

Painel Telebrasil 2015

The regulatory model needs to upgrade

Bank of America
Merrill Lynch 

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Refer to important disclosures on page 13-17.

1) Global telcos in perspective

Growth

Pricing

Differentiation

Investment returns

M&A

2) Brazil in the global context

How Brazil compares globally

Margins

M&A

3) The need to upgrade the regulatory model

Opex/capex with little benefits

Investment uncertainty

1) Global telcos in perspective

1.1) Low growth globally

- Lower growth rates across the globe
 - Maturity across segments
 - Wireless data disappointing as growth driver for now
 - Emergence of new technologies
 - Lower economic growth
- Emerging markets still growing a bit more (a bit)
 - Low wireless data and smartphone penetration
 - Fixed-to-mobile substitution

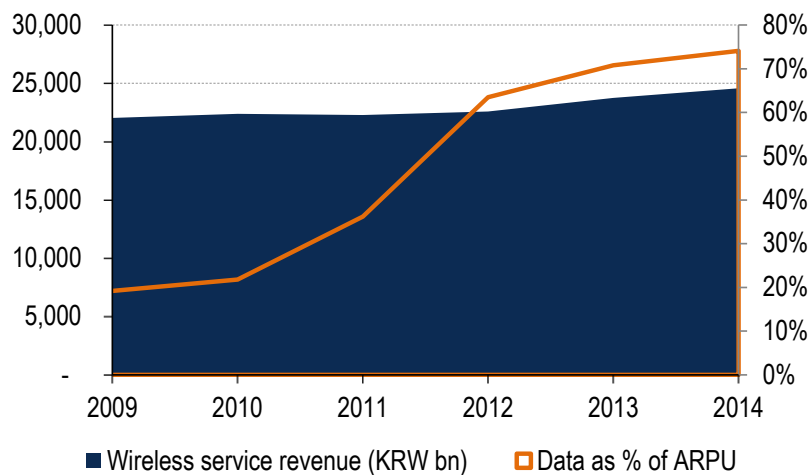
	YoY service revenue growth (in reporting currency terms)									
	2008	2009	2010	2011	2012	2013	2014	2015E	2016E	
Global Markets	8.5%	4.8%	6.3%	7.1%	5.4%	3.5%	1.3%	3.0%	3.5%	
Developed Markets	2.4%	-0.8%	1.0%	0.1%	-1.2%	-4.0%	-2.4%	-0.5%	-0.8%	
Emerging Markets	18.8%	7.7%	9.1%	10.5%	8.5%	6.9%	2.9%	4.5%	5.3%	
Latin America	17.9%	6.3%	11.6%	11.0%	9.1%	3.8%	1.1%	3.2%	4.8%	
Brazil	20.8%	9.1%	10.0%	11.9%	6.3%	1.3%	-1.2%	1.0%	2.4%	

Source: BofA Merrill Lynch Global Research

1) Global telcos in perspective

1.2) Who's capturing the value?

- Challenge to turn higher capex into higher revenues/EBITDA
 - Little differentiation and high fixed-costs
 - The industry seeks pricing power
 - Korea example (it's the rule) – data vs. voice
 - Emerging markets not different so far
- OTTs so far a double-edged sword
 - Opportunity or threat in emerging markets?



Company	Market Cap. (US\$bn)	Net income (US\$bn)	P/E
Netflix	48.3	0.2	242x
Yahoo	31.1	0.6	50x
Facebook	250.4	8.0	31x
Alibaba	178.2	6.7	27x
Google	445.7	23.3	19x
Deutsche Telekom	79.5	4.5	18x
Microsoft	345.2	20.5	17x
Telecom Italia	23.4	1.5	16x
Telefonica	69.4	4.6	15x
TIM Brasil	5.8	0.4	14x
France Telecom	42.3	3.0	14x
America Movil	59.7	4.4	14x
Telefonica Brasil	17.9	1.4	13x
British Telecom	56.0	4.5	13x
AT&T	203.5	16.4	12x
Verizon	186.2	16.4	11x
Amazon	243.7	NA	NA
Oi	0.7	NA	NA

1) Global telcos in perspective

1.3) Investment returns fell globally

- Capital intensity just went up
 - Need to cope with explosive wireless data = fiber, coverage, capacity
 - Capex/sales: from 14-15% to 20%, and it was thought to be 10-12%
- It's mathematical
 - Same or lower revenues/EBITDA + higher capex = lower investment returns
- Want to differentiate? Invest.
 - Who wants to be a commodity?
 - It's unavoidable: LTE and fiber = **more capex, not less**

