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Q209 Update

Smooth operators

The telecom industry has successfully passed the test of the first quarter. 2008 guidance has been met in all cases, equity markets (consensus) and management expect top-line growth above European GDP levels and CFOs have all pledged stable FCF targets for 2009. Still, many elements seem to show that the sector is getting ready for a more challenging environment in the quarters to come: commercial activity has been boosted to move pre-paid customers to post-paid packages (less cyclical), most mobile operators indicate that they will focus on customer retention rather than acquisitions (cost efficiencies), several operators have announced a more conservative financial strategy (sometimes due to the weaker economic outlook in emerging markets) and refinancing programmes for 2010 seem to have been put forward … where possible.

■ CDS spreads…

The outperformance of our telecom CDS index vs the iTraxx Main hides the fact that, overall, single-name volatility has increased significantly during the quarter. This phenomenon is shared by most sectors in a market that is proving far more sensitive to specific news than ever in the past. Apart from France Telecom, KPN and TeliaSonera, all operators have seen an increase in volatility for a variety of reasons ranging from exposure to the macroeconomic downturn to M&A or potential legal risks.

■ …and ratings

Unlike in other sectors, negative rating actions during the first quarter have not been linked to rising operational risk but to issuer-specific issues (Telenor, BT, Belgacom). In contrast to many industrial sectors, the relative rating drift observed in the sector (Telenor, Belgacom downgraded, Telefonica upgraded and BT under negative watch) remains benign (see page 5).

■ Sector recommendations unchanged

- **CDS recommendation**: Outperform
- **Cash recommendation**: Outperform

■ Q209: what to watch for

Mobile is obviously the part of the industry where operators are better equipped to fight the crisis generally so we would essentially remain cautious about negative surprises in the fixed segment. With operators' guidance and equity market consensus aligned, the chances of equities negatively impacting CDS are decreasing. As for the first quarter, the main areas on which to focus attention will be issuer-specific (see issuer snapshot).

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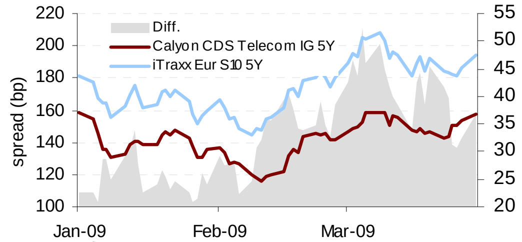
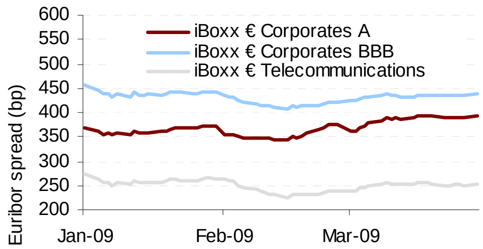
CDS YTD performance vs iTraxx Main



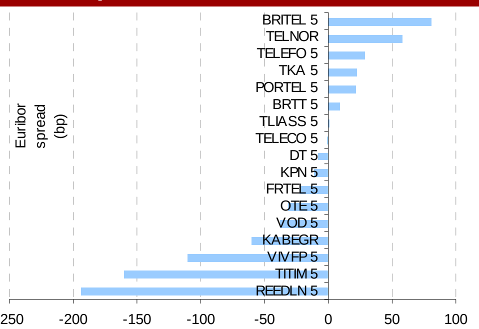
Source: Calyon

iBoxx telecoms YTD performance vs iBoxx corporates

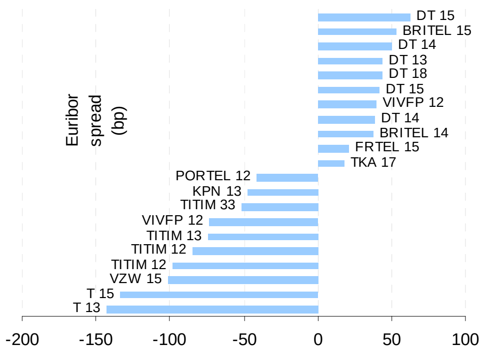


Source: iBoxx

Under/outperformers in telecoms CDS



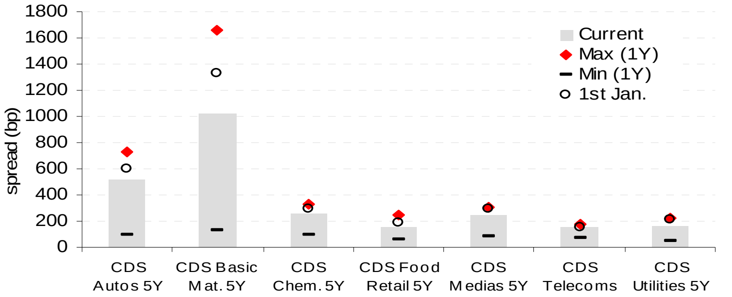
Under/outperformers in telecoms cash



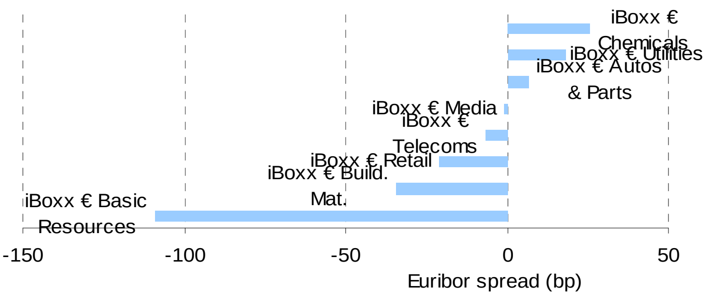
Sources: Bloomberg, Calyon

Sector recommendations

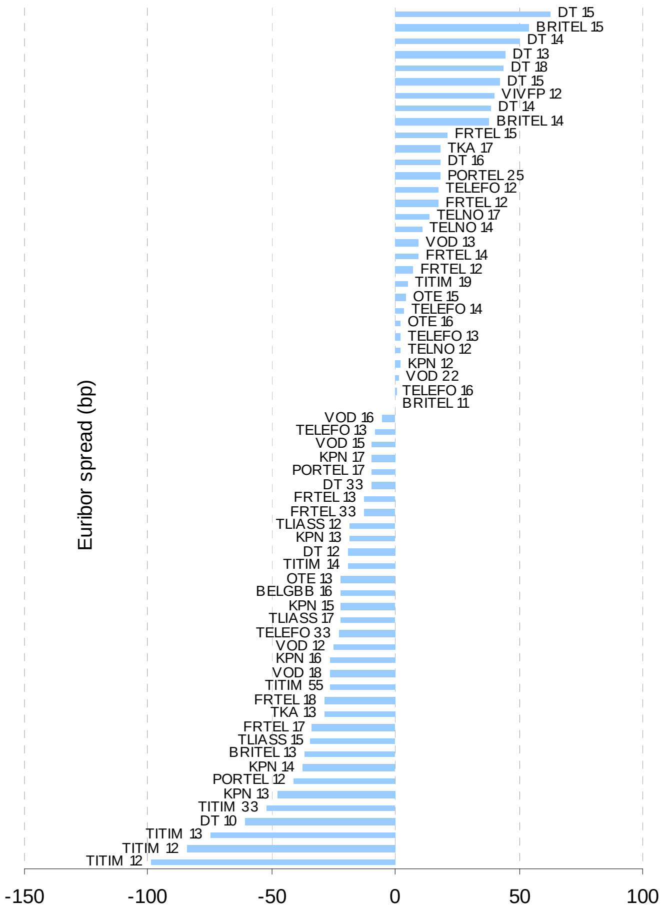
Telecoms CDS YTD performance: steady



iBoxx telecoms YTD performance



Telecoms Cash YTD performance since 5 January 2009



Source all charts: Bloomberg

Recommendation performance

A relatively quiet story

Only one profit warning (BT – downgraded), one large M&A transaction (Telenor – likely to be downgraded?), a double upgrade (TEF) and smooth access to the primary market. This is in a nutshell the story of the telecom sector in the first quarter. By a telecom analyst's standards this is enough newsflow to keep busy but we must admit that this sector is not facing the turbulence other industries are currently facing (massive downgrades, impossible access to primary markets, profit warnings or massive primary issuance schedule). This explains the less volatile profile of the sector and its steady performance (see chart left).

