

Telio Holding

BUY

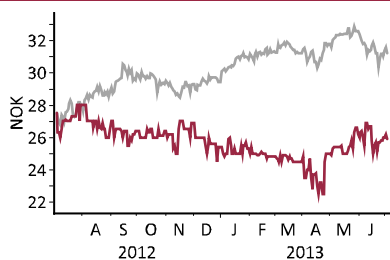
Key share data

Sector	Technology
Reuters	TELIO.OL
Bloomberg	TELIO:NO

Market Cap (NOKm)	603
Net debt (NOKm)	347
EV (NOKm)	950

Issued shares (mill.)	23.3
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Share price



—Telio Holding—OSEBX (Rebased)

Performance

	1m	3m	12m
TELIO	0%	4%	0%
OSEBX	-4%	-1%	12%

Upcoming events

2Q13 Report	August 21 2013
3Q13 Report	October 29 2013

Telio Holding is a market making client of Norne Securities

Analyst

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Initiation of coverage: Significantly undervalued

We initiate coverage of Telio Holding, a telecommunications company, operating in the market, which undergoes rather drastic changes. With the recent strategic acquisition, strong balance sheet and solid track record, we believe Telio is well positioned to face the challenges presented. This coupled with attractive valuation prompts us to issue a Buy recommendation under a target price of NOK 37.00 per share.

Strengthening position in the broadband market

We initiate coverage of Telio Holding (Telio), the second largest landline telephone operator in Norway. In 1Q13 Telio has acquired NextGenTel to strengthen its presence in the Norwegian broadband market, thus becoming third largest broadband provider. Historically, the bulk of Telio's revenues came from VoIP services, but after the acquisition we estimate that roughly 64% of revenues should come from NextGenTel in FY2014. NextGenTel is primarily a broadband provider. Thus, we believe the growth in the broadband should at least partially offset the revenue decline from the VoIP service. Growth of mobile service should also help in offsetting the decline, albeit at a much smaller scale.

Telio well positioned for transition

Telio operates as the Broadband, VoIP and GSM service provider. Broadband subscriber base in Norway rose by 27% over the past five and a half years. During the same period the number of mobile telephone subscribers has increased by 14%, whereas the number of mobile broadband users increased by almost 650%. However, the total number of VoIP subscribers has declined by 5.6% from 2009 to 1H12. These developments present a challenge for Telio, as a large part of the company's revenue comes from VoIP. Still, we believe that with the recent acquisition of NextGenTel, strong balance sheet and good track record Telio is well positioned to meet these challenges.

Buy, target at NOK 37.00 per share

Based on our forward P/E, forward EV/EBITDA, DCF, and peer-based SOTP valuations we arrive at the price target of NOK 37.00 (discount of 30% applied). Seeing a substantial upside, strong balance sheet, solid cash flows and value accretive strategic acquisition of NextGenTel we issue a Buy recommendation.

Company profile

Telio is a Norwegian developer and provider of IP-based services to private and business consumers. Telio offers a wide range of products: VoIP, traditional GSM mobile products, mobile applications, broadband and mobile internet. Historically, the primary source of income for Telio was the VoIP service, which gives access to voice communication through Internet, for a flat monthly fee. However, after the acquisition the main service is going to be broadband.

The company employs 440 people, 140 of whom work for Telio and 300 work for NextGenTel. Telio owns four subsidiaries and operates in Norway, Denmark, Switzerland and the Netherlands, and its share is traded on the Oslo Børs since 2006.

Key people

Eirik Lunde – CEO

Eirik Lunde has more than 26 years of experience in the telecommunications and technology industries. Mr Lunde has held several senior positions; most recently as the CEO of telecommunications provider Ventelo Norge. Mr Lunde holds a degree of marketing economist from NMH, and executive MBA from Insead and London Business School.

Tom Nøttveit – CFO

Tom Nøttveit has more than 19 years of experience in the telecommunications and IT industries and has held several key positions; such as the CFO of Norman ASA and accounting director of Norman ASA. Mr Nøttveit holds a degree in Business Administration (BBA) from Pacific Lutheran University and the Norwegian 'Siviløkonom' degree.

Erik Osmundsen – Chairman of the Board

Erik Osmundsen serves as the Chairman of the board since May 3, 2006. Mr Osmundsen is also the CEO of waste management company Norsk Gjenvinning AS. He has previously held several senior positions; among them the position of investment director at Kistefos and Senior Engagement Manager at McKinsey & Co. Mr Osmundsen holds an MBA from Harvard Business School and MSc in Business from the Norwegian School of Management (BI).

