European Telecoms

Q1 wrap - no longer the default short

- **The Q1 earnings season has come to an end with few major surprises.** Allied to this, consensus numbers longer term are in line with our forecasts, so in the short term we see little risk of downgrades. Thus it seems earnings momentum is no longer the only driver of share prices.
- **Valuation no longer appears to be a share price driver.** The sector trades in line with the market (avg 2007E PE 14x), but as only 3 sectors are cheaper we would not expect Telecoms to fall. On the other hand, FCF yields are now unusually low (avg 8% 2007E) so this is unlikely to drive share prices up. Few parallels can be drawn with the US, where the RBOCs trade on higher multiples but are now experiencing accelerating growth due to improving fundamentals.
- **Sentiment now seems to be the key driver in the sector** with discussions on cashflow returns and M&A speculation (incl network sharing) more likely to affect share prices in the short term in our view.
- **Therefore our investment strategy is to choose quality stocks rather than buy the sector as a whole** (but not to avoid the sector as we have advocated in the past). We look for stocks that we believe 1) have earnings upgrade potential – **Telefonica**, **OTE**, **Carphone Warehouse**, **Iliad, CosmOTE**; 2) have potential for an LBO – **Bouygues, KPN**; or 3) are cheap and where earnings downgrade momentum may come to an end – **DT, Swisscom**.

Telecom Services

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Summary ratings and price targets

Company	Price	PT	Rec
Belgacom	€33.6	30.2	N
Bouygues	€64.5	84.0	OW
BT	320p	285	UW
CpW	315p	380	OW
CosmOTE	€23.2	27.0	OW
DT	€13.8	13.0	N
Fastweb	€40.9	44.0	OW
France Telecom	€22.6	18.0	UW
Iliad	€74.7	87.0	OW
Jazztel	€0.56	0.35	UW
KPN	€13	13.0	OW
Mobistar	€62.5	55.5	UW
Neuf Cegetel	€29.4	33.0	OW
OTE	€22.9	27.0	OW
PT	€10	9.4	N
QSC	€5.1	5.6	N
Swisscom	CHF424	460	OW
TkA	€19.5	23.7	OW
TI - Ords	€2.1	2.2	N
TI - Savis	€1.7	2.0	OW
Telefonica	€16.5	19.5	OW
Telenet	€24	24.8	OW
Telenor	Nok114	111.0	N
Telia	Sek51.3	50.0	UW
United Internet	€13.9	16.5	OW
Vod	155p	158	N

Source: Reuters, JPMorgan estimates.

	Q107 EBITDA vs est	Dom wireline change pp in margin YoY	Trend vs Q406	Line loss Q107 YoY	BB mkt share	Dom wireless change pp in margin YoY	Trend vs Q406	Q107 Service rev growth YoY
Belga	4.0%	0.5	↑	-4.5%	49%	-3.0	↓	-2%
BT	-0.2%	0.0	↑	-2.4%	25%			
Cosmo	-0.8%					-0.6	↓	
DT	-0.7%	-6.7	↓	-6.1%	43%	-3.5	-	-3%
FT	1.3%			-5.8%	47%			-1%
KPN	3.1%	-2.0*	↓	-10.8%	40%			9%
OTE	3.9%	8.0		-1.5%	61%			
SCOM	-2.6%	-0.9	↓	-2.2%	47%	0.7	↓	
TI	-0.2%	2.5*	↓	-6.4%	60%			0.5%
TEF	2.1%	0.0	↓	-1.2%	56%	0.0	↑	7%
TKA	-6.1%	-1.5	↓	-7.0%	35%	-1.4	↓	
TNOR	0.0%	2.2	↑	-8.3%	45%	-3.7	↓	2%
Telia	-2.7%	-9.0	↓	-5.4%	41%	4.4	↑	
Vod	-1.0%					-7.8	↓	5.3%

Source: JPMorgan estimates, Company data; Note*: includes wireless as no longer separately reported. In table above right, prices at COB 6/6/07; bold = our preferred stocks.

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Investment thesis

Q1 season

The Q1 earnings seasons was interesting for the lack of major surprises. In both Europe and US the large caps met expectations. The mid/small caps tended to either miss or beat expectations significantly. However, both revenue and EBITDA growth is on the up in the US but that is still not the case in Europe.

Wireline

There's still no relief in Europe with margins generally getting worse and line loss accelerating. The only bright spot for the PTTs is the broadband market share which has stabilised. In the US it is a similar situation but with the RBOCs gaining broadband market share without depressing ARPU.

Wireless

Top down shows a recovery in growth and margins, bottom up shows that it is a case of smaller competitors doing better and market repair in the Nordic region. The only European market that is seeing the kind of margin deflation experienced in the Nordic region is the UK. In the US, both Cingular and Verizon recorded strong ARPU growth driven by price increases in the data segment and less pricing pressure in the voice segment.

European Telecoms sector outlook

Earnings downward pressure has been such that consensus numbers are now in line with our estimates. We see little short term risk to our numbers but the sector does not look 'cheap'. The Telecoms sector is line with the market (avg P/E multiple of 14x for 2007E) but there are only three sectors cheaper than the Telecoms sector. However, the Telecoms sector is trading at its three year FCF yield low of 8% so valuation is unlikely to be a further driver of the sector. We see potential for further catalysts such as cash returns and M&A but these are unlikely to crystallise in the short term (in our view LBO works for very few stocks, breakup unlikely with share prices moving up and intra-country consolidation is only likely in the UK because margins are so depressed here, but we believe a more realistic scenario for the UK is network sharing). Nevertheless we recognise that sentiment is a driver of share price in this sector, and there are ample opportunities and reasons for there to be wide ranging discussions on the catalysts, therefore in the short term we see few reasons for the sector to fall. Longer term, the fundamentals for the sector look poor and are not improving.

For these reasons we advocate choosing stocks not the sector.

Stocks we like

- Earnings upgrade potential: Telefonica (OW Price target €19.5), OTE (OW, PT €27), CosmOTE (OW PT €27), Iliad (OW PT €87) & CpW (OW PT 380p).
- Stocks that look most likely to benefit from M&A: Bouygues (OW PT €84) & KPN (OW PT €13).
- Stocks that look 'cheap' (as earnings downgrade momentum not coming to an end) but could rebound when numbers are no longer being cut: Deutsche Telekom (N PT €13, on our watch list) and Swisscom (OW CHF 460).

Q1 Wrap

A trait of the Q1 earnings season was that the large caps both in Europe and the US mostly met earnings expectations. Whereas the mid to small caps again in both regions either missed expectations by some way or beat expectations by a healthy amount. However, the parallels stop here as in Europe margins are still being depressed and revenue growth is slowing, whereas in the US both EBITDA and revenue growth is picking up.

Actual vs estimates

The large caps mostly met EBITDA expectations for Q107 but generally met revenue expectations as well. It was more of a mixed picture for the mid size incumbents and altnets who either beat expectations by a healthy margin or missed expectations by some way.

We believe that where companies have beaten forecasts it is mainly because expectations have become too bearish rather than any change in fundamentals.

Table 1: Q1 Revenues & EBITDA against expectations

local currency m

	Revenues				EBITDA		
	Actual	vs JPME	vs Consensus		Actual	vs JPME	vs Consensus
BT	5292	0.0%	-0.7%	BT	1537	-0.2%	0.5%
DT	15,453	1.2%	1.0%	DT***	4,582	-0.7%	-1.6%
FT	12,844	0.5%	0.6%	FT	4,657	1.3%	1.3%
TI	7,540	-0.1%	0.1%	TI	3,191	-0.2%	0.4%
TEF	13,747	0.2%	1.2%	TEF	5,106	2.1%	0.6%
Vodafone	15,510	-2.6%	-0.9%	Vodafone	5,718	-1.0%	-0.5%
Belgacom	1515	1.3%	1.9%	Belgacom	536	4.0%	3.6%
Bouygues	5921	3.7%	2.4%	Bouygues	not reported		
Cosmote	687.6	-1.6%	0.3%	Cosmote	215.2	-0.8%	-1.5%
KPN	2,924	-2.4%	-1.6%	KPN	1,189	3.1%	0.7%
Mobistar	372	0.0%	0.5%	Mobistar	not reported		
Neuf Cegetel	782	1.5%	-0.1%	Neuf Cegetel	not reported		
OTE	1,509	2.4%	-0.7%	OTE***	562	3.9%	5.3%
PT	1,461	4.3%	3.3%	PT	571	7.5%	7.9%
Swisscom	2,376	1.3%	-0.8%	Swisscom	968	-2.6%	-1.7%
TA	1,146	-1.2%	-1.1%	TA	475	-6.1%	-1.9%
Telenor	22,446	0.9%	2.4%	Telenor	7,143	0.0%	1.2%
TeliaSonera	22,724	0.2%	0.7%	TeliaSonera	7,583	-2.7%	-1.2%
CPW *	3992	-1.9%	0.6%	CPW	294	9.3%	9.7%
Fastweb	353	-3.0%		Fastweb	120	-3.2%	
Iliad**	278	1.8%		Iliad	not reported		
Jazztel	75	-5.1%		Jazztel	-6	-54.9%	
QSC	77	-9.4%	-7.2%	QSC	9	-35.7%	-10.0%
Telenet	227	2.3%	1.8%	Telenet	106	3.9%	5.0%
United Internet	337	0.6%	1.5%	United Internet	63	1.6%	3.1%

Source: JPMorgan estimates, Company data, Reuters

Note: *CPW – we use FY results; ** Iliad we adjust revenues for divestments, *** OTE & DT – we adjust EBITDA for one-offs, for OTE by €22m and -€100m for DT

US trends

The trends in the US are similar to that in Europe, with the RBOCs (large caps) generally beating EBITDA expectations by between 1% and 2%, however the mid/small caps either beating expectations healthily or missing expectations by some margin.

Table 2: Results vs. JPMorgan and Consensus Estimates

Local currency, millions

	Revenue			EBITDA		
	Actual	JPM	Cons.	Actual	JPM	Cons.
AT&T	29,378	*0.4%*	*-0.6%*	10,826	*0.7%*	*1.8%*
Qwest	3,446	*-1.7%*	*-1.3%*	1,171	*0.5%*	*1.9%*
Verizon	22,584	*1.5%*	*0.6%*	7,443	*0.7%*	*1.0%*
Subtotal	55,408	*0.7%*	*-0.2%*	19,440	*0.7%*	*1.5%*
Level3	1056	*1.1%*	*1.4%*	170	*15.6%*	*4.2%*
CBeyond	63	*0.0%*	*0.4%*	12	*9.6%*	*15.2%*
Subtotal	1,119	*1.0%*	*1.3%*	182	*15.2%*	*4.9%*
Alaska	91	*4.1%*	*5.0%*	32	*12.0%*	*14.3%*
CenturyTel	601	*-1.2%*	*-0.8%*	296	*1.3%*	*0.9%*
Cincinnati Bell	315	*3.7%*	*-0.7%*	117	*2.4%*	*1.7%*
Citizens	517	*2.4%*	*1.4%*	277	*-0.4%*	*-0.3%*
Consolidated	83	*3.7%*	*3.5%*	35	*6.7%*	*2.8%*
Embarq	1,589	*-2.9%*	*-1.5%*	664	*-0.2%*	*2.1%*
Fairpoint	68	*0.0%*	*-2.0%*	29	*-0.9%*	*-5.6%*
Iowa	62	*4.6%*	*2.9%*	34	*5.3%*	*5.0%*
Windstream	761	*-0.5%*	*-1.6%*	394	*-0.5%*	*-2.5%*
Subtotal	4,086	*-0.7%*	*-0.7%*	1,878	*0.5%*	*0.7%*
Comcast	7,388	*1.1%*	*0.6%*	2,763	*1.5%*	*-1.1%*
Echostar	2,645	*1.3%*	*1.6%*	660	*-5.1%*	*-5.4%*
DirecTV	3,908	*0.2%*	*0.2%*	930	*-2.4%*	*-3.4%*
Subtotal	13,940	*0.9%*	*0.7%*	4,353	*-0.4%*	*-2.3%*
Total	74,554	*0.7%*	*0.0%*	25,853	*0.6%*	*0.8%*

Source: Company reports, JPMorgan estimates and FactSet.

Q1 estimate changes

We have made few significant changes to our forecasts after the Q1 results, see Table 3. The most significant being Portugal Telecom with upgrades being driven by the turnaround in its Brazilian operation and TeliaSonera with downgrades being driven by problems in the Swedish fixed line business.

Table 3: Changes to estimates post Q1 results

%

	Revenues				EBITDA			
	2007E	2008E	2009E	2010E	2007E	2008E	2009E	2010E
Belgacom	0.5%	0.7%	0.5%	0.1%	1.3%	1.4%	1.2%	0.5%
Bouygues	0.9%	0.6%	0.1%	0.3%	6.1%	10.2%	12.9%	15.6%
BT	-0.3%	-0.3%	-0.4%	-0.1%	0.0%	0.7%	0.3%	1.3%
DT	0.3%	1.2%	1.2%	1.4%	-1.4%	1.2%	-0.2%	-0.5%
OTE	0.0%	0.0%	0.0%	0.0%	3.9%	0.4%	0.3%	0.3%
PT	1.3%	0.2%	-0.8%	-1.7%	5.8%	4.8%	3.4%	2.2%
Swisscom	0.4%	1.2%	2.0%	2.4%	-0.6%	-0.3%	0.1%	0.0%
Telekom Austria	-1.3%	-1.1%	-0.6%	-0.4%	-2.1%	-2.2%	-1.8%	-1.5%
Telefonica	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TeliaSonera	-1.3%	0.3%	1.4%	2.6%	-5.3%	-3.4%	-3.7%	-3.9%
Vodafone	-1.2%	-1.0%	-0.4%	-0.3%	-0.3%	0.6%	1.1%	1.1%

Source: JPMorgan estimates. Note: no changes made to CosmOTE, FT, KPN, Mobistar, Neuf Cegetel, TI and Telenor. Please see our recent company notes for details on the changes above.

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Quarterly movement in Revs & EBITDA

Over the last year there have been very few major acquisitions and as a result the organic growth is now the only growth driver. Unsurprisingly revenue growth has fallen significantly and is now running at 4.8%YoY as at Q107, see Table 4. And even this is almost entirely being driven by Telefonica, as if we strip out Telefonica the growth drops to 2.6% YoY.

Table 4: Quarterly revenue trends

Local currency m, %

	currency	Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q1 07E
BT	£	4,820	4,731	4,770	4,916	5,134	4,864	4,941	5,126	5,292	5,290
DT	€	14,288	14,743	15,056	15,517	14,842	15,130	15,480	15,895	15,453	15,270
FT	€	11,443	11,790	11,998	12,853	12,616	12,755	13,070	13,262	12,844	12,774
TI	€	7,023	7,505	7,430	7,961	7,483	7,852	7,769	8,171	7,540	7,545
TEF	€	8,279	9,081	9,868	10,329	11,946	13,217	13,542	14,196	13,747	13,721
Total		45,853	47,850	49,122	51,576	52,021	53,818	54,802	56,650	54,876	54,600
Growth						13.5%	12.5%	11.6%	9.8%	5.5%	
Belgacom	€	1,577	1,370	1,388	1,361	1,507	1,525	1,535	1,533	1,515	1,495
CosmOTE	€	380	411	501	505	496	541	594	752	688	699
KPN	€	2,890	2,950	2,930	3,166	3,002	2,979	3,037	3,039	2924	2996
OTE	€	1,298	1,363	1,411	1,403	1,387	1,432	1,483.90	1589	1508.6	1473
PT	€	1,452	1,577	1,641	1,715	1,566	1,523	1,620	1,635	1,461	1,411
Swisscom	Chf	2,445	2,467	2,386	2,434	2,375	2,398	2,423	2,457	2,376	2,346
TKA	€	1,004	1,008	1,188	1,168	1,159	1,169	1,232	1,199.30	1,145.80	1,159.46
Telenor	Nok	15,270	16,542	17,639	19,474	21,872	22,580	23,868	25,158	22,446	22,252
TeliaSonera	Sek	20,897	21,752	22,229	22,362	21,979	22,737	23,157	23,187	22,724	22,687
Total	€	14,272	14,612	15,127	15,652	15,662	15,897	16,447	16,873	15,939	15,884
Growth						9.7%	8.8%	8.7%	7.8%	1.8%	
Fastweb	€	194	228	258	288	289	289	319	363	353	364
Jazztel	€	51	62	59	75	72	77	74	86	74.5	78.5
QSC	€	42	49	51	53	54	57	68	83	77	85
Telenet	€	177.3	181.6	185.4	189.3	198	201	203	212	227	222
United Internet	€	158	178	208	258	286	312	317	354	337	335
Total		622	698	761	863	899	935	981	1,097	1,068	1,084
Growth						44.5%	34.0%	28.8%	27.1%	18.9%	
Total	€	63,090	65,459	67,329	70,481	71,077	73,015	74,632	77,112	74,455	74,140
Growth						12.7%	11.5%	10.8%	9.4%	4.8%	
Bouygues	€	4,737	6,306	6,456	6,940	5,226	6,826	7,075	7,281	5,921	5,707
CPW	£			1,809		1,237		1,291		2,701	2,779
Mobistar	€	338	366	367	380	364	394	396	393	372	372
Neuf Cegetel	€			672	704	708	715	713	760	782	770
Iliad	€	163	175	183	196	217	225	240	262	278	273
Vodafone	£			14,548		14,802		15,594		15,510	15,917
Total	€	68,328	72,306	99,315	78,701	101,427	81,175	108,148	85,808	108,870	109,046

Source: Company reports and JPMorgan estimates.

As revenue growth has slowed so has EBITDA growth, but competition that is causing pricing deflation is also the reason why margins are falling. EBITDA margins for Q107 are down -1.6pp YoY, see Table 5. Margins at above 34% for the Europeans are still higher than the low point of 32% for the RBOCs.