	Capex to sales						
	2010	2011	2012	2013	2014	2015E	2016E
Global Markets	16.4%	17.1%	16.9%	18.2%	17.5%	18.9%	17.6%
Developed Markets	14.8%	15.3%	14.9%	16.6%	14.9%	15.6%	15.2%
Emerging Markets	19.9%	20.5%	20.6%	20.2%	22.6%	25.7%	22.7%
Latin America	14.1%	17.5%	18.9%	18.2%	20.8%	17.5%	15.8%
Brazil	14.4%	17.5%	20.3%	19.1%	24.8%	20.6%	19.8%

Source: BofA Merrill Lynch Global Research

1) Global telcos in perspective

1.4) M&A is back globally

- Industry conditions seem to lead to M&A
 - Low growth
 - Capital intensity
 - Falling investment returns
 - Network and product convergence
 - Several M&A examples - TEF D/E-Plus, SFR/Numericable, BT/EE, TEF UK/3, Altice/PT
- Balance sheets remain healthy
 - Even if not universally

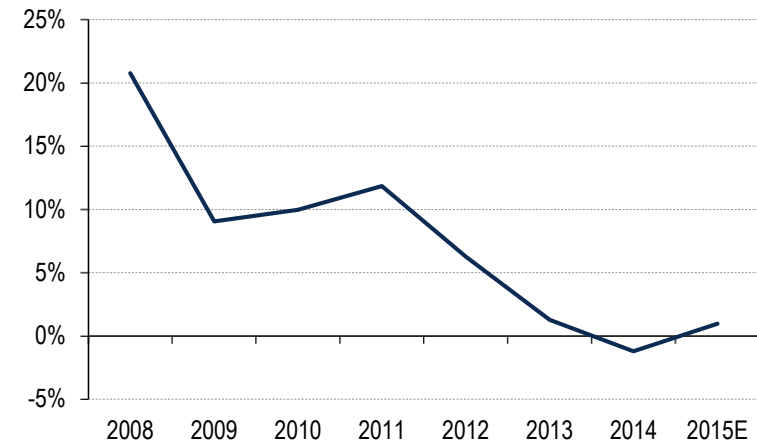
	Net debt to EBITDA			
	2012	2013	2014	2015E
Global Markets	1.5x	1.7x	1.7x	1.7x
Developed Markets	1.7x	2.0x	2.2x	2.3x
Emerging Markets	1.4x	1.5x	0.5x	0.4x
Latin America	1.1x	1.5x	1.5x	1.8x
Brazil	1.0x	1.3x	1.1x	1.3x

2) Brazil in the global context

2.1) Growth also slowed in Brazil

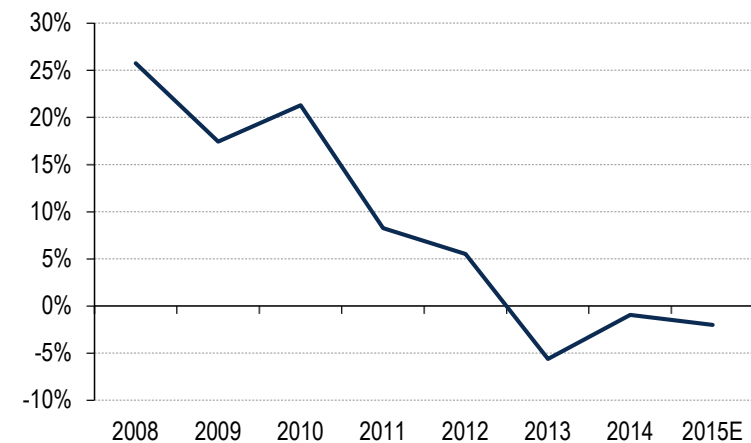
- **Wireless** - 140% penetration, 0-1% growth
- **Wireless data** – main growth driver
 - 30-35% of revenues vs. 45% in developed markets
 - 30% smartphone penetration vs. 55% in developed markets
- **Pay TV and fixed broadband** also drivers
 - Still account for 10-12% of revenues each
 - Penetration of ~30%

Wireless service revenue growth in Brazil (in BRL)



Source: BofA Merrill Lynch Global Research

Wireless EBITDA growth in Brazil (in BRL)