Equities still like telecoms

Obviously equity markets share the same view. Over the past three months, out of the 15 European telecom names, 12 have outperformed vs Eurostoxx with the exception of BT (-29%), TDC (-8%) and Telenor (-1%). Considering the current average dividend yield for the sector (8.9%) and the fact that 2009 guidance remains fairly conservative (in line with consensus) the risk of negative surprises from Q109 results is lower than the average sector.

CDS: Outperform

The CDS market is essentially sensitive to three important elements at this point in time: (1) liquidity risk; (2) macroeconomic exposure; and (3) the aggressiveness of financial policy. We believe that the telecom sector will continue to score highly in all three categories compared with the rest of the field.

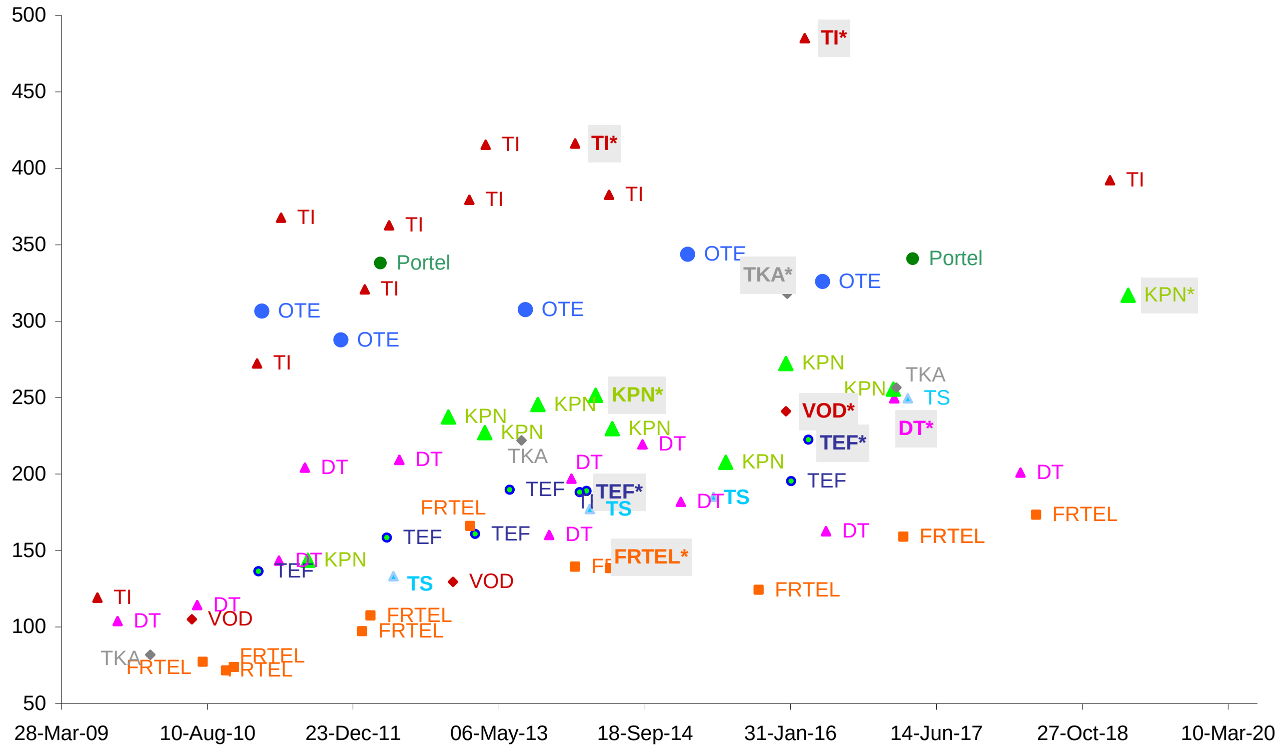
Cash: not as volatile as CDS but prices look technical

With nearly EUR13.1bn of debt issued (third largest sector in terms of new issues, behind Utilities with EUR27.2bn), the Telecom sector has been through a relatively intensive refinancing period in Q109. We estimate that issuers covered nearly 55% of their needs in a scenario of net financing of the 2009 maturing debt (excluding re-leveraging through organic excess FCF). This had no noticeable impact on the iBoxx telecom index and all new issues have performed well (only Autos and Steel new issues widened post issuance).

Cash remains much less volatile than CDS as liquidity remains fairly weak overall. Recent new issues continue to trade significantly wider than previous issues' curves (see telecom bond mapping on the next page). We expect this situation to be corrected gradually over time.

Cash bonds ASW & YTM

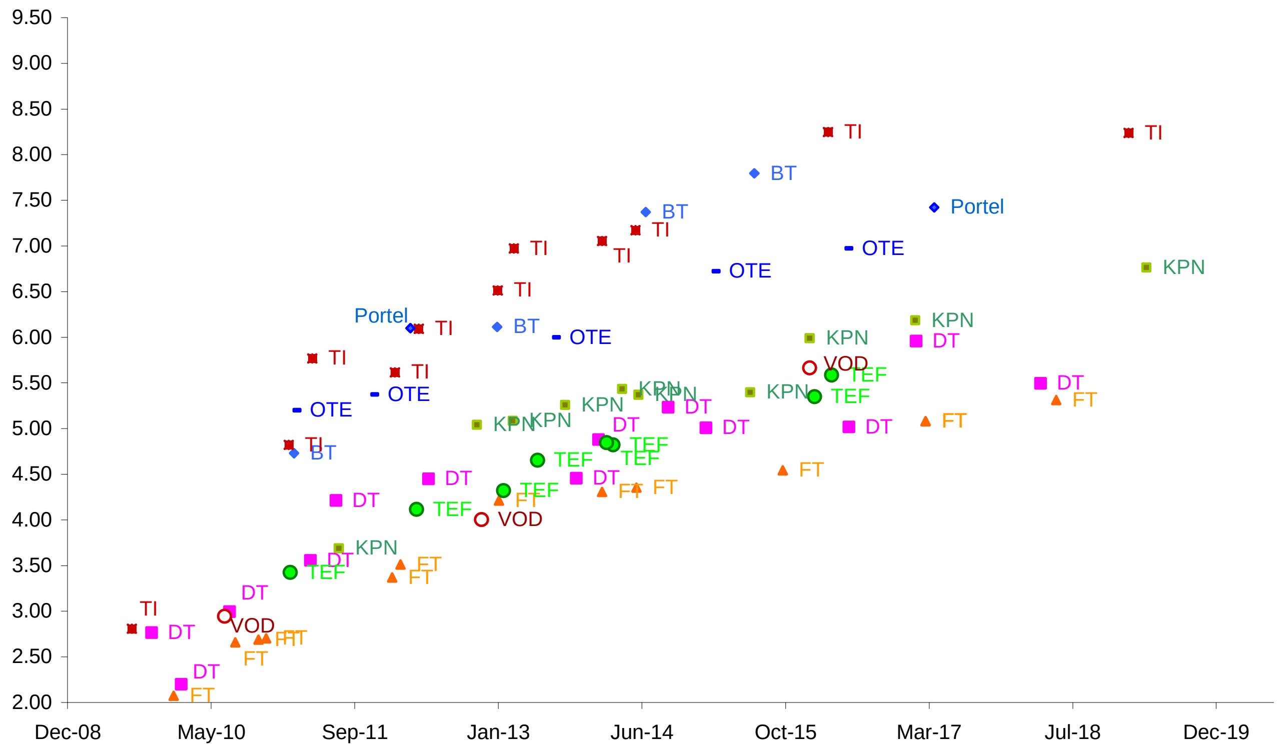
ASM mapping



Issues shaded in grey represent 2009 new issues.