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Table 5: Quarterly reported EBITDA trends

	currency	Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q1 07 clean	Q1 07E
BT	£	1,440	1,357	1,350	1,381	1,431	1,362	1,385	1,412	1,474	1,474	1,475
DT (adjusted)	€	4,841	5,188	5,501	5,199	4,970	4,817	5,099	4,548	4,682	4,582	4,615
FT	€	4,302	4,795	4,720	4,136	4,590	4,668	4,884	4,397	4,657	4,657	4,599
TI	€	3,284	3,201	3,201	3,168	3,295	3,220	3,269	3,065	3,191	3,191	3,197
TEF	€	3,415	3,207	4,224	4,274	4,657	4,585	5,412	4,472	5,106	5,106	4,999
Total	€	17,282	17,748	18,996	18,158	18,943	18,652	20,049	17,894	19,110	19,010	18,885
Margin		37.7%	37.1%	38.7%	35.2%	36.4%	34.7%	36.6%	31.6%	34.8%	34.6%	34.6%
Belgacom	€	575	578	557	149	546	565	535	503	536	536	516
CosmOTE	€	166	180	224	185	191	204	249	233	215	215	217
KPN	€	1,094	1,164	1,147	1,319	1,206	1,281	1,198	1,152	1,189	1,189	1,153
OTE	€	444	499	-336	372	513	517	678	509	540	562	541
PT	€	619	558	608	710	587	503	595	738	571	571	536
Swisscom	Chf	1,092	1,107	1,073	899	1,034	1,046	1,041	932	968	968	994
TKA	€	433	398	546	382	504	478	550	375	475	475	506
Telenor	Nok	5,106	5,630	6,378	6,722	7,888	7,930	9,073	8,313	7,143	7,143	7,145
Telia Sonera	Sek	6,938	6,040	7,786	6,744	7,231	7,801	8,626	7,455	7,583	7,583	7,795
Total	€	5,394	5,415	5,044	5,234	5,943	6,019	6,501	5,918	5,828	5,851	5,811
margin		37.8%	37.1%	33.3%	33.4%	37.9%	37.9%	39.5%	35.1%	36.6%	36.7%	36.6%
Fastweb	€	60	68	81	97	90	93	113	127	120	120	124
Jazztel	€	-16.4	-26.3	-35.1	-48.7	-45	-38	-33	-17	-6	-6	-13
QSC	€	1	2	-1	4	2	4	5	10	9	9	14
Telenet	€	85	87	81	130	89	94	94	91	106	106	102
United Internet	€	30	25	32	41	55	64	69	54	63	63	62
Total	€	161	156	158	223	190	216	249	264	293	293	289
margin		25.8%	22.3%	20.7%	25.8%	21.2%	23.1%	25.4%	24.1%	27.4%	27.4%	26.7%
Total (m €)	€	23,537	23,978	24,854	24,286	25,772	25,549	27,472	24,762	25,947	25,870	25,702
Growth YoY						9.5%	6.6%	10.5%	2.0%	0.7%	0.4%	-0.3%
Margin		37.3%	36.6%	36.9%	34.5%	36.3%	35.0%	36.8%	32.1%	34.8%	34.7%	34.7%
Bouygues	€	513	914	924	916	536	886	917	940			
CPW	£			55		107		70		126	126	119
Mobistar	€		284		291		309		306			
Neuf Cegetel	€		108		128		253		291			
Iliad	€		95		129		154		178			
Vodafone	£			5,907		5,859		6,242		5,718	5,718	5,774
Total (m €)	€	24,299	25,823	35,088	26,196	35,434	27,581	38,215	26,934	34,632	34,555	34,459

Source: JPMorgan estimates, company reports

US trends

In the US, total Telecoms revenues have grown, and due to a recovery at the RBOCs total revenue growth YoY is at its highest point over the last three years, see Table 6, this is driven by the wireless segment which we discuss subsequently.

Table 6: Quarterly Revenue Trends

$ in millions

	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07
AT&T	29,361	29,239	29,189	28,900	29,204	29,392	29,558	29,378
Qwest	3,470	3,504	3,480	3,476	3,472	3,487	3,488	3,446
Verizon	21,298	21,597	21,755	21,448	21,876	22,450	22,598	22,584
Total RBOC	54,129	54,340	54,424	53,824	54,552	55,329	55,644	55,408
y/y change	*0.6%*	*0.1%*	*1.2%*	*0.8%*	*0.8%*	*1.8%*	*2.2%*	*2.9%*
Level 3	390	384	418	822	835	875	846	1,056
Sprint Nextel	8,900	9,059	9,132	9,401	9,290	9,653	9,644	9,796
Subtotal	9,290	9,443	9,550	10,223	10,125	10,528	10,490	10,852
y/y change	*9.0%*	*7.5%*	*7.2%*	*12.4%*	*9.0%*	*11.5%*	*9.8%*	*6.2%*
Alaska	81	86	82	83	85	90	92	91
CenturyTel	606	657	620	610	609	619	608	601
Cincinnati Bell	315	300	305	298	323	320	329	315
Citizens	576	591	588	589	588	591	587	576
Consolidated	78	81	81	79	79	80	82	83
Embarq	1,634	1,715	1,714	1,666	1,630	1,606	1,617	1,589
Fairpoint	63	66	70	65	65	71	70	68
Iowa	58	58	58	57	57	60	60	62
Windstream	760	764	755	747	750	763	782	761
Total RLEC	4,173	4,317	4,274	4,195	4,187	4,200	4,226	4,145
y/y change	*-0.6%*	*2.6%*	*1.1%*	*1.4%*	*0.3%*	*-2.7%*	*-1.1%*	*-1.2%*
Total Telecom	67,592	68,100	68,248	68,242	68,864	70,057	70,360	70,405
y/y change	*2.3%*	*1.2%*	*2.0%*	*2.5%*	*1.9%*	*2.9%*	*3.1%*	*3.2%*

Source: Company reports and JPMorgan calculations.

Note: AT&T and Verizon are pro forma the acquisitions of legacy AT&T/BLS and MCI. Level3 excludes Software Spectrum. Sprint Nextel excludes equipment revenue and is pro forma the wireline spin-off. CZN prior periods adjusted to exclude ELI and include CTCO (1Q07 contribution is an estimate). WIN excludes directories.

The better revenue growth has translated into margin growth for the RBOCs, whereas the smaller players have generally seen their margins fall, see Table 7.

Table 7: Quarterly EBITDA Trends

$ in millions

	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07
AT&T	9,603	10,069	9,332	9,802	10,261	10,755	10,788	10,826
Qwest	991	1,002	1,053	1,067	1,109	1,134	1,080	1,171
Verizon	6,845	7,041	7,283	6,962	7,253	7,259	7,321	7,443
Total RBOC	17,439	18,112	17,668	17,831	18,623	19,148	19,189	19,440
margin	*32.2%*	*33.3%*	*32.5%*	*33.1%*	*34.1%*	*34.6%*	*34.5%*	*35.1%*
y/y change	*-0.9%*	*1.9%*	*9.1%*	*5.6%*	*6.8%*	*5.7%*	*8.6%*	*9.0%*
Level 3	100	84	85	147	170	176	189	170
Sprint Nextel	2,902	2,935	2,779	2,926	3,219	3,364	3,169	2,583
Subtotal	3,002	3,019	2,864	3,073	3,389	3,540	3,358	2,753
margin	*32.3%*	*32.0%*	*30.0%*	*30.1%*	*33.5%*	*33.6%*	*32.0%*	*25.4%*
y/y change	*16.4%*	*10.3%*	*6.3%*	*10.1%*	*12.9%*	*17.3%*	*17.2%*	*-10.4%*
Alaska	29	29	27	28	30	32	31	32
CenturyTel	316	341	308	298	297	302	300	296
Cincinnati Bell	124	114	110	112	116	114	112	117
Citizens	316	317	319	322	329	318	308	296
Consolidated	31	33	33	33	34	33	33	35
Embarq	749	740	705	729	747	656	655	664
Fairpoint	29	28	33	29	29	30	30	29
Iowa	34	31	31	32	32	31	31	34
Windstream	390	404	415	402	398	393	409	394
Total RLEC	2,018	2,037	1,981	1,984	2,012	1,910	1,910	1,897
margin	*48.4%*	*47.2%*	*46.4%*	*47.3%*	*48.0%*	*45.5%*	*45.2%*	*45.8%*
y/y change	*-1.2%*	*2.4%*	*-4.5%*	*-0.1%*	*-0.3%*	*-6.2%*	*-3.6%*	*-4.4%*
Total Telecom	22,459	23,168	22,514	22,888	24,023	24,599	24,457	24,090
margin	*33.2%*	*34.0%*	*33.0%*	*33.5%*	*34.9%*	*35.1%*	*34.8%*	*34.2%*
y/y change	*1.4%*	*3.0%*	*7.4%*	*5.7%*	*7.0%*	*6.2%*	*8.6%*	*5.3%*

Source: Company reports and JPMorgan calculations.

Note: Cingular did not provide pro forma data for 4Q04 EBITDA and therefore the 4Q05 growth rate is skewed. AT&T and Verizon are pro forma the acquisitions of legacy AT&T/BLS and MCI. Level3 excludes Software Spectrum. Sprint Nextel is pro forma the wireline spin-off. CZN prior periods adjusted to exclude ELI and include CTCO (1Q07 contribution is an estimate). WIN excludes directories.

Wireline trends

Few European operators have managed to stem the reduction in EBITDA margins. Line loss continues unabated both in Europe and the US. The outlook is marginally brighter in the broadband segment where the European PTTs have managed to stabilise market share and the RBOCs have managed to grow market share and stabilise ARPUs.

Margins

Few operators increased their domestic wireline margins YoY, they are Belgacom, Telenor and OTE, of which only OTE has managed to do this for at least two consecutive quarters. OTE's restructuring has been helped by the Government allowing redundancies for civil servants and really it is only restructuring that is helping to stem the tide for other operators, but as yet there are few signs that we have reached the trough.

Table 8: Movements in domestic wireline EBITDA margins

%

	Q405	Q406	Q106	Q107	Q4 YoY pp	Q1 YoY pp	Q4/Q1 delta
Belgacom	34.6%	30.3%	30.5%	31.0%	-4.3%	0.5%	↑
Telenor	32.9%	29.7%	33.3%	35.5%	-3.2%	2.2%	↑
BT (post leavers)	28.3%	27.5%	27.9%	27.9%	-0.7%	0.0%	↑
PT - Portugal	50%	47%	50%	50%	-3.3%	0.6%	↑
OTE (clean)	22.0%	26.0%	27.0%	35.0%	4.0%	8.0%	↑
Telekom Austria	28.7%	24.1%	39.3%	37.8%	-4.6%	-1.5%	↓
DT	37.0%	26.9%	38.2%	31.6%	-10.1%	-6.7%	↓
Swisscom	35.8%	36.3%	41.1%	40.2%	0.5%	-0.9%	↓
KPN - wireline	37.7%	36.1%	NR	NR	-1.6%		↓
KPN - wireline & wireless			43.5%	41.4%		-2.1%	↓
TEF	42.5%	42.9%	44.0%	44.0%	0.4%	0.0%	↓
TI - wireline	44.0%	41.8%			-2.2%		↓
TI - wireline and wireless			50.5%	48.0%		-2.5%	↓
TeliaSonera	34.2%	38.2%	39.6%	30.6%	4.0%	-9.0%	↓

Source: Company reports.

Broadband market share

The overall markets share of PTTs remains relatively constant, with only PT, Telenor, TKA and TI showing any drop sequentially, see Table 9 and Figure 2. Unsurprisingly ULL market share has also been increasing and is currently at 21.8% of the total market, see Figure 1, however as the PTT retail market share is still stable, the increase in ULLs has come from the conversion of wholesale DSL lines and loss of cable market share. This process allows competitors to improve margins and so we still see some long term risk to the PTT market share as competitors can still lower prices as they become profitable, but in the short term the current metrics suggest some stability in market share.

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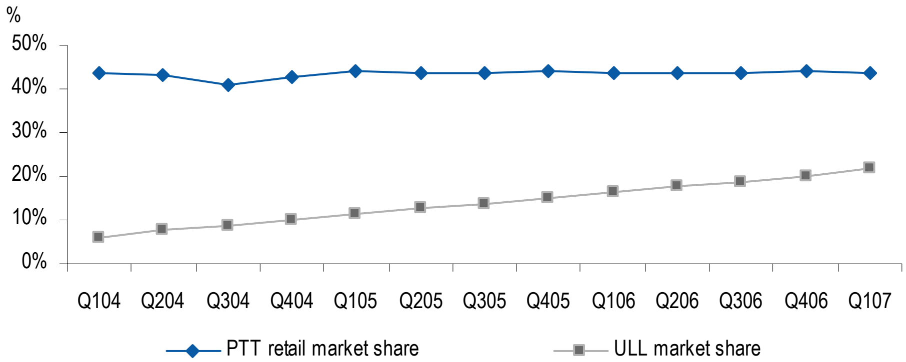
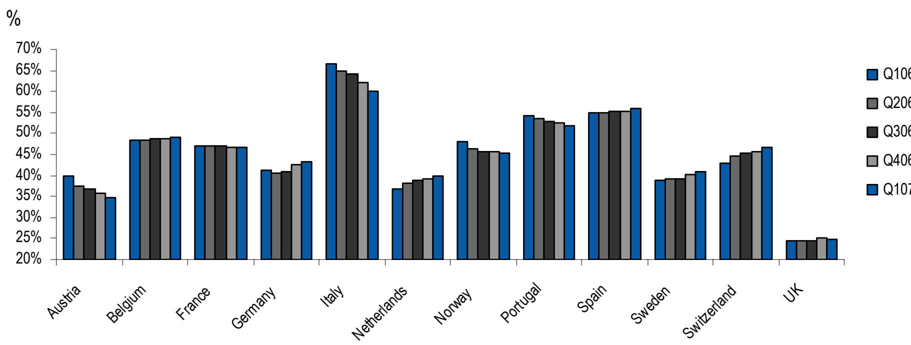
Figure 1: Movement of total PTT market share vs total ULL market share of broadband subs



Source: JPMorgan estimates, Company data, regulators

Figure 2: Market movements of the incumbents



Source: JPMorgan estimates, Company data, regulators

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Table 9: Broadband market movements

000s, %

		Q104	Q204	Q304	Q404	Q105	Q205	Q305	Q405	Q106	Q206	Q306	Q406	Q107
Austria	MS	35%	35%	35%	35%	37%	39%	40%	40%	40%	37%	37%	35.6%	34.8%
	TKA retail	228	249	260	298	349	397	424	469	502	520	549	571	598
	ULL	26	46	59	73	84	97	109	128	147	163	179	200	236
	Total	644	707	751	843	943	1,017	1,069	1,162	1,263	1,389	1,499	1,605	1,718
Belgium	MS	52%	52%	51%	50%	49%	49%	49%	48%	48%	48.5%	48.6%	48.6%	49.0%
	Belg retail	712	748	788	828	870	901	937	977	1,025	1,057	1,086	1,127	1,164
	ULL	0	0	0	0	2	4	8	14	25	25	25	25	25
	Total	1,366	1,447	1,555	1,663	1,766	1,833	1,906	2,016	2,117	2,181	2,234	2,318	2,376
France	MS	45%	44%	43%	43%	45%	44%	47%	47%	47%	47%	47%	47%	47%
	FT retail	2,042	2,234	2,463	2,927	3,431	3,661	3,996	4,457	4,926	5,216	5,536	5,920	6,329
	ULL	456	731	1,049	1,591	2,033	2,330	2,514	2,827	3,157	3,351	3,513	3,919	4,308
	Total	4,530	5,115	5,696	6,750	7,705	8,328	8,483	9,448	10,480	11,097	11,757	12,700	13,590
Germany	MS	48%	47%	37%	47%	45%	43%	42%	42%	41%	41%	41%	43%	43%
	DT retail	2,440	2,620	2,310	3,230	3,520	3,700	4,042	4,454	4,867	5,102	5,448	6,288	6,954
	ULL	550	750	840	930	1,318	1,706	2,094	2,480	2,922	3,214	3,497	3,890	4,435
	Total	5,050	5,563	6,166	6,898	7,880	8,592	9,604	10,721	11,783	12,537	13,319	14,726	16,060
Italy	MS	67%	67%	68%	66%	73%	71%	70%	69%	67%	65%	64%	62%	60%
	TI Retail	1,905	2,225	2,530	3,115	3,722	3,855	4,039	4,817	4,958	5,195	5,382	5,639	5,883
	ULL	254	352	445	681	668	851	933	1,261	1,457	1,764	1,908	2,289	2,714
	Total	2,829	3,327	3,745	4,691	5,103	5,466	5,806	6,968	7,439	8,030	8,365	9,059	9,809
Netherland	MS	25%	26%	27%	29%	31%	31%	33%	35%	37%	38%	39%	39%	40%
	KPN retail	568	663	801	936	1,077	1,152	1,305	1,485	1,664	1,806	1,911	2,044	2,114
	ULL	48	53	62	64	74	86	101	202	324	519	715	973	1,084
	Total	2,285	2,600	2,925	3,235	3,481	3,692	3,951	4,256	4,532	4,733	4,933	5,220	5,323
Norway	MS	44%	45%	46%	49%	50%	50%	49%	48%	48%	46%	46%	46%	45%
	TNR retail	208	235	270	326	385	415	444	475	511	527	542	572	594
	ULL	96	108	123	145	172	192	209	235	254	265	276	285	294
	Total	468	517	583	672	763	836	898	991	1,061	1,139	1,182	1,251	1,306
Portugal	MS	41%	45%	48%	52%	54%	55%	56%	55%	54%	54%	53%	52%	52%
	PT retail	204	260	312	382	451	500	547	585	613	636	658	685	701
	ULL			12	14	24	28	40	72	109	146	173	196	218
	Total	498	574	648	740	839	907	976	1,056	1,129	1,185	1,242	1,308	1,356
Spain	MS	49%	49%	49%	47%	53%	53%	53%	54%	55%	55%	55%	55%	56%
	TEF retail	1,194	1,340	1,444	1,615	2,073	2,247	2,398	2,720	3,043	3,220	3,411	3,743	3,993
	ULL	24	41	58	78	100	121	132	156	226	292.3	336	411	466
	Total	2,459	2,727	2,951	3,446	3,883	4,239	4,507	5,066	5,532	5,870	6,155	6,759	7,142
Sweden	MS	41%	40%	39%	40%	39%	38%	36%	39%	39%	39%	39%	40%	41%
	Retail	423	440	472	533	582	599	633	717	774	819	862	922	971
	ULL	72	99	128	210	255	299	332	374	415	450	482	520	542
	Total	1,037	1,110	1,215	1,337	1,489	1,597	1,779	1,862	2,000	2,095	2,193	2,297	2,368
Switz	MS	36%	36%	37%	38%	39%	40%	41%	42%	43%	45%	45%	46%	47%
	Swc retail	352	390	431	490	550	603	645	708	775	846	886	936	995
	Total	981	1,072	1,169	1,292	1,403	1,499	1,584	1,686	1,803	1,894	1,959	2,044	2,132
UK	MS	26%	25%	25%	25%	25%	25%	24%	24%	24%	24%	24%	25%	25%
	BT retail	967	1,102	1,283	1,509	1,780	1,981	2,167	2,410	2,668	2,826	2,980	3,219	3464
	ULL	4	5	8	12	16	29	49	90	142	232	335	518	764
	Total	3,720	4,333	5,095	6,154	7,176	8,046	8,936	9,900	10,938	11,553	12,257	12,784	13,883
Total sub		25,866	29,092	32,500	37,721	42,431	46,052	49,499	55,132	60,077	63,703	67,096	72,071	77,062
PTT share		43.4%	43.0%	41.1%	42.9%	44.3%	43.4%	43.6%	44.0%	43.8%	43.6%	43.6%	43.9%	43.8%
ULL share		5.9%	7.6%	8.6%	10.2%	11.5%	12.9%	13.8%	14.9%	16.2%	17.5%	18.5%	20.2%	21.8%

Source: JPMorgan estimates, Company data, regulators

Line loss

Line loss continues to gather momentum, worsening from -4.5%YoY at Q406 to -4.9% at Q107. There are however some companies that have managed to keep the line loss low at around -2%, which are Portugal Telecom, Telefonica and BT. For Portugal Telecom we would argue that holding the cable operator has helped to reduce competitive intensity and is unlikely to continue. For Telefonica the economic growth and reducing competitive intensity have helped. In BT's case we would argue that line loss will worsen significantly as wholesale subs are converted to ULL.