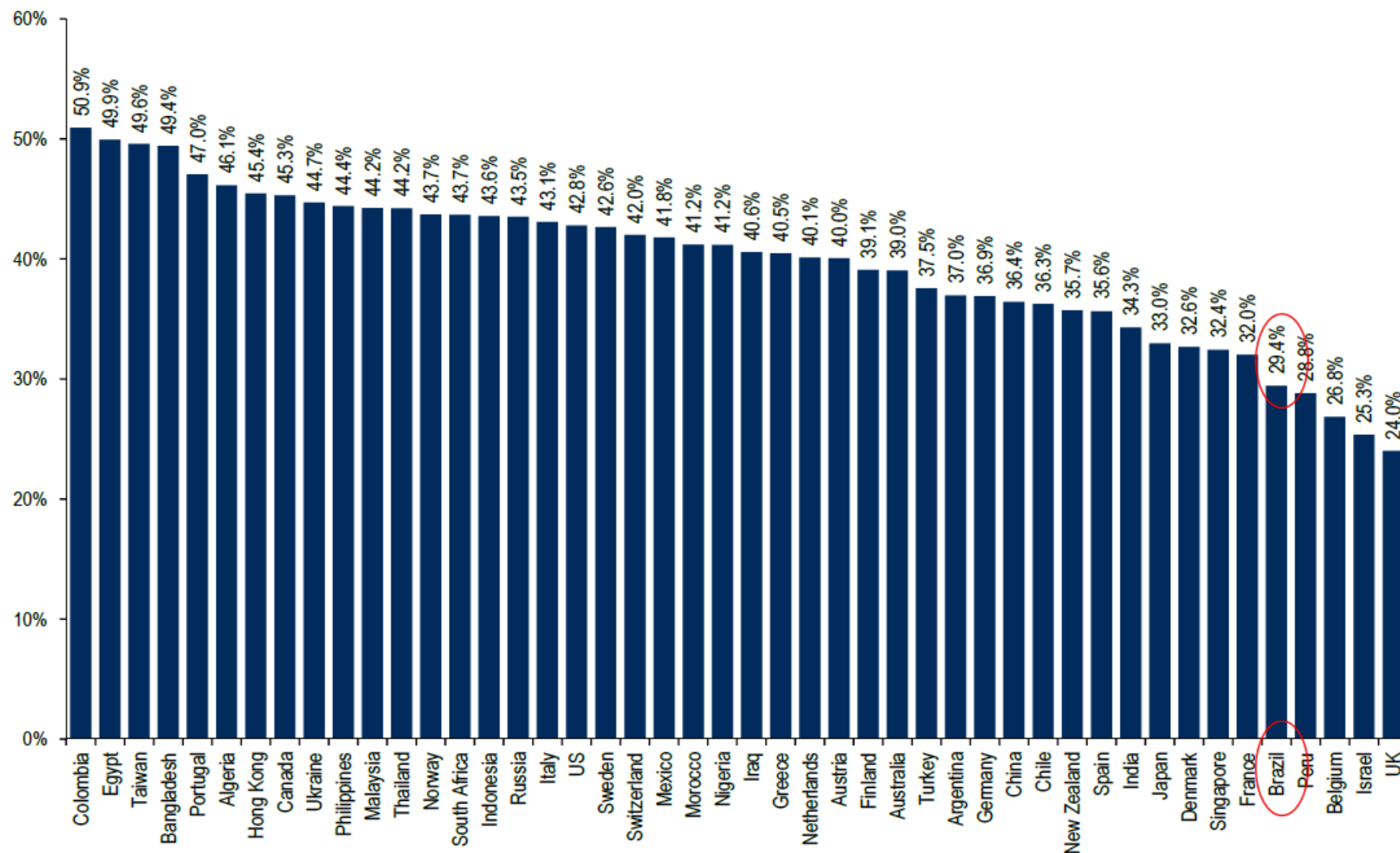
Source: BofA Merrill Lynch Global Research

2.2) Margins remain low vs. rest of the world

- **Four wireless operators**
- **Very low market share concentration**
 - No wireless carrier has more than 30% share
 - All wireless carriers have 20-30% market share
 - HHI of 0.24 in Brazil vs. global average of 0.35
- **ICMS and other taxes make the product more expensive**
 - ICMS + PIS/Cofins = +40%
 - VAT around the world is 15-20%
- **Average EBITDA margin in Brazil = 27-30%**
 - Global average is 35%