Source: Bloomberg. As at 6 April 2009

YTM mapping



Source: Calyon

Issuer recommendations

Recommendation performance YTD

Performance relative to Calyon's telecom indices

as of: 3-Apr-2009	Current relative value rating	Live perf.	Closed as of today	Total	Current spread	Hist. Fair value
BT	Sectorperform	-	11	11	242	169
Deutsche Tel.	Sectorperform	-	-	-	119	127
France Tel.	Sectorperform	-	-	-	82	102
KPN	Underperform	12	-	12	94	107
OTE	Sectorperform	-	12	21	117	134
Portugal Tel.	Underperform	20	-	20	167	155
Telecom It.	Outperform	-	43	43	283	348
Telekom Aust.	Sectorperform	-	7	7	117	113
Telefonica	Sectorperform	-	45	45	159	140
TeliaSonera	Sectorperform	-	18	18	94	101
Telenor	Underperform	-	-	-	198	101
Vodafone	Sectorperform	-	30	30	133	157
Total gain (-loss)		**32**	**176**	**208**		

Source: Bloomberg, Calyon

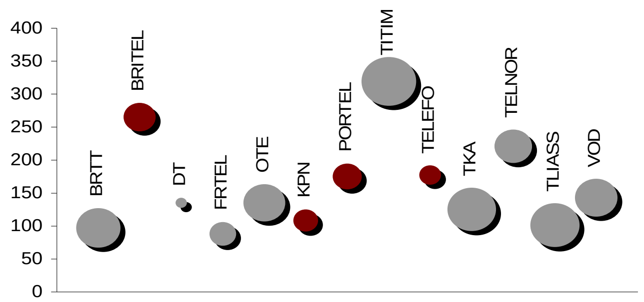
Increasing volatility and refocusing on fundamental rather than technical factors created a number of opportunities in Q109 that helped us to outperform our telecom index by nearly 200bp and generate several profitable trades (see table below). In fact, 100% of our recommendation changes have generated positive returns compared with our benchmark. Key market movers:

Liquidity access? Not really. The only two names with refinancing issues (Portugal Telecom and Telecom Italia) have not particularly underperformed so far.

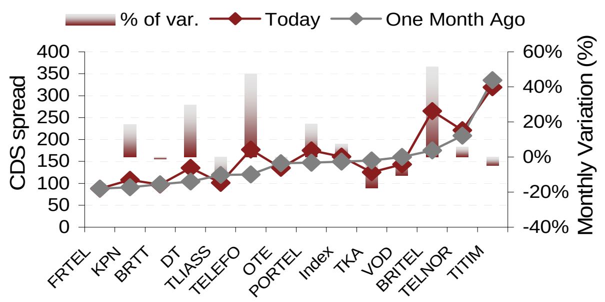
Strategy? Partially. The main differentiating factor is obviously the growth strategy. All operators have decided to 'freeze' their external growth strategies (not always in an explicit way).

Macroeconomic risk? Yes. Although the sector is generally considered as non-cyclical, operators with exposure to weaker economies have underperformed (BT, Telefonica and Portugal Telecom in recent weeks, Vodafone to a lower extent).

Relative value



Absolute variations



The position of the bubble corresponds to the spread of the single name CDS, and the colour of the bubble indicates if the single name has outperformed (grey) or underperformed (red) the sector index during the past month. The size of the bubble corresponds to the 'strength' of this performance. The larger the bubble, the larger the out/underperformance. Small bubbles suggest that CDS do not stand out as either. Source: Markit, Calyon

Changes to issuer recommendations

Over Q109 we changed a number of recommendations as spreads moved towards levels that we consider more appropriate to the financial profile of these issuers:

- BT: from Underperform to Sectorperform (3 February 2009)
- KPN: from Sectorperform to Underperform (24 March 2009)
- OTE: from Outperform to Sectorperform (7 April 2009)
- Telecom Italia: from Outperform to Sectorperform (23 February 2009)
- Telecom Italia from Sectorperform to Outperform (7 April 2009)
- Telefonica: from Sectorperform to Underperform (10 February 2009)
- Telefonica: from Underperform to Sectorperform (27 March 2009)
- Telenor: from Sectorperform to Underperform (6 April 2009)
- TeliaSonera: from Underperform to Sectorperform (3 March 2009)
- Vodafone: from Outperform to Sectorperform (26 January 2009)

Summary of our recommendations on CDS

Issuer	S&P/Moody's	Calyon	Spot CDS	Variation 1 Week	Variation 1 Month	Variation YTD	Expected Trend	Spot vs Index Ratio	Spot vs Index Fair Value	Spot vs Index Spot - FV	CDS Recommendation Previous	CDS Recommendation Since	CDS Recommendation New
British Telecom	BBB/Baa1 neg	Mid-BBB	**241**	19	68	82	↘	165%	**171**	**70**	Sectorperform	03/02/09	Sectorperform
Deutsche Telekom	BBB+/Baa1	High-BBB	**120**	-16	15	-11	→	82%	**127**	**-7**	Sectorperform	10/06/08	Sectorperform
France Telecom	A-/A3	Low-A	**82**	-3	-7	-26	→	56%	**103**	**-21**	Sectorperform	01/09/08	Sectorperform
KPN	BBB+ / Baa2	Mid-BBB	**95**	-3	5	-16	→	65%	**108**	**-13**	Underperform	24/03/09	Underperform
OTE	BBB / Baa2	Mid-BBB	**118**	-12	-28	-52	↗	81%	**132**	**-14**	Outperform	25/03/09	**Sectorperform**
Portugal Telecom	BBB-/Baa2	Low-BBB	**169**	22	24	15	↘	116%	**155**	**14**	Underperform	19/12/07	Underperform
Telefonica	BBB+ Pos / Baa1	Low-A	**157**	-6	36	21	→	107%	**141**	**16**	Sectorperform	27/03/09	Sectorperform
Telenor	BBB+/A3	Mid-BBB	**200**	-30	-8	30	→	137%	**160**	**40**	Underperform	06/04/09	Underperform
Vodafone	A-/Baa1	Low-A	**132**	-2	-25	-48	→	90%	**155**	**-23**	Sectorperform	26/01/09	Sectorperform
Telecom Italia	BBB/Baa2	Mid-BBB	**285**	-47	-45	-175	↗	195%	**343**	**-58**	Sectorperform	23/02/09	**Outperform**
TeliaSonera	A-/A3	Low-A	**94**	-6	-22	-5	→	64%	**101**	**-7**	Sectorperform	03/03/09	Sectorperform
Telekom Austria	BBB+ neg/A3	High-BBB	**112**	-13	-42	13	→	77%	**115**	**-3**	Sectorperform	04/02/09	Sectorperform
Index Telecom			**146**	-7	-2	-12	→						

Key: ↘ *Outperformance expected;* → *No trend reversal is expected;* ↗ *Underperformance expected. Source: Bloomberg, Calyon*

Primary activity and outlook

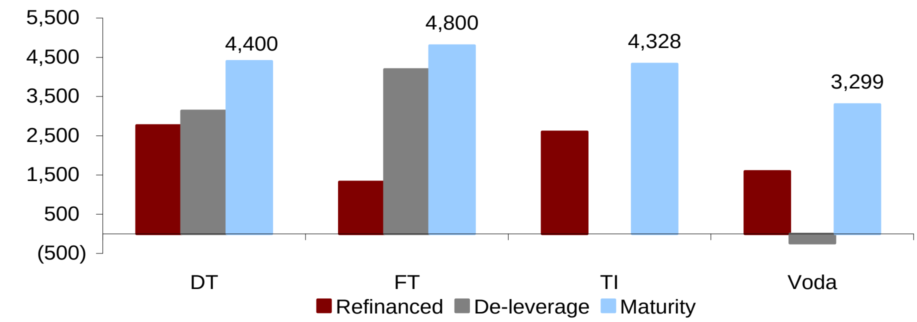
With EUR13bn and 14 new issues spread among 9 different operators in the first quarter, the Telecom sector has been the third most active so far this year. This level represents just over half the amount of our yearly estimate of EUR24bn, proving once again that the sector has, on average, maintained above-average access to the debt market, so far.

