

Convegno ASATI 2015

Telecom Italia: a financial markets perspective

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Company report

Telecoms, Media & Technology
Diversified Telecoms
Equity - Italy

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Telecom Italia (TIT IM)

Buy: Doing the right thing on savers conversion

- Savers conversion would be a marked improvement in corporate governance
- Vivendi could support it, despite voting rights dilution
- Reiterate Buy rating with a EUR1.35 target price on the orders

Board unanimously proposed conversion of savers into ord; On 5 November, TI's board proposed the conversion of saving shares into ord; thus addressing, with an 18-year delay, one of the unresolved issues of the company's privatisation and creating the conditions for a marked improvement in corporate governance, adopting the one share-one vote principle. TI's CEO clarified on the Q3 results conference call that the Board voted unanimously but had not consulted on the matter with key shareholders, including Vivendi (VIV FP, EUR21.7, Hold. TP EUR21), which currently owns 20.03% of the ord; share capital. The conversion terms, in our view, offer a fair deal to savers; shareholders and create value for all TI shareholders by raising up to EUR572m (assuming a 1:1 conversion ratio) with the conversion premium and increasing the liquidity and free-float. The next key date is 15 December when ord; shareholders will convene in an EGM, a two-thirds qualified majority of registered attending shareholders is needed to approve the proposal. Vivendi's support may be crucial.

Should Vivendi support the savers conversion? If the conversion is approved, Vivendi will see its percentage of voting rights diluted to 13.8% by means of introducing the one share-one vote principle (in fact, the conversion will not reduce the share capital but will change its composition). *Prima facie* Vivendi would have no interest in supporting the conversion plan, given its voting rights would be diluted. However, we believe that TI's board is doing what is best for the company by proposing the conversion and we therefore think Vivendi would oppose it (something that would be perceived negatively by the market, in our view). Voting against the proposal would be at odds with recent messages by Vivendi's management team whereby Vivendi considers itself a "good shareholder", interested in the "great development potential of TI and of the Italian market" (*Il Corriere della Sera*, 25 June). We would therefore not be surprised if Vivendi, in its effort to keep building bridges in Italy and with a "long-term investment horizon" (*di de Profontaine* interview to *LeFigure* 30 October) in mind, was to vote in favour of the conversion.

Pursuing *pacta serventur*. Tension between TI and domestic athletes has increased over the years and claims (legal and regulatory) now amount to EUR2.2bn. In an effort to address these tensions, TI is proposing a more pronounced form of functional network separation, which has been discussed with the relevant authorities. *Ma Patauro* disclosed that a settlement has been signed yesterday with Fastweb, the most significant claimant.

Index	DO ALL-SHARE INDEX	Enterprise value (EURm)	49,174
Index level	1,242	Free float (%)	79
RIC	TIT IM	Market cap (USDm)	23,028
Bloomberg	TIT IM	Market cap (EURm)	22,028

Source: HSBC

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The most important drivers in telecoms ...

