)				
EPS Rep (diluted)	-0.08	0.06	0.08	0.09
HSBC EPS (diluted)	0.08	0.09	0.09	0.11
DPS	0.15	0.15	0.15	0.16
Book value	2.58	2.50	2.42	2.36

Key forecast drivers

Year to	03/2017a	03/2018e	03/2019e	03/2020e
Europe Revenues	34,550	33,416	33,675	34,072
Europe EBITDA	10,283	10,667	10,781	11,014
Europe EBITDA margin (%)	29.8	31.9	32.0	32.3
AMAP Revenues	11,773	11,291	11,469	11,997
AMAP EBITDA	3,854	3,659	3,725	3,908
AMAP EBITDA margin (%)	32.7	32.4	32.5	32.6

Valuation data

Year to	03/2017a	03/2018e	03/2019e	03/2020e
EV/sales	2.2	2.2	2.2	2.2
EV/EBITDA	7.6	7.4	7.3	7.0
EV/IC	1.4	1.4	1.5	1.5
PE*	32.0	28.9	28.2	24.4
PB	1.0	1.0	1.1	1.1
FCF yield (%)	-2.9	7.5	7.1	7.5
Dividend yield (%)	5.7	5.9	6.0	6.1

* Based on HSBC EPS (diluted)

Issuer information

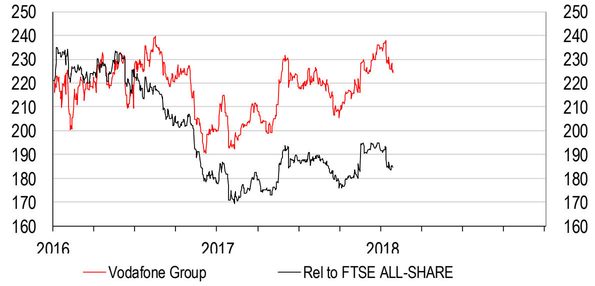
Share price (GBPp)	226	Free float	100%
Target price (GBPp)	230	Sector	Wireless Telecoms
Reuters (Equity)	VOD.L	Country	United Kingdom
Bloomberg (Equity)	VOD LN	Analyst	Stephen Howard
Market cap (USDm)	85,349	Contact	44 20 7991 6820

ESG metrics

Environmental Indicators		Governance Indicators	
GHG Intensity (kg/USD)	0.050	No. of board members	11
Energy Intensity (kWh/USD)	0.119	Average board experience (years)	4.5
CO2 reduction policy	Yes	Female board members (%)	36
Social Indicators		Board members Independence (%)	82
Employee costs as % of sales	11.6		
Employee turnover (%)	18		
Diversity policy	Yes		