The situations vary greatly from one operator to another, however. In the chart below we summarise the liquidity positions of our coverage list. To highlight these differences, we have compared the percentage of the annual refinancing needs covered by refinancing already achieved this year and the expected excess cash flow that can be affected to the de-leveraging of the company.

Telecom Italia and Vodafone still expected to raise debt in 2009

Deutsche Telekom and France Telecom do not need to maintain their liquidity position as of now. Given the current financial policies recently reaffirmed, any new issuance would therefore be assimilated to a pre-refinancing for 2010. On the other side, Telecom Italia and Vodafone will probably need to issue more debt this year.

Heavy issuers' refinancing position for 2009, as at 20 March 2009

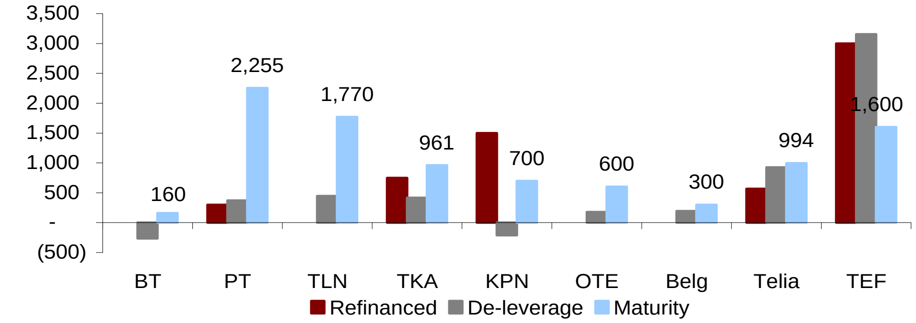


Source: Company, Calyon

Most likely issuers: Portugal Telecom … and the rest.

In the past three months only four operators have not issued public debt, namely **Belgacom**, **OTE**, **Telenor** and **Portugal Telecom**. The first two have limited refinancing needs in 2009, which may explain their decision not to come to the market. The situation of Telenor (uncertainties surrounding the financing of the acquisition of its Indian mobile subsidiary) explains the absence of this issuer. That leaves Portugal Telecom as the main potential issuer in the short term. However, looking at the spreads paid by the Lusitanian issuer on its recent tap (nearly twice that of SFR for the same maturity at MS+465bp), the spread could easily go beyond MS+500bp for a 4Y maturity.

Other issuers: more deals from PT, Telenor and Belgacom?



Source: Company, Calyon

Nevertheless the primary activity should not be limited to these issuers. We would expect telecom operators with important refinancing needs in 2010 – like Telefonica – to come back to the market and continue to issue more than we had initially anticipated (EUR24bn).

New supply activity in Q109

Euro new issues in 2009

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Issue spread
14-Jan-08	Telecom Italia	Baa2	BBB	Italy	7.875%	22-Jan-14	500	500 + MS
08-Jan-09	Vodafone	Baa1	A-	UK	6.250%	15-Jan-16	1,250	290 + MS
13-Jan-09	Deutsche Telekom	Baa1	BBB+	Germany	6.000%	20-Jan-17	2,000	265 + MS
14-Jan-09	France Telecom	A3	A-	France	5.000%	22-Jan-14	1,000	205 + MS
14-Jan-09	SFR		A-	France	3.725%	18-Jul-12	200	250 + MS
19-Jan-09	Telekom Austria	A3	BBB+	Austria	6.375%	29-Jan-16	750	325 + MS
20-Jan-09	Telefonica	Baa1	A-	Spain	5.431%	29-Jan-14	2,000	250 + MS
28-Jan-09	KPN	Baa2	BBB+	Netherlands	6.250%	29-Jan-14	750	335 + MS
28-Jan-09	KPN	Baa2	BBB+	Netherlands	7.500%	29-Jan-19	750	400 + MS
02-Feb-09	Portugal Telecom	Baa2	BBB-	Portugal	tap	26-Mar-12	300	465 + MS
02-Mar-09	TeliaSonera	A3	A-	Finland	5.125%	13-Mar-14	550	250 + MS
12-Mar-09	Telecom Italia	Baa2	BBB	Italy	6.750%	21-Mar-13	650	435 + MS
12-Mar-09	Telecom Italia	Baa2	BBB	Italy	8.250%	21-Mar-16	850	525 + MS
17-Mar-09	Telefonica	Baa1	A-	Spain	5.496%	01-Apr-16	1,000	235 + MS
Total						**10-Dec-14**	**12,550**	

GBP new issues in 2009 Exchange rate: 0.91

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Equivalent euro
19-Feb-09	Vodafone	Baa1	A-	UK	4.63%	08-Sep-14	325	356
02-Apr-09	Deutsche Telekom	Baa1	BBB+	Germany	6.50%	02-Apr-22	700	766

CHF new issues in 2009 Exchange rate: 1.52

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Equivalent euro
06-Feb-09	France Telecom				3.38%	06-Sep-13	500	329

SEK new issues in 2009 Exchange rate: 10.82

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Equivalent euro
23-Mar-09	TeliaSonera				Floater	23-Mar-09	200	18

USD new issues in 2009 Exchange rate: 1.33

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Equivalent euro

Others

Date	Issuer	Type	Coupon	Maturity	Nominal	Equivalent euro
	Telecom Italia	EIB Loan		8 yrs	600	600
	Telecom Italia	private placement	7.94%	5 yrs	500	500

Issuers	EUR	GBP	SEK	NOK	CHF	USD	09 refinancing
Belgacom	-	-	-	-	-	-	**-**
BT	-	-	-	-	-	-	**-**
Deutsche Telekom	2,000	766	-	-	-	-	**2,766**
France Telecom	1,000	-	-	-	329	-	**1,329**
KPN	1,500	-	-	-	-	-	**1,500**
OTE	-	-	-	-	-	-	**-**
Portugal Telecom	300	-	-	-	-	-	**300**
Telefonica	3,000	-	-	-	-	-	**3,000**
Telecom Italia	3,100	-	-	-	-	-	**3,100**
Telekom Austria	750	-	-	-	-	-	**750**
TeliaSonera	550	-	18	-	-	-	**568**
Telenor	-	-	-	-	-	-	**-**
Vodafone	1,250	356	-	-	-	-	**1,606**
Total	**13,450**	**1,122**	**18**	**-**	**329**	**-**	**14,920**

Source: Calyon, as of 6 April 2009.