Table 10: Narrowband line loss

'000s,%

Narrowband lines	Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	competitive intensity
DT	36400	36000	35600	35241	34737	34234	33695	33192	32605	Worsening
Change YoY					-4.6%	-4.9%	-5.4%	-5.8%	-6.1%	
Change QoQ		-1.1%	-1.1%	-1.0%	-1.4%	-1.4%	-1.6%	-1.5%	-1.8%	
swisscom	3,903	3,870	3,841	3,822	3,811	3,789	3,759	3,747	3,727	improving
Change YoY					-2.4%	-2.1%	-2.1%	-2.0%	-2.2%	
Change QoQ		-0.8%	-0.7%	-0.5%	-0.3%	-0.6%	-0.8%	-0.3%	-0.5%	
Portugal Telecom	4427	4445	4471	4478	4447	4433	4418	4404	4,357	worsening
Change YoY					0.5%	-0.3%	-1.2%	-1.7%	-2.0%	
Change QoQ		0.4%	0.6%	0.2%	-0.7%	-0.3%	-0.3%	-0.3%	-1.1%	
TEF	16258.3	16236.5	16,181	16,136	16,109	16,020	15,978	15,950	15,920	improving
Change YoY					-0.9%	-1.3%	-1.3%	-1.2%	-1.2%	
Change QoQ		-0.1%	-0.3%	-0.3%	-0.2%	-0.6%	-0.3%	-0.2%	-0.2%	
Telenor	2066	2021	1980	1936	1893	1853	1809	1769	1736	Worsening
Change YoY					-8.4%	-8.3%	-8.6%	-8.6%	-8.3%	
Change QoQ		-2.2%	-2.0%	-2.2%	-2.2%	-2.1%	-2.4%	-2.2%	-1.9%	
KPN	7,264	7,173	7,067	6,907	6,775	6,571	6,395	6,278	6,046	Stable
Change YoY					-6.7%	-8.4%	-9.5%	-9.1%	-10.8%	
Change QoQ		-1.3%	-1.5%	-2.3%	-1.9%	-3.0%	-2.7%	-1.8%	-3.7%	
FT	21,770	21,585	21,278	21,301	21,022	20,717	20,420	20,156	19,802	Improving
Change YoY					-3.4%	-4.0%	-4.0%	-5.4%	-5.8%	
Change QoQ		-0.8%	-1.4%	0.1%	-1.3%	-1.5%	-1.4%	-1.3%	-1.8%	
Telecom Italia	22359	22216	22035	21725	21502	21217	20992	20540	20118	Stable
Change YoY					-3.8%	-4.5%	-4.7%	-5.5%	-6.4%	
Change QoQ		-0.6%	-0.8%	-1.4%	-1.0%	-1.3%	-1.1%	-2.2%	-2.1%	
BT	26698	26582	26389	26314	26114	25881	25727	25655	25492	Worsening
Change YoY					-2.2%	-2.6%	-2.5%	-2.5%	-2.4%	
Change QoQ		-0.4%	-0.7%	-0.3%	-0.8%	-0.9%	-0.6%	-0.3%	-0.6%	
TKA	2,875.9	2,852.4	2,823.3	2,801.9	2,770.2	2,732.4	2,695.1	2,642.6	2,575.50	stable
Change YoY					-3.7%	-4.2%	-4.5%	-5.7%	-7.0%	
Change QoQ		-0.8%	-1.0%	-0.8%	-1.1%	-1.4%	-1.4%	-1.9%	-2.5%	
Belgacom	3,894.0	3,845.5	3,812.5	3,795.5	3,770.5	3,713.0	3,674.0	3,639	3,599	stable
Change YoY					-3.2%	-3.4%	-3.6%	-4.1%	-4.5%	
Change QoQ		-1.2%	-0.9%	-0.4%	-0.7%	-1.5%	-1.1%	-1.0%	-1.1%	
TeliaSonera	5,578	5,551	5,484	5,417	5,351	5,305	5,221	5,131	5,064	Worsening
Change YoY					-4.1%	-4.4%	-4.8%	-5.3%	-5.4%	
Change QoQ		-0.5%	-1.2%	-1.2%	-1.2%	-0.9%	-1.6%	-1.7%	-1.3%	
Total lines	153,493	152,377	150,962	149,874	148,300	146,465	144,784	143,104	141,041	
Change YoY					-3.4%	-3.9%	-4.1%	-4.5%	-4.9%	
Change QoQ		-0.7%	-0.9%	-0.7%	-1.0%	-1.2%	-1.1%	-1.2%	-1.4%	

Source: JPMorgan estimates, Company data.

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US trends

Despite the fibre rollout and investment in the last mile, RBOCs continue to lose lines. However, they are aggressively selling DSL into their existing subscriber base such that their market share of broadband is increasing. For Europe, line loss continues unabated and as mentioned, broadband market share remains static.

Losses to Substitution and Cable Continued

The RBOCs reported total line losses of -7.3% y/y, worse than -6.9% last quarter and -5.9% in the prior year. Verizon again saw the largest decline at -7.9% YoY, we mostly attribute Verizon's more rapid deterioration in access line trends to higher exposure to cable competition, lower DSL penetration and higher pricing.

Table 11: Quarterly RBOC Total Access Line Trends

Access lines in 000s

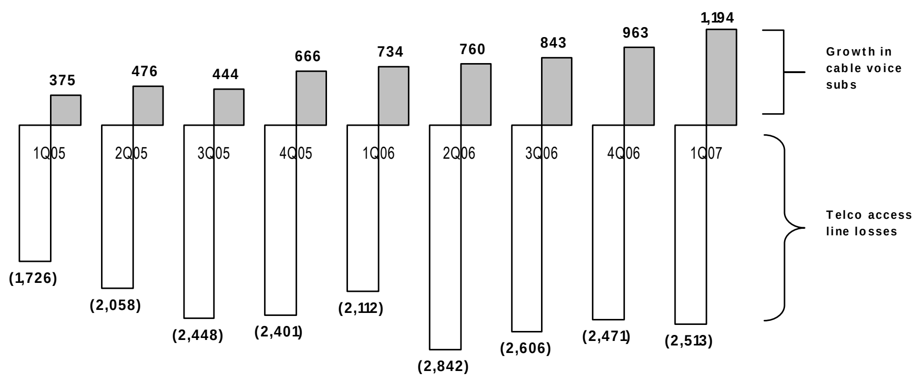
	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07
Access lines								
AT&T	71,277	70,180	69,068	68,173	66,845	65,698	64,569	63,400
Qwest	15,087	14,933	14,739	14,546	14,283	14,037	13,795	13,551
Verizon	50,691	49,689	48,803	47,966	46,950	45,973	45,079	44,154
Total RBOC	137,055	134,802	132,610	130,685	128,078	125,708	123,443	121,105
y/y change	*-4.9%*	*-5.3%*	*-5.6%*	*-5.9%*	*-6.5%*	*-6.7%*	*-6.9%*	*-7.3%*
Net adds								
AT&T	(763)	(1,097)	(1,112)	(895)	(1,328)	(1,147)	(1,129)	(1,169)
Qwest	(252)	(154)	(194)	(193)	(263)	(246)	(242)	(244)
Verizon	(840)	(1,002)	(886)	(837)	(1,016)	(977)	(894)	(925)
Total RBOC	(1,855)	(2,253)	(2,192)	(1,925)	(2,607)	(2,370)	(2,265)	(2,338)

Source: Company reports.

Note: AT&T excludes out-of-region legacy AT&T CLEC lines (in-region captured in wholesale). Verizon excludes MCI out-of-region CLEC lines (in-region captured in retail).

Figure 3: Retail Voice Subscriber and Line Trends

Subs and access lines in 000s



Source: Company reports.

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Broadband Growth Remained Robust; Telco Share Gains Slow

Total broadband subscribers were 54.4 million at the end of first quarter (up 21.4 % y/y). Total net adds came in at 2.83 million down from 2.99 million last year. We attribute most of the yearly decline in net adds to AT&T, Verizon and Cablevision. The telcos continued to capture a higher share of industry net adds, at 53.5%, than their overall market share of 47%. Of the individual carriers, AT&T took the highest share of industry net adds at 24.4%, followed by Comcast at 19.9%, Verizon at 14.7% and Time Warner at 12.9%.

Table 12: Quarterly Broadband Subscriber Trends

Subs in 000s

	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07
Subscribers								
Cablevision	1,520	1,600	1,694	1,807	1,891	1,964	2,039	2,118
Charter	2,022	2,120	2,196	2,322	2,375	2,343	2,402	2,526
Comcast	8,677	9,184	9,639	10,130	10,463	11,000	11,487	12,050
Insight	391	439	470	515	535	579	611	656
Mediacom	426	453	478	504	516	544	578	600
Time Warner	5,196	5,440	5,713	6,064	6,294	6,632	6,889	7,254
Other	2,846	3,002	3,143	3,243	3,088	3,226	3,363	3,480
Total cable	21,079	22,239	23,334	24,585	25,162	26,288	27,369	28,684
y/y change	*24.7%*	*22.9%*	*20.8%*	*20.9%*	*19.4%*	*18.2%*	*17.3%*	*16.7%*
AT&T	8,441	9,174	9,803	10,576	11,048	11,604	12,170	12,861
Qwest	1,190	1,340	1,480	1,678	1,798	1,973	2,138	2,305
Verizon	4,142	4,531	5,144	5,685	6,125	6,573	6,982	7,398
Subtotal	13,773	15,045	16,427	17,939	18,971	20,150	21,290	22,564
Alaska	30	33	36	38	40	42	44	45
CenturyTel	195	220	249	286	313	340	369	413
Cincinnati Bell	145	154	163	171	177	188	198	208
Citizens	298	324	347	375	396	414	438	464
Consolidated	33	36	39	44	46	49	53	56
Embarq	590	638	693	777	849	933	1,017	1,104
Fairpoint	41	43	45	49	51	57	59	63
Iowa	23	27	31	36	39	45	50	55
Windstream	359	407	450	502	548	603	656	715
Total DSL	15,486	16,927	18,480	20,217	21,429	22,821	24,175	25,687
y/y change	*43.0%*	*42.3%*	*41.2%*	*39.3%*	*38.4%*	*34.8%*	*30.8%*	*27.1%*
Total broadband	36,564	39,166	41,815	44,802	46,592	49,109	51,544	54,371
y/y change	*21.7%*	*21.3%*	*20.4%*	*28.6%*	*27.4%*	*25.4%*	*23.3%*	*21.4%*

Source: Company reports.

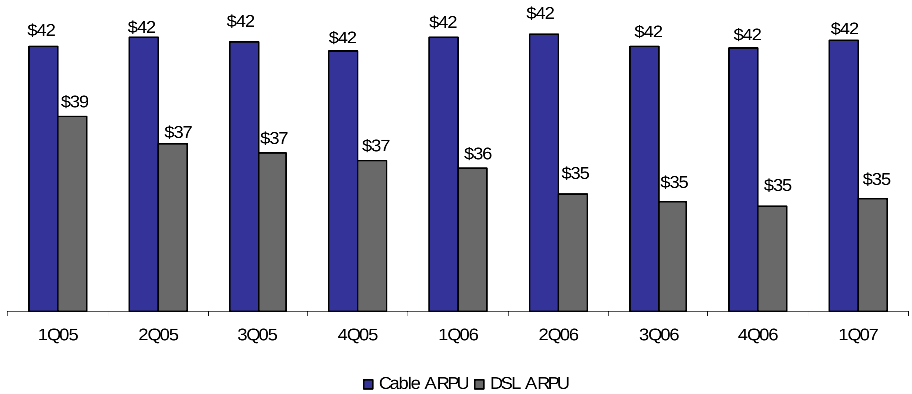
Note: AT&T is pro forma the acquisition of BLS. Cable results are pro forma recent acquisitions and consolidations. CZN is pro forma CTCO.

Broadband ARPU Gap Stabilizes

We estimate that DSL ARPU was down 3.6% y/y but was up slightly sequentially and has been relatively stable around $35 for the last four quarters. In addition, the ARPU gap between DSL and cable has been relatively stable at around $7 for the last four quarters.

Figure 4: Cable vs. DSL ARPU

$



Source: Company reports.

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Wireless trends

In contrast to the wireline segment, the wireless is doing a little better showing improving revenue and EBITDA growth for the European operators, however, this is driven by smaller competitors doing better or through market repair (ie the Nordic region). We focus on the wireless trends to predict which country may be next in line for 'repair' and we would argue that the UK could see some repair but more likely through collaboration rather than consolidation. In the US ARPUs for Verizon and Cingular are growing healthily whereas Sprint Nextel is seeing weakness (unsurprising given its higher ARPU).

Europe

Whilst overall service revenue growth shows a slight pick up from 3.2%YoY at Q406 to 3.4%YoY for Q107; this is mostly driven by competitors gaining share ie Bouygues in France, E-Plus in Germany etc. Out of the countries for which we can obtain service revenues data, the only one that shows growth for all operators is Spain. So for the moment, trends show that smaller competitors are in a much better position.

Table 13: Quarterly service revenue growth

% change y/y

		Q104	Q204	Q304	Q404	Q105	Q205	Q305	Q405	Q106	Q206	Q306	Q406	Q107
Austria	T-Mobile	6.3%	4.8%	4.2%	1.3%	-0.9%	0.5%	3.9%	3.5%	-0.5%				
Belgium	Belgacom		0.0%		-1.2%		4.0%		3.5%	-1.6%	-3.0%	-0.4%	-3.7%	-2.4%
Denmark	Telenor						18.9%	13.4%	18.6%	11.4%	4.9%	10.3%	11.3%	10.4%
France	Orange	10.1%	11.0%	8.3%	8.3%	5.9%	4.2%	5.1%	5.2%	1.6%	0.6%	1.3%	0.8%	-0.8%
	Bouygues	9.5%	9.3%	9.8%	15.7%	6.8%	5.4%	3.9%	1.9%	0.2%	-0.1%	1.3%	3.7%	6.4%
	SFR	12.8%	11.1%	8.1%	9.3%	2.6%	5.2%	1.4%	3.2%	2.1%	0.3%	0.1%	-1.3%	-0.9%
Greece	Vodafone						9.1%	7.2%	12.3%	11.6%	7.8%	0.7%	-1.8%	-6.8%
Germany	T-mobile	4.6%	2.4%	1.3%	0.3%	1.3%	1.5%	0.6%	2.0%	-3.1%	-3.2%	-2.6%	-7.8%	-3.0%
	Vodafone	7.0%	7.0%				3.7%	1.9%	-0.4%	-1.0%	-2.9%	-3.1%	-4.3%	-5.5%
	E-Plus	12.7%	11.1%	10.9%	11.7%	6.6%	10.9%	8.1%	4.3%	7.6%	9.8%	10.9%	10.0%	8.4%
	O2	35.0%	27.9%	29.1%	29.8%	25.3%	23.4%	21.7%	13.7%	12.5%	7.8%	6.1%	6.1%	6.1%
Italy	TIM	6.7%	4.6%	3.2%	3.2%	2.7%	1.0%	-2.0%	-1.4%	-1.1%	-1.0%	0.9%	2.0%	0.5%
	Vodafone	13.0%	10.0%	6.0%	8.0%	6.0%	6.5%	5.5%	-1.7%	-2.9%	-3.3%	-2.9%	1.8%	-0.6%
Norway	Telenor					4.9%	3.5%	3.7%	5.0%	5.8%	7.7%	6.6%	0.1%	2.0%
Netherlands	KPN	-0.9%	-2.6%	-4.6%	-6.0%	-1.7%	6.0%	6.5%	29.2%	28.6%	24.8%	27.9%	6.5%	9.1%
	T-Mobile	35.8%	20.1%	21.7%	10.9%	7.4%	4.6%	0.8%	6.2%	9.4%	6.4%	8.3%	9.7%	5.9%
	Orange	27.3%	24.3%	19.8%	14.2%	4.1%	4.7%	0.7%	2.3%	-6.3%	-7.5%	-6.7%	-8.3%	1.7%
Portugal	PT					3.0%	1.5%	0.9%	2.5%	-4.9%	-16.5%	-4.9%	-3.4%	-7.5%
	Vodafone						-0.2%	1.6%	1.0%	5.0%	6.1%	4.6%	7.1%	5.9%
Spain	TEM	20.6%	14.9%	9.6%	7.8%	6.7%	7.8%	7.8%	6.8%	4.7%	4.8%	4.2%	4.2%	7.0%
	Vodafone			21.4%	22.5%	23.0%	26.2%	21.8%	22.6%	18.2%	14.9%	11.3%	12.4%	12.7%
UK	Orange	6.3%	4.8%	4.2%	1.3%	-2.2%	-0.1%	0.0%	4.1%	4.7%	-0.1%	-0.1%	0.8%	1.7%
	Vodafone	8.0%	7.0%	7.0%	3.0%	0.8%	0.6%	2.4%	2.7%	0.6%	1.6%	1.4%	2.7%	5.3%
	O2	20.1%	23.3%	17.8%	8.2%	7.6%	3.4%	3.6%	12.0%	16.6%	14.9%	14.9%	13.7%	13.7%
	T-mobile	13.0%	10.0%	2.5%	-6.2%	-9.4%	-3.5%	0.2%	1.2%	6.6%	12.6%	14.0%	14.9%	12.8%
Avg Margins		13.8%	10.6%	10.0%	7.5%	5.0%	5.9%	5.0%	6.4%	5.0%	3.6%	4.3%	3.2%	3.4%

Source: Company reports and JPMorgan estimates.

Average wireless margins for Europe are actually improving, see Table 14. This is due to a combination of market repair and competitors doing better. The market repair scenario applies mostly to the Nordic market where operators have chosen to reduce the amount of subsidy and reduced the amount of price cuts.

Countries that have seen immense price competition affecting margins are Finland and Denmark. As mentioned, competitors in these markets have reduced their competitive intensity.

When we look at Table 14, we find that margins in the Netherlands and the UK are falling and are at low levels. France Telecom has already said that it is looking at offers for its Dutch unit, and press (Bloomberg) speculate that Deutsche Telekom is likely to buy this unit thus leading to consolidation in the Dutch markets.

In the UK none of the operators have talked about divesting their mobile assets, so rather than consolidation in the short term we may see a reduction in competitive intensity, similar to the Nordic markets.