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1. Regulation

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1. Regulation
2. Regulation

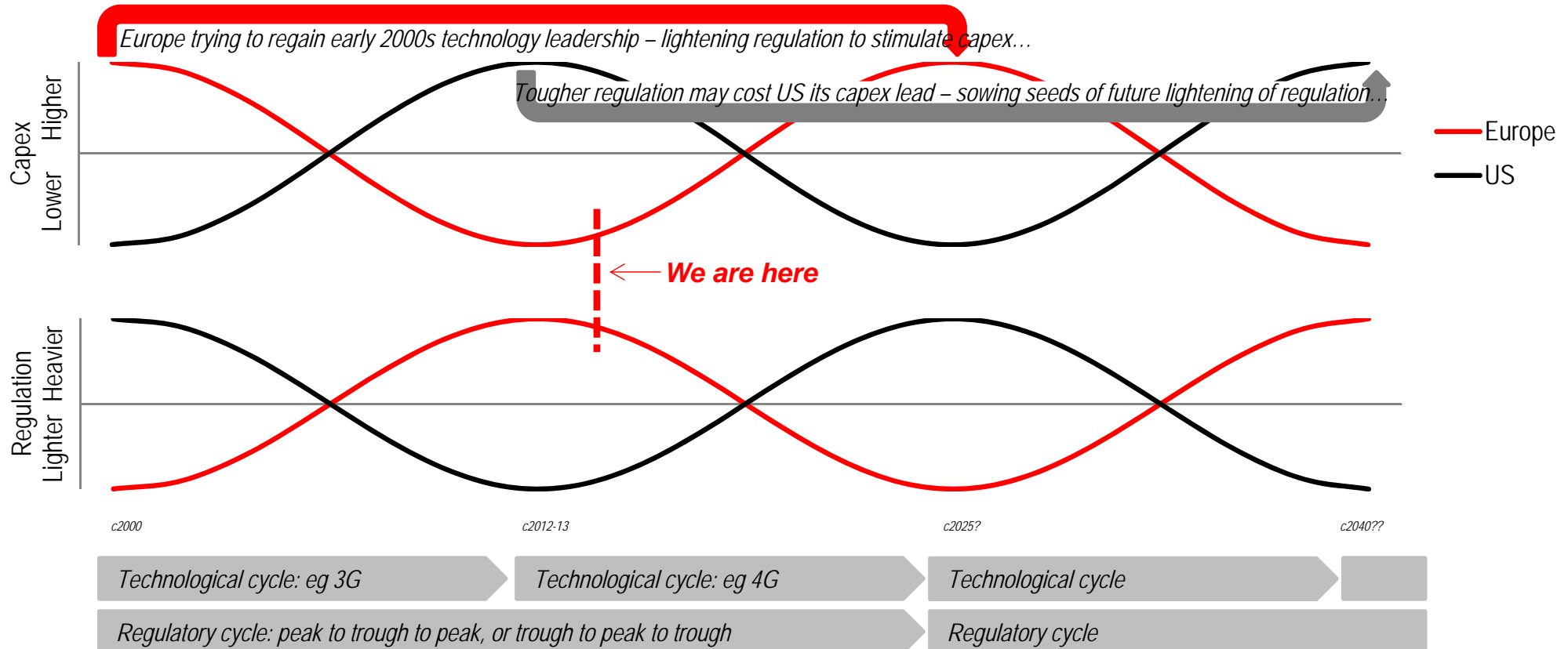
The most important drivers in telecoms ...

1. Regulation
2. Regulation
3. Competition

The regulation and capex cycle

Wavelength of regulatory cycle seems twice that of technological cycle

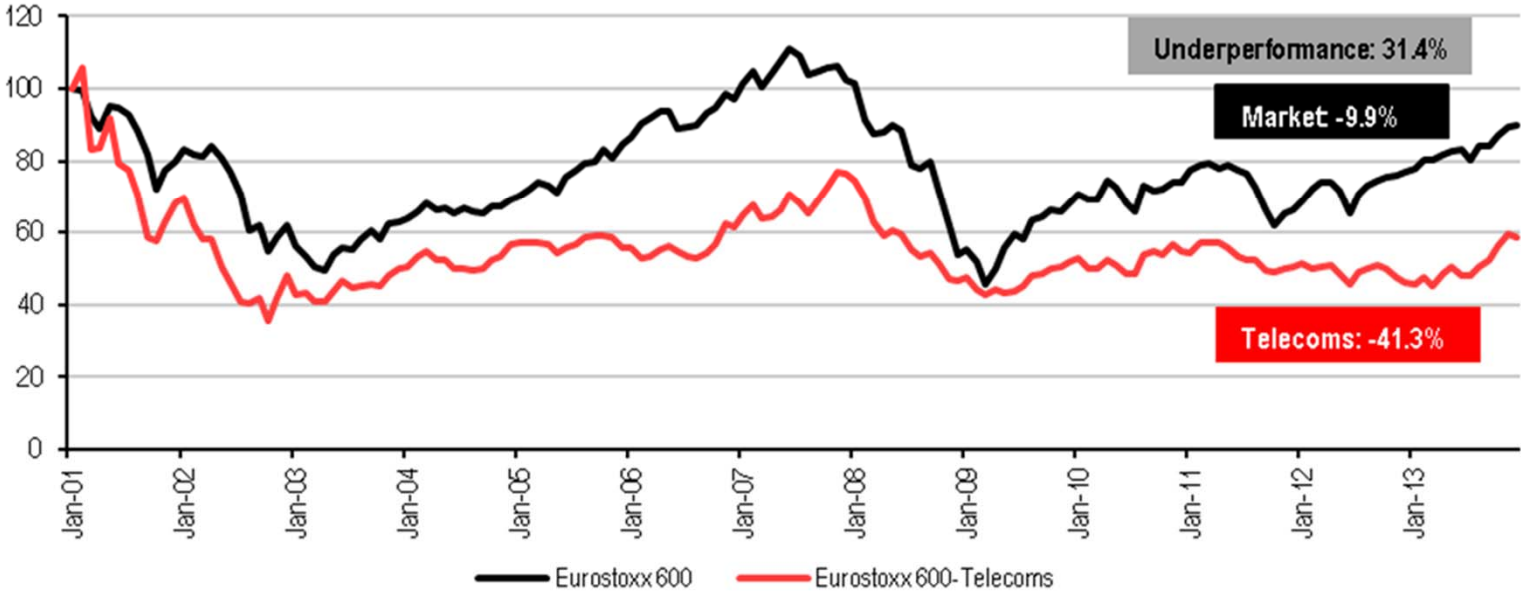
- Regions acquire technological leadership
- Toughen regulation, which discourages capex, costing them technological leadership
- And then, lighten regulation to regain technological leadership