Source: Company data, HSBC

Price relative



Source: HSBC

Note: Priced at close of 26 Jan 2018

Valuation and risks

		Valuation	Risks
BT Group BT/A LN **Buy**	Current price: **GBP2.63** Target price: **GBP3.60** Up/downside: **36.9%**	We value BT using a FCFF-based DCF valuation. We use a RFR of 2.5%, an MRP of 5.5% and a beta of 1.2 (all unchanged). We continue to incorporate a 50bps stock-specific risk into the MRP, to account for increased regulatory risk. This leads to an unchanged cost of equity of 9.1% and unchanged WACC of 7.8%. We assume a contingent liability against net pension deficit of GBP7.7bn. This gives us a fair value target price of 360p, implying 36.9% upside and we rate the stock Buy.	Key downside risks include: (i) BT's entry into mobile sparking a renewed bout of price competition; (ii) adverse regulation; (iii) higher-than-expected pension deficit; (iv) further poor trading in the company's Global Services and Business & Public Sector divisions; (v) Ofcom deciding to conclude its WLA review at the harsher end of its indicated range of options, and (vi) the Italian accounting issue not being concluded with January 2017 release.
		Stephen Howard | stephen.howard@hsbcib.com | +44 20 7991 6820	
Deutsche Telekom DTE GR **Buy**	Current price: **EUR14.57** Target price: **EUR18.50** Up/downside: **26.9%**	We value DT using multiple based SoTP method, except for listed T-Mobile US which is valued at HSBC TP (see valuations and risks below). We use a target multiple of 7.8x 2018e EV/EBITDA to value DT's German and integrated European operations (all unchanged). We see a fair value for DT's mobile-centric assets at 5.0x EV/EBITDA and DT's GHS division at 5.0x. These multiples are assigned relative to the multiple calculated in our report *The 4Cs – stock picks* (28 January 2016), in which we derived a theoretical multiple for a telecoms market undergoing repair. Our unchanged TP of EUR18.50 implies 26.9% upside; we maintain our Buy rating on the stock.	Downside risks include further delays in a return to revenue growth in Germany, Europe in aggregate not delivering sustained EBITDA growth, less support from regulation, US growth momentum stalling and DT being less financially disciplined in M&A activities.
		Stephen Howard | stephen.howard@hsbcib.com | +44 20 7991 6820	
Elisa ELISA FH **Reduce**	Current price: **EUR33.05** Target price: **EUR29.5** Up/downside: **-10.7%**	We value Elisa using a FCFF-based DCF methodology to arrive at a fair value target price of EUR29.50 (from EUR29.20). This increase is primarily driven by increase in rolling forward of our valuation to current date. We use a RFR of 2.5%, a MRP of 6.0% and a beta of 1.0 (all unchanged). This leads to unchanged WACC of 7.1%. Our TP implies downside of 10.7%; we maintain our Reduce rating on the stock as the growth offered does not justify the valuation premium to the sector in our view.	Upside risks to our rating and target price include: (i) an improved economic environment leading to accelerated mobile revenue growth, especially in the Corporate sector, as well as a potential slowing of the decline in fixed line services; (ii) better operating cost performance than we currently expect; and (iii) consolidation in the European telecoms sector progressing from in-market deals to cross-border ones.
		Adam Fox-Rumley | adam.fox-rumley@hsbibc.com | +44 20 7991 6819	
KPN KPN AS **Buy**	Current price: **EUR2.88** Target price: **EUR3.70** Up/downside: **28.2%**	We use a DCF methodology to derive our valuation for the domestic business of KPN. We assume a risk-free rate of 2.5%, a market risk premium of 6.0%, beta of 1.1, and terminal growth rate of 1.0% (all unchanged). We value the 9.5% Telefonica Deutschland (O2D GR; CP EUR3.99; Hold) stake at the current trading price. We reiterate our Buy rating, with an unchanged target price of EUR3.70, implying 28.2% upside.	Downside risks include: (1) A pricing environment in the Netherlands being disrupted could lead operators to switch from the current focus on up-selling/cross-selling towards market shares gains; (2) A lower-than-guided dividend from Telefonica Deutschland (TD), in which KPN owns 9.5%. KPN has so far been passing through the dividend received from TD to its shareholders; and (3) changes in fixed-line wholesale regulation for KPN and/or cable.
		Luigi Minerva | Luigi.minerva@hsbibc.com | +44 20 7991 6828	
Orange ORA FP **Buy**	Current price: **EUR14.85** Target price: **EUR17.0** Up/downside: **14.5%**	We derive our target price of EUR17 using a sum-of-the-parts. We use a DCF to value France (WACC 8.1%), Spain (8.4%), other Europe (8.1%), Enterprise segment (8.7%), Africa & Middle East (10%), and ICSS (8.6%); all assumptions are unchanged. We use HSBC target prices for Orange Polska (OPL PW, PLN6.10, Hold, TP PLN5.9) and Orange Belgium (OBEL BB, EUR17.02, Buy, TP EUR26), and we bring in all other associates at their respective market prices. Our TP implies 14.5% upside; we reiterate our Buy rating as we believe further upside from the strategic plan outlined in December 2017 is possible, including value creation from fibre deployment.	Key downside risks include: i) worse-than-expected market conditions in France driven by price wars and rising content costs, ii) price war in Spain and iii) business disruption in Africa due to geopolitical risk.
		Nicolas Cote-Colisson | nicolas.cote-colisson@hsbcib.com | +44 20 7991 6826	

