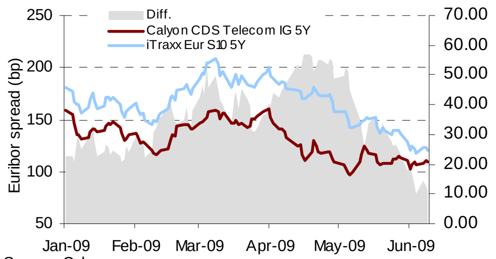
Telecoms Quarterly

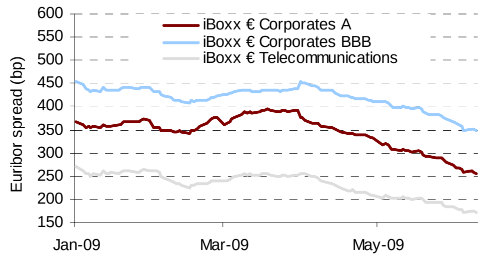
Jean-Francois Paren
Global Head of Credit Research
(+33 1 41 89 33 95) jean-francois.paren@calyon.com

CDS YTD performance vs iTraxx Main



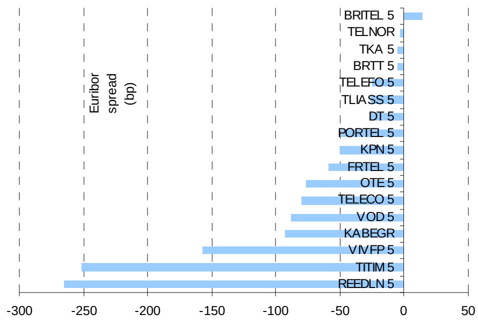
Source: Calyon

iBoxx telecoms YTD performance vs iBoxx corporates

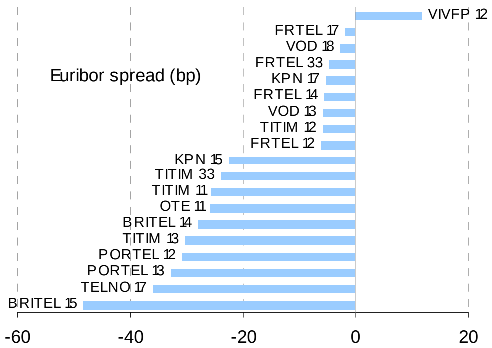


Source: Bloomberg

Under/outperformers in telecoms CDS



Under/outperformers in telecoms cash



Sources: Bloomberg, Calyon

Q309 Update

Stress-testing strategies

Here and there the crisis has broken the first line of defence of the Telecoms sector with most operators now dropping their annual top-line forecast presented only three months ago. For now, with the exception of BT, telecom CFOs are still holding on to their FCF guidance despite the fact that maintaining that target will probably claim further sacrifices. As capex cuts remain the most efficient tool in the arsenal, operators with heavy investment commitments/requirements (Deutsche Telekom, Telenor, Portugal Telecom) may soon be in a situation where they need to review their priorities (dividend? capex? asset disposal?). So far, rating activity on the sector has remained fairly quiet in Q209: one down (Vodafone outlook by Fitch) for one up (Portugal Telecom long-term rating raised from BBB- to BBB by S&P). Considering that the 12-month trailing rating drift was -28% at the end of May, this is a pretty comfortable situation, and the fundamental situation of the sector is still above that of other sectors.

■ Primary focus… becoming a scarce resource

Telecoms new issues represent 'only' 9.6% of the non-financial corporate eurobond primary market and yet, according to our estimates, the Telecoms sector has covered 67% of its refinancing needs for 2009 (excluding excess FCF generated to reduce debt). This is the first time that the Telecoms sector has dipped into single-digit territory coming from a high point of 28.5% in 1999. Always considered a negative technical factor for the sector, primary activity is about to become a favourable element and should support the outperformance of future deals … and secondary.

■ Sector recommendation unchanged

The iBoxx telecom index has outperformed the iBoxx corporate index since January but gave up some of its earlier gains in the recent rally. Limited primary supply, strong fundamentals and rating stability position the sector favourably in the event of a sudden change in market dynamic.

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

■ Q309: what to watch for

The focus will remain on EBITDA protection and/or potential strategic adjustments that could result from negative surprises in H109 numbers. The tension perceived during several presentations has probably not been eased looking at how the environment has changed since then, and several issuers will be in the hot seat (DT, Telecom Italia and Telenor). The Q209 reporting season starts on 23 July with KPN.

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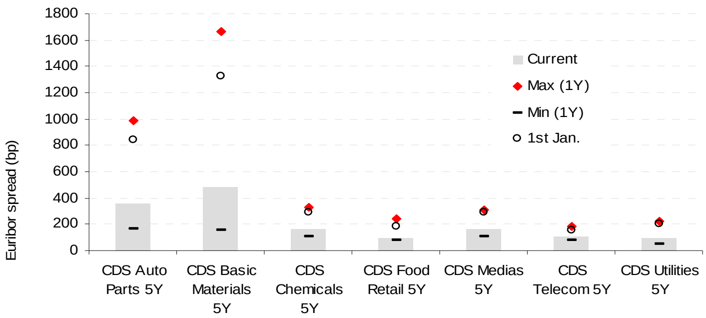
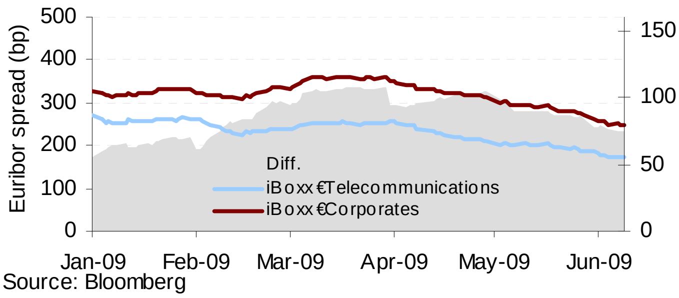
Sector recommendations

Telecoms CDS YTD performance: steady

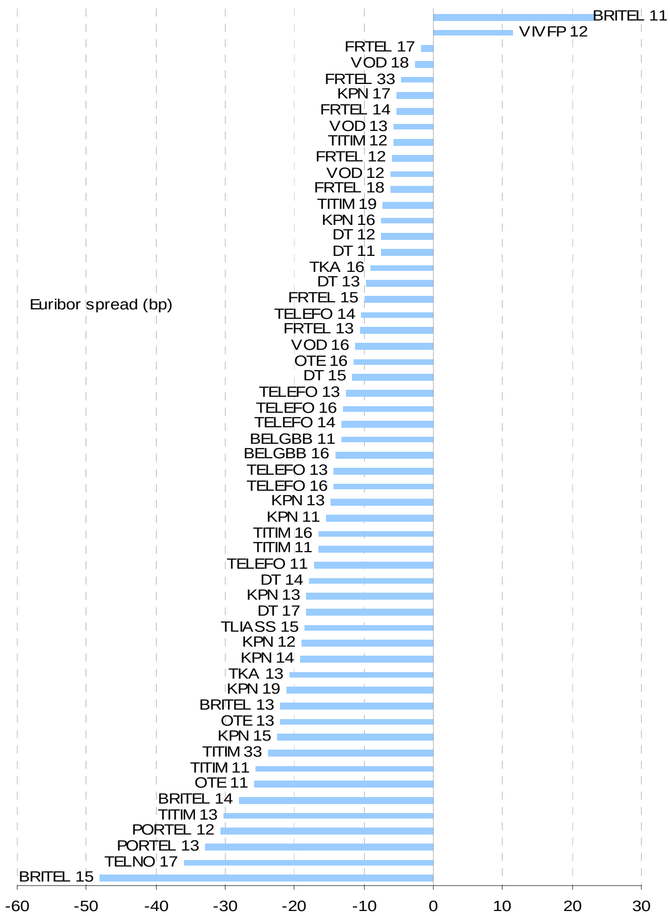


iBoxx telecoms YTD performance



Source: Bloomberg

Telecoms Cash YTD performance since 5 January 2009



Source all charts: Bloomberg

Recommendation performance

Giving some of its earlier gains in the rally…

The telecoms sector has given back some of the gains of Q1 in the recent brutal rally. The outperformance on both cash and CDS remains positive, however, for now. From a purely fundamental point of view we still see the absolute market levels as reflecting a very high level of default rate (1.67% on the iTraxx Main vs 3.2% at the top). It is true that the risk of liquidity shortage has vanished (for IG only) but the fact is that the overall rating migration (28.8% for Europe according to Moody's as at end of May) remains a key concern for investors and that default rates are on the rise.