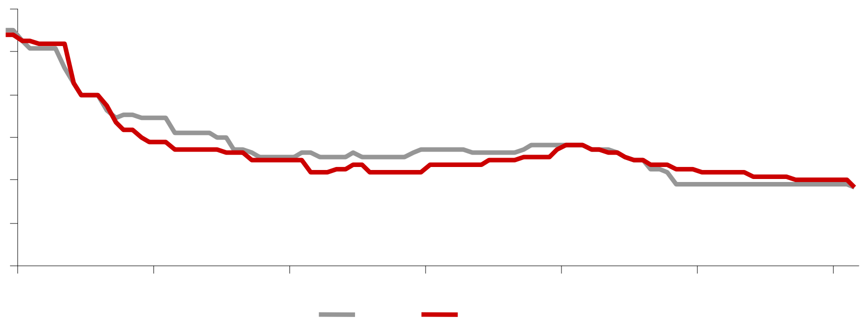
Credit trend

Outlook and credit trend

Benign rating environment

Negative rating actions during the first quarter were not linked to a rising operational risk but to issuer-specific issues (Telenor, BT, Belgacom). In contrast to many industrial sectors, the relative rating drift observed on the sector (Telenor, Belgacom downgraded, Telefonica upgraded and BT under negative watch) has not been driven by a deterioration of the industrial outlook.

Telecom sector rating drift



Source: Rating agencies, Calyon

Regulatory framework … new networks issue not yet settled

At the end of March, the European Commission and Parliament finalised the terms of the regulatory framework for the telecom sector between 2010 and 2015. The final agreement did not diverge materially from the initial terms approved by the 27 member states last year. On 1 January 2010 the BEREC (Body of European Regulators for Electronic Communications) will be created, which will be able to act upon the approval of the voting majority. This will effectively push towards greater harmonisation in Europe. The power of the European Commission will also be enhanced as the new framework allows it to impose measures to ensure that previous recommendations are implemented in one or several markets if needed. Finally, the new framework will impose a maximum delay on number portability of 24 hours but does not provide the necessary base for fibre-optic deployment.

Conservative 2009 guidance … still above market consensus

Contrary to Q108, the conservative guidance provided by the sector did not trigger a sharp market reaction in the equity markets. We believe that this factor is essentially attributable to three factors: (1) guidance remaining marginally above market consensus; (2) top-line guidance remaining above GDP expectations; and (3) FCF targets remaining unchanged compared with last year.

2009 forecast

	Sales		EBITDA		FCF
Issuer	**Guidance**	**Consensus**	**Guidance**	**Consensus**	**Guidance**
Belgacom	-1.0%	-1.1%	"stable"	1.5%	
BT (GBP)	-	-0.3%	"up"	8.8%	floor: GBP1bn
Deutsche Telekom**		5.8%	"stable"	5.1%	Stable
France Telecom	">GDP"	-1.7%		-4.0%	Stable bef. Spec. Items
KPN*	2.1%	-1.6%	4.3%	2.7%	Down 10%
OTE		1.0%		2.9%	
Portugal Telecom	-	-1.0%	-	-2.5%	-
TEF	"up"	-0.2%	1%/3%	-1.9%	
TI	"stable"	-2.1%	"stable"	-2.6%	
Telekom Austria	-0.9%	-0.5%	0.2%	-1.6%	
Telenor (excl. India)	"stable"	3.7%	"up"	-4.1%	
TeliaSonera	"up"	6.6%	-	4.3%	Lower capex
Vodafone (GBP)		7.4%		5.9%	

*Source: companies. * 2010 guidance. ** Excluding OTE.*

Financial policies becoming ever more conservative than before…

One of the key features of Q109 was the ‘softening’ of financial policies. This was expressed in different ways by operators:

- France Telecom: net debt to EBITDA not to go beyond 2.0x until crisis settled vs temporarily lower if opportunities arise.
- Telecom Italia: cutting dividend policy to support ratings and ease access to primary market.
- Deutsche Telekom: confirming acquisition policy is on the back-burner and renewing net debt to EBITDA commitment (2.0-2.5x).
- Telefonica: fundamentals still improving, not announcing further share buybacks (for now?).
- Telekom Austria: share buybacks implicitly suspended until H109 results.

We expect Vodafone, and BT even more so, to follow the same trend as they publish their 2009/10 guidance.

This element should contribute to maintain the sector in the low-beta category for some time. As presented in our 2009 outlook, the sector conservatively distributes 50% of its FCF in ordinary dividend maintaining therefore a comfortable excess cash-flow capacity.

Issuer snapshot

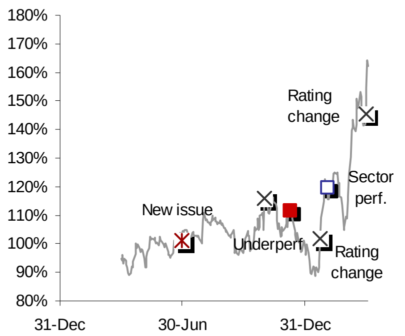
Belgacom (Aa3 neg/A): time to change strategy?

On 6 February Moody's downgraded Belgacom's rating from Aa2 to Aa3 (negative outlook) on the basis that the rating agency "expects that, going forward, Belgacom will sustain a level of shareholder remuneration that will maintain the pressure on the company's ratios". While we do not expect the company to maintain the level of shareholder remuneration seen in 2008, the absence of a clear financial policy leaves the door open for potential (small to medium-sized) acquisitions. The 2009 outlook that came with the Q4 results was somewhat benign (2009 sales to decline only 1% and EBITDA margin to remain between 32% and 33%), though it implies a 6% decline in EBITDA, which stands at the bottom of the industry in Europe.

One year rating target: Mid-A (maintained)

Relative value: Underperform (maintained since 09/12/08)

BT's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

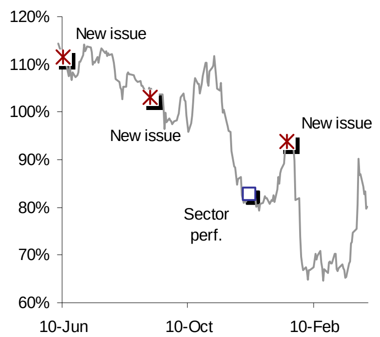
BT plc (BBB /Baa1 neg)

As highlighted by the sudden widening of its CDS, perception of BT has sharply changed during Q109, including for rating agencies. BT is the only operator with a high probability of a downgrade, reflecting the deterioration of its operating performance at the end of 2009. Compared with the mobile operators present in the UK, BT seems to be much more exposed to the cycle than any other operator. After cutting its annual target, the group put a floor on FY09/10 FCF at GBP1bn (not including additional pension contributions). Like for Telecom Italia, a dividend cut is now widely expected (consensus has declined from nearly GBP0.13 per share to GBP0.085 per share). We believe that a dividend per share of GBP0.08 (62% of targeted FCF) is realistic but we are not certain that this would be sufficient to maintain the ratings at current levels. Any decision to maintain the current dividend would trigger a downgrade from S&P.

One year rating target: Mid-BBB (maintained)

Relative value: Sectorperform (maintained since 03/02/09)

Deutsche Telekom's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

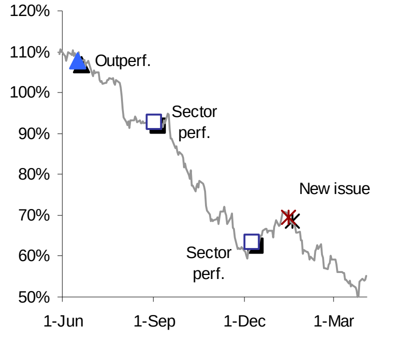
Deutsche Telekom (BBB+/Baa1)

We continue to see DT as the operator with the lowest financial flexibility (excess cash flow after dividend relative to its debt) of the 'Big Four' (FT, Telefonica and Vodafone), justifying to a large extent the rating differential. This financial flexibility could be even further constrained by mobile spectrum acquisitions in Germany and other strategic markets (not included in our forecast of net debt to EBITDA of 2.2x at the end of 2009 after consolidating OTE). We nevertheless expect the newsflow to remain fairly benign overall even if EUR/USD rates and the rhythm of the decline of the German economy continue to be important market-movers. As presented, the 2009 FCF guidance looks achievable and the group has already made significant progress towards its refinancing programme for 2009.