Priced at 26 Jan 2018
Source: HSBC estimates

HSBC

Valuation and risks

		Valuation	Risks
Proximus PROX BB **Hold**	Current price: **EUR28.10** Target price: **EUR32.0** Up/downside: **13.9%**	We use a DCF methodology to arrive at our target price of EUR32 per share. We use a WACC assumption of 7.3% (unchanged) in our DCF model, which incorporates a risk-free rate of 2.5%, market risk premium of 6% and beta of 1.0 (all unchanged). Our TP implies 13.9% upside and we reiterate our Hold rating given the uncertainties arising from new regulation in the fixed broadband market and its implications.	Key upside risks include: (i) a less competitive than expected market, allowing Proximus to reduce subsidies; and (ii) higher savings derived from the cost cutting plan compared to the EUR150m over 2015 and 2019 planned by the management. Key downside risks include: (i) high fixed-line market share losses driven by a stronger-than expected success of Orange Belgium's fixed-line offers; and (ii) a potential disposal of part of the state's 55.9% stake now that the law authorises such a disposal.
		Nicolas Cote-Colisson | nicolas.cote-colisson@hsbcib.com | +44 20 7991 6826	
Swisscom SCMN VX **Hold**	Current price: **EUR518.80** Target price: **EUR515.0** Up/downside: **-0.7%**	We value Swisscom using a DCF-based sum-of-the-parts methodology. We use a WACC of 5.7% for the Swiss operations (RFR 2.5%, MRP 4.5%, beta 1.0 - all unchanged) and 7.5% WACC for Italy (RFR 2.5%, MRP 6.0%, beta 1.2 - all unchanged). We maintain our Hold rating with an unchanged target price of CHF515 per share. Our TP implies -0.7% downside and we rate the stock Hold.	**Key upside risks** include faster-than-expected revenue and EBITDA growth should competitors' offers be not well-received in the market. **Key downside risks** include increased price competition in mobile and/or fixed line in Switzerland, leading to market share loss or ARPU decline; Iliad's mobile entry in Italy may hurt Fastweb's performance.
		Luigi Minerva | luigi.minerva@hsbibc.com | +44 20 7991 6828	
T-Mobile US TMUS US **Buy**	Current price: **USD65.28** Target price: **USD70.0** Up/downside: **7.2%**	We use a DCF methodology to value TMUS US, based on a WACC of 6.3%, composed of a RFR of 2.5% (consistent with our valuation of other US peers), MRP of 4.1% (20-year average – market implied equity risk premium), beta of 1.0x, cost of equity of 7.2%, and a debt/total capital ratio of 30% (all unchanged). The unchanged WACC lead us to a fair value target price of USD70. Our TP implies 7.2% upside. The superior growth potential in EBITDA and operating cash flow of the stock versus peers as well as a healthy ROIC forecast of 8.6% in 2017e-20e contribute to our Buy rating. Although we expect mobile competition to remain intense in the near term, TMUS could continue to gain market share as it expands its footprint with the rollout of 600MHz spectrum.	Downside risks include: (i) deteriorating subscriber growth as "Un-Carrier" initiatives run out of steam; (ii) competitors reacting more actively, potentially resulting in a sustained value destructive price war; and (iii) an acquisition at an unreasonable price.
		Sunil Rajgopal | sunilrajgopal@us.hsbc.com | +1 212 525 0267	
TDC A/S TDC DC **Hold**	Current price: **DKK40.07** Target price: **DKK39.8** Up/downside: **-0.7%**	We value TDC using a FCFF based DCF. We use a RFR of 2.5%, a MRP of 6.0%, beta of 1.1 and cost of debt of 3.5% (all unchanged), leading to WACC of 6.5%. We incorporate the EUR750m hybrid bond as 100% debt, though credit rating agencies ascribe 50% of it to be equity. We also add the NPV of estimated cash flow for future spectrum auctions in Denmark as a contingent liability. Changes to our cash flow estimates (explained above) and the roll forward our DCF valuation leads to a fair value target price of DKK 39.8 (earlier DKK38.0). Our TP implies -0.7% downside and we rate the stock Hold.	Key upside risks: (1) a better than expected recovery in the domestic mobile market should pricing trends improve further, (2) lower levels of competition in both the business market and consumer broadband than we currently expect, (3) four-to-three mobile consolidation coming back onto the agenda in Denmark (albeit in a different form to that previously proposed), and (4) cross-border M&A. Key downside risks: (1) increased mobile market price competition, (2) local loop unbundling of TDC's cable network leading to significant customer loss in the fixed-line broadband market, (3) an inability to transfer business customers significantly quickly and/or the creation of disruption which leads to customer loss and, (4) deteriorating Group prospects leading to a credit rating downgrade and associated higher interest costs.
		Adam Fox-Rumley | adam.fox-rumley@hsbibc.com | +44 20 7991 6819	