… but defensive profile still favoured in our baseline scenario

The Telecoms sector remains immune to any visible migration at this point, and other technical factors now play in its favour (supply, low beta and average rating) should the rally end abruptly.

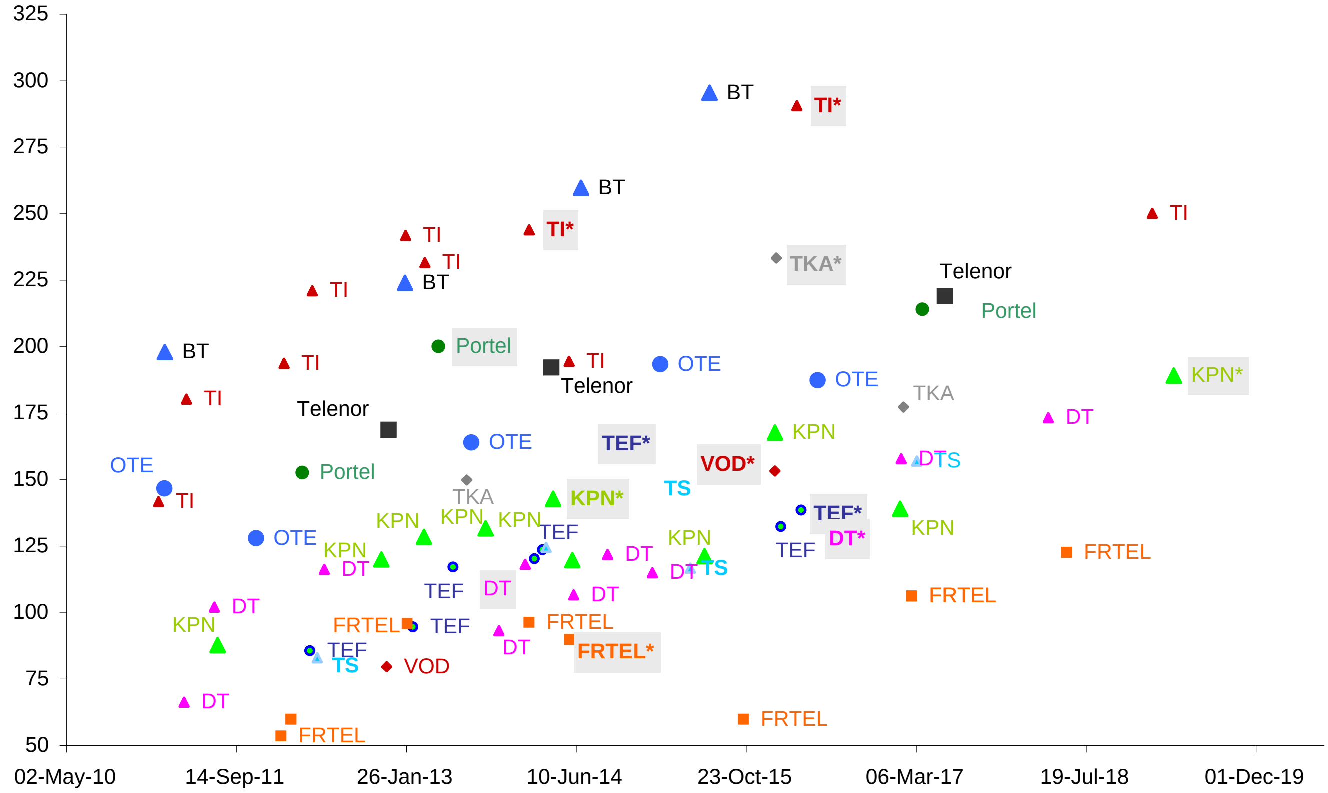
Cash: new issues and high beta leading the run

On average Telecoms new issues have tightened by 90bp since issuance (calculation based on 14 new issues). That should be compared with 10-15bp of tightening for bonds issued before January 2009. Excluding very specific examples (see our strategy on Portugal Telecom issued on 5 June 2009 – *Trade Idea - Telecoms: two strategies*), new issues are now trading in line with secondary levels. This element will undeniably contribute to reduce the premium on future primary deals.

The outperformance was also quite noticeable on high-beta names (Telecom Italia, Portugal Telecom, BT). All three operators issued additional debt on the primary market during Q2 while newsflow remained relatively benign in general. These two elements have obviously played an important role.

Cash bonds ASW & YTM (as at 17/06/09)

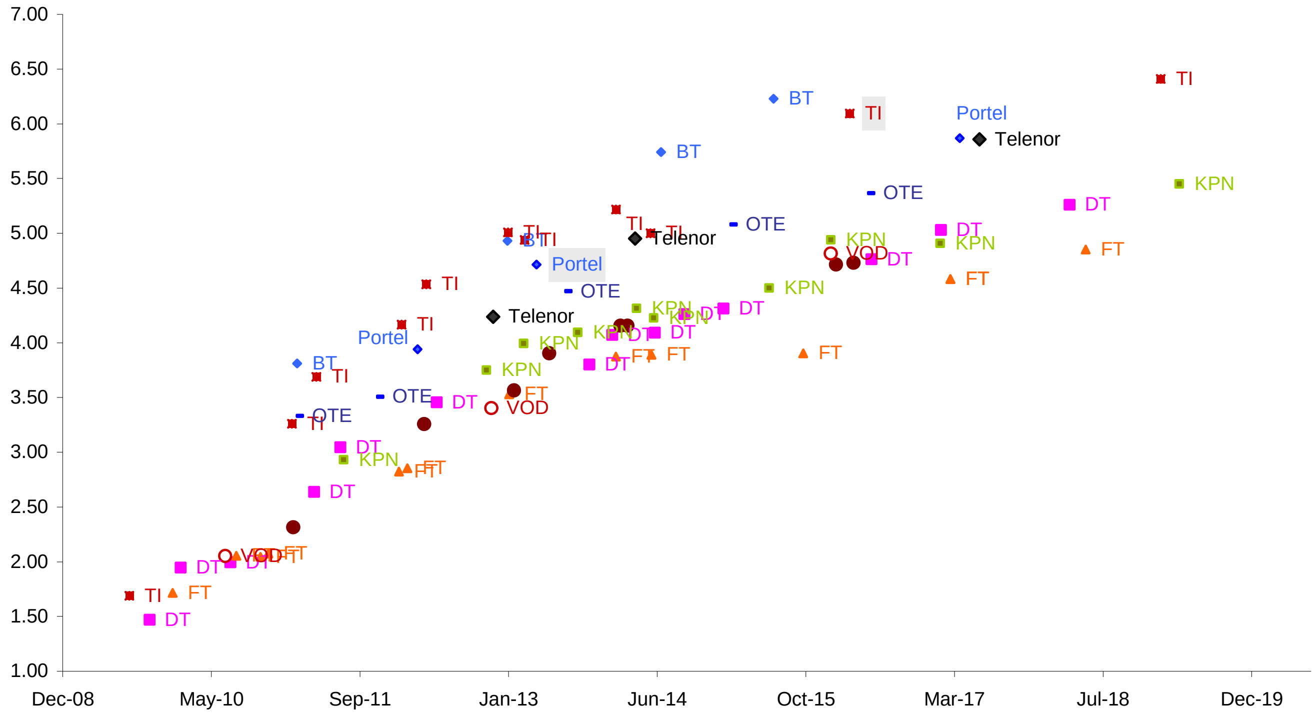
ASW mapping



Issues shaded in grey represent 2009 new issues.

