HSBC Global Research

European Telecoms

Regulation now

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- **DG CONNECT proposals are on-track**
- **NRAs not dogmatic on # of operators**
- **Fixed-line: much agreement, except Italy**

Our recent forum in London provided an opportunity to 'take the pulse' of the current state of the regulatory debate. Joining members of DG CONNECT were national regulators (NRAs) from Germany (BNetzA), France (ARCEP), the Netherlands (ACM), Austria (RTR) and the UK (Ofcom).

DG CONNECT seems satisfied with the outcome of the recent European Council, which not only signalled to the European Parliament the heads of states' strong wish the proposals get prompt attention, but also made specific mention of the most controversial topic: spectrum. Brussels wants a veto over the mode of issuance, to ensure spectrum is allocated in a fair and transparent manner, and at a level of expense that will not impair investment. Many operators were lukewarm about the single market package, but this may now be changing now it is clearer that spectrum reform really is in prospect (facilitating investment and consolidation). DG CONNECT hopes to see adoption in 2014 (as early as June or as late as December).

On consolidation, all parties were at pains to emphasise that remedies were the decision of DG COMPETITION. But that body consults widely and hence the views of NRAs are very relevant. The BNetzA believes it would be necessary to redistribute spectrum should the E-Plus/Telefonica Deutschland merger be cleared, but it would like to see this without ring fencing or other asymmetric measures favouring entrants. Most of the NRAs (including ARCEP and BNetzA) stated that they had no dogmatic opinions on the number of players per market, even while seeing the appeal of four rather than three (a view that was clearest at Ofcom). That said, it was observed that DG COMPETITION had set up an experiment on how many operators a market can support via its Austrian remedies, with the answer being, in this case, three. As regards the interest of certain international players in Europe, DG CONNECT was clear that the continent is open to investment.

DG CONNECT saw good agreement on the new fixed-line measures (ULL stability, fibre pricing flexibility), but with an exception in Italy. Much credibility hinges on this dispute: the Commission must decide if it is to take matters to court – although, if the single market package is approved, it could deploy its newly acquired veto right in 2014.

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Regulation now

- DG CONNECT agenda on-track following European Council boost
- NRAs not dogmatic on number of mobile operators per market
- Broad agreement on fixed-line regulation – except in Italy

Introduction

Our recent forum in London provided an opportunity to 'take the pulse' of the regulatory debate in Europe. Joining members of DG CONNECT were national regulators from Germany (BNetzA), France (ARCEP), the Netherlands (ACM), Austria (RTR) and the UK (Ofcom). This report summarises the key points of an illuminating series of discussions, starting with the bigger picture, and then moving on to examine the most topical individual issues, such as spectrum (see p.5) and consolidation (see p.7). We would like to thank all those who gave their time to join us.

Problem analysis

When devising a solution, an essential preliminary step is to establish clearly the nature of the problem that needs remedy. With respect to the European telecoms sector, however, there has not even been consistent agreement that a problem exists in the first place. Opinions on this matter continue to show a good deal of divergence, although we suspect that this discrepancy is less of a worry than it might at first appear.

The greatest concern for the health of the industry is seen in Brussels, at the telecoms ministry DG CONNECT. Indeed, it is the latter's anxiety at the state of the sector – and the fear that it will be unable to invest in infrastructure at the pace that politicians would wish – that has prompted the single market proposals now under consideration.

Representatives from the national regulatory authorities (NRAs), on the other hand, generally took a less gloomy view. For example, the BNetzA, ARCEP and Ofcom were each able to point to varying indicators of progress in terms of network upgrades. Nonetheless, each of the above was also positive on the new fixed-line regulation (the non-discrimination and cost methodology recommendation, to give its – abbreviated – formal title). Hence, while there may be a difference of opinion on the urgency of the issues facing the sector, there does seem to be a wide measure of agreement (albeit not unanimity) on the desirability of regulation that more overtly supports investment.