Priced at 26 Jan 2018
Source: HSBC estimates

Valuation and risks

		Valuation	Risks
Telecom Italia TIT IM **Hold**	Current price: **EUR0.72** Target price: **EUR0.85** Up/downside: **18.0%**	We use a DCF methodology to derive our valuation for the domestic business of Telecom Italia. To calculate our WACC, we take a risk-free rate of 2.5%, a market risk premium of 6.0% and a beta of 1.3 (all unchanged). For the purpose of valuing TI's Brazilian assets, we value TIM Participaçoes (TIMP3 BZ, BRL13.39, Reduce) at market price. Our target price of EUR0.85 (unchanged) implies upside of 18.0%. We rate the stock Hold in view of our concerns over the impact the entry of Iliad as an MNO in the Italian market may have in the form of increased competitive pressures. **Luigi Minerva** | luigi.minerva@hsbcib.com | +44 20 7991 6828	**Key upside risks** include: (i) Less-than-anticipated increase in competitive intensity in the Italian mobile market; (ii) a disposal of TIM Participaçoes (Bloomberg, 18 June 2015) at an attractive valuation scenario; (iii) slow or no progress from Open Fiber in its parallel fibre access network deployment. **Key downside risks** include: (i) slower-than expected progress in the 2017-19 cost-cutting programme announced by management with the 2016 results; and (ii) a more substantial network disintermediation as a result of OF's parallel fibre deployments.
Telefónica TEF SM **Hold**	Current price: **EUR 8.50** Target price: **EUR 9.0** Up/downside: **5.8%**	We use a DCF-based SOTP valuation to calculate a fair value of EUR9.0 (earlier EUR9.3) for Telefonica. We use a WACC of 8.2% for the Spanish operations (RFR 2.5%, MRP 6.0%, beta 1.1) and 7.2% WACC for UK (RFR 2.5%, MRP 5.0%, beta 1.1) – all unchanged. We add 130bps to the risk premium for emerging assets, and value Telefonica Brasil (VIVT4 BZ, BRL52.94, Hold) at market price. The change in target price is mainly due to combination of reduction in our estimates (explained in the company section of this report) and incorporation of EUR1bn recent hybrid issue in our valuation partially offset by roll forward of our valuation to February 2018. Our new TP implies 5.8% upside and we rate Telefonica Hold primarily in view of our concerns on the competitive environment in Spain. **Luigi Minerva** | luigi.minerva@hsbcib.com | +44 20 7991 6828	Key downside risks include: competition becoming more intense than we expect in LatAm and Spain. Key upside risks include: favourable market conditions for asset disposals and decline in the cost of debt.
Telefonica Deutschland O2D GR **Hold**	Current price: **EUR3.99** Target price: **EUR4.1** Up/downside: **2.7%**	We use a DCF approach to value the group assuming a WACC of 7.4% based on an 18% long term debt/total capital ratio, 1.0 beta, 6.0% market risk premium, 2.5% risk-free rate, 3% cost of debt, and 12.75% terminal tax rate. Our terminal growth rate assumption is +0.5% to reflect our prudence on the company's long-term growth outlook. Based on these assumptions, which are all unchanged, and our marginally revised estimates, our fair value target price remains EUR4.10. Our target price implies 2.7% upside and we reiterate our Hold rating based on an attractive dividend yield supported by strong cash conversion but limited valuation upside. **Luigi Minerva** | luigi.minerva@hsbcib.com | +44 20 7991 6828	**Downside** risks include a more aggressive than anticipated competitive environment resulting in delays in market repair, execution risk on the merger integration, a long-term competitive disadvantage from not owning fixed-line infrastructure, and the share overhang from KPN's residual stake. **Upside** risks include O2D benefiting more from overall market bill-inflationary market growth, higher synergies and Telefonica potentially raising its stake in the company to reduce dividend leakage.
Telekom Austria TKA AV **Reduce**	Current price: **EUR7.93** Target price: **EUR7.50** Up/downside: **-5.4%**	We value Telekom Austria using a FCFF based DCF. We use a RFR of 2.5%, beta of 1.0. Our ERP of 7.2% (from 6.8%), is an EBITDA-weighted average for the Group's key counties, incorporating a 50bps stock-specific risk into the domestic MRP. This leads to a WACC of 7.3% (up from 7.0%). This adjustment is offset by upward forecast revisions (explained above) and rolling forward the valuation to January 2018, leading to fair value TP of EUR7.5 (from EUR7.0). Our target price implies -5.4% downside and we reiterate our Reduce rating given competition concerns. **Adam Fox-Rumley** | adam.fox-rumley@hsbcib.com | +44 20 7991 6819	Key upside risks include a substantial lessening of competition from MVNOs in Austria leading to improved mobile service revenue performance, better than expected trends in CEE mobile service revenue growth and better than expected cost control leading to improved profitability.