Source: Bloomberg. As at 17 June 2009

YTM mapping (%)



Source: Calyon

Issuer recommendations

Performance relative to Calyon's telecoms indices

as of: 17-Jun-2009	Current relative value rating	Live perf.	Closed as of today	Total	Current spread	Hist. Fair value
BT	Underperform	- 11	11	0	183	158
Deutsche Tel.	Sector perform	-	11	11	108	97
France Tel.	Sector perform	-	-	-	51	66
KPN	Underperform	1	-	1	63	74
OTE	Sector perform	-	21	21	94	101
Portugal Tel.	Underperform	- 3	-	- 3	108	116
Telecom It.	Outperform	5	43	49	209	235
Telekom Aust.	Sector perform	-	7	7	93	87
Telefonica	Sector perform	-	45	45	118	109
TeliaSonera	Sector perform	-	18	18	71	73
Telenor	Sector perform	-	9	9	169	73
Vodafone	Sector perform	-	30	30	93	110
Total gain (-loss)		**- 8**	**196**	**188**		

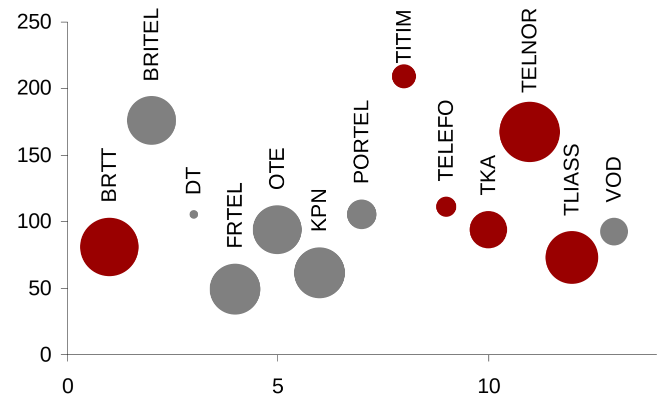
Source: Bloomberg, Calyon

Recommendation performance YTD

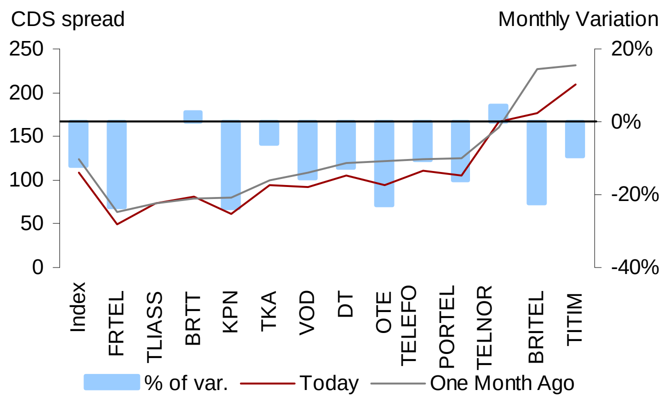
Increasing volatility and refocusing on fundamental rather than technical factors have created a number of opportunities in Q109 that helped us to outperform our telecom index by nearly 200bp and generate several profitable trades (see table below).

Only one CDS recommendation is currently generating a negative mark to market and that is on BT. Our Underperform recommendation has been challenged by probable profit-takers on the group CDS over the past two weeks. It is fair to say that most of the bad news is probably behind us now (changes to FCF target, pension liabilities) and that the most recent new issue comforted investors (despite the absence of short-term refinancing requirements for the next 18 months). We nevertheless maintain our recommendation on the basis that BT's profile remains much more sensitive than any of its peers'.

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

While we had a busy first quarter in terms of changes to our recommendation, the second quarter has been and the only recommendation we have changed is on Telenor, from Underperform to Sectorperform. This is also a reflection of the declining volatility seen on the sector for single names.

Summary of our recommendations on CDS

			Spot	Variation			Expected	Spot vs Index			CDS Recommendation		
Issuer	S&P/Moody's	Calyon	CDS	1 Week	1 Month	YTD	Trend	Ratio	Fair Value	Spot - FV	Previous	Since	New
British Telecom	BBB/Baa2 neg	Low-BBB	**175**	-2	-23	16	→	162%	**155**	**20**	Underperform	15/05/09	Underperform
Deutsche Telekom	BBB+/Baa1	High-BBB	**106**	-2	3	-25	→	98%	**96**	**10**	Sectorperform	29/05/09	Sectorperform
France Telecom	A-/A3	Low-A	**49**	-2	-7	-59	↗	45%	**68**	**-19**	Sectorperform	01/09/08	Sectorperform
KPN	BBB+ / Baa2	Mid-BBB	**61**	-3	-8	-50	→	56%	**74**	**-13**	Underperform	24/03/09	Underperform
OTE	BBB / Baa2	Mid-BBB	**94**	-6	-11	-76	→	87%	**97**	**-3**	Sectorperform	07/04/09	Sectorperform
Portugal Telecom	BBB /Baa2	Low-BBB	**105**	-1	-9	-49	→	97%	**115**	**-10**	Underperform	19/12/07	Underperform
Telefonica	A- / Baa1 Pos	Low-A	**111**	1	-7	-25	→	103%	**107**	**4**	Sectorperform	27/03/09	Sectorperform
Telenor	BBB+ neg/A3	Mid-BBB	**163**	12	16	-7	→	151%	**133**	**30**	Sectorperform	05/05/09	Sectorperform
Vodafone	A-/Baa1	Low-A	**91**	-4	-15	-89	↗	84%	**107**	**-16**	Sectorperform	26/01/09	Sectorperform
Telecom Italia	BBB/Baa2	Mid-BBB	**205**	-7	18	-255	→	190%	**225**	**-20**	Outperform	07/04/09	Outperform
TeliaSonera	A-/A3	Low-A	**72**	0	7	-27	→	67%	**72**	**0**	Sectorperform	03/03/09	Sectorperform
Telekom Austria	BBB+ neg/A3	High-BBB	**94**	0	12	-5	→	87%	**85**	**9**	Sectorperform	04/02/09	Sectorperform
Index Telecom			**108**	-1	-2	-50	→						

Key: ↘ *Outperformance expected;* → *No trend reversal is expected;* ↗ *Underperformance expected.*

Source: Bloomberg, Calyon

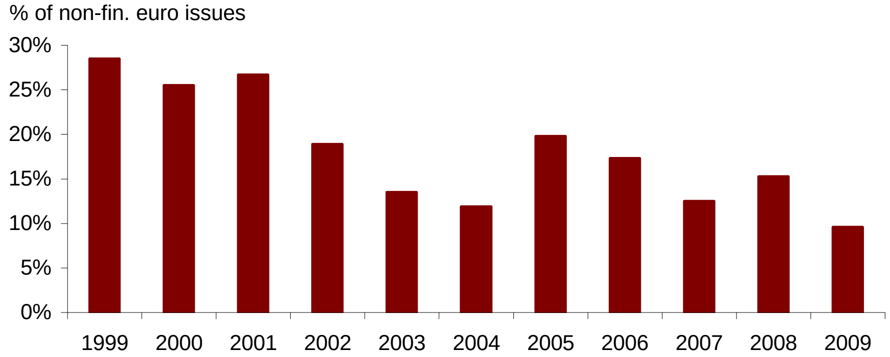
Primary activity and outlook

Telecoms issues: only 9% of the non-financial corporate primary market…

The pace of the European primary market continues to decline. The weekly average for new primary issues fell from EUR11bn in Q1 to EUR6bn over the past two weeks. According to our estimates, the Telecoms sector has covered 67% of its refinancing needs for 2009 (excluding excess FCF generated to reduce debt) but represents 'only' 9% of the euro debt market (including non-European issuers). This is obviously well below the weighting of the Telecoms sectors in credit indices. This technical effect will remain positive for the sector as a whole. The sector has not been more active in other currencies as the EUR market represents 69% of the new issues since 1 January (19% in GBP).

Telecoms new issues are becoming a scarce resource in 2009. For the first time Telecoms issues have fallen below the 10% mark of non-financial euro bonds new issues

Telecoms primary issues as % of non-financial issuance



Source: Calyon

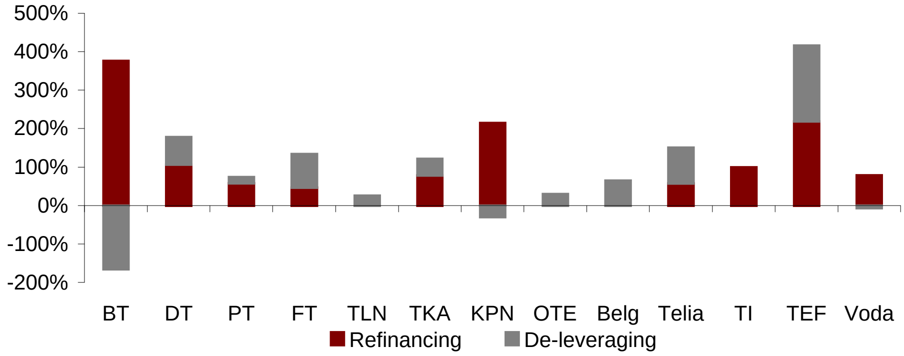
2009 refinancing is done, now for 2010…

As at 1 January we estimated the total debt to refinance in 2009 at EUR26.2bn. At 16 June, all maturities included, the sector has secured EUR22bn of refinancing, or 84% (see table on next page).