Inevitably, the question of subsidiarity will intrude into this debate. Regulators in Brussels, aware of how variations in national regulation across the continent may interfere with the emergence of a telecoms single market, will be keen to secure greater harmonisation, which will in turn imply a greater degree of centralisation. Meanwhile, NRAs, aware of the local peculiarities of each national market, will be concerned to protect their own autonomy.

Those (such as DG CONNECT) making the case for the single market proposals – and the rapid timetable scheduled for their adoption – naturally point to the industry's plight as justifying swift action. By contrast, those seeking to preserve local flexibility argue that the situation does not warrant over-hasty intervention. This is an important debate, but it should not overshadow the fact that both DG CONNECT and the majority of NRAs have already chosen to embrace fixed-line regulation that is actively supportive of investment. (An exception to this majority is discussed below).

We should also add that we believe the new fixed-lien regulation has already had a positive impact on operators' investment decisions. Indeed, one of the most important reasons we believe that next generation access (NGA) fibre upgrades are now taking place is the supportive nature of the regulation first unveiled almost a year and a half ago, in the summer of 2012. In our view, most equity investors see the telecoms sector as being in tremendous difficulty – and the fact fibre investment is proceeding in any case should be seen as testament to the enlightened nature of the new regulation, rather than being interpreted as reflecting the industry's underlying health.

Approach

One of the most consistent and encouraging features of DG CONNECT's narrative is its recognition of the desirability of revenue growth within the telecoms sector. Of course, there is a right and a wrong way to achieve this: specifically, DG CONNECT would like to see operators offering 'more for more' – that is to say, selling much more capacity for a somewhat higher price tag, such that volume growth outstrips ARPU growth, and thus unit prices decline. From our perspective, this is a 'win-win' scenario for Europe: revenues and ARPUs rise (supporting investment) but unit prices fall (delivering better value-for-money).

We suspect that not all member states are yet in agreement on this point. The risk is that certain politicians define as their only objective lower telecoms bills, without properly considering the ramifications in terms of quality of service and value for money. Ironically, this will ultimately result in relatively *higher* per unit prices, as continued ARPU and revenue contraction will support only a slower pace of network upgrade – and it is technology upgrades that power the greatest improvements in efficiency and hence the price per MB (or minute).

It is also clear that DG CONNECT's goal is – wherever possible – to de-regulate. In essence, to return telecoms to the status of a 'normal' sector, in which competition law can suffice. Furthermore, certain of the sacrosanct paradigms of the past, in particular the 'ladder of investment' concept, now sharply divide opinion. The theory of the ladder of investment was that entrants would first be lured into the sector by wholesale arrangements offering attractive arbitrages, but that they would then invest their profits in building infrastructure of their own – at first, relatively light, but then progressively deeper.

Many of the NRAs accepted that this had failed to work in practice, with entrants instead contenting themselves with the generous arbitrage opportunity, which required very little capital commitment on their part (hardly, one might add, a surprising outcome). However, the 'ladder' approach still has its defenders, such as ARCEP, which points to the success of this model in France. Looking at the European continent as a whole, however, many would consider this to be the exception that proves the rule.

A rather clearer divide between DG CONNECT and the NRAs, though, is over the topic of the current single market proposals. Note, though, that the debate here remains measured in tone. Most of the NRAs support the need for some degree of greater harmonisation, but are concerned about what they perceive as Brussels' 'one size fits all' approach. The ACM, BNetzA, ARCEP and RTR each variously expressed a desire to see a greater degree of consultation going forwards. For instance, ARCEP wanted an assessment of what had and had not worked in the current regulatory framework and an extensive round of consultation in the next European Parliament.

European Council

We believe that DG CONNECT will be extremely satisfied with the outcome of the recent European Council (October 2013). This not only indicated to the European Parliament the heads of states' strong wish that the proposals receive prompt attention, but also made specific mention of that most crucial of topics, spectrum, even if it also talked about necessary regard to "national competencies" in this area.