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Table 14: EBITDA margins by operator

% of total revenues

		Q4 04	Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	YoY
France	Orange	43.6%		41.0%		38.7%		40.1%		37.5%		
	Bouygues	31.5%	30.8%	30.6%	32.8%	25.1%	28.5%	28.1%	29.3%	22.6%	31.8%	3.3pp
	SFR	37.8%	38.2%	42.6%	39.8%	32.7%	36.6%	46.8%	41.9%	33.6%	41.0%	4.4pp
Germany	T-mobile	45.7%	39.8%	42.5%	42.5%	42.3%	39.4%	39.3%	42.1%	39.9%	35.9%	-3.5pp
	VOD		46.2%		46.4%		47.5%		44.7%		44.6%	-2.9pp
	E-Plus	26.9%	21.1%	21.7%	23.7%	24.5%	25.6%	37.0%	35.7%	29.5%	36.2%	10.7pp
	O2		18.6%		17.9%		22.6%	22.0%	19.6%	8.2%	19.1%	-3.5pp
Italy	TIM	49.6%	54.8%	52.3%	50.8%	44.5%		49.5%	50.6%	45.6%		
	Vodafone		53.0%		60.1%		43.6%		57.8%		43.1%	-0.5pp
Spain	TEM	47.5%	47.5%	43.3%	49.1%	46.9%	44.0%	45.4%	47.0%	42.9%	44.0%	0
	Vodafone		33.4%		36.6%		32.2%		35.8%		33.8%	1.6pp
Netherlands	KPN	37.2%	34.8%	39.8%	38.9%	34.3%		39.1%	34.6%	38.4%		
	T-mobile	15.4%	10.2%	12.7%	19.6%	22.4%	7.7%	9.2%	24.8%	24.1%	21.2%	13.4pp
UK	Orange	33.5%		26.9%		29.3%		26.6%		20.2%		
	Vodafone		34.3%		30.4%		34.0%		30.8%		26.2%	-7.8pp
	O2		30.2%		28.5%		28.7%	26.9%	27.5%	30.3%	24.0%	-4.7pp
	T-mobile	23.8%	28.0%	32.3%	37.2%	27.9%	16.1%	15.2%	28.0%	26.9%	19.2%	3.1pp
Austria	T-Mobile	30.2%	27.9%	25.4%	27.8%	20.9%	27.2%	27.4%	32.8%	26.9%	36.1%	8.9pp
	Mobilkom	28.1%	39.9%	36.8%	31.2%	28.1%	40.0%	34.8%	37.3%	28.8%	38.6%	-1.4pp
Belgium	Mobistar	42.3%		43.8%		43.1%		44.4%		43.6%		
	Proximus	49.4%	51.2%	48.9%	45.8%	45.0%	50.1%	49.1%	47.0%	41.0%	47.1%	-3.0pp
	Base	37.7%	36.9%	37.7%	38.8%	35.6%	39.6%	46.2%	43.8%	40.0%	39.5%	-0.1pp
Greece	Cosmote	39.6%	42.2%	42.2%	44.7%	39.2%	41.1%	41.9%	46.2%	42.7%	40.5%	-0.6pp
	Stet Hellas	36.9%	26.4%	25.8%	31.7%	27.3%	33.3%	34.0%	35.5%	22.9%	33.0%	-0.3pp
Portugal	TMN	47.9%	45.1%	44.2%	42.0%	41.9%	43.7%	44.9%	43.9%	43.0%	44.3%	0.6pp
	Optimus	24.0%	29.6%	27.9%	26.8%	22.6%		28.3%	29.4%	22.0%		
Switz	Swisscom	43.5%	48.9%	46.1%	42.3%	40.0%	48.2%	43.0%	46.6%	41.8%	49.0%	0.7pp
	TDC (Dkk)	43.8%	44.2%	43.3%	42.2%	51.6%	43.7%	40.4%	43.4%	51.4%	42.3%	-1.4pp
Finland	Sonera	41.1%	23.3%	19.7%	26.1%	15.9%	21.8%	24.7%	31.0%	25.8%	34.7%	12.9pp
	Elisa- Euro	32.1%	27.0%	42.3%	24.2%	24.9%	27.2%	22.8%	28.6%	30.6%	29.0%	1.8pp
Sweden	Telia	46.0%	37.2%	35.9%	41.8%	35.7%	38.3%	37.3%	36.9%	36.7%	42.7%	4.4pp
	Tele 2	43.8%	41.5%	45.3%	48.3%	43.6%	43.8%	44.4%	42.9%	38.5%	36.0%	-7.8pp
	Telenor						13.1%	16.9%	23.9%	20.2%	21.7%	8.6pp
Norway	NetCom	33.2%	38.0%	36.1%	33.1%	33.5%	36.6%	41.2%	30.4%	41.6%	37.4%	0.8pp
	Telenor	37.8%	35.3%	35.0%	39.0%	36.7%	42.6%	41.7%	43.8%	40.1%	38.9%	-3.7pp
Denmark	Sonofon		21.3%	23.3%	22.4%	22.8%	23.0%	22.5%	27.5%	26.0%	26.0%	3.0pp
	Telia	2.6%	2.3%	9.8%	13.2%	5.8%	16.8%	18.3%	19.4%	20.3%	17.5%	0.7pp
	TDC	27.9%	31.0%	34.2%	31.8%	26.6%	30.1%	30.4%	31.8%	27.5%	29.7%	-0.4pp
Avg margins		34.9%	34.4%	35.1%	35.5%	32.6%	33.3%	34.1%	36.3%	32.7%	34.5%	1.1pp

Source: JPMorgan estimates, Company data. Company's without quarterly margin data only disclose half-yearly margins. TIM and KPN mobile Netherlands margins are no longer reported

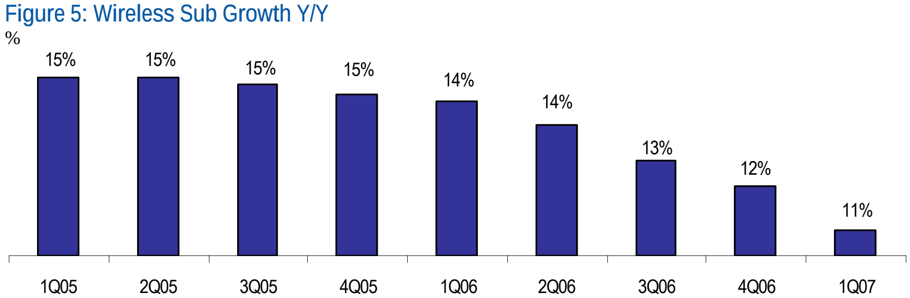
US trends

Wireless subscriber growth slowed to 11% y/y, with declining gross adds and higher disconnects (stable churn on higher subscriber base). However, service ARPU pressure moderated (down 0.3% y/y compared to 1.6% last quarter) due to continued strong growth in data ARPU. In addition, wireless margins expanded 90bps y/y on merger synergies and lower adds; however, rising SAC and retention costs may be a concern in future quarters as competitive intensity escalates.

Wireless Subscriber Growth Slowed

The industry ended the quarter with 229 million total subscribers, up 10.7% y/y (versus 12-15% y/y growth over the past two years). Wireless net adds were 4.6 million, down about 29% y/y to their lowest level in the last 8 quarters.

Figure 5: Wireless Sub Growth Y/Y

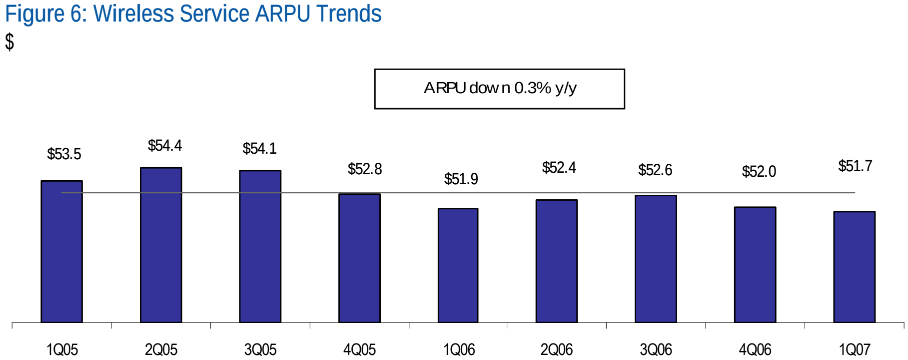


Source: Company reports.

Service ARPU Pressure Eased

Service ARPU was $51.7 in the first quarter, down just 0.3% y/y, an improvement from a 1.6% decline in 4Q06 and a 3% decline in 1Q06. The improvement was driven mostly by continued strong growth in data ARPU at all three of the major carriers (see Table 15). ARPU pressure was most severe at Sprint (down 5.7%), while Verizon and AT&T saw total ARPU grow modestly again this quarter (fourth quarter of accelerating growth for Verizon, third quarter of growth for AT&T).

Figure 6: Wireless Service ARPU Trends



Source: Company reports.

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Table 15: Select Wireless ARPU Trends

As indicated

	2Q05	3Q05	4Q05	1Q06	2Q06	3Q06	4Q06	1Q07
Verizon								
Voice ARPU	$45.90	$45.91	$44.37	$43.03	$43.27	$43.44	$42.07	$41.32
+ Data ARPU	$3.47	$4.23	$4.85	$5.58	$6.40	$7.16	$7.91	$8.73
= Total ARPU	$49.37	$50.14	$49.22	$48.61	$49.67	$50.60	$49.98	$50.05
memo: voice ARPU y/y	*-5.6%*	*-6.6%*	*-6.3%*	*-6.2%*	*-5.7%*	*-5.4%*	*-5.2%*	*-4.0%*
memo: data ARPU y/y	*62.9%*	*74.8%*	*73.8%*	*79.4%*	*84.4%*	*69.3%*	*63.1%*	*56.5%*
memo: total ARPU y/y	*-2.8%*	*-2.8%*	*-1.9%*	*-0.7%*	*0.6%*	*0.9%*	*1.5%*	*3.0%*
memo: data % of total	*7.0%*	*8.4%*	*9.9%*	*11.5%*	*12.9%*	*14.2%*	*15.8%*	*17.4%*
Cingular								
Voice ARPU	$46.39	$45.29	$44.01	$43.32	$43.12	$43.47	$41.82	$41.33
+ Data ARPU	$4.16	$4.33	$4.71	$5.22	$5.77	$6.32	$7.19	$7.88
= Total ARPU	$50.55	$49.62	$48.72	$48.54	$48.89	$49.79	$49.01	$49.21
memo: voice ARPU y/y	*-11.3%*	*-11.2%*	*-6.2%*	*-5.9%*	*-7.1%*	*-4.0%*	*-5.0%*	*-4.6%*
memo: data ARPU y/y	*183.0%*	*147.4%*	*63.0%*	*41.1%*	*38.7%*	*46.0%*	*52.7%*	*51.0%*
memo: total ARPU y/y	*-6.0%*	*-5.9%*	*-2.2%*	*-2.4%*	*-3.3%*	*0.3%*	*0.6%*	*1.4%*
memo: data % of total	*8.2%*	*8.7%*	*9.7%*	*10.8%*	*11.8%*	*12.7%*	*14.7%*	*16.0%*
Sprint Nextel (direct postpaid only)								
Voice ARPU	$60.56	$59.52	$57.22	$55.87	$54.46	$53.32	$51.85	$50.05
+ Data ARPU	$5.00	$5.25	$6.00	$7.00	$7.25	$7.75	$8.75	$9.25
= Total ARPU	$65.56	$64.77	$63.22	$62.87	$61.71	$61.07	$60.60	$59.30
memo: voice ARPU y/y		*-5.4%*	*-6.5%*	*-6.9%*	*-10.1%*	*-10.4%*	*-9.4%*	*-10.4%*
memo: data ARPU y/y		*40.0%*	*50.0%*	*55.6%*	*45.0%*	*47.6%*	*45.8%*	*32.1%*
memo: total ARPU y/y	*-1.2%*	*-2.8%*	*-3.0%*	*-2.5%*	*-5.9%*	*-5.7%*	*-4.1%*	*-5.7%*
memo: data % of total	*7.6%*	*8.1%*	*9.5%*	*11.1%*	*11.7%*	*12.7%*	*14.4%*	*15.6%*
Total								
Voice ARPU	$49.91	$49.20	$47.58	$46.50	$46.14	$46.10	$44.54	$43.55
+ Data ARPU	$4.14	$4.53	$5.10	$5.82	$6.38	$7.01	$7.86	$8.54
= Total ARPU	$54.05	$53.74	$52.68	$52.32	$52.53	$53.11	$52.40	$52.10
memo: voice ARPU y/y		*-8.0%*	*-6.4%*	*-6.3%*	*-7.5%*	*-6.3%*	*-6.4%*	*-6.3%*
memo: data ARPU y/y		*80.9%*	*62.0%*	*57.1%*	*54.4%*	*54.5%*	*54.2%*	*46.9%*
memo: total ARPU y/y		*-4.0%*	*-2.4%*	*-1.9%*	*-2.8%*	*-1.2%*	*-0.5%*	*-0.4%*
memo: data % of total	*7.7%*	*8.4%*	*9.7%*	*11.1%*	*12.2%*	*13.2%*	*15.0%*	*16.4%*

Source: Company reports and JPMorgan calculations.

Note: Sprint Nextel ARPU reflects direct postpaid only, and will differ from ARPU shown elsewhere in this report (which includes the impact of Boost Mobile).

Valuation

The RBOCs trade on a 2007E EV/EBITDA of 6.7x which is higher than European Telecoms at 6.4x. The RBOCs look more expensive than the European peers when looking at P/E and FCF yield but the RBOCs have seen an improvement in fundamentals, justifying their outperformance in our view.

We do not expect the performance gap between the European Telecoms sector and the RBOCs to narrow unless there is a shift in fundamentals, M&A or increased cash returns, and none are in our opinion likely to happen in the short term.

Table 16: European sector trading multiples

		Static P/E					CAGR	EV/ EBITDA					CAGR
	Local P	2006	2007E	2008E	2009E	2010E	06-09E	2006	2007E	2008E	2009E	2010E	06-09E
Belgacom	34.78	12.1	13.3	13.3	13.0	12.9	-2.4%	6.7	6.9	7.1	7.2	7.4	-2.6%
Bouygues	65.12	17.6	18.3	16.1	14.3	13.3	7.0%	7.9	7.3	6.7	6.3	6.2	7.9%
BT	3.29	14.5	14.3	14.6	15.2	14.8	-1.6%	6.3	6.2	6.3	6.5	6.5	-1.4%
CPW	3.035	30.9	13.3	10.6	9.5	8.9	48.4%	12.1	6.9	5.9	5.5	5.1	30.2%
Cosmote	23.68	21.9	15.3	12.9	11.6	10.4	23.8%	12.4	10.1	9.0	8.3	7.9	14.3%
DT	14.1	16.0	19.8	16.4	15.4	14.8	1.2%	5.7	5.8	5.5	5.5	5.5	1.0%
FT	23.2	10.9	14.5	13.8	13.4	12.9	-6.7%	6.1	6.2	6.2	6.1	5.9	0.3%
Iliad	75.2	32.9	24.6	17.1	13.8	12.0	33.7%	12.4	8.9	7.1	6.1	5.6	26.4%
Jazztel	0.6	(3.3)	(8.0)	(10.9)	(16.3)	(26.5)	-41.0%	(6.5)	(46.4)	128.3	29.3	16.7	-160.4%
Fastweb	41.6	(73.8)	61.5	29.5	20.2	15.6	-254.1%	10.1	7.3	6.4	5.9	5.8	19.6%
KPN	12.7	16.1	15.2	13.5	11.9	10.6	10.7%	7.1	7.1	7.0	6.9	6.9	1.4%
Mobistar	65.9	13.9	14.7	15.2	16.2	16.7	-4.9%	6.7	7.0	7.2	7.5	7.8	-3.9%
Neuf Cegetel	29.6	26.7	25.7	19.0	15.3	12.2	20.3%	11.7	8.6	7.5	6.9	6.3	19.3%
OTE	23.2	19.8	15.7	15.1	12.9	12.2	15.3%	7.8	7.2	7.2	6.8	6.7	4.6%
PT	8.5	-	14.6	15.8	15.3	14.5	-15.1%	-	6.6	6.9	7.1	7.2	-2.8%
QSC	5.2	(131.0)	44.1	20.6	14.8	12.4	-307.1%	30.0	11.1	7.7	6.3	5.6	68.4%
Swisscom	432.5	14.8	12.1	12.1	12.0	11.9	7.0%	7.8	7.6	7.7	7.8	7.9	0.0%
TI Group	2.15	13.6	16.6	15.6	16.8	16.2	-7.3%	6.3	6.4	6.3	6.5	6.6	-1.4%
Telefonica	16.98	17.5	14.2	11.9	10.6	9.6	18.1%	7.3	6.8	6.4	6.2	6.0	5.6%
T.Austria	20.24	17.0	18.1	15.7	12.9	11.1	9.7%	6.7	7.0	7.0	6.8	6.8	-0.7%
Telenet	23.64	281.9	48.4	19.4	14.0	12.2	172.3%	9.8	8.6	8.0	7.6	7.4	9.1%
Telenor	116.5	11.8	15.7	15.5	14.2	13.3	-6.1%	6.3	6.7	6.6	6.4	6.2	-0.4%
TeliaSonera	51.75	13.6	14.6	14.0	13.2	12.8	1.0%	7.0	6.8	6.7	6.7	6.6	1.8%
UTDI	14.53	32.7	24.6	18.6	14.6	12.3	30.9%	14.9	12.9	10.9	8.8	7.6	19.4%
VOD (cons)	1.617	14.4	14.8	14.2	13.2	12.5	2.8%	6.3	6.3	6.1	5.9	5.8	2.5%
Sector		14.7	15.6	14.3	13.4	12.6	2.2%	6.5	6.4	6.2	6.1	6.1	2.2%

Source: JP Morgan estimates, Company data, Bloomberg. Based on prices at COB 4th of June 2007.