All telecom issuers have now issued euro benchmarks this year with a good degree of success (all issues tightened post issuance). The situations vary from one operator to another, however. In the chart below we summarise the liquidity positions of our coverage list. To highlight these differences, we compare the percentage of annual refinancing needs covered by refinancing already achieved this year and the expected excess cash flow that can be affected by the de-leveraging of the company.

Telecom operators have already refinanced 2009 maturities in most cases. BT, Telefonica and KPN have obviously started to work on their 2010 liquidity profile; more operators should do so in H2.

Telecom refinancing needs: now focusing on 2010…



Source: Company, Calyon

Eight out of thirteen telecom operators have already refinanced the debt maturing in 2009; two have nearly done so, leaving just Telenor and OTE as the most likely issuers. Telenor confirmed during its Q209 roadshow that it could make its comeback on the primary in the second half of the year depending on market conditions. Telenor may wait for its newsflow to improve before coming back to the primary market.

EUR new issues in 2009

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal (EURm)	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		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
30-Apr-09	Portugal Telecom	Baa2	BBB-	Portugal	6.000%	30-Apr-13	1,000	345 + MS
01-Apr-09	Vodafone	Baa1	A-	UK	3.625%	29-Nov-12	250	
19-May-09	Telefonica	Baa1	A-	Spain	5.496%	01-Apr-16	500	197 + MS
26-May-09	Deutsche Telekom	Baa1	BBB+	Germany	4.375%	02-Jun-14	500	167 + MS
04-Jun-09	BT	Baa1	BBB	UK	6.125%	11-Jul-14	600	320 + MS
Total					**5.869%**	**5.4 yrs**	**15,400**	

GBP new issues in 2009

Exchange rate: 0.85

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal (GBP m)	Equivalent euro
19-Feb-09	Vodafone	Baa1	A-	UK	4.63%	08-Sep-14	325	383
02-Apr-09	Deutsche Telekom	Baa1	BBB+	Germany	6.50%	02-Apr-22	700	825
30-Apr-09	France Telecom	A3	A-	France	5.00%	30-Apr-16	750	884
18-May-09	Telecom Italia	Baa2	BBB	Italy	7.38%	15-Dec-17	750	884
28-May-09	Vodafone	Baa1	A-	UK	5.38%	05-Dec-17	600	707

CHF new issues in 2009

Exchange rate: 1.51

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Equivalent euro
06-Feb-09	France Telecom	A3	A-	France	3.38%	06-Sep-13	500	332
22-Apr-09	Deutsche Telekom	Baa1	BBB+	Germany	3.75%	04-Aug-22	400	265

SEK new issues in 2009

Exchange rate: 10.86

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Equivalent euro
23-Mar-09	TeliaSonera	A3	A-	Sweden	Floater	23-Mar-09	200	18

USD new issues in 2009

Exchange rate: 1.38

Date	Issuer	Moody's	S&P	Country	Coupon	Maturity	Nominal	Equivalent euro
15-Jun-09	Deutsche Telekom	Baa1	BBB+	Germany	4.875%	15-Jun-14	750	543
15-Jun-09	Deutsche Telekom	Baa1	BBB+	Germany	6.000%	15-Jun-19	750	543
15-Jun-09	Telecom Italia	Baa2	BBB	Italy	6.175%	15-Jun-14	1000	724
15-Jun-09	Telecom Italia	Baa2	BBB	Italy	7.175%	15-Jun-19	1000	724

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

		New issues equivalent euro						2009 maturities
Issuers	**EUR**	**GBP**	**SEK**	**NOK**	**CHF**	**USD**	**Total '09**	
Belgacom	-	-	-	-	-	-	**-**	300
BT	600	-	-	-	-	-	**600**	160
Deutsche Tel	2,500	825	-	-	265	1,085.6	**4,676**	4,400
France Telecom	1,000	884	-	-	332	-	**2,216**	4,800
KPN	1,500	-	-	-	-	-	**1,500**	700
OTE	-	-	-	-	-	-	**-**	600
Portugal Tel	1,300	-	-	-	-	-	**1,300**	2,255
Telefonica	3,500	-	-	-	-	-	**3,500**	1,600
Telecom Italia	2,000	884	-	-	-	1,447.5	**4,332**	4,328
Telekom Austria	750	-	-	-	-	-	**750**	961
TeliaSonera	550	-	18	-	-	-	**568**	994
Telenor	-	-	-	-	-	-	**-**	1,770
Vodafone	1,500	1,090	-	-	-	-	**2,590**	3,299
Total	**15,200**	**3,684**	**18**	**-**	**597**	**2,533**	**22,032**	**26,167**

Source: Calyon, as at 11 June 2009

Credit trend

Q109 results: Facts and figures

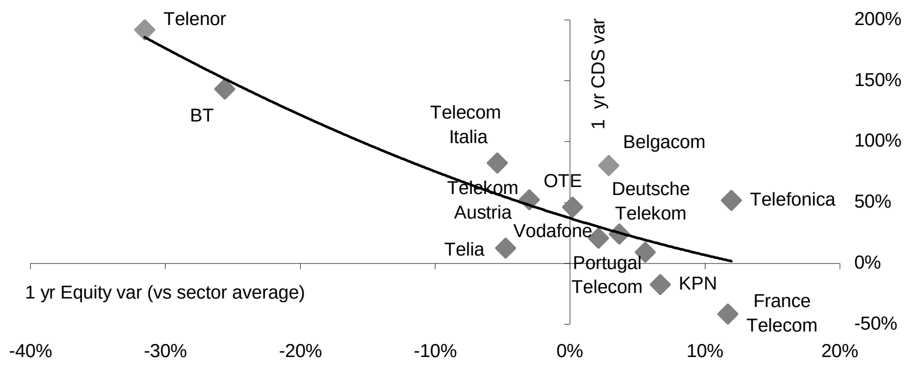
Q109 results confirmed several hypotheses that we made in our *Telecoms 2009 Outlook* (published December 2008):

- **Mobile revenue growth in mature markets is a thing of the past:** While the subscriber base increased 7% YoY, 12-month rolling revenues declined 1.8%. This decline is attributable to several factors putting pressure on ARPU: (1) marketing efforts to push pre-paid customers to post-pay packages; (2) stabilisation of volumes; (3) slower growth in data usage; and, more importantly (4) pressure on regulated tariffs (30% of mobile telephony revenues on average).
- **Fixed top-line continues to slide too:** This should be no surprise. In fact, we expected a more brutal acceleration of revenue decline in the fixed-line business. Operators had widely anticipated that move and absorbed the impact on EBITDA with further cost-cutting measures.
- **Mobile EBITDA: slightly up!:** Out of the top 14 European markets that we cover, only France (-1ppt), Italy (-2ppt) and the UK (-2ppt) have reported a lower EBITDA margin YoY.
- **FCF protection is still holding and remains a key theme:** Capex seasonality (usually concentrated over the last quarter) makes it easy for European telecom operators to publish first quarter FCF that are in line with the annual guidance. Excluding KPN (cash impact of pension mainly) and BT (pension payments to be added to declining operational perspectives), all European telecom operators have confirmed their annual FCF.

Impact: Equity and credit markets still aligned

We saw relatively little negative share price reaction on the day of Q109 results publications. On average, Telecoms stocks gained 2.4% the day following their Q1 results despite a long list of changes to the top-line guidance. Overall, the hierarchy of best and worst performers remains relatively unchanged.

Relative stock & CDS performance



Source: Rating agencies, Calyon

The main outliers for now are Telefonica (heavy primary activity) and Deutsche Telekom (Q109 revealed strategic issues).