Largest shareholders

Telio Holding shareholders		
Investor	# of shares	% of total
Veen A/S T.D.	2,119,704	9%
Talir Holding AS	1,810,000	8%
Xfile AS	1,500,000	6%
UBS AG	1,419,889	6%
J.P. Morgan Chase Bank N.A. London	1,282,894	6%
Frank Mohn A/S	930,000	4%
Siljan Industrier AS	913,598	4%
Aker Pensjonskasse	804,887	3%
Synesi AS	750,000	3%
Optinvest II AS	615,502	3%
Zico AS	521,500	2%
Midelfart Invest AS	515,000	2%
Verdipapirfondet Alfred Berg Gamba	505,999	2%
Sandnes Investering AS	500,000	2%
Storebrand Vekst	485,811	2%
Arctic Funds PLC	452,636	2%
OP-Europe Equity Fund	419,551	2%
Sirius AS	400,000	2%
Storebrand Optima Norge A	302,967	1%
NHO - P665AK	299,000	1%
Other investors	6,734,242	29%

Source: Infront / The Online Trader, updated 03.07.2013

Brief history of Telio

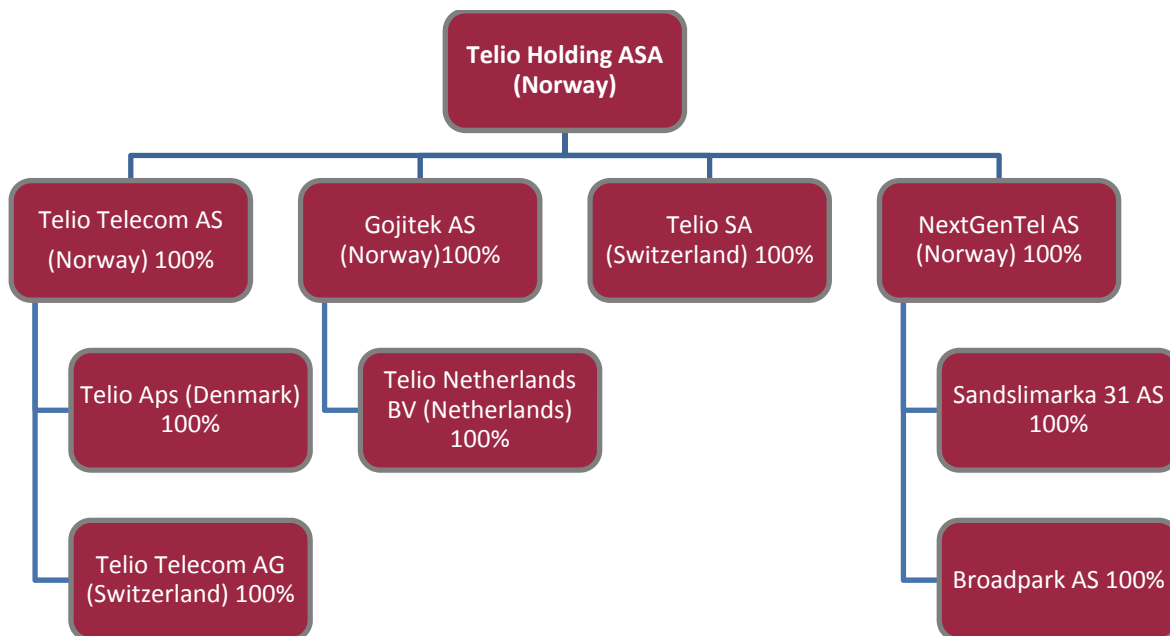
Telio was founded by Aril Resen, Alan Duric and Espen Fjogstad in 2003, who all were veterans from Global IP Sound. In the following year the first VoIP service was launched to Norwegian customers. The early VoIP service was intended to be a fixed telephone line replacement with a flat fee pricing for domestic calls only.

In 2006 the GSM mobile service for Norwegian VoIP customers was added to the product range. However, currently users can become GSM subscribers without subscribing to VoIP land lines. The same year Telio was listed on the Oslo Børs.

In 2007 VoIP service was launched for corporate clients and mobile VoIP service was first introduced to the market. 2010 was an important year for the company, as it acquired VoIP provider Bellit AS, entered the Swiss market and launched Telio touch and Teliophone in the Norwegian market.

In the following years Telio launched Goji and SkyCall mobile apps as well as broadband service for the Norwegian market. SkyCall phone app was developed for Norwegian Air Shuttle airlines, which offers free broadband to its customers during flights.