Table 17: European sector multiples

%

	Normalised EFCF Yield					CAGR	Static Divi Yield					CAGR
	2006	2007E	2008E	2009E	2010E	05-10E	2006	2007E	2008E	2009E	2010E	05-10E
Belgacom	8.7%	7.1%	7.0%	6.8%	6.6%	-4.6%	5.4%	5.3%	5.3%	5.4%	5.5%	4.7%
Bouygues	4.1%	3.8%	4.8%	5.4%	6.0%	9.8%	1.8%	2.1%	2.4%	2.7%	2.9%	16.1%
BT	2.4%	4.0%	5.0%	5.3%	5.9%	3.0%	4.6%	4.7%	4.6%	4.4%	4.5%	4.7%
CPW	2.2%	8.3%	11.0%	13.2%	13.7%	34.6%	1.1%	1.9%	2.8%	3.2%	3.4%	32.7%
Cosmote	3.7%	10.0%	7.4%	8.6%	10.1%	18.7%	3.1%	3.9%	4.4%	5.1%	5.7%	16.5%
DT	4.2%	7.7%	9.7%	10.5%	10.4%	6.8%	5.1%	5.3%	5.5%	5.7%	6.0%	13.2%
FT	9.9%	7.6%	7.6%	6.8%	6.8%	-5.0%	5.2%	5.2%	5.2%	5.2%	5.2%	3.7%
Iliad	-0.1%	1.1%	1.3%	1.3%	2.5%	71.4%	0.4%	0.8%	1.8%	2.2%	2.5%	56.4%
Jazztel	-26.5%	-10.4%	-7.7%	-5.1%	-3.9%	-24.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Fastweb	-5.7%	1.7%	5.7%	7.4%	5.0%	-180.2%	4.5%	4.5%	4.8%	5.0%	5.3%	-10.4%
KPN	8.6%	8.5%	8.9%	9.3%	9.7%	3.2%	4.0%	4.4%	4.8%	5.3%	5.7%	10.2%
Mobistar	6.4%	7.3%	7.1%	6.8%	6.6%	-0.7%	4.1%	4.4%	4.6%	4.3%	4.2%	2.8%
Neuf Cegetel	3.4%	4.6%	4.6%	5.2%	6.8%	-298.5%	1.4%	1.4%	2.1%	2.9%	4.1%	0.0%
OTE	5.5%	4.9%	6.1%	8.1%	9.7%	4.1%	2.0%	2.2%	2.4%	2.6%	2.9%	0.0%
PT	0.0%	7.1%	7.3%	6.7%	6.6%	5.7%	0.0%	5.6%	6.8%	6.8%	6.8%	3.9%
QSC	-0.8%	-5.6%	5.1%	7.2%	8.5%	-354.7%	0.0%	0.0%	2.1%	2.6%	3.2%	0.0%
Swisscom	8.3%	6.8%	8.0%	8.6%	8.8%	-2.0%	3.9%	4.1%	4.1%	4.2%	4.2%	2.5%
TI Group	5.4%	6.5%	6.8%	9.4%	9.0%	-6.3%	8.8%	6.3%	7.2%	6.8%	7.0%	-5.0%
Telefonica	7.9%	9.0%	9.5%	11.3%	11.8%	18.9%	3.5%	4.2%	5.1%	5.9%	6.5%	-4.6%
T.Austria	4.7%	7.3%	8.0%	8.1%	8.2%	-3.3%	3.7%	3.7%	4.1%	5.0%	5.8%	17.1%
Telenet	4.4%	3.1%	5.6%	7.1%	8.8%	45.7%	0.0%	0.0%	0.0%	0.0%	0.0%	16.8%
Telenor	2.1%	3.7%	5.9%	7.6%	7.9%	14.6%	2.1%	2.6%	3.3%	3.5%	7.2%	0.0%
TeliaSonera	7.6%	5.1%	5.1%	5.4%	6.2%	-1.4%	3.7%	3.4%	3.6%	7.6%	7.8%	33.1%
UTDI	1.1%	3.5%	4.7%	6.2%	7.5%	23.0%	0.8%	1.0%	1.3%	1.7%	2.0%	25.0%
VOD (cons)	7.7%	7.0%	7.7%	8.3%	8.5%	-0.4%	4.2%	4.3%	4.5%	4.6%	4.8%	3.4%
Sector	7.3%	7.0%	7.8%	8.6%	8.9%	-0.3%	4.2%	4.3%	4.7%	5.1%	5.4%	5.0%

Source: JP Morgan estimates, Company data, Bloomberg. Based on prices at COB 4th of June 2007.

Table 18: Telecom Valuation Summary

$ in millions and as indicated

Company	Adj. Equity Value	Adj. Enterprise Value	EV / 07E EBITDA	Price / 07E EPS	Dividend Yield	2007E FCF Yield
RBOCs						
Q	$19,081	$32,839	6.8x	15.1x	0.0%	10.1%
T	$249,307	$309,529	7.0x	14.9x	3.5%	5.5%
VZ	$120,765	$195,363	6.3x	17.8x	3.9%	4.2%
Average			6.7x	15.9x	2.5%	6.6%
Other telcos						
LVLT	$9,507	$14,169	15.9x	NMF	0.0%	NMF
CBEY	$957	$913	18.2x	83.0x	0.0%	NMF
Average			17.1x	83.0x	0.0x	NMF
RLECs						
ALSK	$697	$1,097	8.7x	21.7x	5.4%	8.9%
CTL	$5,731	$8,296	7.0x	17.0x	0.5%	9.4%
CBB	$1,399	$3,393	7.3x	16.5x	0.7%	4.6%
CZN	$4,990	$8,449	7.0x	22.1x	6.5%	10.3%
CNSL	$532	$1,099	8.2x	30.7x	7.7%	9.5%
EQ	$9,792	$15,841	6.0x	13.8x	3.9%	8.6%
FRP	$623	$1,235	10.6x	36.9x	8.9%	9.7%
IWA	$699	$1,194	9.3x	23.5x	7.5%	10.5%
WIN	$6,983	$12,108	7.5x	15.5x	6.8%	9.0%
Average			7.9x	22.0x	5.3%	9.0%

Source: Company reports and JPMorgan estimates. Note: CTL and CBB excluded from RLEC average for dividend yield.

Note: Q and CBB do not pay a common dividend at present. NMF= Not Meaningful

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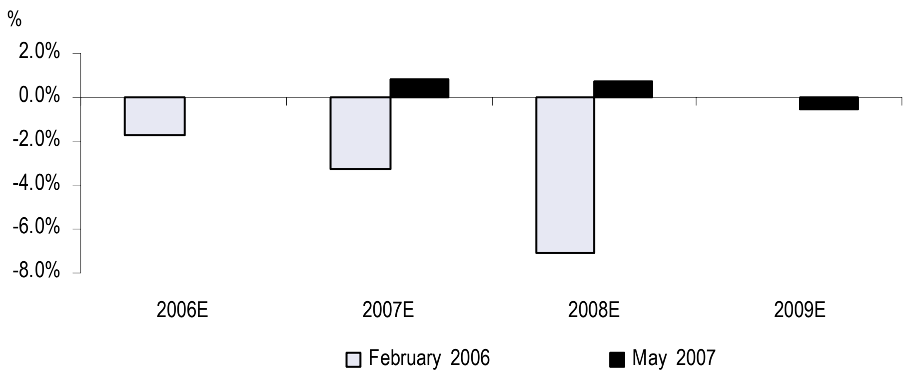
Sector outlook

The earnings downgrade cycle in the Telecoms sector has been severe, but with Q107 reporting season ending with few major surprises and consensus in line with our numbers we now believe that at least for the short term earnings momentum will not be the driving factor. Whilst the Telecoms sector trades in line with the market there are only three other sectors that are cheaper and so we do not believe that there is a compelling reason for the sector to give up recent gains. However, we do not see the sector as being cheap in its own right, with it now trading at its lowest FCF yield in three years. Therefore we think the sector will find it difficult to outperform without other catalysts such as increased cash returns (for which there is capacity) and/or M&A crystallizing. On the latter we believe that there are few candidates for Private Equity buyers, and with share prices going up we believe that the breakup story becomes more unlikely. We believe that consolidation is possible but more likely is operators easing back in competitive intensity by for example network sharing. Hence we would pick stocks over the sector.

Over the last 15 months we have seen consensus numbers fall gradually, so that having started last year with numbers that were significantly below consensus our forecasts for the European Telecoms sector are now more or less in line with consensus.

Figure 7: JPM EBITDA forecasts vs consensus as at February 2006 and May 2007



Source: JPMorgan estimates, IBES

So with Q107 reporting passing almost without major incident and considering that we don’t anticipate worse numbers than consensus as the year progresses, the question is now whether European Telecoms can outperform the market at large.

Having underperformed the market at large by 5% between the beginning of the year and the middle of May, the Telecoms sector has reclaimed much of the ground over the last few weeks.

Looking at the Telecoms sector compared to the rest of the market over the last 5 years we find that the Telecoms sector only traded at a significant discount to market multiples (ie 12 month forward P/E) during 2006, see Figure 8. In the other years the Telecoms sector has at least traded in line with the market, as it is doing now.

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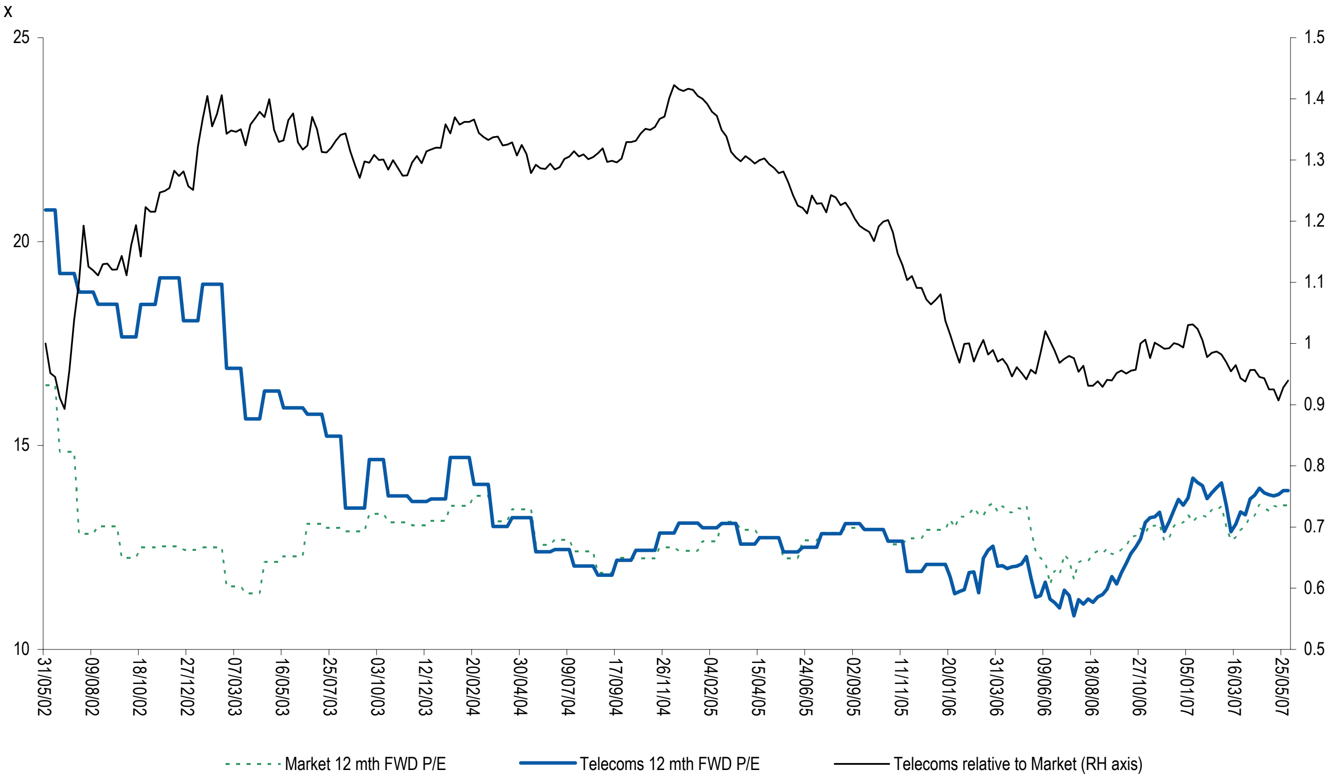
Figure 8: Telecoms against market, and 12 forward P/E for Telecoms and market



Source: Datastream

There are other sectors that are cheaper than the market and hence the Telecoms sector, but there are only three of them: Energy, Financials and Materials, see Table 19.

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Table 19: Trading multiples against other sectors

x, %

	P/E pre-Goodwill			Dividend Yield			EV/EBITDA			Price to Book		
	2006E	2007E	2008E	2006E	2007E	2008E	2006E	2007E	2008E	2006E	2007E	2008E
Europe	15.2	14.0	12.9	2.8%	3.1%	3.3%	8.4	7.5	6.9	2.4	2.4	2.0
Energy	11.0	11.4	11.2	3.4%	3.6%	3.7%	5.0	4.3	4.3	2.5	2.4	2.0
Materials	14.9	13.0	12.6	2.1%	2.1%	2.3%	7.6	6.3	6.0	2.5	2.5	2.0
Chemicals	19.0	16.2	15.2	2.2%	2.3%	2.5%	9.2	8.1	7.5	2.6	2.7	2.2
Construction Materials	16.1	15.1	13.8	1.7%	2.1%	2.3%	8.6	7.8	7.1	2.2	2.3	1.8
Metals & Mining	12.3	10.8	11.0	1.9%	1.9%	1.9%	6.4	5.1	5.0	2.8	2.6	2.0
Industrials	20.2	17.4	15.0	2.0%	2.2%	2.4%	10.2	9.2	8.1	3.2	3.1	2.5
Capital Goods	20.7	17.5	15.1	1.9%	2.2%	2.4%	11.3	10.1	8.7	3.2	3.2	2.5
Transport	17.6	16.0	14.0	2.2%	2.3%	2.5%	7.3	6.9	6.3	2.7	2.7	2.2
Consumer Discretionary	20.0	17.3	14.9	2.3%	2.5%	2.8%	10.8	7.8	6.9	2.8	2.7	2.2
Automobile	18.1	14.6	12.1	1.8%	2.1%	2.4%	8.0	4.3	3.9	1.9	1.8	1.5
Consumer Durables	20.2	17.2	15.4	1.9%	2.1%	2.3%	12.3	10.7	9.5	2.7	2.5	2.1
Media	18.8	17.6	15.4	2.9%	3.0%	3.2%	10.6	9.3	8.4	3.4	3.4	2.9
Retailing	21.8	18.9	16.5	2.5%	2.9%	3.2%	11.1	9.8	8.4	3.8	3.7	3.1
Hotels,Restaurants&Leisure	25.9	22.0	18.7	2.4%	2.5%	2.8%	12.7	10.1	9.0	4.1	3.9	3.3
Consumer Staples	20.3	18.6	16.8	2.1%	2.3%	2.5%	10.5	10.1	9.2	3.7	3.6	3.0
Food & Drug Retailing	21.1	19.5	17.4	1.9%	2.2%	2.4%	9.4	8.8	8.1	2.9	2.9	2.4
Food Beverage & Tobacco	19.5	17.9	16.2	2.2%	2.5%	2.8%	10.1	10.2	9.3	4.0	3.7	3.2
Household Products	25.8	23.0	20.4	1.4%	1.5%	1.7%	18.7	14.2	12.7	4.9	4.5	3.7
Healthcare	17.9	16.4	14.9	2.3%	2.4%	2.6%	10.3	9.7	8.6	3.8	3.5	2.9
Financials	12.3	11.5	10.6	3.3%	3.8%	4.1%	-	-	-	1.7	1.8	1.5
Banks	12.4	11.5	10.4	3.6%	4.1%	4.5%	-	-	-	1.8	1.9	1.6
Diversified Financials	12.0	11.7	10.8	3.2%	3.4%	3.8%	-	-	-	2.1	2.1	1.8
Europe Insurance	10.9	10.3	10.1	2.9%	3.3%	3.6%	-	-	-	1.4	1.7	1.4
Europe Real Estate	23.6	22.6	20.2	2.4%	2.6%	2.7%	-	-	-	1.2	1.1	1.0
Information Technology	21.2	18.1	15.5	1.7%	1.7%	1.9%	10.4	9.9	8.3	3.1	3.3	2.6
Software and Services	23.1	20.4	17.2	1.4%	1.5%	1.7%	12.1	11.8	9.9	4.0	3.8	2.9
Technology Hardware	19.1	16.8	14.6	1.9%	2.1%	2.4%	10.4	10.0	8.4	3.1	3.6	2.7
Semicon & Semicon Equip	33.3	21.9	17.2	0.1%	0.5%	0.7%	8.3	7.3	6.1	2.3	2.2	2.0
Telecoms	14.8	14.4	13.1	4.5%	4.6%	4.9%	6.8	6.4	6.1	2.0	2.1	1.9
Utilities	17.8	16.3	15.0	3.6%	3.6%	3.9%	9.3	8.5	8.0	2.6	2.7	2.3

Source: Datastream

Note: Telecoms trading multiples above based on IBES consensus and does not include altnets which JPMorgan forecasts do in Table 16 & Table 17

It is clear that the energy sector is very cheap, and JPMorgan strategists believe that this sector is ripe for a rally, see their note of 23 May 2007, *European Focus Deja vu: Energy vs Telecoms*.

However the recent move in the Telecoms sector has not come at the expense of Energy, see Figure 9, whereas in the past we have seen rotation from Energy into Telecom. Therefore investors seeking a sector that is cheap and with defensive characteristics might still be tempted by the telecoms sector.

Figure 9: Telecoms vs energy (from 3 June 2005 to 4 June 2007)

Indexed to 1

Source: datastream

However, before looking to go overweight in the sector we would add a word of caution, which is that the free cashflow yields which have traditionally supported the sector are unfortunately no longer compelling.

Despite its underperformance relative to the market, the Telecoms sector is trading a its lowest normalised FCF yield at 8% now (note 8.4% on Figure 10 relates to 22 May) compared to any other point over the last three and a half years.

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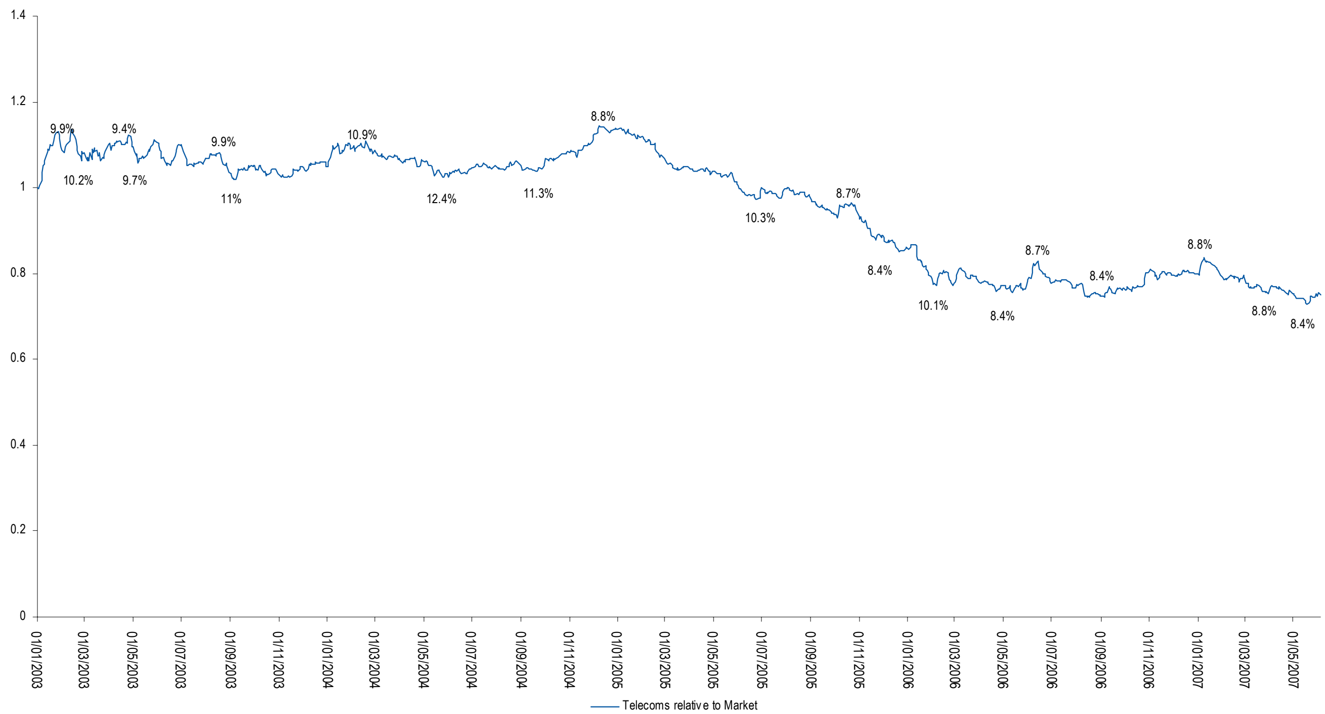
Figure 10: Telecoms sector vs market - populated with normalised FCF yield one year out
indexed to 1



Source: datastream, JP Morgan estimates

Catalysts

Without the benefit of compelling valuations, we believe that for the sector to outperform as a whole in the absence of the general meltdown in markets there need to be some catalysts.