European mobile sector operating trend

As of Q109	Austria	Belgium	Denm.	Finland	France	Germ.	Greece	Italy	Portug.	Neth.	Norway	Spain	Sweden	UK(GBP)	*Average*
Population	8.2	10.7	5.5	5.3	62.4	82.1	9.2	59.2	10.6	16.5	4.8	38.4	9.3	60.9	**26.2**
% of GDP per capita	1.4%	1.5%	1.3%	1.1%	1.5%	1.0%	1.8%	1.7%	1.8%	1.4%	1.5%	2.4%	0.9%	1.3%	**1.6%**
Subscribers	10.8	11.9	6.8	7.0	56.5	107.0	19.8	90.0	15.8	19.9	4.9	53.1	11.6	77.5	**33.7**
Subs. Growth rate	8.7%	7.1%	7.7%	12.7%	4.8%	7.6%	19.6%	0.1%	9.1%	6.6%	4.0%	4.7%	9.1%	3.3%	**7.0%**
Contract cust	7.4	5.2	3.4	6.2	38.3	46.8	5.4	10.5	4.1	10.1	3.3	31.5	7.4	30.0	**209.6**
% base	68.3%	43.8%	49.8%	88.2%	67.8%	43.7%	27.2%	11.7%	25.9%	50.7%	66.7%	59.4%	64.0%	38.7%	**47.1%**
Penetration rate	132%	111%	124%	133%	90%	130%	215%	152%	149%	121%	103%	138%	124%	127%	**132%**
Monthly ARPU	24.4	25.9	28.6	24.1	35.1	15.2	16.6	19.1	16.6	28.6	39.9	26.3	22.1	20.9	**23.8**
Monthly ARPU chg. %	-8.9%	-9.6%	-6.5%	-9.1%	0.6%	-8.1%	-23.7%	-2.1%	-13.7%	-2.2%	-3.3%	-11.3%	-6.5%	-6.3%	**-7.9%**
Data as % of serv. Rev.	28.1%	23.9%	17.5%	21.0%	20.2%	27.3%	15.0%	23.6%	23.4%	22.7%	23.5%	17.7%	20.7%	31.8%	**22.1%**
Change (Y-1)	4.6%	2.1%	1.5%	0.0%	3.4%	3.1%	1.5%	1.7%	5.1%	2.0%	2.3%	2.2%	3.3%	4.0%	**2.2%**
MOU	199	145	189	281	253	126	153	134	122	134	246	153	202	178	**175**
MOU change	-2.3%	-4.3%	0.9%	-8.9%	-0.7%	-5.7%	2.7%	2.6%	5.6%	-3.6%	3.8%	-3.6%	6.0%	2.8%	**-0.1%**
Revenues (12 m)	3,300	4,323	2,273	2,266	24,842	22,421	4,536	21,495	3,721	6,881	3,088	19,583	2,944	18,221	**9,617**
Rev. Change %	-5.3%	0.2%	-2.9%	-0.9%	0.0%	3.8%	-4.8%	0.0%	1.0%	5.4%	-0.1%	-4.7%	3.3%	2.4%	**-1.8%**
EBITDA (12 months)	1,011	1,763	588	652	8,908	8,251	1,708	9,683	1,416	2,162	945	7,284	933	4,438	**3,467**
EBITDA margin %	31%	41%	26%	29%	36%	37%	38%	45%	38%	31%	31%	37%	32%	24%	**35.1%**
EBITDA% N-1	31%	41%	24%	28%	37%	36%	38%	47%	37%	31%	29%	35%	32%	25%	**33.5%**
Var	-0.5%	-0.3%	2.2%	1.0%	-0.7%	1.3%	-0.3%	-1.5%	0.6%	0.7%	1.7%	2.4%	-0.6%	-0.5%	**3.8%**
Capex (EURm)	370	416	312	296	2,713	2,678	600	2,198	587	602	218	1,688	318	1,971	**1,027**
Capex as % sales	11%	10%	14%	13%	11%	12%	13%	10%	16%	9%	7%	9%	11%	11%	**11.1%**
Traffic growth	2.0%	-0.7%	4.7%	-2.5%	1.7%	-1.9%	12.5%	2.7%	10.1%	-0.3%	5.8%	-1.3%	10.5%	4.4%	**3.4%**
Churn	34.8%	19.2%	35.5%	17.5%	23.1%	25.7%	29.6%	21.0%	25.2%	31.6%	30.3%	25.3%	13.0%	35.0%	**25.7%**
Sub. Market share															
Winner	TKA	BASE	TDC	DNA	SFR	E Plus (KPN)	Cosmote (DT)	Wind	Optimus	KPN	Telenor	Vodafone	"3"	Hutchison	
	1.2%	2.5%	0.9%	1.8%	0.1%	1.4%	3.0%	1.2%	0.2%	0.9%	0.9%	0.2%	0.8%	1.0%	
Loser	T-Mobile	Orange	Telia	Elisa	Orange	Vodafone	Vodafone	TIM	Vodafone	T-Mobile	Telia	TEM	Telenor Mob	T-Mobile	
	-1.4%	-1.7%	-1.3%	0.3%	-0.6%	-1.0%	-3.2%	-1.8%	-0.3%	-1.4%	-0.9%	-0.9%	-0.9%	-1.3%	
Rev. Market share															
Winner	TKA	Base	Sonofon	DNA	Orange	Vod	Cosmote (OTE)	Vodafone	Vod	T-Mob	Telenor	Vodafone	Telia	O2	
	2.1%	0.8%	3.1%	1.8%	1.2%	1.7%	3.8%	2.0%	3.3%	0.3%	0.9%	1.5%	2.0%	1.7%	
Loser	Connect	Proximus	TDC	Elisa	SFR	T-Mob	TIM Hellas	TIM	TMN	Vod	Telia	TEM	Telenor	T-Mobile	
	-3.0%	-1.6%	-4.3%	-0.9%	-1.4%	-1.5%	-2.2%	-2.1%	-2.6%	-0.7%	-0.9%	-1.7%	-1.9%	-1.1%	

Source: Calyon

Q109 results: already repositioning the annual guidance… without too much damage

Only two out of the top thirteen European telecom operators have maintained their top-line guidance for 2009 (KPN and Belgacom). For the rest of the field, reduced roaming revenues and declining voice revenues as customers trade down have been more difficult to hide.

As expected in our *Telecoms 2009 Outlook*, that has had little impact on the sector's FCF guidance. Apart from KPN, all operators have in fact confirmed or raised their 2009 FCF guidance, implicitly confirming that investors remain more focused on actual cash-flow generation than top-line growth prospects.

'New guidance' following Q109 results

	Sales		EBITDA		Capex	FCF	
Issuer	Guidance	Trend	Guidance	Trend	Guidance	Guidance	Trend
Belgacom	To decline 1%	→	Confirmed stable margin	→	→	-	-
BT (GBP)	To decline 4-5%	↘	Lower margin	↘	↘	GBP1bn	↘
Deutsche Telekom**	-	-	From stable to down 2-4%	↘	-	Stable	→
France Telecom	Decline with GDP	↘	-	-	→	Confirmed stable	→
KPN*	Stable	→	Stable	→	→	From EUR2.6bn to EUR2.4bn	↘
OTE	From "stable" to "impacted"	↘	From stable to lower margins	↘	↘	-	-
Portugal Telecom	No guidance provided						
Telefonica	Growing revenues	→	Confirmed +1% to +3%	→	↘	+8% to +11%	↗
Telecom Italia	From "stable" to "lower"	↘	Confirmed stable margin	→	↘	-	-
Telekom Austria	From "stable" to "weaker"	↘	Confirmed to stable	→	→	1.1	→
TeliaSonera	From "up" to "stable"	↘	Confirmed Stable margin	→	↘	-	-
Vodafone (GBPbn)	-	-	Lower margin	↘	→	6.0-6.5	↗

** 2010 guidance. ** Excluding OTE.*

Source: Companies

Investment themes for H209

Emerging markets: back to the forefront

FCF sustainability will remain the main theme in H209. Declining top-line guidance will only reinforce investors' focus. While European markets look under control for now, issuers with significant exposure to Central European markets are likely to see their guidance challenged.