One year rating target: High-BBB (maintained)

Relative value: Sectorperform (maintained since 10/06/08)

France Telecom's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

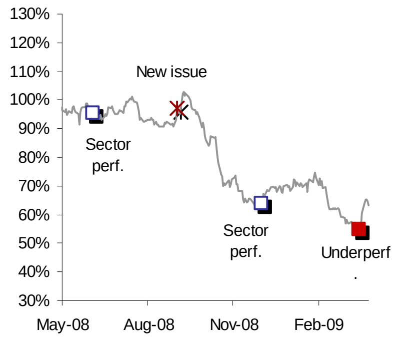
France Telecom (A-/A3): rock solid

The investor day that took place in Paris in early March was the occasion for France Telecom to come back on its key priorities: (1) preservation of balance sheet structure; (2) shareholder remuneration; and (3) M&A. On the last point the group considers itself "on vacation" meaning that there is no subject on the table. We double-checked with the CFO, who confirmed that the group did not intend to go beyond the 2.0x net debt to EBITDA – even on a temporary basis – until the environment has changed. FT's CFO insisted that in difficult times his group needed to become even more conservative than before... Many of the slides in his second presentation seemed to justify why the group needed to de-leverage further, but we believe that one of the key reasons is still lacking. Given the close links between FT and its main shareholder, we believe that FT could be anticipating a second support plan from the government, in which it could be asked to take a more active role. Also confirmed by the CFO, current capex plans do not factor in any acceleration of the FTTx deployment in France. For now we consider that FT will remain the tightest spread of the sector.

One year rating target: Low-A (maintained)

Relative value: Sectorperform (maintained since 01/09/08)

KPN's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

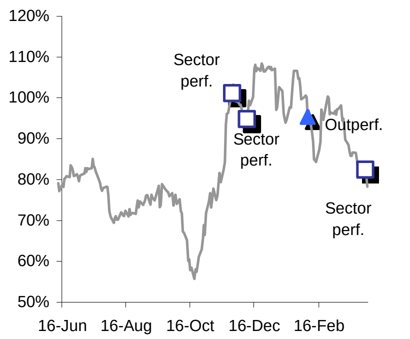
KPN (BBB+/Baa2): still pricing in a (near-) perfect world

Despite its relatively low rating, its high level of shareholder remuneration (31% of outstanding shares cancelled since 2004) and a deteriorating pension exposure (cash funding expected to be close to EUR120bn), KPN remains one of the best-performing stocks and CDS in the sector. But is it that defensive? With 71% of the group EBITDA generated from its domestic market, the group has no Plan B if things do not go as planned in the Netherlands. Credit investors may feel protected by the outstanding amount of 'exceptional' remuneration paid every year in the form of share buybacks that could easily cover debt redemptions but which has not been tested yet (KPN is planning a seventh consecutive year of share buybacks in 2009). Nothing indicates at this point that KPN's 2010 guidance is not achievable and the Q408 results confirmed the stability of the group. Having said that, we consider that the financial strategy, which consists of distributing more cash than generated organically (real estate disposals will be used to support the share buybacks and dividend), cannot be considered as a conservative strategy. As such, we consider that KPN's CDS is pricing a stable environment for the group which may not last if the economic situation continues to deteriorate.

One year rating target: Mid-BBB (maintained)

Relative value: Underperform (maintained since 24/03/09)

OTE's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

OTE (BBB/Baa2): domestic instability?

The Greek operator remains confident enough about 2009 despite the fact that its domestic market is proving much less stable than in the past. A price war in the mobile sector pushing ARPU 15% lower and the reshaping of the fixed-line industry do not seem to be affecting the 2008 results nor the 2009 guidance (top-line trend expected to be in line with 2008, +1.4%) … but the response from competitors will probably impact OTE in early 2009. At the EBITDA level, the guidance has been changed from positive growth to flat as its competitors start to react to its aggressive commercial activity in the mobile sector (OTE increased its customer base by a staggering 25.7%), reducing the scope for capex rationalisation. The market for Rom Telecom remains difficult because of the deteriorating macroeconomic environment. Overall, we consider a slightly negative trend in revenues and EBITDA and a small increase in capex would be reasonable in 2009, which is a little lower than the company's guidance (flat revenue, EBITDA and capex). As a result we move from Outperform to Sectorperform.

One year rating target: Mid-BBB (maintained)

Relative value: Sectorperform (previously Outperform, since 25/03/09)

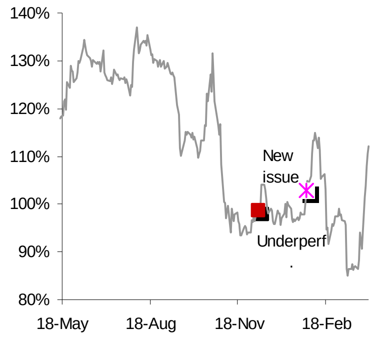
Portugal Telecom (BBB-/Baa2): no de-leveraging in sight

2008 was initially expected to be the low point in terms of credit metrics, implying that 2010 would be the start of a more positive period. At the end of 2008, Portugal Telecom's results were marked by a contraction in domestic margins and a 15% deterioration in the EUR/BRL exchange rate. The deterioration of the after-tax pension deficit from EUR1.0bn to EUR1.3bn and the lack of growth potential from the domestic business have increased the dependency of the group on Vivo (32% economic interest). On an EBITDA-capex basis, and after the split of PTM, the division among the top three activities (mobile-fixed-Vivo) is now comparable making Brazil a very important contributor to the group's FCF. It is important to notice that PT has not provided any guidance for 2009, essentially to avoid bad surprises. On the other hand, management has stated that it is comfortable with the present level of the consensus.

One year rating target: Low-BBB (maintained)

Relative value: Underperform (maintained since 19/12/07)

Portugal Telecom's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

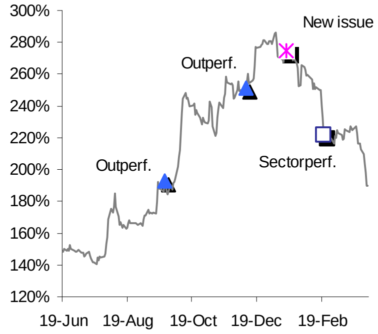
Telecom Italia (BBB/Baa2): on a recovery path?

This could be a relatively quiet year for TI if the group manages to refinance the outstanding debt to mature in 2009 (still nearly EUR2bn to go). Looking at the Q4 results trend (see our *Credit Focus – Telecommunications Q408: how robust are European telecom markets?,* published 18 March 2009), it seems that the domestic market has started to stabilise and that the strategy put in place by TI is starting to pay off in the mobile sector. The prospects for fixed/broadband are not as strong but we do not consider this market to be risky. Given the relatively conservative de-leveraging target set by the group for 2009 (debt expected to remain stable), TI should be able to stay on track this year and could even do better should disposals take place (Hansenet valued at EUR1bn – Germany). The decision to cut dividends (announced on 27 February) was widely expected and reflects a more "conservative approach" according to its CEO. We believe that this decision was essentially aimed at reducing the pressure on S&P's rating and facilitating access to the primary market. Recent CDS performance shows that Telecom Italia has started to regain some of the confidence lost but the premium remains very large. As a result, <u>we change our recommendation from Sectorperform to **Outperform**</u>.