As a broad package of measures, the single market proposals will attract opposition from different quarters over different aspects of the initiative. The harmonisation of spectrum issuance is not, for example, likely to prove especially contentious within the European Parliament, whose members are usually happy to endorse policies with this effect. (Instead, it is more likely to raise objections over matters such as net neutrality, as discussed later in this report). The member states, by contrast, were not expected to raise problems over net neutrality, but could very plausibly have baulked at the idea that their ability to issue spectrum might be in any way constrained.

We think the DG CONNECT proposals in this area are carefully crafted. Brussels is not proposing to issue the spectrum itself, or take any of the proceeds, which will remain entirely with the member state in question. Rather it is looking merely to have a veto over the mode of issuance, in order to ensure that spectrum is issued in a fair and transparent manner – and not at a level of expense that will jeopardise investment. But even with these modest ambitions, the risk was clearly that the member states would refuse. The inclusion of reference to this most potentially contentious of topics is therefore further useful evidence that DG CONNECT has proven persuasive in making the case that the telecoms sector is in urgent need of assistance, and that the *status quo* needs to change.

So far as the operators are concerned, we believe that the proposals on spectrum reform represent the most powerful potential positive of the single market package. The prospect of more orderly auctions, affording greater transparency and predictability, together with the removal of asymmetric conditions, could powerfully revive the network investment case in the mobile subsector.

On the whole, operators initially gave a lukewarm reception (at best) to the single market programme. However, we suspect that this stance will have been influenced by the suspicion that there is not enough time for the proposals to make it through – together with the supposition that the most attractive component of the initiative (spectrum reform) might not even clear the first real hurdle (the European Council). Our assessment, though, is that the measures stand a real chance of adoption, and that from the operator perspective there is now something conspicuously worth fighting for. As a consequence, the tone of the operators may well now improve, and it was interesting to see Vodafone adopting a cautiously optimistic stance on regulatory prospects at its interim results (12 November 2013).

Additionally, it should be highlighted that the backing of the European Council indicates support for the single market proposals at the highest levels in Europe: from the prime ministers of the member states. This support is doubtless a factor in DG CONNECT's optimism that the package can be approved, even while acknowledging that a choppy ride is likely, given the reservations held by many NRAs about the consultation procedure, as well as about the proposals themselves.

Timeline

DG CONNECT hopes to see the measures approved during the course of 2014, perhaps as early as June or as late as December. The committees involved are already at work on the proposals. Admittedly, the rapporteurs responsible for guiding the new legislation through the European Parliament have had some critical words for DG CONNECT's programme. However, it does seem that the parliament is accepting the need for a tight timetable.

This suggests (at least, to our eyes) that now is the time for the industry to make further proposals to the European Parliament on those additional measures that it would like to see incorporated into the single market agenda. Our interpretation is that DG CONNECT has been involved in a delicate balancing act, bringing together a mix of proposals with something to offer the broad range of support required to see the measures passed. This has led to concern in the telecoms industry that the more investment-favourable aspects of the proposals have been watered down. Now is a chance to potentially reverse that, by making additional proposals to the European Parliament.

The NRAs identified various potential impediments to the package, with one suggesting that the more straight-forward components might be handled before the European elections, leaving the more contentious and complex matters for later. The body representing the NRAs in Brussels, BEREC, is to have its next meeting in Budapest on 7-10 December – with the single market obviously being a prominent item on the agenda. The BNetzA commented that preparation on this topic was likely to be a key focus of work over the next month.

Spectrum

Spectrum allocation is the most important of subjects, and represents – in our opinion – perhaps the most important element of the single market programme. Over the past couple of years, there have been vastly different outcomes of spectrum issuance, some positive for the industry (and hence the investment case), and some considerably less so: the extremely expensive auctions in the Netherlands and Austria spring to mind.

In all, there seemed to be a broad measure of agreement that a more symmetric approach and more orderly outcomes were desirable – even if such conclusions had only been reached in the aftermath of what proved to be (so far as the sector, at least, was concerned) some extremely unpleasant auctions.