EBITDA var. in selected Central & Eastern European countries

Q109 EBITDA YoY chg	Bulgaria	Croatia	Slovenia	Czech Rep.	Hungry	Poland
DT/OTE	2.7%	7.5%		-19.6%	-15.2%	-40.2%
Telefonica				-8.2%		
Telekom Austria	-17.5%	-23.1%	-29.9%			
Average	**-7.4%**	**-7.8%**	**-29.9%**	**-13.9%**	**-15.2%**	**-40.2%**

Source: Companies

M&A risk: resurfacing already

The environment is not yet favourable for announcing a large and juicy 'debt-financed' acquisition, but several operators are obviously already looking to invest some of the excess cash flow that they are generating in small and medium-sized assets left behind. However, larger opportunities may come soon from operators that have taken the most aggressive stance in terms of footprint expansion and are now caught by macroeconomic troubles.

Two groups have formed, in our view:

- **Potential sellers**: Deutsche Telekom, Portugal Telecom and Telecom Italia. All three operators have very limited excess FCF (FCF after dividend) and, in the first two cases, their ability to reduce capex will be constrained in the next two years. Other operators could join the club: Telenor (no disposals announced yet, but we see the group's business plan as too optimistic in the next two years), OTE (already sold one unit) or Telekom Austria.
- **Potential buyers**: France Telecom, Vodafone and Telefonica. These three operators have one thing in common: they have not yet committed the very large excess free cash flow they expect to generate this year (in line with our forecast). Other potential buyers with less flexibility include KPN, TeliaSonera and Belgacom.

Recent and potential M&A transactions in the sector

Buyer (Competitors)	Seller	Trading entity	Details	Status
France Telecom	–	Sonatel (Senegal)	Increase stake from 42.3% to 52.2%	Confirmed
France Telecom	–	Bidding for 2G/3G licence in Tunisia		Confirmed (Ministry of telecoms)
France Telecom		Mobinil (Egypt)	Buy 3% at EGP230 per share	In talks
Telekom Slovenije DD	**OTE**	Operations in Macedonia	EUR190m	Confirmed
Vodafone, TEF, United Internet AG	**Telecom Italia**	Hansenet (German)	Could fetch about EUR1bn	In talks
Vodafone		Hella On Line (Greek)	Buy a stake between 20% and 25%	In talks
Middle-Eastern bidders	**Portugal Telecom Telefonica (co-owner)**	Meditel (Morocco)	32% stake, worth EUR300-400m	In talks
N/A	**Deutsche Telekom**	T-Mobile UK	Book value: GBP4.5bn, with GBP1.2bn of debt	In talks
Vodafone	Telkom SA	Vodacom	15% stake (GBP1.7bn)	Done
Vodafone	N/A	N/A	Acquisitions in sub-Saharan Africa	Potential
Telefonica	N/A	VIVO	Acquire remaining 50% share capital	Potential
Telefonica	N/A	ChinaUnicom	Reach up to 10% of share capital	Potential

Source: Calyon, companies, Bloomberg news report

Issuer snapshot

Belgacom (Aa3 neg/A): heavy ARPU pressure confirmed

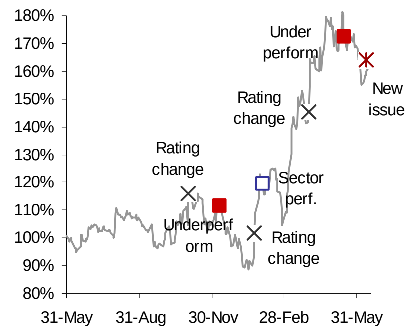
As a result of a four-fold increase in revenue at International Carrier Services (ICS), overall revenue improved marginally in Q1 (+1.5%), which was better than the full-year guidance (-1%). However, EBITDA margin fell to 33% (-2.3%) driven by the cost of acquisitions and lower profitability in both consumer and business units. The economic tensions were particularly visible on sales as corporate clients continue to cut mobile-phone usage despite lower prices (postpaid ARPU -12.3% – the worst performance across Europe). With net debt increasing 41.2% during the past year due to the acquisition and enhanced shareholder distributions in 2008 (totalling around EUR1.4bn), the group's credit metrics continue to deteriorate further.

At the end of April CDS started to recover from the negative impact of Moody's downgrade action. It might remain stable at the sector's level for the rest of this year because: (1) the successful reduction in working capital and the different timing of the income tax payment pushed FCF to a remarkable increase of 30% YoY in Q1; (2) it seems unlikely it will issue new bonds in a short time (since it issued EUR125m 5Y bonds in November 2008); (3) no acquisitions are expected in 2009.

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

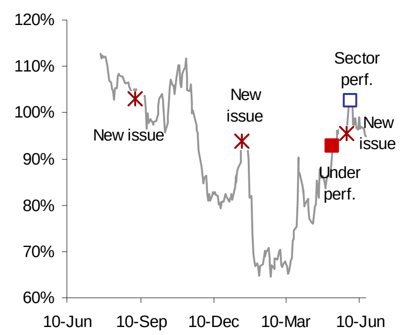
BT plc (BBB/Baa1 neg): heading for a downgrade

BT saw its operating cash flow cut in half last year, and it is becoming more and more questionable whether the group will be able to reach its GBP1bn target for next year. BT's business profile is obviously not as resilient and solid as other European names but its dividend policy remains comparable. Can rating agencies look at BT from a different angle after the FY08/09 results? For now BT has avoided a downgrade thanks to a significant dividend cut (60% – more than the consensus expected) but we doubt this element alone will be sufficient to maintain credit metrics. BT expects to spend 50% of the FCF (before pension contribution) on dividends, which is in fact the industry standard. However, once the pension contribution is included BT will have no excess free cash flow to cover additional debt.

One year rating target: Low-BBB (maintained since 15/5/09)

Relative value: Underperform (maintained since 15/5/09)

Deutsche Telekom's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

Deutsche Telekom (BBB+/Baa1)

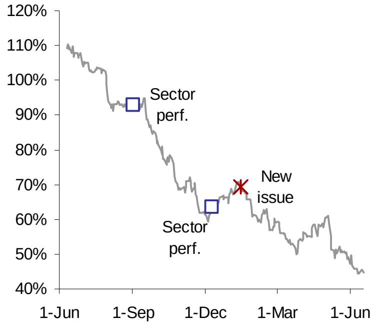
Prior to the Q109 results announcement, we perceived DT as the operator with the lowest financial flexibility (excess cash flow after dividend relative to its debt) of the 'Big Four' (FT, Telefonica and Vodafone), justifying to a large extent the rating differential. Things have not improved. In fact, with all key markets (Germany, US, UK and Poland) now seeing their operating performance declining and the requirements for further investments increasing (mobile spectrum acquisitions in Germany and other strategic markets, 3G deployment in the US), DT may soon have to review its asset portfolio (sell UK mobile operations?).

DT is now trading at a very significant premium to France Telecom, KPN or TeliaSonera. We doubt that this situation will change in the near future as the proceeds of any disposal are likely to be reinvested in other markets (Germany: FttH, US mobile, etc).

One year rating target: High-BBB (maintained)

Relative value: Sectorperform (maintained since 29/05/09)

France Telecom's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

France Telecom (A-/A3): rock solid

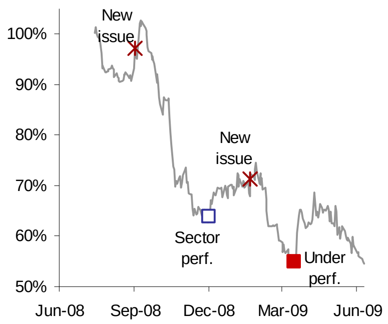
The investor day that took place in Paris in early March was the occasion for France Telecom to come back on its key priorities: (1) preservation of balance sheet structure; (2) shareholder remuneration; and (3) M&A. On the last point the group considers itself "on vacation", meaning that there is no subject on the table for discussion. 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.

Q109 results revealed another solid quarter for FT, confirming the group's position as the best performer over the past year in both equity and CDS. While we do not expect negative surprises on the operating side, we have seen increasing concern from investors over the risk of a potentially large M&A deal should the macroeconomic situation stabilise.