Priced at 26 Jan 2018
Source: HSBC estimates

Valuation and risks

		Valuation	Risks
Telenor TEL NO **Hold**	Current price: **NOK182.15** Target price: **NOK170.0** Up/downside: **-6.7%**	With this report we have moved to use DCF based valuation (from SoTP valuation earlier). We use RFR of 2.5%, ERP of 6.0%, beta of 1.0. Our cost of debt assumption of 3.4% is in line with company's average cost of gross debt. This leads to WACC of 7.2%. We assume 1% terminal growth rate, in-line with most of European incumbents. We incorporate expected spectrum auction outflow (proportionately) in Asian countries in 2018 as contingent liability. This gives us a fair value target price of NOK170 (up from NOK150); implying 6.7% downside. We reiterate our Hold rating as we believe current share price is supported by sector leading cost performance. **Adam Fox-Rumley** | adam.fox-rumley@hsbibc.com | +44 20 7991 6819	Upside risks include a quick recovery in Thailand and Malaysia; lower than expected spectrum costs; and net opex savings coming in earlier than we currently expect. Downside risks include a sustained phase of decline in Norway, no recovery in Thailand and Malaysia, and a failure to deliver on net opex savings
Telia Company TELIA SS **Hold**	Current price: **SEK38.53** Target price: **SEK37.60** Up/downside: **-2.4%**	We value Telia using a FCFF-based DCF. We use a RFR of 2.5%, beta of 1.1, MRP of 6.2% and cost of debt of 2.2% (all unchanged). This leads to unchanged WACC of 6.8%. We have included 50% of hybrid capital, which is not in reported net debt, as a contingent liability and also include capital gain tax liability in Nepal at 25% probability. We hold the Eurasian assets at 3.0x EBITDA (unchanged) and associate Turkcell (TCELL TI, Buy, CMP16.4) at HSBC target price. Our fair value target price reduced to SEK37.6 from SEK42.0, primarily driven by c.25% lower realisation from associate stake sale in Turkcell and Megafon than our estimates. Our TP implies downside of -2.4%; we reiterate our Hold rating as we believe strong dividend yield and prospect of further cost savings are likely to provide support to stock price. **Adam Fox-Rumley** | adam.fox-rumley@hsbibc.com | +44 20 7991 6819	Key upside risks are: (1) better-than-expected adoption of fibre broadband in Sweden, (2) an improved market structure in Denmark. Downside risks are: (1) increased price competition in Swedish mobile market, (2) increased competition following Tele2's acquisition of Com Hem, (3) higher than expected market pressure in Norwegian mobile market from new entrants
Vodafone Group VOD LN **Hold**	Current price: **GBP2.26** Target price: **GBP2.30** Up/downside: **2.0%**	We use a multiples-based sum-of-the-parts approach to value Vodafone. For Vodacom (VOD SJ, CP ZAR163.00, Hold), we use a FY18e EV/EBITDA multiple implied by HSBC's target price. We assign target multiples to FY18e EV/EBITDA (ranging from 5.5x to 8.3x) for the remaining country units. We assign these multiples relative to the multiple calculated in our report *The 4 Cs – stock picks* (28 January 2016) in which we derived a theoretical multiple for a telecoms market undergoing market repair of 8.3x. Vodafone India is valued at 6.4x EBITDA, in line with the implicit deal multiple. Forecast changes (explained above) and changed TP of Vodacom are offset as we roll forward our model, to give us unchanged fair value target price of 230p implying 2.0% upside. We reiterate our Hold rating as we remain concerned about the competitive developments in Italy and India. We do not incorporate potential synergies from the proposed merger in India (which we estimate could be worth c11p per share) in our valuation as the deal continues to be dependent upon regulatory approval. **Stephen Howard** | stephen.howard@hsbcib.com | +44 20 7991 6820	Upside risks include: (1) an improvement in competitive intensity in the Indian market coming earlier than expected, or a better than-expected recovery post this stabilisation; (2) potential involvement of Vodafone Group in M&A activity (The Register, 15 March 2017). Downside risks include: (1) rivals applying larger discounts to convergent pricing, (2) spectrum costs exceeding our assessment, (3) adverse FX moves, and (4) adverse regulation.