2) Brazil in the global context

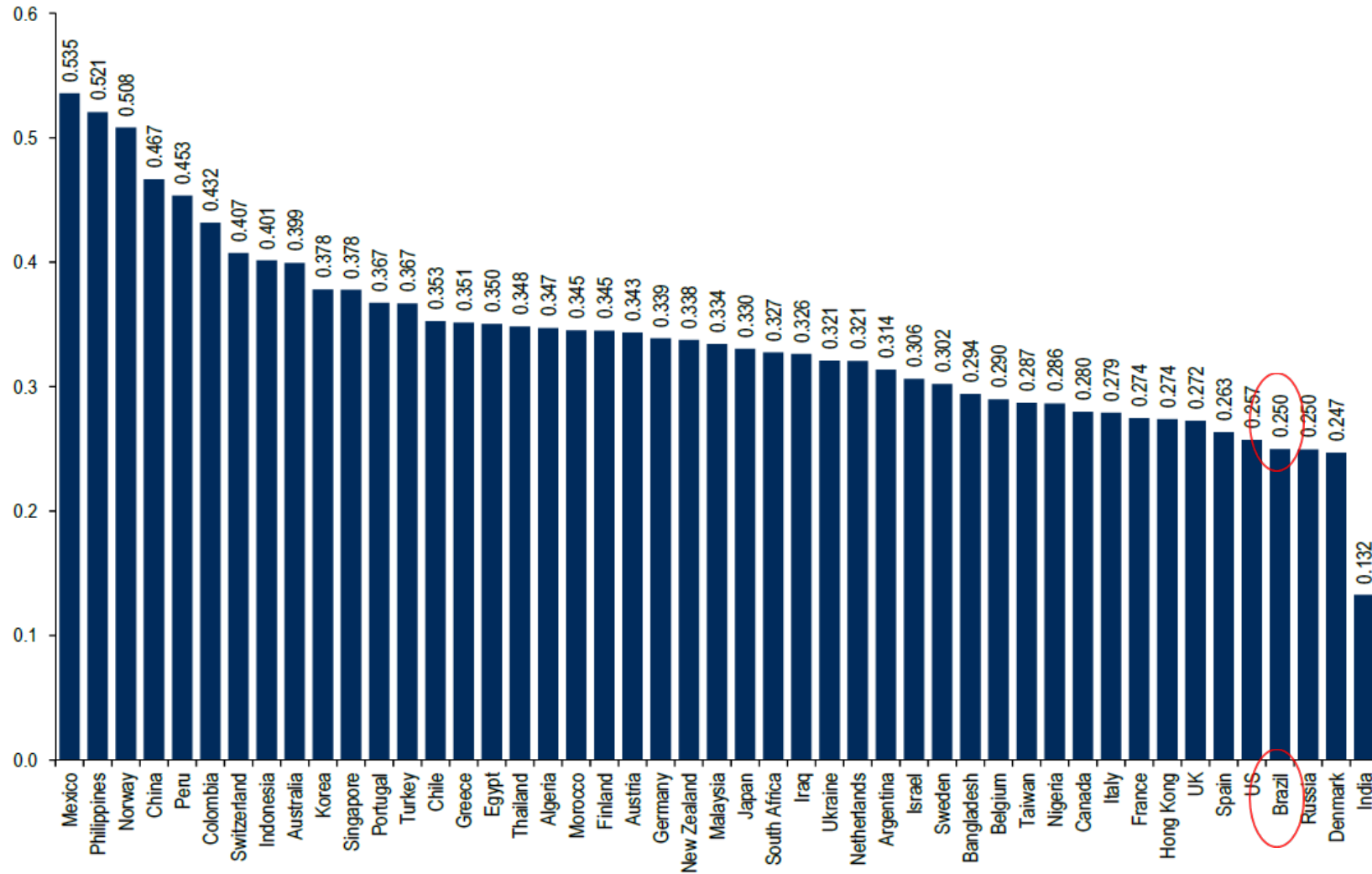
EBITDA service margin by country (1Q15)



Source: BofA Merrill Lynch Global Research

2) Brazil in the global context

HHI Index, 1Q15



Source: BofA Merrill Lynch Global Research

2.3) Monetizing wireless data is crucial

- **Investment returns dropped even more in Brazil**
 - Capital intensity is similar at ~20% of revenues
 - But margins are lower
 - And cost of capital is higher
- **Higher returns require:**
 - More capital, despite the contradiction that it implies
 - Rational competitive dynamics, higher margins – M&A?
 - Healthy balance sheets
 - **A regulatory environment that boosts investments**

3) The need to upgrade the regulatory model

A) Concession contracts have two critical problems:

1) Severe coverage and service quality requirements

- Public phones available to whom?
- Strict quality requirements in fixed-line when wireless is everywhere?
- Broadband for all? Wireless will take care of this

2) Reversibility of assets curb investments

- Assets to offer fixed-line voice in 2025?
- Who wants to deploy fiber to offer voice?

B) Should the concession contract be substituted?

- It definitely needs an upgrade
- Regulatory obligations should be significantly revised
- Reversibility of assets should be eliminated or have much more limited scope

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