The two that we can identify are cash returns and M&A activity.

Cash returns

Some of the companies have chosen to increase their cash return but a lot more have chosen to leave their cash distribution policy unchanged.

Table 20: Changes in cash distribution policy

	New policy	Change
Belgacom	Payout ratio of 50% to 60%	Unchanged
Bouygues	To keep a consistent payout ratio	Unchanged
BT	£2.5bn share buyback over 2 years, FY08E 15.4p	Increase
Cosmote	To keep a consistent payout ratio	Unchanged
DT	Announced DPS of € 0.75	Unchanged
France Telecom	Announced DPS of € 1.20	Unchanged
KPN	Committed to distributing €2bn in dividends and share buybacks	Unchanged
Mobistar	Payout ratio of between 50% and 57%	Unchanged
OTE	To pay a dividend	Unchanged
PT	Total Shareholder remuneration over 2006-2009 of €6.2bn. Annual dividend of €57.8c per share 2008-2009.	Unchanged
Swisscom	Now distributes a minimum of 50% of operating free cash flow (adjusted for minorities & WC)	Increase
Telekom Austria	Has increased leverage target to 2x net debt allowing for more cash returns	Increase
Telecom Italia	80% to 85% payout ratio	Reduction
Telefonica	Buyback program of €1.5bn in 2007. DPS €0.72	Unchanged
Telenor	Payout ratio of 35% to 50%	Unchanged
TeliaSonera	Payout ratio of 35% to 50% & special dividend of Sek10bn where affordable	Increase
Vodafone	60% payout ratio on a pre license EPS rather than reported EPS	Slight increase

Source: JPMorgan estimates, Company data.

As a result there is scope for companies to increase their cash returns or spend the cash on increased capex or acquisitions. If the companies in the sector choose to increase their leverage to 2.5x EBITDA then they could distribute an additional 14% of their market cap in 2007.

Table 21: Potential returns if the sector leverages up

€, %

	2007E	2008E	2009E	2010E
EFCF pre DIV	50,952	48,990	57,131	56,458
Other Net Investment	(8,293)	1,684	2,047	1,667
Div	(27,260)	(25,049)	(26,807)	(29,194)
Buyback	(7,082)	(3,402)	(1,648)	(1,491)
EFCF excess	8,317	22,223	30,723	27,441
Total rets	(34,342)	(28,451)	(28,455)	(30,685)
% Market cap	5.9%	4.9%	4.9%	5.3%
Net Debt	245,099	228,048	203,543	182,661
EBITDA	130,016	133,483	135,255	136,921
Leverage x	1.9	1.7	1.5	1.3
New leverage ratio x	2.5	2.5	2.5	2.5
Excess cashflow as a results	79,941	105,660	134,595	159,640
Yield Market cap	14%	18%	23%	28%

Source: JPMorgan estimates

M&A activity

There are three areas of M&A activity that we briefly look into:

- LBO candidates: our overriding conclusion being that returns would no longer be sufficient for Private Equity with the exception of Bouygues and KPN
- Breakup candidates: Ironically as share prices increase managements are under less pressure to break up their companies to unlock value
- Intra country consolidation or collaboration: this tends to happen when margins fall to low levels for all operators (ie 25% or below), at present we can only identify the UK fitting this requirement.

LBO

TeliaSonera (2 May 2007 TeliaSonera: LBO no longer works)
A leveraged buyout model does not work at current prices in our opinion. In our scenario a bid price of Sek 57 per share would give an IRR of only 5% and this is based on an exit multiple of 7x. We believe that the special dividend paid recently has made any LBO transaction improbable.

A break up of the company is unlikely, in our view, as are disposals of the emerging market associates given the various disputes over control. We believe that a potential merger with Telenor is unworkable not just because of the overlap but also because of cultural differences.

In our opinion the placing by the Swedish government of 8% in TeliaSonera recently is likely to reduce any bid speculation.

Telefonica (31 May 2007 Telefonica: Q1 post, positive catalysts ahead, buy on weakness
We do not foresee an LBO approach because of political obstacles, but our scenario model suggests a €20 offer and 6.5x EBITDA exit multiple would yield 23.5% IRR.

KPN (19 February 2007, KPN: German re-focusing bolsters value)
There is a widely held assumption that KPN, unhampered by political constraints, will be the next candidate for private equity (e.g. Bloomberg). But a deal could face sizeable challenges. Arriving at the conclusion that a transaction can be constructed which creates sufficient value for private equity investors and lenders, whilst also delivering material upside for current KPN shareholders, is not as trivial as we believe is sometimes assumed. Working with our Credit research colleagues, we have assessed current debt market conditions and the lessons of TDC to understand the constraints that would be applied to any KPN LBO. We have then developed an LBO model to check whether the numbers really work. Our analysis suggests that a take-out at €13.5-14.0/share is feasible.

Bouygues (14 March Bouygues: Telco market share gains support new €66 TP; 'blue sky' €75
We do not believe that an LBO is possible for the whole of Bouygues group given the ownership structure. However we believe that it is possible for Bouygues Telecom to be sold at a higher premium than implied by the current share price. We believe that Telecom can be divested for 8.0x FY07E EV/EBITDA. We believe this is not an extremely optimistic multiple in the context of the February-07 acquisition of TIM Hellas - a third player in Greece with substantially less operating momentum than Bouygues Tel enjoys in France - for 7.5x 2007E EV/EBITDA. Further support for this multiple comes from Vodafone’s recent divestments, like its 25% stake in Belgacom Mobile and Swisscom Mobile for 9.1x/7.5x Dec-06 EV/EBITDA respectively. Unlike Bouygues' 89.5% stake in Bouygues Telecom, the Vodafone stakes did not confer control and both assets are arguably ex-growth, in contrast to Bouygues Telecom. Using an 8x multiple for Bouygues Telecom and making other similar assumptions for the other assets our blue sky scenario value is €75.

BT (see our note of 30 May 2007 BT Group: Not an obvious equity target)
For a number of reasons we think BT Group is an unlikely target for private equity at current share price levels. On our below-consensus EBITDA forecasts (08E £5.6bn JPMe vs £5.7 cons, 09E £5.6bn JPMe vs £5.9bn cons owing to our more cautious LLU assumptions), there is simply not enough cash flow to cover the costs and achieve a satisfactory return.

Even based on the market's more optimistic EBITDA outlook, we see two main risks for a private equity acquirer: BT's pension obligations and the punchy exit multiple that would need to be assumed.

To achieve a target IRR of >13% at 360p on consensus forecasts would presuppose an exit multiple of 7x EBITDA as well as efficiency gains. At 6.5x exit EBITDA, we estimate the IRR would only amount to 8%.

Even assuming a 7x exit multiple, any material pension pre-funding would materially deteriorate the economics of a private equity bidder. For every £1bn extra pension funding, the projected IRR would shrink by 2%. Even without pre-funding we think BT's pension liabilities represent a sizeable risk for any acquirer.

Breakup scenario

DT (see note of 24 May 2007, Deutsche Telekom: Alltel valuation read-across)

A few weeks ago private equity submitted a bid to acquire Alltel, a US mobile operator. In our note of 24 May we explore two options how DT could potentially achieve valuation read-across: (i) a potential T-Mobile US IPO and (ii) a potential disposal of T-Mobile UK.

We believe that DT trades below its break-up value. This, however, in our view has been true for many years. Meanwhile negative operating performance has dominated share price performance. With politicians and Blackstone exerting pressure on management to achieve a better share price performance more radical options might be considered (as reported by Der Spiegel on 7 April). However, for political reasons we don't think a full break-up is likely for another 2-3 years.

(i) DT could consider to IPO T-Mobile US. This may allow DT to capture some of the upside implied by the Alltel bid, which achieved 8.5x EV/08 JPMe EBITDA. We currently value T-Mobile US at 7.0x.

Subtracting our $US43bn US mobile DCF value from DT's EV implicitly values the remainder at 4.5x. This seems low, except if one accepts our DCF for domestic wireline (T-Com, T-Systems ex IT, GHS) at 3.0x. Applying instead the €8.5x achieved in the Alltel deal would suggest c. €7bn potential upside (€1.6/share).

This analysis may understate the upside in the event of a sale of T-Mobile US because T-Mobile US is higher growth. However, we believe a sale of T-Mobile US would be tantamount to a break-up of DT, and are doubtful that similar valuation upside could be demonstrated in an IPO.

There are three steps to this argument. Again, T-Mobile should trade at a higher multiple than Alltel in our view. However, IPOs usually trade at a minority discount, while Alltel was bought based on an LBO premium, seemingly justified by higher leverage and cash flow control. Very simplistically, if step 1 were to add c.1x EBITDA, step 2 and 3 may take off >2x EBITDA, hence an IPO-ed T-Mobile may well trade below the Alltel LBO multiple, more in line with the value that is already implicit in our sum-of-parts.

(ii) As we wrote in our 13 February note, DT may consider a sale of its UK mobile operations to another operator. Depending on the terms of any deal DT should benefit in any operational and revenue synergies achieved by an acquiring operator, which we quantify very roughly at around €4bn. Also, such a deal may boost sector valuations in general. The minor flipside would be that such a deal would be moderately dilutive (-€0.2bn), on our numbers, until UK taxation kicks in (we estimate in 2010).

Vodafone
VOD continues to price in expectations of bid interest from AT&T, a topic discussed at VOD's recent investor meeting. We think a bid is not on AT&T's current agenda for several reasons:

VOD doesn't fit their stated M&A criteria: Incoming CEO, Randall Stephenson, has publicly said M&A strategy will focus on small international targets that improve the reach/scale of the Enterprise business. Based on conversations with AT&T's IR our AT&T analyst, Jonathan Chaplin thinks that more suitable targets may include operators that lower access costs for Enterprise and accelerate top line growth.

AT&T faces numerous other challenges, notably BellSouth integration and positioning AT&T Wireless to capitalise on strong data appetite in US mobile. Next month sees AT&T Wireless selling the iPhone, and management has set high expectations.

Valuation: In the past we have highlighted how a VOD break-up valuation of c.180p/share could be justified. This was interesting 'blue sky' thinking when VOD was at 140p. At 160p, we believe the upside potential doesn't justify execution risks on break-up to the same extent. And remember that break-up valuations have traditionally assumed European deals that result in intra-market consolidation.

VZW: AT&T would need to sell the 45% VZW stake to VZ. Where we have historically speculated on VZW exit multiples of 8-9x, it not obvious why VZ would pay more than 7x in this scenario. And VOD has confirmed that AT&T would not have any preferential mechanism to avoid or reduce capital gains tax in order to sweeten the economics around the disposal.

Consolidation
Over the last five years there has been continuous speculation about intra-country consolidation, however, returns have been attractive enough such that operators have continued with their operations.

In the Nordic region where there has been the most pressure we have seen consolidation of sorts with MVNOs being acquired by the network based operators and consolidation to a smaller extent, with Orange Denmark being acquired by TeliaSonera. Using Denmark as the basis to determine which other markets could see consolidation, we identify the UK as the most likely candidate where margins are below 26% for all of the operators.

Assuming capex to sales of 9%, tax of 30% and asset turn of 1x this give a ROCE of 12% in the best case scenario falling to 8% where margins are lower. A ROCE of 8% is clearly unsustainable, and this would lay the groundwork for consolidation or for all operators to reduce their competitive intensity as we have seen in Finland. Given the operators' stated reluctance to exit the UK we expect a reduction in competitive intensity in the form of network sharing.

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Stocks we like

To summarise, we do not believe that there is much short term pressure on numbers as consensus is already low. And whilst the Telecoms sector is trading in line with the market there are only three other sectors that are cheaper.

However, Telecoms on its own is trading at multiples that are the highest they've been in the last three years, that's with no discernible change to fundamentals unlike the US.

There are some positive catalysts that may crystallize such as increased cash returns and M&A which could help drive the sector, but we see no compelling reason why this should arise in the short term, thus we believe its better to choose quality stocks rather than buy the sector as a whole.

We would hold stocks that fit in three different categories:

- Earnings upgrade potential: Telefonica, OTE, CosmOTE, Iliad, Carphone Warehouse
- Stocks that look most likely to benefit from M&A: Bouygues & KPN
- Stocks that look cheap (due to earnings downgrade momentum not coming to an end) but could rebound when numbers are no longer being cut: Deutsche Telekom and Swisscom.

Bouygues

Q1 wrap

Overweight

€64.50

6 June 2007
Price Target: €84

Telecom Services

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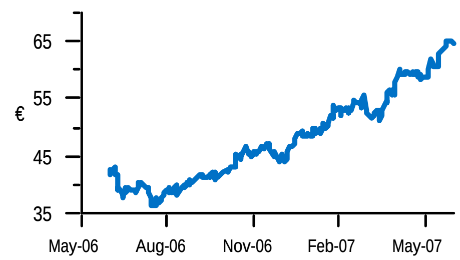
Price Performance



	YTD	-3M	-6M	-12M
Absolute	32.9%	10.2%	22.7%	51.5%

Source: RIMES, Reuters.

- New Dec-07 SOP-based TP of €84 (30% potential upside). 3 months ago we set a €66 TP and presented a 'blue sky' scenario that delivered a valuation of €75. We now believe that €84 is justified, based on increased Telco forecasts, a richer Telco multiple and PPP opportunities (see our note published 7 June).
- Strong Telco margin uplift in Q1 supports our thesis of hidden value. Wednesday's results revealed a Telco EBITDA margin +3.3pp y/y to 34.0% (JPMe: +1-1.5pp). This follows a previously reported acceleration in service rev growth to +6.4% y/y (vs -1% for Orange/SFR). We believe Bouygues Tel is well positioned to grow its revenue share to 25% from the current 20%. It can price aggressively with Orange/SFR unlikely to react aggressively as they have less scope to trade ARPU for market share gains.
- Structural trends are favouring the smaller mobile operators. German No. 3, E-Plus, has also shown how market-leading revenue growth can be combined with margin gains. Differentiation on tariffs is reducing reliance on subsidies for Europe's aggressive smaller mobile players, in our view.
- Telco margin forecasts raised substantially in our note of 7 June ('The route to €84'). We are now more confident that rev market share gains can be twinned with material margin improvement. We raise 07E EBITDA to €1,326m (from €1,250m), raising margins +110bp (from -60bp). With no non-Telco changes, Group EPS rises 4-7% in 07E-09E.
- Bouygues Tel now valued at 8.7x 07E EV/EBITDA (from 7.0x). Strategic value is becoming increasingly clear with KPN/Weather both citing Bouygues Tel as a potential target in recent press conferences. And +8% EBITDA CAGR 06-09E contrasts favourably with declining EBITDA for most larger players

Carphone Warehouse

Q1 wrap

- **Q1 results:** Carphone reported strong FY results, comfortably ahead of JPMe and consensus (10% ahead of both at EBITDA). We anticipate material increases to consensus EPS forecasts, underlining the cheap valuation of the stock.
- **Positive implications:** (1) Distribution margins have held up in a period when Vod UK (which partially withdrew from Carphone on 1st Dec) has been marketing very aggressively. This supports our view on just how aggressively the UK operators are prepared to spend to poach each others' subs. (2). Strong Telecom margin should cause consensus, which cut broadband profit forecasts in April, to reassess. In April, Carphone guided to higher customer service costs but many observers overlooked that wholesale costs should be tracking lower due to a higher rate of unbundling.
- **Outlook:** No changes to the FY08 expectations published in April. Carphone still expects 15% contract connection growth (UK plus non-UK), compared to JPMe 6.6%. On broadband, Carphone says it expects the 'improving trend in execution to continue' and that, with unbundling now a much smoother process, the runrate of profitability by the end of FY07 should give very good visibility of future earnings growth and cash generation. Group capex is expected to decline over the medium term.
- **Valuation well supported.** Carphone trades on 13.3x headline PE FY08E, a 15% discount to European Telcos, despite much more attractive growth: FY08-11E EPS CAGR of 14.4% vs 7.0%. Now that FY07 EPS estimates become actuals, investor attention is likely to shift to FY08E/09E. In our view this should stimulate more widespread recognition that this is a potentially very cheap stock.

Overweight

315p

6 June 2007
Price Target: 380p

Wireless Services

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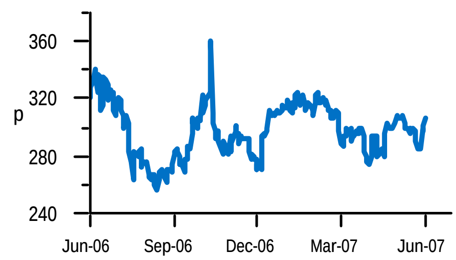
Price Performance



	YTD	-3M	-6M	-12M
Absolute	-2.5%	-0.5%	5.8%	-4.5%

Source: RIMES, Reuters.

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CosmOTE

Q1 wrap

- **Q1 results - financials weak as expected:** Results came in below consensus and compare unfavourably vs. FY guidance. Q1 EBITDA of €215m represents only 21.3% of 2007 guidance and 20% of our FY forecast. However one should note that Q1 is a seasonally weak quarter and in 2006 Q1 only accounted for 21.8% of FY EBITDA.
- **But Q2 should prove supportive:** Q2 results should be supported by a further narrowing of the €10m EBITDA loss reported in Romania in Q1 (we believe EBITDA may be achieved in Q2), and growth across the group should be bolstered by the strong subscriber momentum visible within the Q1 KPIs.
- **Domestic revenue growth set to rebound:** Q1 revenue growth of 3.8% (Q4 8.9%, Q3 6.4%) was impacted by the compounded effect of a succession of MTR cuts the most recent being the €1c introduced in Jan 07. As this works through the numbers, revenue growth should rebound reflecting the strong subs growth being achieved (210k Q1 vs. 106k Q1 06). We note management also outlined that the FY domestic EBITDA margin would be c.43% (Q1 40.5%) therefore implying a substantial pick-up through the year.
- **Bold FY guidance reiterated:** Targets of >30% / >15% revenue and EBITDA growth were reiterated offering continued support for our belief that the acquisition of Germanos will drive a permanent uplift in Cosmote's operational momentum.
- **Valuation supportive:** Our Dec-07 SoTP-based TP of €27 (see our note of 23 February: *Q4 results to prompt next round of upgrades*). Cosmote trades in-line with the sector: 07E PE 15.3x (sector 15.6x) despite stronger earnings growth (06-09E CAGR 24%, sector 3%).