One year rating target: Mid-BBB (maintained)

Relative value: Outperform (previously Sectorperform, since 23/02/09)

Telecom Italia's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

Telefonica (A-/Baa1): at its best ... and still

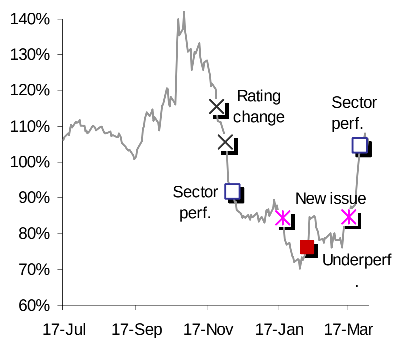
This was a very prolific quarter for the Spanish operator, which managed to achieve a double upgrade to A- (S&P and Moody's) and completely reshape its debt maturity profile. Before issuing EUR3bn on the market (largest telecom issuer this year to date) Telefonica extended the EUR6bn revolving facility related to the acquisition of Cesky Telecom (2005). Under the new terms, EUR2bn can be extended from 2011 to 2012 and EUR2bn up to 2013.

Telefonica's geographical mix is arguably the most exposed to the financial crisis in the European Telecom sector after BT. As BT's CDS started to widen essentially on the impact of the recession in the UK it is therefore not completely surprising to see Telefonica's CDS following the same path (hence our previous Underperform rating modified on 27 March). We believe that Telefonica has recently adopted a more conservative financial approach. With the Argentine crisis in 2001-03 the group has gained some useful experience should the situation deteriorate further. We do not foresee any short-term M&A risk, and the group is also advanced as far as its 2009-10 refinancing programme is concerned (2009 expected excess cash flow + refinancing = EUR6.5bn vs EUR7.3bn maturing, according to our estimates).

One year rating target: Low-A (maintained)

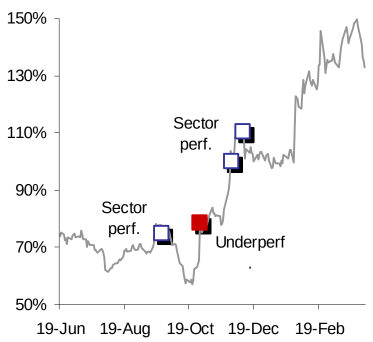
Relative value: Sectorperform (maintained since 27/03/09)

Telefonica's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

Telenor's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

Telenor (BBB+/A3): too much bad news at the same time…

Once the lowest beta in the sector, Telenor is now the second-widest CDS. This underperformance is attributable to three factors: (1) the decision to invest massively in India (mostly debt financed); (2) the sudden rise in legal risk (USD1.7bn claim made against Telenor, 17% of market cap); and (3) the weakness of the RUB.

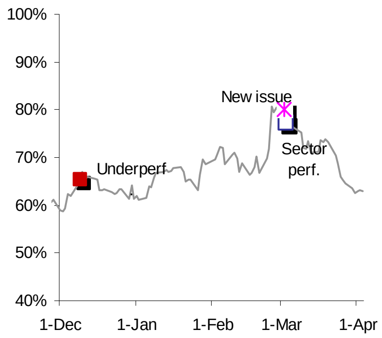
India will weigh heavily on the group's financial structure. Most of the deterioration in the group's financial profile (we expect the net debt to EBITDA ratio to deteriorate from 1.4x at end-2007 to 2.3x at end-2011) is directly attributable to that decision, which essentially moves the group's centre of gravity to emerging markets.

On 3 April Telenor was legally informed that it would have five days to pay USD1.7bn as a penalty in the legal battle that opposes arimex products. This claim represents 17% of Telenor's market capitalisation. Telenor reacted immediately in a press release issued the same day insisting that it has "no intention of honouring such a horrendous claim, which is based on an illegal Russian court ruling, still under appeal by us". Paying this claim would have a meaningful impact on the credit metrics of the group. According to our estimates, the net debt to EBITDA ratio at the end of the year would move from 2.4x to 2.8x (vs 1.9x at the end of 2008). This claim would significantly damage Telenor's ability to de-leverage over 2009-11 (net debt to EBITDA of 3.1x according to our forecast). We expect both rating agencies to review their rating following this announcement. As a result of this new development we have changed our rating from Sectorperform to Underperform but maintain our one-year rating target at Mid-BBB (see *Morning Credit*, 6 April 2009).

One year rating target: Mid-BBB (maintained)

Relative value: Underperform (maintained since 06/04/09)

TeliaSonera's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

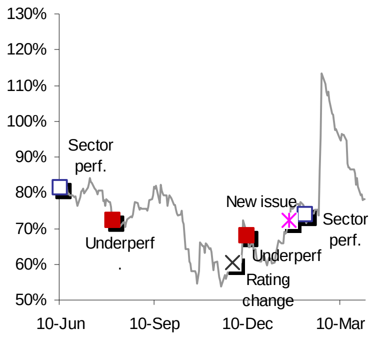
TeliaSonera (A-/A3): still aggressive

TeliaSonera is, with KPN and Telenor, one of the few European telecom operators that will see its key metrics deteriorate further in 2009 and beyond thanks to an aggressive financial policy. The 2008 EBITDA margin remains stable for the year (in line with guidance and for the fourth consecutive quarter) and the net debt to EBITDA ratio stands at 1.5x. The 2009 outlook is still positively oriented as the group expects positive top-line growth (organically) and stable EBITDA margins. Capex is nevertheless expected to decline somewhat. The group announced a stable dividend for the year-end and will also ask approval for another share buyback plan representing 10% of group shares (SEK17bn compared with SEK11bn FCF at the end of 2008). Negative rating pressure could nevertheless crystallise on Moody's rating as RCF to adjusted net debt had already fallen below 30% (estimated at 25%) even before the launch of the new share buyback. Knowing that TeliaSonera has a rating target of A-/BBB+, this should not represent a major surprise though.

One year rating target: Low-A (maintained)

Relative value: Sectorperform (maintained since 03/03/09)

Telekom Austria's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

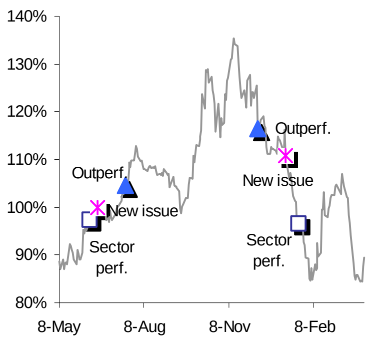
Telekom Austria (BBB+ neg/A3): more conservative … on emerging-market economic outlook?

At first glance, TKA has provided very cautious guidance for 2009 with an EBITDA target of EUR1.9bn (stable) and a new financial policy. With now 40% of its EBITDA generated in Bulgaria and other Eastern European countries, vs 30% at end-2006, the operator has very little room to manoeuvre under the new parameters (even less if we look at the current capex guidelines). The main positive news is the stabilisation of domestic activities, although the trend remains to be confirmed in Q1 and beyond. It is difficult to say whether there is a link between the two but TKA's financial policy is now guiding to a net debt to EBITDA of between 1.8x and 2.0x (vs 2.0x). Excess cash flow will be split between growth projects and share buybacks after the second quarter of the year. The trend of the dividend policy is in line with the EBITDA guidance (stable) setting a floor for DPS at EUR0.75 over the 2009-12 period (+/- 50% of FCF). For now, the excess cash flow looks set to be dedicated to de-leveraging (net debt to EBITDA excluding restructuring programme >2.1x end-2008).Overall, we believe that recent announcements have been positive credit-wise; nevertheless, TKA has very little headroom to reach its financial targets with an operating profile that is among the most challenging in the sector.

One year rating target: High-BBB (maintained)

Relative value: Sectorperform (maintained since 04/02/09)

Vodafone's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

Vodafone (A-/Baa1)

The newsflow from Vodafone has been fairly quiet since the start of the year. The fact that all European operators have posted 'reassuring' numbers for Q408 has had a positive impact on the perception of the group. Vodafone's CDS continues to move in what we consider to be an acceptable range around our 5Y CDS telecom index (90-100%). The group will present its 2008/09 results on 19 May. Clearly, Vodafone's main challenge will be to demonstrate that its regional performance in key markets such as Spain, the UK and Italy remains comparable to that of incumbent operators. Last year, a slight underperformance in Spain caused its spreads and stock to underperform quite significantly.