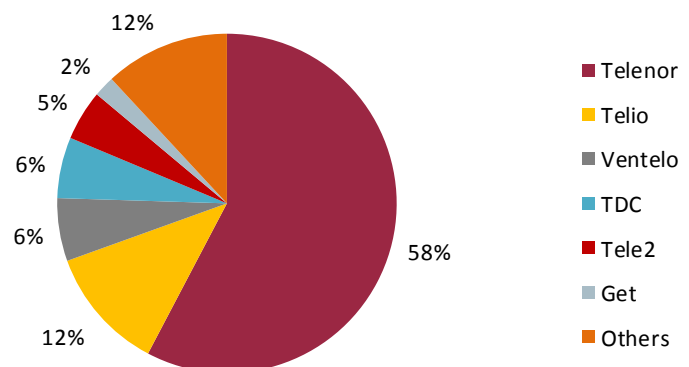
As of the end of 2012, Telio VoIP users can call 200 international destinations.



Source: Telio

Telio is the second largest fixed telephone operator in Norway, holding approximately 12% of the total market. For comparison Telenor has the biggest share of roughly 58%. Other companies have 6% or less of the Norwegian market (see chart below).

Landline telephone operators in Norway (1H12)

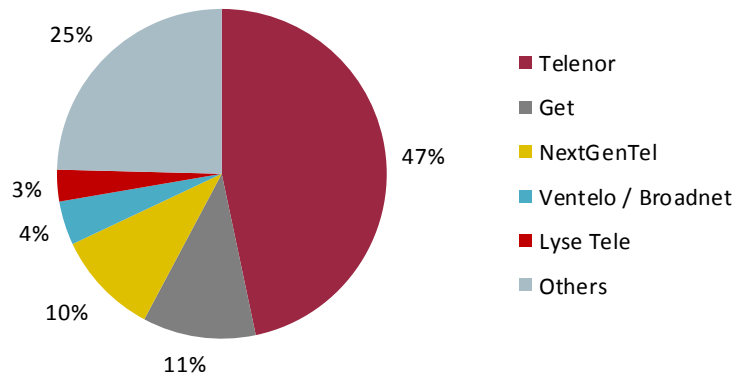


Source: Norwegian Post and Telecommunications Authority, Norne Securities

Brief history of NextGenTel

The company was founded in 2000 by six telecom industry veterans and was the first to offer television services over the DSL technology in Norway. After expansion and a number of acquisitions NextGenTel became the third largest fixed broadband provider in Norway. The company has roughly 10% of the whole market. The largest player in the broadband market is Telenor which holds approximately 47% of the Norwegian market, but its market share has slightly decreased over the last few years. The second largest provider is Get with 11% share.

Broadband providers in Norway (1H12)



Source: Norwegian Post and Telecommunications Authority, Norne Securities

In addition to Broadband (ADSL, VDSL and fiber), NextGenTel also offers the following services:

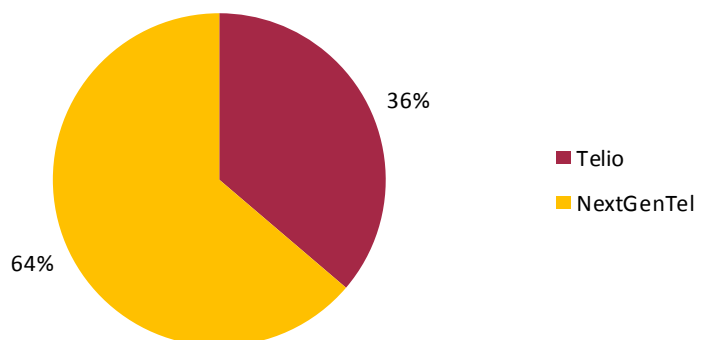
- Mobile broadband through NetCom;
- VoIP;
- Television.

However, NextGenTel is a relatively small player in these segments. For example, the company has only 0.9% of VoIP market in Norway.

Telio after acquisition

Following the acquisition, the distribution of Telio's income from services has shifted. We estimate that the largest part of revenues will come from the broadband market as 81% of NextGenTel customers are fixed broadband subscribers.

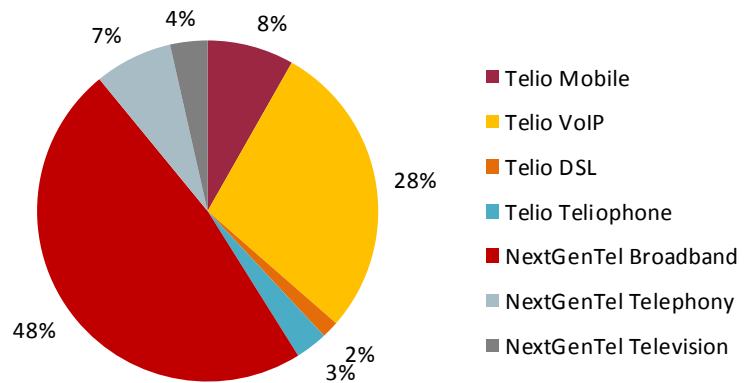
Revenue estimates after the acquisition of NextGenTel (FY14E)



Source: Norne Securities

Customer distribution by service also shifted after the acquisition. The largest part of customer base is composed of broadband customers, which accounts to roughly 50% (NextGenTel and Telio). As can be seen from the graph below, the share of VoIP has decreased to 28% after the acquisition.