Overweight

€23.2

6 June 2007
Price Target: €27.00

Wireless Services

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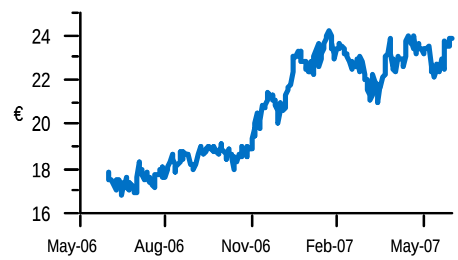
Price Performance



	YTD	-3M	-6M	-12M
Absolute	6.3%	2.9%	8.2%	33.7%

Source: RIMES, Reuters.

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JPMorgan

Deutsche Telekom

Q1 wrap

- **DT's Q1 was a mixed bag.** We downgraded 2007E EBITDA by -1.4%, EPS by -12% (higher depreciation), but maintain that DT can make its 2007 EBITDA guidance. However, we upgrade our 2008E EBITDA forecast to €19.9bn (+1.2%), reflecting a number of positive Q1 07 underlying trends (German mobile, US ARPU). Our forecast changes are detailed in our note of 15 May - *Some hopeful signs – on the watch list*. .
- **Full-year target still seems on track.** While Q1 'underlying' EBITDA at €4.6bn is only 24% of the 2007 target, DT's typical seasonality pattern makes Q1 results compatible with management's full-year target, in our view.
- **The main worry** is around how much of the improving mobile revenue momentum can be translated into EBITDA, following weakness in both German and UK mobile margins. Also, DT's €5 June DSL price cuts are being matched by competition, which could dilute revenues further
- **Wait until Q2.** With continued uncertainty on results and the impact of industrial action we believe it is worth waiting for Q2 to confirm several nascent positive fundamental trends.
- Our €13.0 year-end price target is based on DCF. Due to depreciation exceeding capex and tax credits, DT looks expensive on headline P/E and cheap on headline free cash flow yield. We acknowledge valuation upside potential in the case of a break-up scenario (T-Mobile US, T-Mobile UK disposals), but believe such action is not imminent, and that a T-Mobile US IPO would not deliver Alltel-style multiples.

Neutral

€13.82

6 June 2007
Price Target: €13.00

Telecom Services

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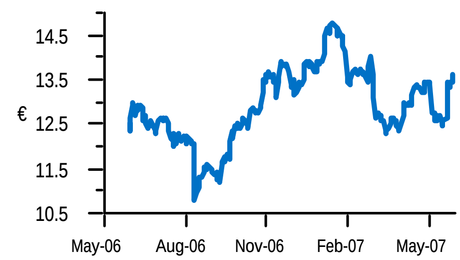

	YTD	-3M	-6M	-12M
Absolute	-2.1%	1.1%	0.3%	8.8%

Source: RIMES, Reuters.

Iliad

Q1 Wrap

Overweight

€75.00

6 June 2007
Price Target: €87.00

Wireline Services/Incumbents

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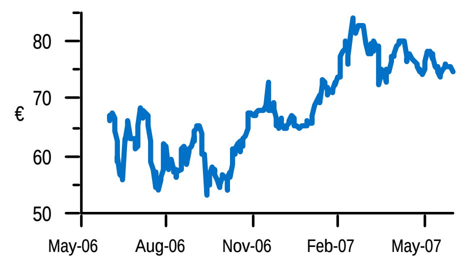
Price Performance



	YTD	-3M	-6M	-12M
Absolute	13.8%	-0.3%	-5.58%	13.2%

Source: RIMES, Reuters.

- **Strong results in Q107** with Iliad looking as though it is likely to beat its subscriber guidance for the full year. Net adds were 220k, higher than our 200k estimate, and the highest number of net adds the company has ever done and also equating to 25% market share for Q1. Iliad's total number of ADSL subscribers amounts to 2,498k and Iliad is guiding to reach 2.8m subscribers by the end of 2007; this and our forecast already look to be low.
- Iliad stated that SAC remained below €50 per sub. Iliad is making a concerted effort to gain market share in 2007 as there is a lot of churn in the market. With Iliad confirming that it still makes a €20 gross margin on its unbundled customers, we expect margins to remain strong and not adversely affected by the strong net adds.
- **Market share a key driver of valuation**: We had assumed that Iliad would have 18.5% market share in the terminal year, but the market is consolidating such that 87% of the DSL market is controlled by 3 players and we now estimate that Iliad will maintain its current market share of 20% till the terminal year.
- For every 1pp increase in terminal year market share expectations our valuation increases by 6%.
- **Fibre:** We build in projections for the rollout of fibre. We assume that Iliad will be able to cover 6m households by the terminal year, and whilst we don't expect any savings until 2008 we estimate the project to be NPV positive.
- **A new last mile:** With Noos Numericable upgrading its network there is a possibility that it chooses to unbundle its network. This would help Iliad defer capex investment in its fibre rollout and/or allow Iliad to get a lower unbundling price than it has with France Telecom. For every euro that is cut from the unbundled price we estimate Iliad's EBITDA improves by 7% (excl move to fibre).
- We keep our end-2007 DCF-based price target at €87 and maintain our Overweight recommendation**.**

KPN

Q1 wrap

- **Q1 07 results**: At the group level results were better than expected with EBITDA reporting 1% ahead of consensus. However within the mix this comprised stronger than anticipated mobile numbers with these somewhat offset by disappointing fixed line trends.
- **Robust growth at E-Plus**: Service revenue growth came in at +8.4% y/y (JPM +6.4%). The better-than-expected figure reflects strong prepay growth on the non E-Plus brands where ARPUs tend to be higher. Prepay adds were 467k (Q4 372k, Q3 252k).
- **E-Plus reported very strong margins:** EBITDA came in at €253m (cons €217m, JPMe €200m), equating to a margin of 36.2% (cons 30.5%, JPMe 29.5%). This reflects the marketing focus on the no-frills brands where SACs (as for Zehnsation) are lower than on legacy tariffs.
- **Dutch mobile:** The increasingly oligopolistic nature of this market drove an attractive combination of strong service revenue growth (+9.1% y/y) and EBITDA margins (39.8%, +540bp y/y) on 102k contract net adds.
- **Reiterate OW:** We believe the results signalled areas of upside beyond our €13 TP. In particular we see room to upgrade both E-Plus and NL mobile margin forecasts. For E-Plus management seem increasingly confident in their ability to maintain margins ahead of 30% over the foreseeable future, and in the case of NL mobile market consolidation seems likely to result in a more benign competitive environment thereby affording margin recovery.

Overweight

€13.0

6 June 2007
Price Target: €13.00

Wireline Services/Incumbents

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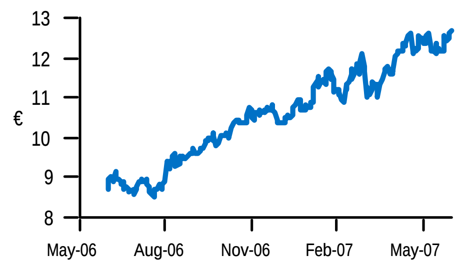

	YTD	-3M	-6M	-12M
Absolute	17.5%	1.2%	8.5%	45.1%

Source: RIMES, Reuters.

OTE

Q1 Wrap

- We maintain our Overweight stance with our SOP-based end 2007 price target of €27. We believe that there are a variety of scenarios that combined could lead us to increase our price target to over €30.
- We increased our EBITDA numbers by 4% and 0.4% for 2007 and 2008 respectively following the Q107 results, driven by lower than expected redundancy costs in the fixed line and improved operating performance at RomTelecom.
- Despite raising our numbers we are still below guidance (of revenue growth 6%/7%, EBITDA growth 8%/9% CAGR 07to09), which suggests that there is room for further upgrades as OTE unveils further cost cutting projects during the year
- Government contribution to redundancy scheme cleared by the EU: This is the main reason why we raised our price target to €27. However, pension scheme reforms, real estate portfolio rationalization and further redundancies could drive further increases.
- Share buyback proposed: this we believe is a positive catalyst and we believe will help to alleviate the fears of a Government placing (which the Government has said is an option for OTE).
- Group trading multiples are affected by CosmOTE, which trades at a premium to the sector due in our view to its superior growth and ability to beat expectations; we calculate that the fixed line trades on a 2008E EV/EBITDA of 4.7x

Overweight

€22.90

6 June 2007
Price Target: €27.00
Wireline Services/Incumbents

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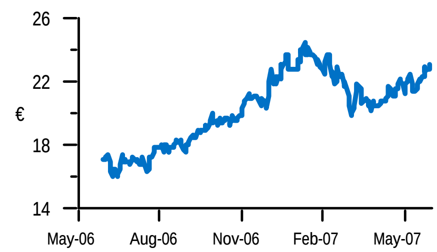
Price Performance



	YTD	-3M	-6M	-12M
Absolute	1.5%	9%	12.7%	5.9%

Source: RIMES, Reuters.

Swisscom

Q1 Wrap

- **Favorable Fastweb tender result:** 82% ownership is almost ideal for SCOM, in our view. Not only will SCOM avoid major equity issuance, but a listed Fastweb will retain an "Italian identity", which should help in forthcoming regulatory debates.
- **Pro-forma financials look attractive:** For '07E, we estimate a P/E of 12x and a free cash flow yield of 8%. We see these metrics at 11.5x and 10% in '08E, which we consider attractive in a sector context especially considering low Swiss government bond yields.
- **Post Q1 forecasts:** Our EBITDA forecasts remain essentially unchanged despite H2 '07 Antenna Hungaria deconsolidation. Capex is up. Please refer to our note of 16 May for details.
- **Unbundling discussion positive:** We believe that unbundling will not be a serious threat before 2009, by which time Swisscom's VDSL network should be largely completed.
- **Better shareholder distribution:** Positively, SCOM now guides for divis at 50% operating free cash flow, compared to 50% net income when deal was announced, and for 2x net debt/EBITDA, which could see all equity free cash flow distributed in the future.
- **Our end 2007 price target based on the DCF of the business is CHF 460:** Stable Swiss business plus Italian opportunity. The main risk is deteriorating business prospects for Fastweb due to changes in regulation. SCOM's outlook for Fastweb at Q2 results could involve forecast changes, such as greater opex or capex spend in early years to expand the business.

Overweight

SF 424

6 June 2007
Price Target: SF 460

Telecom services

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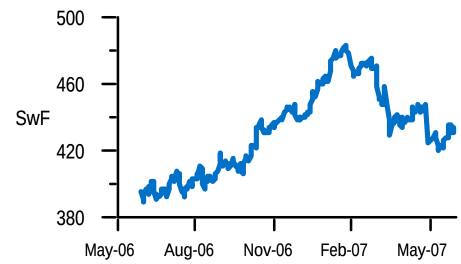
Price Performance



	YTD	-3M	-6M	-12M
Absolute	-5.9%	1.8%	-5.2%	9.6%

Source: RIMES, Reuters.

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Telefonica

Q1 Wrap

- **Buy TEF following underperformance.** Negative catalysts are now priced in, in our view, and we forecast strong results and upgrades to guidance/consensus estimates through the remainder of 2007. This derives a standout valuation versus peers, on our estimates (08E PE 10.8x vs. peers 12.8x) and it is no coincidence that management is increasingly geared into TEF's prospects.
- **Positive catalysts ahead, management is confident.** Strong domestic momentum bodes well for a 3rd guidance upgrade, perhaps at H1. We est. 2.7%/5.6% upside to consensus 2007/08 OIBDA and note that 2009 consensus EPS is 10% below TEF's target. This overlooks a recent investment by the CEO in options that supports upside to guidance and ongoing growth thereafter.
- **LBO model shows value.** We do not foresee an LBO approach because of political obstacles, but our scenario model suggests a €20 offer and 6.5x EBITDA exit multiple would yield 23.5% IRR.
- **Underlying forecasts upgraded in our note of 31 May (*Q1 post: positive catalysts ahead, buy on weakness*).** Upgrades to domestic forecasts offset material reductions to O2 forecasts (we forecast 6.9% O2 Germany revenue growth vs. 14-17% guidance), thus we upgraded pro-forma 2007/08E OIBDA +0.1/0.8%, Net Income +0.4/1.9%.
- •Consolidation effects. Airwave/Endemol/TI transactions drive headline changes; 2007/08E OIBDA -2.5/-1.8%, Net -0.1/+1.8%.16% valuation upside. Pro-forma upside offsets TI at market value. Dec 07 DCF-based target price unchanged at €19.5/share

Overweight

€16.50

6 June 2007
Price Target: €19.50

Telecom services

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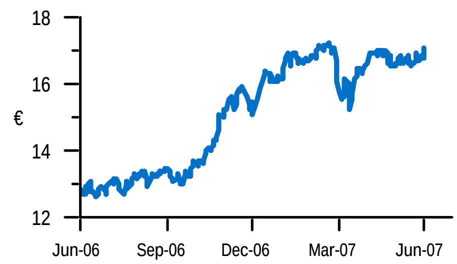
Price Performance



	YTD	-3M	-6M	-12M
Absolute	5.9%	3.4%	6.0%	33.6%

Source: RIMES, Reuters.

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Company valuations

Our €84 TP for Bouygues Group is based on our sum of parts valuation

Table 22: Bouygues Group sum of parts valuation (Eu m)

€ million

	Stake	Equity market value, 100%	Net debt/(cash) Dec 07E, 100%	Enterprise value, 100%	Bouygues share of EV	% of EV
Telecom	89.5%		(42)	11,505	10,297	40%
Media	42.9%	5,610	379	5,989	2,569	10%
Construction	100.0%		(2,258)	2,976	2,976	12%
Colas	95.6%	9,273	(475)	8,799	8,412	33%
Immobilier	100.0%		4	870	870	3%
Parent	100.0%		5,492	383	383	2%
EV of controlled operations					25,507	
Less prop net debt, Dec-07E					3,101	
Add equity value of 25% Alstom stake					4,060	
Invest €5bn in PPP, IRR 10% over 20 yrs					1,555	
Equity value					28,021	21,971
Shares in issue (m)					335	
Value per share (Eu)					84	

Source: JPMorgan estimates

Our end-2007 price target of 380p for Carphone Warehouse is based on our DCF valuation.

Table 23: Carphone Warehouse DCF valuation

£ million

31 March year end	2007 E	2008 E	2009 E	2010 E	2011 E	2012 E	2013 E	2014 E	2015 E
EBITDA	269.0	473.9	548.0	593.9	639.2	669.2	689.0	694.9	702.0
Tax	(27.4)	(63.7)	(79.9)	(97.0)	(129.5)	(141.1)	(150.2)	(156.0)	(161.3)
Change in WC	(51.2)	(30.4)	(9.6)	(9.6)	(6.9)	(4.3)	(2.0)	(1.0)	(0.8)
Capex	(277.4)	(281.7)	(263.0)	(231.8)	(230.1)	(228.4)	(229.2)	(228.9)	(228.6)
FCF	(86.9)	98.1	195.5	255.5	272.8	295.5	307.6	309.1	311.3
Discount Factor	0.0	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5
PV		94.6	175.1	212.7	211.1	212.5	205.6	192.0	179.7
PV Terminal Value	2,750								
PV Present Value	1,483								
EV (£m)	4,233								
Term V. as a % of FV	65%								
Net debt (cash) end FY07E	699								
Equity value (£m)	3,534								
Share-count (m)	939								
Ex-div value/share (p)	376.3								
Final dividend FY07E + interim FY08E	4.2								
Fair Value (p)	380								

Source: JPMorgan estimates

Our end-2007 price target of €27 for Cosmote is based on our sum of parts valuation

Table 24: Cosmote sum of parts valuation

€ million

	Stake	Target EV (DCF based)	Value of COSMOTE stake	Contribution to Group EV	EV/EBITDA 2008E	WACC	g
Greece	100%	6,716	6,716	62%	8.3	7.9%	0.5%
Albania	85%	915	778	7%	8.2	8.6%	1.0%
Bulgaria	100%	1,590	1,590	15%	9.2	8.6%	1.0%
FYROM	100%	163	163	2%	8.8	8.6%	1.0%
Romania	70%	1,035	724	7%	29.8	8.6%	1.0%
Germanos	90%	967	870	8%	11.8	7.8%	1.0%
Total EV			10,842			8.1%	
Net debt (cash)			1,846				
Equity Value			8,995				
Minority discount							
Shares			334				
Target Price			27.0				

Source: JPMorgan estimates

Our end-2007 price target of €13 for Deutsche Telekom is based on our DCF valuation

Table 25: Deutsche Telekom DCF valuation

€ in millions

Main item	Value	Per share	Comment
Value of cash flows	98785	22.7	
Cash flows before 2015	44001	10.1	WACC 7.9%
Terminal value	54784	12.6	Terminal growth rate 0%
Other (net)	0	0.0	
Other assets (net)	3000	0.7	Surplus real estate/towers, Toll Collect
Future license costs Europe	-1000	-0.2	Estimates for Germany, UK
Other license contingency US	-500	-0.1	Requirements beyond AWS auction
PTC	-1500	-0.3	Estimated residual purchase price
Headcount reduction plan (post tax)	0	0.0	Already included in cash flows
Minorities	-5267	-1.2	
Matav (41%)	-2048	-0.5	DCF
HT (49%)	-1539	-0.4	DCF
Slovak Telecoms (49%)	-938	-0.2	DCF
T-Mobile Czech Republic (30%)	-743	-0.2	DCF
Tax credits	5852	1.3	
US	2456	0.6	$US10bn tax loss carried forward
UK (incl. license), NL, Austria	1152	0.3	Not recognised in DCF
German license tax shield	1452	0.3	Not recognised in DCF
German tax shield	792	0.2	€6bn tax losses carried forward
EV before discount	99370	22.8	
Adjusted net debt	-37233	-8.5	Year end 2006
Pension deficit	-6167	-1.4	Last reported number
Minority share of net debt	820	0.2	Company reports and estimates
Equity value	56789	13.0	

Source: JPMorgan estimates.