Source: HSBC

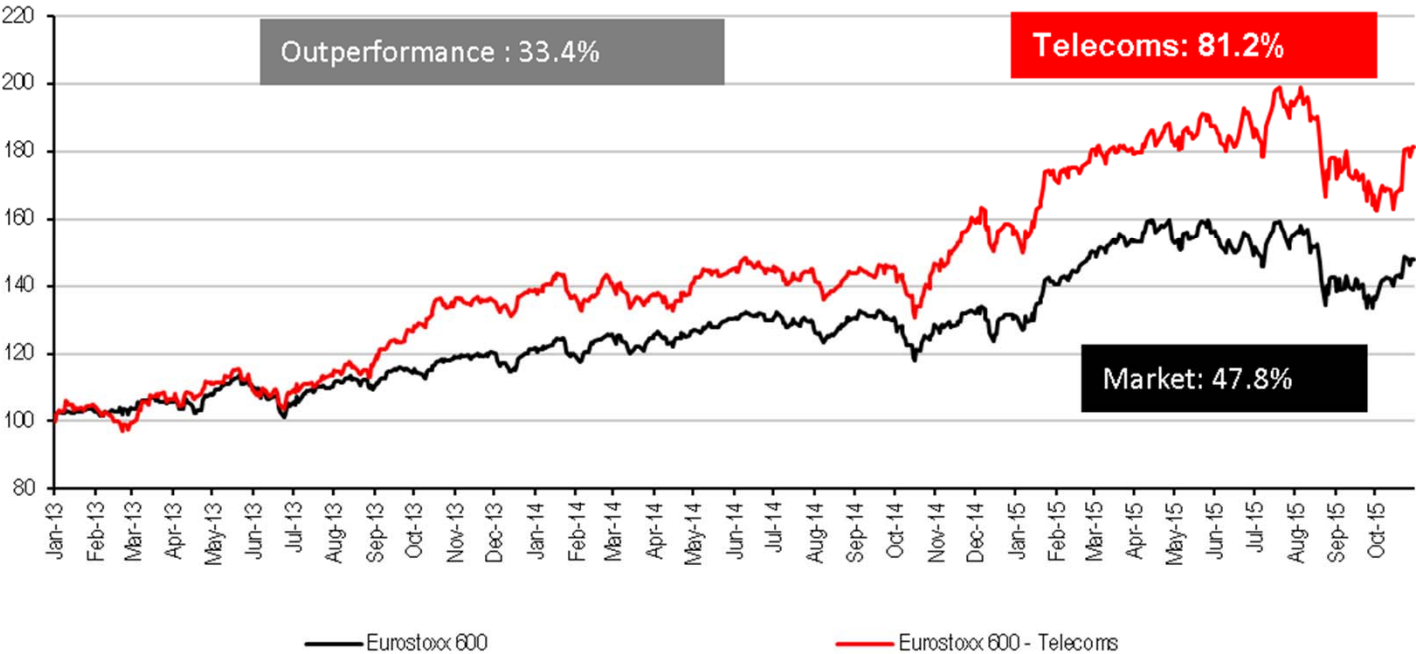
Investors have suffered poor returns for over a decade ...