In the view of DG CONNECT, regulation that provided for asymmetric spectrum issuance was appropriate at an earlier stage of the market's evolution, but going forwards was likely to be counter-productive. This point was relevant not merely to the reservation of spectrum on behalf of entrants, but also to the imposition of spectrum holding caps. DG CONNECT seems to be of the opinion that such measures should not be used to conduct (in effect) industrial policy, when in reality it is economics that should prevail.

In the debate over the relative 'sweet vs sour' content of the single market package, it has been suggested that the 'sour' elements come first, and are only subsequently followed by the 'sweet'. Whatever the (de)merits of this argument, the immediate relevance of spectrum reform has been questioned. However, DG CONNECT countered, it is surely better to address these matters now, ahead of any further rounds of auctions (such as for 700MHz frequencies), rather than wait until these are underway. Given the insatiable demand of the industry for new radio frequency real estate, this reasoning surely has value.

DG CONNECT would also like to see more consistent issuance processes and sensible licence durations. With regard to the latter, it seems most unlikely (in our view) that AT&T will see its desire for perpetual licences realised, but there may well be scope to extend shorter durations.

Moving onto the perspective of the NRAs, the BNetzA believes that it may well be necessary to redistribute spectrum in the event that the E-Plus/ Telefonica Deutschland merger receives approval, but it would like to see this take place without ring fencing – the preference being for an auction design that is symmetric (ie does not favour an entrant) and transparent. Newcomers to the market are, of course, welcome, but in the BNetzA's view, entrants should be required to pay the same price as those operators that have already committed capital to the market. However, the BNetzA also made plain that the remedies required of the merging parties were the decision of DG COMPETITION, and that the auction rules will be set in this context.

Additionally, the BNetzA emphasised two further points. First, the importance of ensuring that the industry had sufficient spectrum (with various releases of fresh radio frequencies scheduled); and second, the fact that it did not wish to see operators overpaying for spectrum, as this would only undermine future investment.

In France, ARCEP explained that spectrum policy was a responsibility shared between ARCEP and the ministry, although the latter took charge of the financial aspects. There was an effort to balance three separate and potentially conflicting objectives: maintaining competition, raising money, and ensuring country-wide coverage. One way ARCEP envisaged of promoting the extent of the roll out was to either accept less money up front, or to make the shift to on-going fees (such as a percentage of sales, for instance).

We think that this particular idea has much to commend it, as we suspect it would lead operators to budget for spectrum on a 'business as usual' basis, rather than being tempted to write off the cost as a 'one off' (albeit one that keeps recurring…). The outcome might well be more rational pricing decisions, as a result of annual costs better reflecting the average cost of the business (as opposed to the lower, marginal cost – shorn of spectrum expense).

ARCEP's justification of providing Iliad with a mobile licence provides the industry with a salient cautionary tale. ARCEP reasoned that the French market was moving towards quad-play, and concluded that it was easier for a mobile operator to launch fixed-line services (courtesy of unbundling) than it was for a fixed-line operator to enter the mobile market. When no MVNO arrangement emerged for Iliad, ARCEP decided that it would need to contemplate a fourth licence.

Two of the most expensive 4G auctions in Europe, on a per head basis, were presided over by RTR and ACM, in Austria and the Netherlands respectively. According to press reports (*Reuters*, 8 November 2013), T-Mobile (a subsidiary of DT) is planning a legal challenge as a result of the Austrian auction; while the outcome of the Dutch auction provoked a strongly worded blog from none other than Vice President Neelie Kroes herself (the politician responsible for DG CONNECT).

We believe that the ACM did not anticipate the price differential between the 'incumbent' Dutch mobile operators and the new entrant would grow so large. This underlines, in our view, the potential hazards of an asymmetric approach (in this case, reserving one of three available 800MHz blocks for an entrant, such that there were only two banks of spectrum available to the existing three operators). It was also interesting to hear the RTR's observation that spectrum caps (ie limits on one party's spectrum ownership) were undesirable. The RTR believes that it is reasonable that a larger operator be able to purchase more spectrum than its smaller peers.