Priced at 26 Jan 2018
Source: HSBC estimates

Changes in ratings/Target prices

Company	Ticker	Currency	Share price	New Rating	Old Rating	New TP	Old TP	Upside/Downside
BT Group	BT/A LN	GBP	2.63	Buy	Buy	3.60	3.60	36.9%
Deutsche Telekom	DTE GR	EUR	14.58	Buy	Buy	18.50	18.50	26.9%
Elisa Oyj	ELISA FH	EUR	33.05	Reduce	Reduce	29.50	29.20	-10.7%
KPN	KPN NA	EUR	2.89	Buy	Buy	3.70	3.70	28.2%
Orange	ORA FP	EUR	14.85	Buy	Buy	17.00	17.00	14.5%
Proximus	PROX BB	EUR	28.10	Hold	Hold	32.00	32.00	13.9%
Swisscom	SCMN VX	CHF	518.80	Hold	Hold	515.00	515.00	-0.7%
TDC	TDC DC	DKK	40.07	Hold	Hold	39.80	38.00	-0.7%
Telecom Italia	TIT IM	EUR	0.72	Hold	Hold	0.85	0.85	18.0%
Telefonica	TEF SM	EUR	8.50	Hold	Hold	9.00	9.30	5.8%
Telekom Austria	TKA AV	EUR	7.93	Reduce	Reduce	7.50	7.00	-5.4%
Telenor	TEL NO	NOK	182.15	Hold	Hold	170.00	150.00	-6.7%
Telia Company	TELIA SS	SEK	38.53	Hold	Hold	37.60	42.00	-2.4%
Vodafone	VOD LN	EUR	2.26	Hold	Hold	2.30	2.30	2.0%
Telefonica Deutschland	O2D GR	EUR	3.99	Hold	Hold	4.10	4.10	2.7%

Source: HSBC estimates. Price as of 26 January 2018

Notes

Notes

Notes

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), or strategist(s) who is(are) primarily responsible for this report, including any analyst(s) whose name(s) appear(s) as author of an individual section or sections of the report and any analyst(s) named as the covering analyst(s) of a subsidiary company in a sum-of-the-parts valuation certifies(y) that the opinion(s) on the subject security(ies) or issuer(s), any views or forecasts expressed in the section(s) of which such individual(s) is(are) named as author(s), and any other views or forecasts expressed herein, including any views expressed on the back page of the research report, accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Stephen Howard, Nicolas Cote-Colisson, Luigi Minerva, Adam Fox-Rumley, CFA and Sunil Rajgopal

Brazilian Securities Exchange Commission (CVM) Regulation No. 483

Pursuant to CVM Ruling No. 483 (July 2010), HSBC has obtained from the analyst(s) listed above under "Analyst Certification" and disclosed (where applicable), the statements set forth in Article 17 and have rendered (where applicable) the statements set forth in Article 18, under the sections titled "Analyst Certification" and "HSBC & Analyst Disclosures". The analyst(s) furthermore certifies(y) that the recommendations contained in this report have been prepared independently, even in relation to HSBC.