One year rating target: Low-A (maintained)

Relative value: Sectorperform (maintained since 26/01/09)

Performance of recent strategies

Closed Strategies	Entry Date	P&L (€)	Selling Leg	Amount	Entry Spread	Last Spread	Buying Leg	Amount	Entry Spread	Last Spread	Closing Date
Sell TITIM CDS EUR SR 5Y - Buy BRITEL CDS EUR SR 5Y	08/01/09	330,570	TITIM	5M	375	287	BRITEL	15M	120	243	28/01/09
Sell TITIM CDS EUR SR 1Y - Buy BRITEL CDS EUR SR 1Y	08/01/09	56,238	TITIM	5M	431	317	BRITEL	15M	139	265	28/01/09
Sell OTE CDS EUR SR 5Y - Buy DT CDS EUR SR 5Y	05/02/09	161,209	OTE	5M	124	134	DT	8M	86	135	25/03/09

Source: Calyon

Telecoms earnings calendar

Apr-Jun 2009

Date	Company	Event
01/04/09	Telia	Annual General Meeting
06/04/09	TI	Annual Report + AGM
07/04/09	KPN	Annual General Meeting
08/04/09	Belgacom	Annual General Meeting
24/04/09	Telia	Q109 results
28/04/09	KPN	Q109 results
29/04/09	FT	Q109 results
30/04/09	DT	Annual General Meeting
05/05/09	TLN	Q109 results
07/05/09	DT	Q109 results
07/05/09	PT	Q109 results
07/05/09	TI	Q109 results
11/05/09	TLN	Annual General Meeting
13/05/09	TEF	Q109 results
13/05/09	TKA	Q109 results
14/05/09	BT	Q4/FY 2008/09
14/05/09	Vivendi	Q109 results
15/05/09	Belgacom	Q109 results
19/05/09	Vodafone	Q4/FY 2008/09
20/05/09	TKA	Annual General Meeting (to be confirmed)
26/05/09	FT	Annual General Meeting (to be confirmed)
27/05/09	PT	Annual General Meeting
11/06/09	TLN	Capital Markets Day, 2009

Source: Calyon

Appendix – Summary of CDS recommendations

	Ratings		Spot	Variation			Expected	Spot vs Index			Perf. Expectation vs Sector Index		
Issuer	S&P/Moody's	Calyon	CDS	1 Week	1 Month	YTD	Trend	Ratio	Fair Value	Spot-FV	Previous	Since	New
Issuer's Names							(1)		(2)			(3)	

Expected trend

According to our quantitative model, this column indicates the expected trend for each single name (sector) relative to its sector index (the iTraxx Main):

↗ The single name (resp. sector) should underperform its sector (resp. iTraxx Main) in the month following. Indeed, the single name CDS over sector index ratio has tightened a lot in the past few days and so the model anticipates a trend reversal. This means that it is a good time to play the underperformance (but not necessarily the widening as we are in relative value)

➔ No trend reversal is expected

↘ The single name (resp. sector) should outperform its sector (resp. iTraxx Main) in the month following. The ratio single names CDS/sector index has widened a lot in the past few days and so the model anticipates a trend reversal. This means that it is a good time to play the outperformance (but not necessarily the tightening as we are in relative value)

Fair value model

The ratio corresponds to the single name spread divided by its sector index (or sector index divided by iTraxx Main).

The historical fair value model has been developed to enhance our recommendation on every issuer of the coverage list. Its principle is based on a historical observation of the positioning of the 5Y CDS spread over the sector index. The average between the 3M, 6M and 12M ratios is considered to be the fair positioning of the 5Y CDS over the sector index. Therefore, with the spot value of the index, we can compute the historical fair value of the CDS.

The calculation of the historical fair value is achieved in several steps.

- **Step 1:** Using Calyon prices, we compute the ratio: '5Y CDS spread/index' for every trading day. It is worth noting that the computation of the index takes into consideration the PV01 weighting method (the wider the name, the less impact it has upon the fair value calculation for the index).
- **Step 2:** Once step 1 has been achieved, we compute the average value of the ratios over three months (3M), six months (6M) and one year (12M).
- **Step 3:** The average between the 3M, 6M and 12M ratios is considered to be the fair positioning of the 5Y CDS over the sector index. Therefore, with the spot value of the index, we can compute the historical fair value of the CDS. Comparing the spot price of the CDS and its fair value according to our model gives the analyst a quantitative tool to appreciate the potential future performance of an issuer vs the sector.

Performance expectation vs sector index

This represents the view of our analysts based on a fundamental analysis. It also indicates how long a particular recommendation has been held.

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Certification

The views expressed in this report accurately reflect the personal views of the undersigned analyst(s). In addition, the undersigned analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report.

Jean-François Paren

Recommendation System:

Fundamental credit assessment: We evaluate the fundamental credit quality trend of an issuer for the next 12 months.

Calyon's Credit Research evaluates the potential changes of an issuer for the next 12 months and assigns a one year forward rating based on S&P's scale. This rating is to be compared with the average long-term rating assigned by S&P and Moody's.

Internal credit rating: We assign a rating to a company which reflects the assessment of the credit quality by the credit analyst. The timeframe for the rating is one year. As a rating scale we use a scale similar to the one of S&P and Fitch, however, we substitute the rating agencies plus or minus by high and low, ie. the Calyon scale uses AAA, High-AA, Mid-AA, Low-AA, High-A, Mid-A etc.

Performance of credit instruments: We express our expectation of how the 5 year CDS is going to perform vis-à-vis its sector. The timeframe of that recommendation is one month. When the analyst changes a recommendation he/she should indicate in the analysis when the last recommendation was made.

Outperform: CDS spreads should outperform the sector performance.
Sectorperform: CDS spreads should perform in line with the sector performance.
Underperform: CDS spreads should underperform the sector performance.

Credit products rating distribution table:
(as of 16th Jan 2009)

	All covered companies		Companies where Calyon provided Investment Banking Services in past 12 months	
	Count	**Percentage**	**Count**	**Percentage**
Outperform	21	20%	3	14%
Sectorperform	44	41%	5	11%
Underperform	42	39%	4	10%

Disclosures

Company Name	Disclosure
Belgacom	None
BT	None
Deutsche Telekom	None
France Telecom	E, G
KPN	None
OTE	None
Portugal Telecom	None
Telecom Italia	None
Telefonica	G
Telekom Austria	None
Telenor	None
TeliaSonera	G
Vodafone	None
Vivo	None
Kyivstar	None
Vimpelcom	None

A	NOT IN USE
B	NOT IN USE
C	The Company owned more than 5% of the total issued share capital of Crédit Agricole SA as of the end of the second most recent month preceding the publication date of this report.
D	NOT IN USE
E	One or more companies in the Crédit Agricole S.A. group owned more than 3 % of the total issued share capital of the Company as of the end of the second most recent trading day preceding the publication date of this report.
F	Crédit Agricole Cheuvreux and/or a company in the Crédit Agricole S.A. group is a market maker or a liquidity provider for the financial instruments of the Company.
G	Calyon and/or a company of the Crédit Agricole S.A. group has been lead or co-lead manager over the previous 12 months in a publicly disclosed offer of or on financial instruments of the Company.
H	Calyon and/or a company in the Crédit Agricole S.A. group has concluded or is party to a non confidential agreement relating to the provision of investment banking services (except publicly disclosed offers mentioned under G) to the Company during the past 12 months or that has given rise during the same period to the payment of compensation or to the promise to get a compensation paid.
I	This research has been communicated to the Company and following this communication, its conclusions has been amended before its dissemination.
J	An executive director of the Credit Agricole S.A. group is a director or board member of the company.

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