Consolidation

Closely associated with the topic of spectrum is, of course, consolidation. All parties were at pains to point out that the decisions on proposed acquisitions were for DG COMPETITION to take. Nevertheless, this body consults widely, including with DG CONNECT (which is purely focused on the telecoms sector) as well as with the relevant NRAs. Hence, the opinions of the above parties is of great interest on this topic – arguably the most important in telecoms today.

Most of the NRAs stated clearly that they had no 'religious' opinions on the number of players appropriate to a given market. That said, there were naturally concerns – voiced to varying degrees – about the impact on competition of any prospective move from four to three operators per country. This was articulated most firmly by Ofcom, but the BNetzA also indicated that (from a purely competitive standpoint) four was preferable to three as a starting point.

However, this was not to suggest that a case could not be made for consolidation as bringing net benefits to the customer – indeed, the NRAs also emphasised the importance that they attached to dynamic efficiency gains (that is to say, the way in which greater investment leads to lower unit prices). Nor was Ofcom, for instance, opposed to higher ARPUs – but these should be driven by operators providing improved services that were, as a result, more valuable, rather than by putting up the prices for existing offerings.

The lack of dogmatism over the number of operators per country also encompassed ARCEP. The French regulator (as discussed above) had issued Iliad a mobile licence on the grounds that the market was moving towards quad-play, and hence the company would have been at a disadvantage had it lacked mobile capabilities. Iliad has now taken its place among the ranks of the integrated fixed-line and mobile operators, and the question of a merger between two of these parties represents a separate issue.

Several of the NRAs emphasised that their desire was simply to see an adequate level of competition, and hence much depended on the behaviour of the operators concerned. It is the Dutch experience here that perhaps provides the relevant cautionary tale to the industry. Here, although the ACM again had no dogmatic views on the 'correct' number of operators in the market, there was considerable political unhappiness with the quality of service and pricing of the mobile operators post consolidation in 2007. This again underlines the fact that, if the industry is to enjoy the benefits of consolidation, it will need to pro-actively share these with the customer – or face the consequences.

What then of the Austrian experience post DG COMPETITION's decision to permit the acquisition of Orange by 3 Austria? There have been reports of higher prices resulting, but – given the extensive history of tumbling mobile prices in Austria – the RTR does not appear unduly concerned at the moment (although it is monitoring the situation continuously).

As several regulators observed, events in Austria have provided a useful experiment on the question of how many operators a market can in fact support. DG COMPETITION's remedies ingeniously created an 'option' on market entry (indeed, on favourable terms), should a fourth player prove interested. In actuality, though, no new entrant appeared. The market's verdict is that Austria will function best as a three-player country.

International interest

In terms of potential M&A, there is surely no subject that has attracted greater attention than the intentions of AT&T within Europe. But the US giant's potential investment into the EU could raise some difficult dilemmas.

DG CONNECT's first message was to make it crystal clear that Europe is open to investment. Many European multi-nationals – with telecoms operators prominent amongst them – have investments in non-European markets, and hence it would be inconsistent for the EC to adopt a hostile stance to inward investment. DG CONNECT conceded that the disappearance of certain businesses – such as Nokia's handset operations – had an emotional impact, but argued that Europe's politicians had plenty of strategic reasons to avoid an emotive response.

We have suspected that the recent rise to prominence of privacy issues might also introduce fresh difficulties for US firms in particular looking to buy into the European market. However, DG CONNECT did not think that this would prevent transactions.

Critics of Europe's past telecoms regulatory regime might suggest that the vulnerability of the continent's operators to international take-overs is the result of an overly tough approach. This is perhaps something for which a revised policy might now compensate – even if the original and central motivation was to encourage and support infrastructure upgrades.