Additionally, for purposes of Article 16, the principal analyst responsible for compliance of the mentioned regulation is the first name in the list under "Analyst Certification" that has local certification, where applicable.

Important disclosures

Equities: Stock ratings and basis for financial analysis

HSBC and its affiliates, including the issuer of this report (“HSBC”) believes an investor's decision to buy or sell a stock should depend on individual circumstances such as the investor's existing holdings, risk tolerance and other considerations and that investors utilise various disciplines and investment horizons when making investment decisions. Ratings should not be used or relied on in isolation as investment advice. Different securities firms use a variety of ratings terms as well as different rating systems to describe their recommendations and therefore investors should carefully read the definitions of the ratings used in each research report. Further, investors should carefully read the entire research report and not infer its contents from the rating because research reports contain more complete information concerning the analysts' views and the basis for the rating.

From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst’s assessment of the stock’s actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC’s rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock’s domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

Rating distribution for long-term investment opportunities

As of 29 January 2018, the distribution of all independent ratings published by HSBC is as follows:

Buy	45%	(27% of these provided with Investment Banking Services)
Hold	42%	(28% of these provided with Investment Banking Services)
Sell	13%	(18% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see "Stock ratings and basis for financial analysis" above.

For the distribution of non-independent ratings published by HSBC, please see the disclosure page available at http://www.hsbcnet.com/gbm/financial-regulation/investment-recommendations-disclosures.

Information regarding company share price performance and history of HSBC ratings and target prices in respect of long-term investment opportunities for the companies that are the subject of this report is available from www.hsbcnet.com/research.

To view a list of all the independent fundamental ratings disseminated by HSBC during the preceding 12-month period, please use the following links to access the disclosure page:

Clients of Global Research and Global Banking and Markets: www.research.hsbc.com/A/Disclosures

Clients of HSBC Private Banking: www.research.privatebank.hsbc.com/Disclosures

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price date	Disclosure
BT GROUP PLC	BT.L	2.63	29 Jan 2018	1, 5, 6, 7
DEUTSCHE TELEKOM	DTEGn.DE	14.58	29 Jan 2018	4, 6
ELISA OYJ	ELISA.HE	33.05	29 Jan 2018	5
KPN	KPN.AS	2.88	29 Jan 2018	4
ORANGE	ORAN.PA	14.84	29 Jan 2018	1, 4, 5, 6, 7
PROXIMUS	PROX.BR	28.10	29 Jan 2018	7
SWISSCOM	SCMN.S	518.80	29 Jan 2018	4
TELECOM ITALIA	TLIT.MI	.72	29 Jan 2018	6, 7
TELEFONICA	TEF.MC	8.50	29 Jan 2018	1, 2, 4, 5, 6
TELEFONICA DEUTSCHLAND	O2Dn.F	3.99	29 Jan 2018	6, 11
TELEKOM AUSTRIA	TELA.VI	7.93	29 Jan 2018	2, 5
TELENOR	TEL.OL	182.15	29 Jan 2018	5
VODAFONE GROUP	VOD.L	2.26	29 Jan 2018	1, 2, 4, 5, 6

Source: HSBC

1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.

2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.

3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.

4 As of 31 December 2017 HSBC beneficially owned 1% or more of a class of common equity securities of this company.

5 As of 31 December 2017, this company was a client of HSBC or had during the preceding 12 month period been a client of and/or paid compensation to HSBC in respect of investment banking services.