Telecoms share price performance
2001 to 2013 vs Eurostoxx 600 (rebased to 100)



Something radical has changed: outperformance since mid-2013

Telecoms share price performance 2013 to date vs Eurostoxx 600 (rebased to 100)

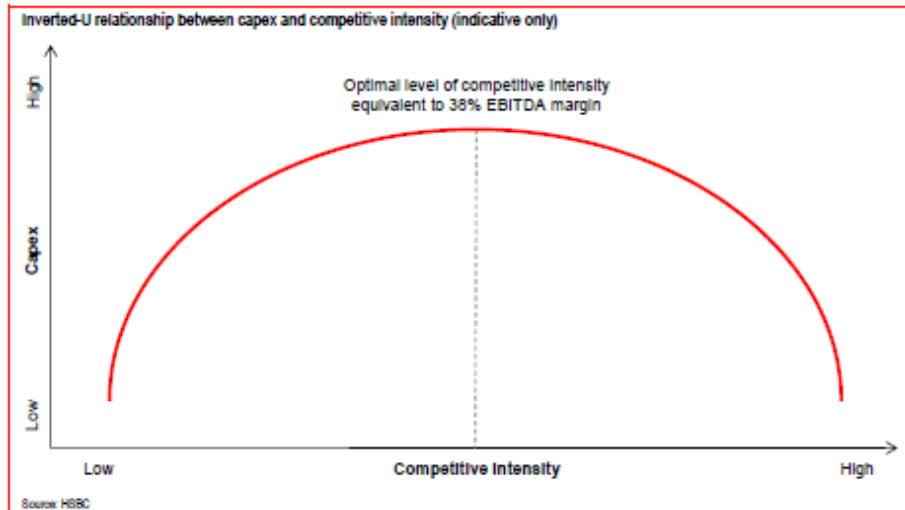


Regulation: fixed-line

- Almost 20 years of regulatory arbitrage: no incentive to invest in infrastructure
- The EC's "*Non discrimination and cost methodology*" Recommendation (Sept 2013) aims to recreate the conditions to invest. Three key principles:
 1. NGN technology agnosticism
 2. LLU prices stable in real terms
 3. Wholesale fibre prices non cost-oriented
- When investing in infrastructure:

Co-operation > Competition

Regulation: mobile and Italian consolidation



The dynamic efficiency gains virtuous cycle:

Consolidation



Higher profitability



Higher network investments

Lower unit prices



Larger capacity



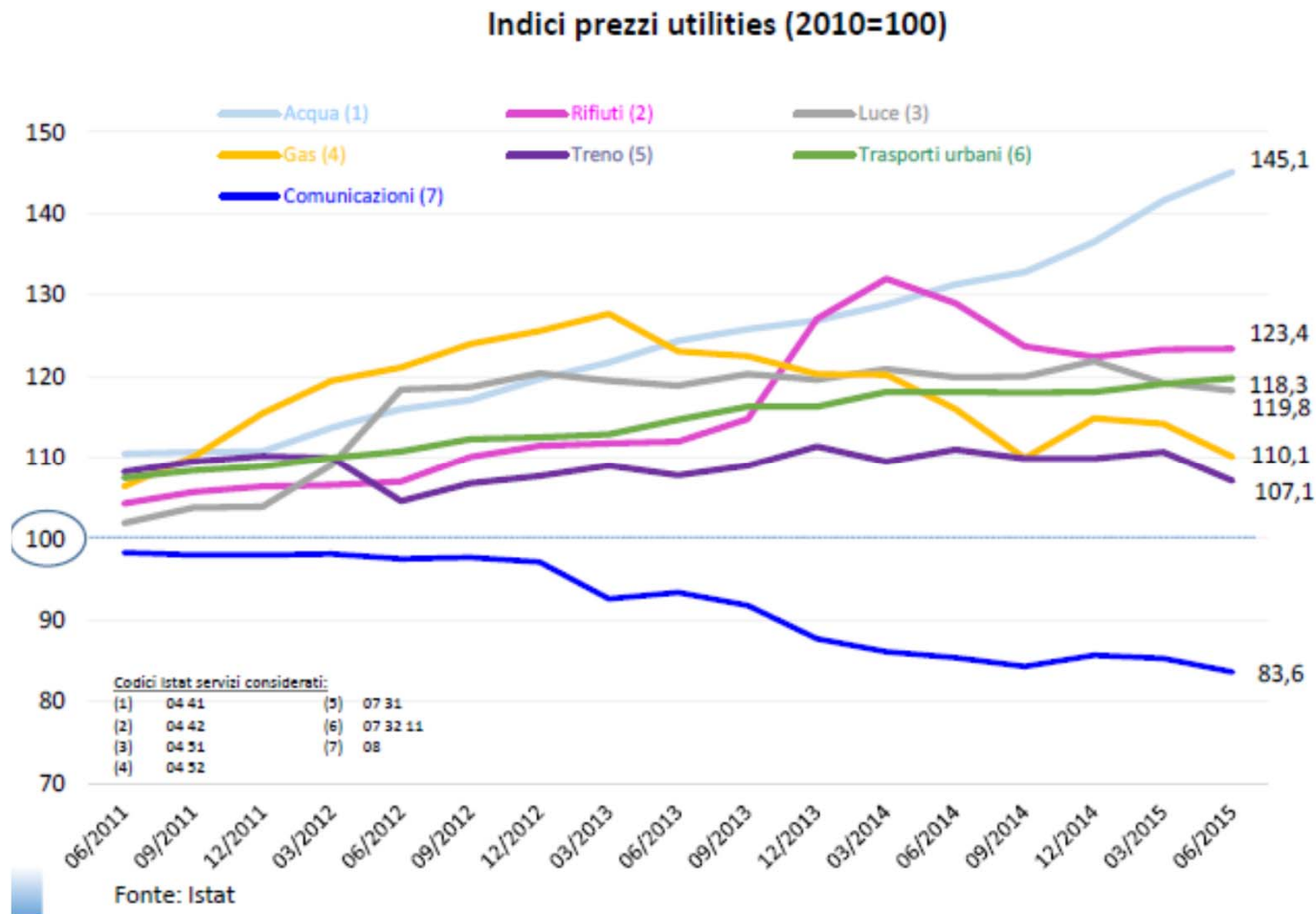
- Non-approval of 3Italia-WIND merger: the biggest risk for the investment case of TI and of European telecoms. Two points:

1. Denmark is different
2. Local support a decisive factor

Regulation: mobile and Brazilian consolidation

- Brazil going through the worst recession in 25 years. BRL at an all times low vs EUR and USD: wrong conditions for selling an asset
- A possible TIM+Oi combination could be an option. TIM by far the stronger counterparts. BUT: any valuation of Oi would need to clarify three issues:
 1. Oi's fixed-line concession post 2025?
 2. BRL23bn of contingent liabilities?
 3. Changes to the current Telecoms Law?
- Brazilian consolidation can only happen if ANATEL, Government and Congress all support it

Competition



Telecoms services: the only “utility” on a deflationary trend

TI: corporate governance

- Savers shares proposed conversion, a step in the right direction:
 1. Financially sound
 2. One share – One vote principle
- Corporate governance has improved in recent years:
 1. At least 50% of board members to qualify as “independent”
 2. Majority premium reduced from 4/5 to 2/3 of Board
- I believe an even more proportional representation of shareholders on the Board could create further value for TI and all its shareholders

Disclosure appendix

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

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

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

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Rating distribution for long-term investment opportunities

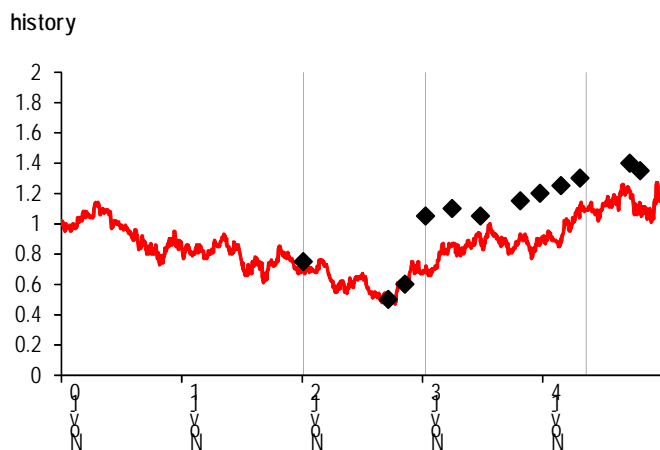
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Share price and rating changes for long-term investment opportunities

Telecom Italia (TLIT.MI) Share Price performance EUR Vs HSBC rating history



Source: HSBC

Recommendation & price target history

From	To	Date
Underweight	Neutral	22 November 2012
Neutral	Overweight	28 November 2013
Overweight	Buy	29 March 2015

Source: HSBC

Target Price	Value	Date
Price 1	0.75	22 November 2012
Price 2	0.50	07 August 2013
Price 3	0.60	26 September 2013
Price 4	1.05	28 November 2013
Price 5	1.10	17 February 2014
Price 6	1.05	14 May 2014
Price 7	1.15	11 September 2014
Price 8	1.20	10 November 2014
Price 9	1.25	13 January 2015
Price 10	1.30	12 March 2015
Price 11	1.40	10 August 2015
Price 12	1.35	10 September 2015

Source: HSBC

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Company	Ticker	Recent price	Price Date	Disclosure
TELECOM ITALIA	TLIT.MI	1.15	19-Nov-2015	1, 2, 4, 5, 6, 7

Source: HSBC

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