AT&T has made plain its interest in a number of regulatory reforms, with its views on spectrum issuance already discussed above. Beyond this, the company would evidently prefer to see a greater degree of homogeneity in European regulation, something that other cross-border operators have also called for, including Vodafone.

A 'patchwork' quilt approach is plainly poorly adapted to the interests of an operator with pan-European activities. This raises a further point: were AT&T to purchase a European mobile operator such as Vodafone, how might the combination of its global scale plus newly acquired cross-border European presence impact the views of competition regulators about the heretofore avowedly national scope of markets? Time may tell.

Finally on this topic, it will not be forgotten that the most recent attempt at investment into Europe has ended (for the present, at least) in failure: AMX's bid for control of KPN. However, this would seem to have been the result of matters internal to KPN, rather than because of external regulatory intervention.

Roaming

If spectrum is the 'sweet' ingredient in the single market package, roaming is conspicuously the 'sour' element. This has provoked howls of protest from an industry whose revenues and margins are already under enormous pressure – but the DG CONNECT response is that there are two options within the proposals, with scope for the operators to simply continue (for the time being) on the existing 'Roaming 3' regulation. This has led to suggestions that the whole debate now resembles something out of a Ionesco play (and admittedly, certain parallels between telecoms and the 'Theatre of the Absurd' do spring to mind).

The view of the NRAs is broadly that operators have kept roaming prices at excessive levels, leading to billshock (especially with respect to data services). Politicians – and particularly those seeking to promote an integrated single market – have long been demanding a resolution, which the new proposals do provide. In any case, whether for technological reasons (VoIP) or because of the political impetus, it is clear that roaming must disappear – with much of the controversy being over the time scale over involved.

The alternative proposed in the single market package to simply sticking to pre-existing 'Roaming 3' regulation is to create roaming alliances, and shift to a 'bill and keep' system within these groupings. Aside from thereby addressing an acute political sensitivity, DG CONNECT is also looking to send a more fundamental message here, and one with relevance for the industry consolidation debate. It sees the roaming alliances as a way to legitimise a scale advantage, and is taking some flak for this stance from certain of the smaller stakeholders. Nonetheless, DG CONNECT wants to signal that scale economies should be rewarded, and that they are an obtainable and legitimate goal.

Net neutrality

Operators tend to view the single market approach to net neutrality considerably more favourably than that to roaming. Their anxiety on this score has typically been that the eminently sensible proposals (at least, to our mind) that have been put forward will be undermined by a vigorous and vocal internet lobby.

However, it was certainly not apparent that opposition to the current proposals would emanate from the NRAs (indeed, the threat is more likely to originate among factions within the European Parliament). BEREC and DG CONNECT look aligned on many of the key points, and the NRA that has arguably had to deal with the greatest controversy over net neutrality, the ACM (courtesy of action taken by the Dutch parliament), is keen to see a single set of EU-wide rules. While operators may (reasonably) fret about the potential for the European Parliament to amend initially well-formed proposals, the Netherlands provides an example of the danger inherent in leaving the area alone, with the result that national parliaments fill the vacuum with legislation of their own.

Fixed-line measures

Finally, amid all the discussion of the single market proposals now before the European Parliament, it would be wrong to overlook the measures already adopted in the form of the fixed-line recommendation (or, to give it a slightly longer title, the non-discrimination and cost methodology recommendation). DG CONNECT thought that there was more agreement on this topic than was generally reflected in press commentary, observing that most countries are in the process of stabilising ULL prices and giving fibre pricing flexibility.

The BNetzA emphasised the merits of infrastructure-based competition over the 'ladder of investment' concept. The German regulator continues to point to the need for local flexibility, although its decisions look well aligned with DG CONNECT's new recommendation. Both the BNetzA and the RTR emphasised the desirability of focusing on Equivalence of Output (EOO) only, rather than moving to the more thoroughgoing (but expensive) Equivalence of Input (EOI). This is a debate over how the obligation to sell wholesale services to third parties is handled, but DG CONNECT has been persuaded that either approach is reasonable.