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Issuer of report
HSBC Bank plc
8 Canada Square
London, E14 5HQ, United Kingdom
Telephone: +44 20 7991 8888
Fax: +44 20 7992 4880
Website: www.research.hsbc.com

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[1069952]

Global Telecoms, Media & Technology Research Team

Global

Analyst, Global Sector Head, Telecoms
Stephen Howard +44 20 7991 6820
stephen.howard@hsbcib.com

Analyst, Global Sector Head, Technology
Steven C Pelayo +852 2822 4391
stevenpelayo@hsbc.com.hk

Analyst, Global Sector Head, Internet & E-commerce
Chi Tsang +852 2822 2590
chitsang@hsbc.com.hk

Europe

Analyst
Nicolas Cote-Colisson +44 20 7991 6826
nicolas.cote-colisson@hsbcib.com

Analyst
Antonin Baudry +33 1 56 52 43 25
antonin.baudry@hsbc.com

Analyst
Christopher Johnen +49 211 910 2852
christopher.johnen@hsbc.de

Analyst
Luigi Minerva +44 20 7991 6928
luigi.minerva@hsbcib.com

Analyst
Olivier Moral +33 1 5652 4322
olivier.moral@hsbc.com

Analyst
Adam Fox-Rumley +44 20 7991 6819
adam.fox-rumley@hsbcib.com

Americas

Analyst
Christopher A Recouso +1 212 525 2279
christopher.a.recouso@us.hsbc.com

Analyst
Ronny Berger, CFA +44 20 7991 2750
ronny.berger@hsbc.com

Analyst
Sunil Rajgopal +1 212 525 0267
sunilrajgopal@us.hsbc.com

Global Emerging Markets (GEMs)

Analyst
Hervé Drouet +44 20 7991 6827
herve.drouet@hsbcib.com

Emerging Europe, Middle East & Africa (EMEA)

Analyst
Ziyad Joosub +27 11 676 4223
ziyad.joosub@za.hsbc.com

Analyst
Eric Chang +971 4 423 6554
erichy.chang@hsbc.com

Asia

Analyst
Yogesh Aggarwal +91 22 2268 1246
yogeshaggarwal@hsbc.co.in

Analyst
Vivek Gedda +91 22 6164 0693
vivekgedda@hsbc.co.in

Analyst
Vikas Ahuja +91 22 3396 0690
vikasahuja@hsbc.co.in

Analyst
Neale Anderson +852 2996 6716
neale.anderson@hsbc.com.hk

Analyst
Bruce Lu +8862 6631 2861
bruce.kl.lu@hsbc.com.tw

Analyst
Samson Hung +8862 6631 2863
samson.hm.hung@hsbc.com.tw

Analyst
Ricky Seo +822 37068777
rickyjuilseo@kr.hsbc.com

Analyst
Rajiv Sharma +91 22 2268 1239
rajivsharma@hsbc.co.in

Analyst
Darpan Thakkar +91 22 6164 0695
darpan.thakkar@hsbc.co.in

Analyst
Piyush Choudhary +65 6658 0607
piyush.choudhary@hsbc.com.sg

Analyst
Jena Han +822 3706 8772
jenahan@kr.hsbc.com

Analyst
Will Cho +822 3706 8765
will.cho@kr.hsbc.com

Analyst
Darryl Cheng +8862 6631 2864
darryl.tj.cheng@hsbc.com.tw

Associate
Wayne Wang +852 2914 9935
wayne.n.wang@hsbc.com.hk

Associate
Heather Li +852 2996 6574
heather.q.li@hsbc.com.hk

Associate
Kenneth Shim +822 3706 8779
kennyshim@kr.hsbc.com

Associate
Angus Lin +852 2996 6584
angus.s.h.lin@hsbc.com.hk

Associate
Anthony Liao +8862 6631 2865
anthony.wc.liao@hsbc.com.tw

Associate
Thurston Lee +8862 6631 2866
thurston.jc.lee@hsbc.com.tw

Specialist Sales

James Britton +44 207 991 5503
james1.britton@hsbc.com

Kubilay Yalcin +49 211 9104880
kubilay.yalcin@hsbc.de

Myles McMahon +852 2822 4676
mylesmacmahon@hsbc.com.hk