Our end-2007 price target of €87 for Iliad is based on our DCF valuation

Table 26: Iliad DCF valuation

€ million

€ mn		2008E	2009E	2010E	2011E	2012E	2013E	2014E	2015E	2016E	2017E
Revenues		1,481	1,624	1,688	1,733	1,806	1,881	1,931	1,978	1,974	1,954
growth rates		*16.0%*	*9.7%*	*3.9%*	*2.7%*	*4.2%*	*4.2%*	*2.7%*	*2.5%*	*(0.2%)*	*(1.1%)*
EBITDA		574	669	737	790	851	889	917	968	978	982
EBITDA %		39%	41%	44%	46%	47%	47%	47%	49%	50%	50%
Tax		-128	-159	-182	-198	-220	-234	-243	-261	-268	-286
Capex		-387	-440	-429	-423	-307	-352	-304	-287	-291	-186
Capex/Sales		*26%*	*27%*	*25%*	*24%*	*17%*	*19%*	*16%*	*15%*	*15%*	*10%*
FCF		59	70	126	170	324	304	370	420	420	509
Discount Factor		1.00	2.00	3.00	4.00	5.00	6.00	7.00	8.00	9.00	10.00
PV		54	60	100	125	221	192	216	227	211	237
PV Terminal Value	3,181										
PV Present Value	1,643			WACC	8%						
EV	4,824.2			Cost of equity	9.1%						
Term V. % of FV	66%			Cost of debt	5.2%						
Net debt end 07E	5.2			LT growth	1.0%						
contribution fibre	163										
Altitutde Tel cost	43.2										
Tax assets											
Equity value	4,699.7										
No. of shares (mn)	54										
Fair Value (€)	87										

Source: JPMorgan estimates

Our end-2007 price target of €13 for KPN is based on our DCF sum of parts valuation

Table 27: KPN - DCF sum of parts valuation

€ millions

	Total EV	Stake %	KPN EV	% Total EV	WACC	LTGR	2007E EBITDA margin	Terminal EBITDA margin	Revenue CAGR 2006-09E	EBITDA CAGR 2006-09E
Domestic Fixed Line	16,930	100%	16,930	47.2%	7.1%	0.0%	39.1%	36.4%	-1.5%	-1.3%
Mobile NL	8,609	100%	8,609	24.0%	7.3%	0.0%	36.2%	31.8%	2.7%	0.8%
Mobile Germany	8,182	100%	8,182	22.8%	7.2%	0.0%	29.6%	29.0%	10.2%	7.8%
Mobile Belgium	2,158	100%	2,158	6.0%	7.3%	0.0%	41.3%	36.5%	8.1%	5.3%
Total EV			35,878	100.0%						
Net debt - end 2007E			(9,128)							
Tax asset			(1,451)							
Pension liability			(1,276)							
Equity Value			24,023							
Number of Shares			1,842							
Value per Share (€)			13.0							

Source: JPMorgan estimates.

Our end-2007 price target of €27 for OTE is based on our sum of parts valuation

Table 28: OTE sum of parts valuation

€ million

Unit	Stake	Valuation basis	Value	Implied multiple 2008 EV/EBITDA	
OTE fixed	100%	DCF	4,950	5.3	x
RomTelecom	100%	DCF	1,926	5.6	x
OTE net/directories	100%	EV/ebitda	640	6.5	x
CosmOTE - Greece	100%	DCF	6,716	8.3	x
AMC	85%	DCF	778	8.2	x
Globul	100%	DCF	1,590	9.2	x
Cosmofon	100%	DCF	163	8.8	x
CosmoRom	86%	DCF	892	12.0	x For 2009e
Germanos	90%	DCF	870	11.8	x
Pension		at end of 2005	(358)		
Telecom Serbia	20%	Price for Mobtel & BTC	496		
Enterprise value pre minorities			18,664		
less redundancy liability payable after 2007			(402)		
Timing difference on redundancy payment			232		
Govt contribution (NPV)			300		
less 2007 Net Debt			(2,142)		
Equity value			16,653		
Less minority interests					
Mobile assets	30%	DCF	(2,749)		
RomTelecom	46%	DCF	(886)		
SoP Equity value			13,018		
Per share (€)			27		

Source: JPMorgan estimates

Our end-2007 price target of CHF460 for Swisscom is based on our DCF valuation

Table 29: Swisscom DCF valuation

CHF in millions

Valuation parameter	Value	Comment
Standalone cash flow	8095	6.5% WACC
Standalone terminal value post 2012	20854	- 0.3% terminal CAGR
Value of cash flows (100%)	28948	(EV)
Other assets	381	Belgacom JV, AH, MTA liability, etc.
Excess consideration FWB	-309	7% purchase premium vs. JPM fair value
Net cash	-3,584	Year end 2007
Pension liability	-1597	IFRS
Total	23839	
Number of shares	51800	After 2006 buybacks
Fair value per share	460	

Source: JPMorgan estimates

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Our end-2007 price target of €19.5 for Telefonica is based on our sum of parts valuation

Table 30: Telefonica Sum of parts valuation

€ million

	Total FV	Stake	TEF FV	Per Share	% FV	WACC
ESPANA Wireline	33,298	100%	33,298	7.0	25%	7.5%
ESPANA Wireless	34,151	100%	34,151	7.2	25%	7.5%
LATINO	46,117		38,554	8.1	28%	
O2 Europe	25,296		22,954	4.8	17%	
UK	11,334	100%	11,334	2.4	8%	8.0%
Germany	4,200	100%	4,200	0.9	3%	8.0%
Ireland	2,463	100%	2,463	0.5	2%	8.0%
Cesky	7,299	69%	4,957	1.0	4%	9.5%
Other non-core			6,929	1.5	5.1%	
Total Firm Value			135,886	28.6	100.0%	
2007 reported Net Debt (incl pref equity)			(43,726)	(9.2)		
Cash commitments			(2,958)	(0.6)		
NPV 07 Tax asset			3,369	0.7		
Equity Value			92,572	19.5		
Number of shares			4,757			
Per share (E), YE 07			19.5			

Source: JPMorgan estimates

Risks to our ratings and price targets

Bouygues

- Slower than expected economic growth in France
- A well-funded competitor such as Iliad acquiring the 4th French 3G licence and mounting an aggressive launch into the mobile market
- Unexpected losses on larger construction projects
- Future investments aimed at diversifying the Group into nuclear or other activities could be substantial and may be poorly received by the financial markets.

CosmOTE

- TIM-Hellas starts to compete more aggressively in the postpay segment.
- Steps being taken by competitors to bolster their distribution networks are very effective and reduce the gross adds being delivered by Germanos
- Cosmote is not able to leverage its ownership of Germanos to the extent that we anticipate and as such subscriber growth falls short of our expectations.

Carphone Warehouse

- Distribution - MNOs could act collectively to dis-intermediate CPW, either by withdrawing their products completely from its stores or by offering more heavily subsidized plans through own-stores than those they offer to CPW. Alternatively, if MNOs acted in unison to cut commissions across all distribution channels, barriers to customer churn would increase (handsets more expensive to upgrade) and this could shrink CPW's addressable market of churners/upgraders. The exit of an MNO – such as Hutchison from the UK – might lead to a reduction in CPW volumes since the acquiring MNO would presumably feel less need to fight aggressively for market share, at least for a time.
- Unbundling – A continued slow pace of unbundling BT local exchanges could lead to TalkTalk customers signing up for "free broadband" to be held on wholesaled lines for longer than expected. With group earnings forecasts highly sensitive to the take-up of broadband and the rate of migration onto unbundled lines, any early disappointments could trigger substantial cuts to consensus long-term forecasts.
- Customer adoption at TalkTalk - To date, around 50% of customers applying for "free broadband" have been existing TalkTalk voice customers. If CPW struggles to attract “new” customers in sufficient numbers, our estimates could be too high for the base of voice/line rental customers, which remain a significant contributor to medium/long term group earnings.
- Virgin Mobile France – Faced with an increasingly competitive French mobile market, including numerous other MVNO start-ups, Virgin Mobile may struggle to gain the expected scale or may need to invest more to attract customers.

Deutsche Telecom

Upside risks

- Even greater than expected US mobile ARPU upside
- A major cash release due to European mobile tower disposals. However, we have argued in our 13 February note that we believe that the market is realistic about DT's upside from mobile tower disposals because of the differences between European and US mobile valuation opportunities
- A surprisingly good price paid for T-Systems' IT service activities. We believe that there is up to €1bn upside relative to our implied T-Systems valuation
- A bid for the group, followed by a break-up, during which individual assets are sold at greater combined value than DT's share price currently implies. We believe that, for political reasons, such a scenario is currently unlikely, but cannot be completely ruled out if the share price remains weak (please refer to our 16 November 2006 note on this subject)
- An (unlikely) decision by the German regulator to allow DT to close its local exchanges without providing access to its VDSL infrastructure, and an (unlikely) reluctance by DT's competitors to invest in fibre-to-the-home

Downside risks

- The expected 2008 trend improvement in German mobile and fixed failing to materialize, possibly as a result of escalating price wars in German fixed and German mobile
- Unions blocking or materially diminishing DT's T-Service plans. Along the same lines, a deterioration in DT's German customer service as a consequence of DT's push for lower wages
- DT overpaying for M&A

Iliad

- ·The main risk we see is that Iliad embarks on an undisciplined rollout of fibre in lowly populated areas by itself. However, with the regulator advocating open and shared networks, we see the risk as being small.
- Another risk would be if cable starts to gain more traction in the broadband arena.

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KPN

- With KPN's German strategy seemingly becoming more price-focused than in recent months, forecast risk for this business is rising, in our view. Key uncertainties surround how hard the new Zehnsation tariff will be pushed, whether it will be followed with new prepay and/or flat-rate initiatives, how elastically customers react to lowered prices and how rival networks will respond.
- In Wireline, FY results on 6th Feb could reveal weaker-than-expected line-loss trends. Furthermore, management may give only limited visibility on its progress with IPTV, a product whose success forms an important part of KPN's attempts to reduce customer churn and defend the existing revenue base.
- The Dutch regulator appears intent on preserving unbundling in spite of KPN’s roll-out of a VDSL network (in place 2010E) and the likely dismantling of local exchanges from 2009E. Infrastructure-sharing at the street cabinet level may not prove feasible. Hence the regulator could mandate some form of functional separation of the network, along the lines of Openreach in the UK. This might mitigate some of the positive effects of dis-intermediating the unbundlers which, we believe, are already impounded in current KPN forecasts.
- KPN has not ruled out bidding for other European telco assets. Its attention has so far centred on Belgacom and TDC's Swiss mobile asset, Sunrise. With net debt-to-EBITDA trending to 1.5x in Dec-07E (Group target 2.5x), KPN would appear to have €5bn of potential firepower plus whatever can be created by re-leveraging the target. Any M&A could come as negative surprise to investors accustomed to KPN's very focused strategy of improving current operations over recent years.
- Following the Government exit last year, KPN remains one of the few European incumbents for which political obstacles to being taken over are low. Although we think a take-over is not imminent given financial hurdles – the scale of the funding requirement, a relative lack of cost-cutting opportunity, uncertainties over whether current favourable tax treatment would be available to a new owner – we think it should not be ruled out.

OTE

- If OTE is unable to deliver further cost reductions now that it has made a third of its workforce in the fixed line division redundant.
- Other risks include sustained competition in the fixed line market that continue to drive down prices aggressively regardless of returns
- If OTE management is unable to bring capex expenditure under control.

Swisscom

- Italy becomes the key risk and opportunity

Following the acquisition of Fastweb, Swisscom's risk profile has shifted. The main risks to recommendation and price target, in our view, are the following:

- Adversarial regulation in Italy, following separation of Telecom Italia's access network.
- A deterioration in Fastweb's operational momentum, for instance due to managerial defections or due to loss of public sector contracts now that the company is perceived to be in 'foreign hands' (despite the Italian listing).
- In Switzerland, a takeover of Sunrise by a more aggressive owner, such as KPN.
- A swifter than expected imposition of a workable unbundling regime.
- A more aggressive commercial strategy pursued by Swiss cable operators.

Telefonica

- Domestic competition. We have recently upgraded forecasts following our view that domestic competition is unlikely to have a material impact until 2008. Clearly there could be an unforeseen shift in competitive actions that could create risk to earnings in 2007.
- Latam macro factors. TEF is significantly exposed to Latin American macro risk, as per recent developments in Venezuela to re-nationalise assets.
- M&A: We assume that TEF remains focused on de-gearing in 2008, so the risk we see is that TEF engages in a value-dilutive M&A deal (as per our view of O2 at the time), also impacting sentiment.

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Coverage Universe: **Raj Sinha:** Fastweb (FWB.MI), France Telecom (FTE.PA), Iliad (ILD.PA), Neuf Cegetel (NEUF.PA), OTE (OTEr.AT), Telecom Italia (TLIT.MI), Telecom Italia (Savings) (TLITn.MI), Telenor (TEL.OL), TeliaSonera (TLSN.ST)

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	Overweight (buy)	**Neutral** (hold)	**Underweight** (sell)
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IB clients*	49%	51%	38%
JPMSI Equity Research Coverage	38%	48%	14%
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For purposes only of NASD/NYSE ratings distribution rules, our Overweight rating falls into a buy rating category; our Neutral rating falls into a hold rating category; and our Underweight rating falls into a sell rating category.

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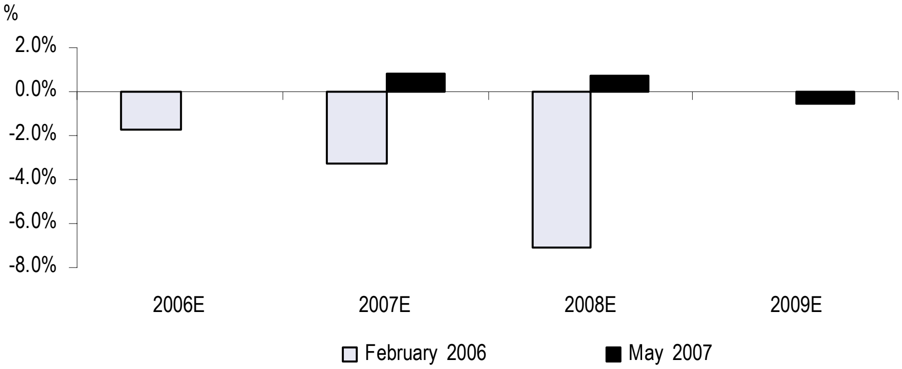
Figure 11: JPMorgan EBITDA forecasts vs consensus as at February 2006 and May 2007



Source: JPMorgan estimates, IBES

Table 31: Trading multiples against other sectors

	P/E pre-Goodwill			Dividend Yield			EV/EBITDA			Price to Book		
	2006E	2007E	2008E	2006E	2007E	2008E	2006E	2007E	2008E	2006E	2007E	2008E
Europe	15.2	14.0	12.9	2.8%	3.1%	3.3%	8.4	7.5	6.9	2.4	2.4	2.0
Energy	11.0	11.4	11.2	3.4%	3.6%	3.7%	5.0	4.3	4.3	2.5	2.4	2.0
Materials	14.9	13.0	12.6	2.1%	2.1%	2.3%	7.6	6.3	6.0	2.5	2.5	2.0
Chemicals	19.0	16.2	15.2	2.2%	2.3%	2.5%	9.2	8.1	7.5	2.6	2.7	2.2
Construction Materials	16.1	15.1	13.8	1.7%	2.1%	2.3%	8.6	7.8	7.1	2.2	2.3	1.8
Metals & Mining	12.3	10.8	11.0	1.9%	1.9%	1.9%	6.4	5.1	5.0	2.8	2.6	2.0
Industrials	20.2	17.4	15.0	2.0%	2.2%	2.4%	10.2	9.2	8.1	3.2	3.1	2.5
Capital Goods	20.7	17.5	15.1	1.9%	2.2%	2.4%	11.3	10.1	8.7	3.2	3.2	2.5
Transport	17.6	16.0	14.0	2.2%	2.3%	2.5%	7.3	6.9	6.3	2.7	2.7	2.2
Consumer Discretionary	20.0	17.3	14.9	2.3%	2.5%	2.8%	10.8	7.8	6.9	2.8	2.7	2.2
Automobile	18.1	14.6	12.1	1.8%	2.1%	2.4%	8.0	4.3	3.9	1.9	1.8	1.5
Consumer Durables	20.2	17.2	15.4	1.9%	2.1%	2.3%	12.3	10.7	9.5	2.7	2.5	2.1
Media	18.8	17.6	15.4	2.9%	3.0%	3.2%	10.6	9.3	8.4	3.4	3.4	2.9
Retailing	21.8	18.9	16.5	2.5%	2.9%	3.2%	11.1	9.8	8.4	3.8	3.7	3.1
Hotels,Restaurants&Leisure	25.9	22.0	18.7	2.4%	2.5%	2.8%	12.7	10.1	9.0	4.1	3.9	3.3
Consumer Staples	20.3	18.6	16.8	2.1%	2.3%	2.5%	10.5	10.1	9.2	3.7	3.6	3.0
Food & Drug Retailing	21.1	19.5	17.4	1.9%	2.2%	2.4%	9.4	8.8	8.1	2.9	2.9	2.4
Food Beverage & Tobacco	19.5	17.9	16.2	2.2%	2.5%	2.8%	10.1	10.2	9.3	4.0	3.7	3.2
Household Products	25.8	23.0	20.4	1.4%	1.5%	1.7%	18.7	14.2	12.7	4.9	4.5	3.7
Healthcare	17.9	16.4	14.9	2.3%	2.4%	2.6%	10.3	9.7	8.6	3.8	3.5	2.9
Financials	12.3	11.5	10.6	3.3%	3.8%	4.1%	-	-	-	1.7	1.8	1.5
Banks	12.4	11.5	10.4	3.6%	4.1%	4.5%	-	-	-	1.8	1.9	1.6
Diversified Financials	12.0	11.7	10.8	3.2%	3.4%	3.8%	-	-	-	2.1	2.1	1.8
Europe Insurance	10.9	10.3	10.1	2.9%	3.3%	3.6%	-	-	-	1.4	1.7	1.4
Europe Real Estate	23.6	22.6	20.2	2.4%	2.6%	2.7%	-	-	-	1.2	1.1	1.0
Information Technology	21.2	18.1	15.5	1.7%	1.7%	1.9%	10.4	9.9	8.3	3.1	3.3	2.6
Software and Services	23.1	20.4	17.2	1.4%	1.5%	1.7%	12.1	11.8	9.9	4.0	3.8	2.9
Technology Hardware	19.1	16.8	14.6	1.9%	2.1%	2.4%	10.4	10.0	8.4	3.1	3.6	2.7
Semicon & Semicon Equip	33.3	21.9	17.2	0.1%	0.5%	0.7%	8.3	7.3	6.1	2.3	2.2	2.0
Telecoms	14.8	14.4	13.1	4.5%	4.6%	4.9%	6.8	6.4	6.1	2.0	2.1	1.9
Utilities	17.8	16.3	15.0	3.6%	3.6%	3.9%	9.3	8.5	8.0	2.6	2.7	2.3

Source: Datastream. Note: Telecoms trading multiples above based on IBES consensus and does not include altnets which JPMorgan forecasts do in Table 16 & Table 17