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): pension worries impact FCF target

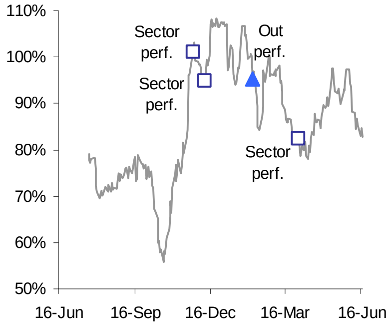
KPN's Q109 results were slightly below market expectations but the group continues to outperform its peers on both operating and financial efficiencies (even in weaker economies such as Belgium and Germany). With these results KPN confirms that it is maintaining a very strong grip on its operations not only domestically but also outside of its borders. With a visible weakening of business segment revenues KPN has, however, reduced its revenue guidance for 2009 to flat revenues vs 2008 ("meaningful progress vs 2008" previously) and a slight increase in 2010 vs 2009 (EUR15bn previously). Management reiterates its cost flexibility, however, and guidance for EBITDA of >EUR5bn in 2010. Due to one-off items the free cash flow should be somewhat lower than in 2008 at around EUR2.4bn in 2009 (stable from an organic standpoint). KPN also reiterated its 2010 dividend target of EUR0.80 (EUR0.60).

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.

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): sacrificing profitability

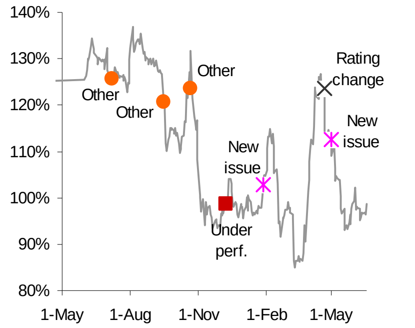
OTE was continuously involved in mobile price wars (Greece, Bulgaria and Albania) during the first quarter of 2009. The total mobile consumer base remarkably increased 25.6% (Greece up 28.8%) but there was a drop in ARPU (-14.2% on average). Traffic (MOU) also increased 10% as a benefit of the lower prices. However, this attractive pricing strategy did not provide OTE with much of a bonus, except bigger market shares, but heavily affected the group's profitability: mobile revenue down 4.1% and margins down in all markets excluding Romania (negative EBITDA in 2008). Pressure from fixed-line was worse in Q1 while both the Greek and Romanian markets showed negative trends in all key performance indicators – with fixed traffic migrating progressively to cheaper mobile offers (AMOU up 13% in Greece).

At the end of Q1, OTE sold its 100% stake in Cosmofon, the entity showing the biggest decline since 2008, to Telekom Slovenije for EUR190m. This action would temporarily lighten the pressure on its FCF. However, we maintain our estimate of net debt to EBITDA at 2.4x while considering the shrinking OCF. OTE is under no real pressure to issue new debt for now. Its EUR600m bond maturing in November this year can be partially refinanced thanks to asset disposals and organic cash flow, and 2010 is free of any bond or loan redemption according to the company's data. OTE could nevertheless take an opportunistic approach should its CDS continue to outperform and market conditions improve.

One year rating target: Mid-BBB (maintained)

Relative value: Sectorperform (maintained since 07/04/09)

Portugal Telecom's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

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

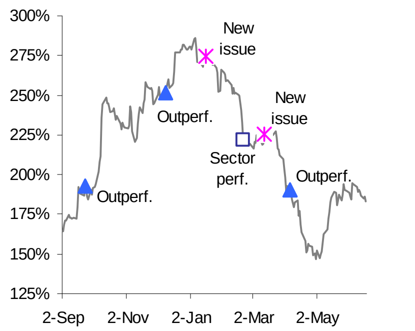
2008 was initially expected to be the low point in terms of credit metrics, implying that 2010 would be the start of a more positive period. At the end of 2008, Portugal Telecom's results were marked by a contraction in domestic margins and a 15% deterioration in the EUR/BRL exchange rate. The deterioration 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.

Portugal Telecom recently indicated that it would consider the disposal of Medi Telecom (32.18% owned stake value estimated at EUR300m). Telefonica (32.2%) has already hired advisors for the sale of its stake.

One year rating target: Low-BBB (maintained)

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

Telecom Italia's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

Telecom Italia (BBB/Baa2): Q109 results stopped the rally

After a solid Q408, the Italian market proved less resilient than expected in Q109. The results were expected to be slightly down, but the weaker-than-expected performance of the mobile operations (in both Italy and Brazil) pushed the top line well below our already low expectations.

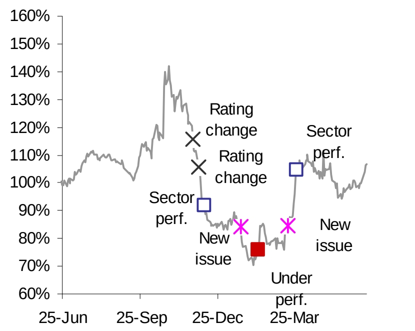
While confirming 2009-11 EBITDA and CF targets, management dropped the guidance at the revenue level (like most operators) and failed to indicate further room for cost-cutting on top of the announced efficiency plan. Telecom Italia's management attributed this disappointing performance to several one-off elements that can implicitly be reversed in Q2.

These disappointing results have nevertheless stopped the CDS outperformance. After regaining some of the lost confidence it looks like the focus on the weaker-than-expected domestic and Brazilian market has relaxed. As a result, we have changed our recommendation from Sectorperform to Outperform.

One year rating target: Mid-BBB (maintained)

Relative value: Outperform (maintained since 07/04/09)

Telefonica's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

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

After a very prolific Q109 for the Spanish operator, with a double upgrade and active primary activity, investors expected the group to publish fairly solid results overall despite being arguably the most exposed in the European Telecom sector to the financial crisis after BT, with operations in Spain, UK and Germany. TEF reiterated its guidance (revenues growing, OIBDA +1-3% in constant currency, OIBDA-capex +8-11%). We maintain our positive stance on Telefonica given its solid fundamentals, defensive profile, high visibility and robust balance sheet (1.9x 2009e debt/EBITDA), and shareholder remuneration (c.8% yield ex-buybacks). In the short term, we do not exclude a share buyback announcement but we expect it to be limited as the company informed us that they would only commit excess FCF already generated.

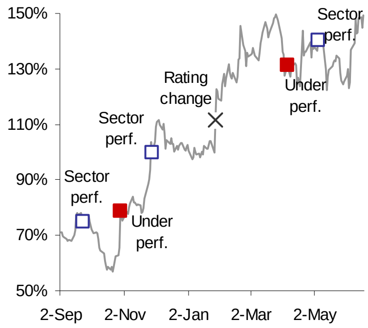
Telefonica's more conservative financial approach and experience gained during the Argentine crisis could amortise most of the newsflow volatility.

One year rating target: Low-A (maintained)

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

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

Telenor's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

It seems that the better-than-expected Q109 results more or less comforted investors after a stream of negative newsflow (India + Vimpelcom). Except the deteriorating Danish mobile business, most of the Nordic markets have recorded slight growth in both consumer base and monthly ARPU. Asian markets (excluding India) also showed strong results in the last quarter as the revenue base increased 16% YoY on average.

Telenor's CDS is, and will remain, much more sensitive to quarterly results than in the past. While other operators have the capacity to reduce capex and debt in 2009 to comply with new market requirements, the announced Indian investment is putting Telenor in an unusual situation (see our Credit Focus – *Telenor: One deal too Far (East)*, 27 May 2009).

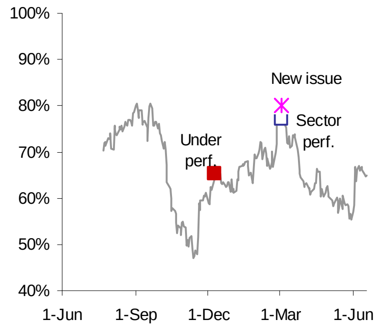
Telenor's ambition to issue during the second half of the year (announced during its non-deal roadshow (maturity: 2014? 2015? 2016?) may put additional pressure on the group's CDS. Alternatively, any positive announcement concerning the group's legal issues in Russia could result in short-term outperformance but there is very little visibility in this area.

One year rating target: Mid-BBB (maintained)

Relative value: Sectorperform (maintained since 05/05/09)

TeliaSonera (A-/A3): still aggressive

TeliaSonera's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

TeliaSonera is, with KPN and Telenor, one of the few European telecom operators that will see its key metrics deteriorate further in 2009 with a high degree of certainty.