However, the highest profile market with respect to the fixed-line regulation is currently Italy, given the difference of opinion between local regulator AGCOM and DG CONNECT. While AGCOM has retreated from several of the more aggressive proposals that it tabled over the summer, it still intends to implement significant cuts to ULL prices – something that obviously flies in the face of the Commission's wishes.

Admittedly, AGCOM began its analysis of the Italian fixed-line market before the new recommendation was in place, and hence its conclusions might be perceived as an artefact of the previous regulatory regime. However, there is no doubt that the case has generated considerable attention, and investors (as well as operators) will be watching closely to see what action DG CONNECT intends to take in response to this challenge to its new regime.

Specifically, DG CONNECT finds fault in AGCOM's fixed-line proposals on two grounds: a lack of predictability and the cost of capital calculations. On the latter, the question is whether the cost of capital should really be significantly different to those in use in Spain or Portugal. AGCOM, however, has not backed down on its proposals, and the EC now has 30 days from 12 November to formally respond.

One might hope that 'softer' tools could be found to achieve a satisfactory outcome, but otherwise the Commission will need to decide whether to take the matter to court with infringement proceedings. Under the terms of the single market package, DG CONNECT will receive a veto right over NRA remedies, thus potentially (at least in future) obviating the need for protracted legal wrangling. If the single market programme is adopted, this would mean that DG CONNECT could veto AGCOM's proposals in 2014. However, there is no denying that much credibility hinges on what DG CONNECT opts to do about Italy in the meantime.

Winners & losers

We think a process of sector repair is now underway. This should have the effect of: firstly, lifting the entire telecoms industry; secondly, promoting network investment of the kind that Europe's beleaguered economy desperately needs; and thirdly, powering lower unit prices to the benefit of customers.

Operators leveraged to the improved conditions that we anticipate in the fixed-line market include Liberty Global, Ziggo, ZON (the cable operators), Jazztel, Iliad (the 'quasi-cable' companies) and certain of the incumbents (such as Swisscom/ Fastweb and BT).

The single market proposals have the effect of extending this positive thesis into the mobile space, in part through facilitating the process of consolidation that we believe the industry ultimately requires. Vodafone provides an immediate means of exposure to this theme, given that it would be a clear beneficiary of a more orderly environment in the European mobile space – as well as being of interest to non-European acquirers such as AT&T.

Finally, a wide range of incumbents should benefit from the improvement in industry conditions across both fixed-line and mobile subsectors. Among the largest, most liquid stocks in this category are the likes of DT and Orange.

Stocks mentioned in this report

Company	Closing price	Ticker	Target price	Rating
Liberty Global	USD78.6	LBTYA.OQ	USD90	Overweight
Ziggo	EUR31.5	ZIGGO.AS	EUR34	Overweight
ZON Optimus	EUR4.8	ZONOP.LS	EUR4.5	Overweight
Jazztel	EUR7.8	JAZ.MC	EUR9.2	Overweight
Iliad	EUR168.5	ILD.PA	EUR210	Overweight
Swisscom	CHF470.4	SCMN.VX	CHF530	Overweight
BT	GBp374	BT.L	GBp440	Overweight
DT	EUR11.15	DTEGn.DE	EUR13	Overweight
Orange	EUR9.68	ORAN.PA	EUR11	Overweight
Vodafone	GBp229.4	VOD.L	GBp255	Overweight

Source: HSBC. Prices as at close 13 November 2013

Notes

Notes

Disclosure appendix

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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 price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 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, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

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

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As of 14 November 2013, the distribution of all ratings published is as follows:

Overweight (Buy)	44%	(32% of these provided with Investment Banking Services)
Neutral (Hold)	38%	(34% of these provided with Investment Banking Services)
Underweight (Sell)	18%	(27% of these provided with Investment Banking Services)

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