During Q109, TeliaSonera successfully quadrupled its FCF (compared with Q108) as a result of its strong growth in revenues (+11.5% YoY) and better cost management. Among all the markets, Eurasia was the strongest contributor through its rapid expenditure in sales (+38% YoY) and high profitability (EBITDA margin 49.9% while capex -16%). Broadband also showed an almost stable trend across all the markets. However, the declining margin of mobile services – mainly in Finland (-3.7%), Denmark (-3.2%) and Eastern Europe (-1.7%) – has partly offset the strong performance in sales. Moreover, the market environment during the rest of this year may become tougher, thus TeliaSonera slightly reduced its sales forecast at its Q1 presentation.

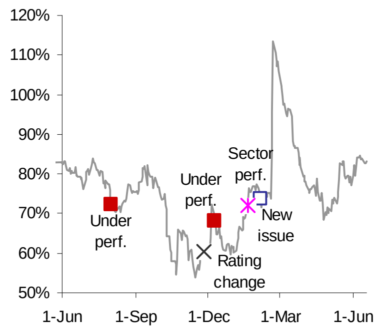
The good news is that TeliaSonera has no significant need to issue bonds during the next two years (stable debt portfolio until 2015). But any potential acquisitions in Eurasia might raise the CDS price again, which dropped 27% during the first five months of 2009.

One year rating target: Low-A (maintained)

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

Telekom Austria (BBB+ neg/A3): both domestic and international operations eroding faster than expected

Telekom Austria's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

At first glance, TKA seemed to have provided very cautious guidance for 2009 with an EBITDA target of EUR1.9bn (stable) and a new financial policy. In the light of Q109 results, this guidance does not seem so conservative. Post Q1 results, TKA now expects slightly less than the originally targeted EUR5.1bn in sales, mainly due to lower fixed-line wholesale revenues and less mobile MTR and equipment revenues. The accompanying lower costs should enable the company to protect its EBITDA of EUR1.9bn but the objective looks more challenging than initially planned. With 40% of its EBITDA now generated in Bulgaria and other Eastern European countries, vs 30% at end-2008, the operator has very little room to manoeuvre under the new parameters (even less if we look at the current capex guidelines).

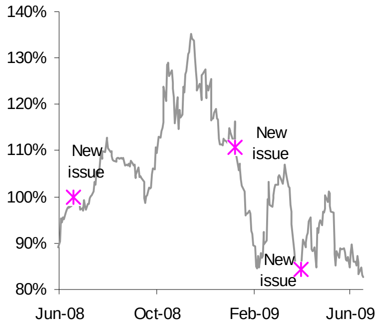
With both domestic and international operations' EBITDA eroding at an annual rate of 4%, the new CEO (started in April this year) confirmed that he will be focusing on the current footprint essentially with a view to maintaining the dividend (c.50% annual FCF on our estimate). With a reported net debt to EBITDA ratio of 2.1x (3.1x including restructuring charges), TKA is not under any pressure to de-leverage for now but nevertheless has already excluded additional M&A for now.

One year rating target: High-BBB (maintained)

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

Vodafone (A-/Baa1): less volatile on FCF guidance

Vodafone's CDS YTD performance



Source: Calyon. CDS as % of telecom CDS index

The newsflow from Vodafone has been fairly quiet since the start of the year. Vodafone management guides for FY09/10 free cash flow of between GBP6.0bn and GBP6.5bn up from GBP5.7bn in FY08/09 and ahead of the medium-term target of GBP5.0-6.0bn. Adjusted operating profit is expected at GBP11.0-11.8bn, which is below market forecasts of GBP12.0bn, due to a higher-than-expected depreciation charge of GBP8.5bn related to India, Vodacom and FX. Like most other operators Vodafone has stopped issuing revenue guidance, but sees the current trend of slightly declining organic revenues continuing.

Vodafone's CDS is now positioned at the very bottom of the historical range. We attribute that performance to the fact that the group has provided higher-than-expected FCF guidance for FY09/10, reducing the impact of a more volatile top line. We nevertheless underline the fact that Vodafone has not provided any guidance regarding the evolution of its credit metrics.

One year rating target: Low-A (maintained)

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

Performance of recent strategies

2009 Track Record

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	8.1.09	330,570	TITIM	5M	375	208	BRITEL	15M	120	174	28.1.09
Sell TITIM CDS EUR SR 1Y - Buy BRITEL CDS EUR SR 1Y	8.1.09	56,238	TITIM	5M	431	175	BRITEL	15M	139	157	28.1.09
Sell OTE CDS EUR SR 5Y - Buy DT CDS EUR SR 5Y	5.2.09	161,209	OTE	5M	124	134	DT	8M	86	135	25.3.09
Sell FRTEL CDS EUR SR 5Y- Buy TKA CDS EUR SR 5Y	30.4.09	107,425	FRTEL	10M	67	53	TKA	10M	78	83	28.5.09
Closed Strategies 2009 P&L		**655,442**									

Curve Strategy	Entry Date	P&L (€)	Selling Leg	Amount	Entry Spread	Last Spread	Buying Leg	Amount	Entry Spread	Last Spread	Closing Date
Sell FRTEL CDS EUR SR 3Y - Buy FRTEL CDS EUR SR 5Y	14.5.09	17,950	FRTEL	16M	59	43	FRTEL	10M	64	51	Open
Sell OTE CDS EUR SR 3Y - Buy OTE CDS EUR SR 5Y	14.5.09	47,269	OTE	16M	121	85	OTE	10M	118	93	Open
Sell KPN CDS EUR SR 3Y - Buy KPN CDS EUR SR 5Y	14.5.09	46,076	KPN	16M	80	53	KPN	10M	79	62	Open

Long-Short Strategy	Entry Date	P&L (€)	Selling Leg	Amount	Entry Spread	Last Spread	Buying Leg	Amount	Entry Spread	Last Spread	Closing Date
Sell DT CDS EUR SR 5Y- Buy TKA CDS EUR SR 5Y	28.5.09	45,513	DT	10M	118	106	TKA	10M	91	89	Open
Sell DT CDS EUR SR 5Y - Buy PORTEL CDS EUR SR 5Y	5.6.09	18	DT	10M	106	106	PORTEL	10M	106	106	Open

Negative Basis	Entry Date	P&L (€)	Cash Leg	Amount	Entry Spread	Last Spread	CDS Leg	Amount	Entry Spread	Last Spread	Closing Date
Buy PORTEL 6 04/30/13 - Buy PORTEL CDS EUR SR 5Y	5.6.09	104,994	POR	10M	231	206	PORTEL	10M	106	106	Open
Total P&L 2009		**917,262**									

Source: Calyon

Telecoms earnings calendar

Date	Company	Event
23/07/09	KPN	H109 results
23/07/09	TLN	H109 results
24/07/09	TeliaSonera	H109 results
24/07/09	Vodafone	Q109/10 results
28/07/09	Vodafone	Annual General Meeting
30/07/09	PT	H109 results
30/07/09	FT	H109 results
31/07/09	TEF	H109 results
31/07/09	Belgacom	H109 results
31/07/10	BT	Q109/10 results
06/08/09	DT	H109 results
07/08/09	TI	H109 results
19/08/09	TKA	H109 results
28/08/09	OTE	H109 results
01/09/09	Vivendi	H109 results
15/09/09	Telenor	Capital Markets Day

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.

Credit Research contact details

Jean-François Paren	Global Head of Credit Research / Telecom Analyst	(33) 1 41 89 33 95			
Credit Research					
Franck Bataille	Utilities Analyst	(33) 1 41 89 14 86	Stuart James	Industrials Analyst	(44) 20 7214 6546
Christophe Boulanger	Autos Analyst	(44) 20 7214 6402	Harpreet Parhar	ABS Analyst	(44) 20 7214 5534
Caroline Brugère	Industrials Analyst	(33) 1 41 89 88 38	Claire Poncet Dumont	Retail Analyst	(33) 1 41 89 94 76
Gwenaëlle Lereste	Financials Analyst	(33) 1 41 89 06 90	Eric Sharper	Autos/Industrials	(33) 1 41 89 00 38
			Guillaume Thomas	Quantitative Analyst	(33) 1 57 87 02 80

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 17th Apr 2009)

	All covered companies		Companies where Calyon provided Investment Banking Services in past 12 months	
	Count	Percentage	Count	Percentage
Outperform	16	18%	4	25%
Sectorperform	43	48%	11	26%
Underperform	31	34%	3	10%

Disclosures

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

A	NOT IN USE
B	NOT IN USE
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