Norwegian customer breakdown after the acquisition (1Q13)



Source: Telio, Norne Securities

These changes make broadband the most important revenue source for the company.

VoIP remains one of the key services for Telio

Second most important source of income for Telio is the VoIP service to consumers and small businesses. VoIP or Voice over Internet Protocol is way of delivering voice communication through internet, rather than through standard telecom line. The VoIP costs are usually significantly lower than the traditional landline phones, because this technology uses already built infrastructure of other Internet services. In addition, IP telephony also allows video communication and instant messaging.

Traditional telecom companies charge their customers for the duration of the call, while Telio charges a flat monthly subscription fee for unlimited calling in Norway and to many international destinations. This pricing strategy is attractive to people and companies who use more minutes and international calling.

Telio segment metrics:

Segment metrics	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13E	3Q13E	4Q13E
Norway - Telio								
Revenue, NOKm	75.1	76.2	78.0	86.6	87.7	87.3	86.8	86.4
ARPU*, NOK	658.7	656.3	651.0	692.6	686.8	679.9	673.1	666.4
EBIT per customer, NOK	128.3	145.5	69.6	15.1	101.0	179.8	117.2	76.4
Customer Growth, QoQ%	1.9%	2.0%	4.3%	4.4%	0.0%	0.5%	0.5%	0.5%
Norway - NextGenTel								
Revenue, NOKm	-	-	-	-	147.5	220.8	220.5	220.3
ARPU, NOK	-	-	-	-	799.5	1,209.1	1,209.1	1,209.1
EBIT per customer, NOK	-	-	-	-	51.6	77.4	77.4	77.4
Customer Growth, QoQ%	-1.1%	-0.5%	-0.5%	0.0%	-1.6%	-0.2%	-0.2%	-0.1%
Denmark								
Revenue, NOKm	9.6	9.2	8.9	9.0	9.2	8.7	8.5	8.6
ARPU, NOK	490.5	468.9	458.0	465.2	476.6	456.6	445.2	452.9
EBIT per customer, NOK	121.2	112.6	116.7	117.8	133.8	101.6	79.1	80.5
Customer Growth, QoQ%	0.2%	-0.8%	-0.4%	-0.7%	-0.6%	-0.3%	-0.3%	-0.3%
Netherlands								
Revenue, NOKm	9.7	9.6	9.5	10.7	11.4	14.8	14.5	15.4
ARPU, NOK	176.6	163.5	145.6	141.7	136.0	158.6	141.2	137.5
EBIT per customer, NOK	68.3	63.6	59.7	58.5	65.0	72.6	66.3	63.7
Customer Growth, QoQ%	7.9%	6.6%	11.2%	15.5%	11.2%	11.1%	10.3%	9.0%
Switzerland								
Revenue, NOKm	4.1	4.4	4.5	4.7	5.0	4.8	4.8	4.7
ARPU, NOK	612.4	633.0	622.7	618.1	652.0	633.0	622.7	618.1
EBIT per customer, NOK	57.3	29.4	154.2	-61.8	43.6	17.9	-9.0	11.6
Customer Growth, QoQ%	11%	6%	3%	5%	0.2%	0.2%	0.2%	0.2%

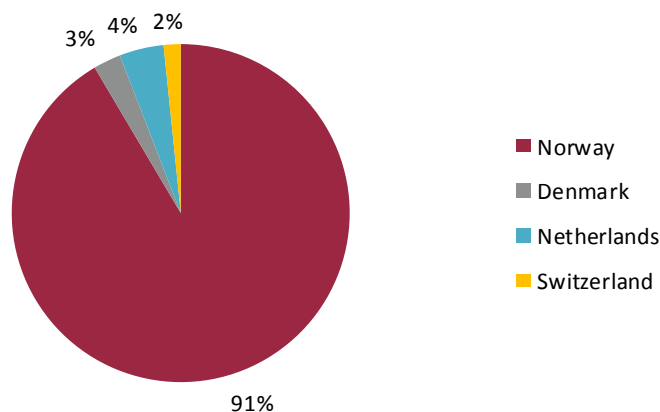
*ARPU (Average revenue per user)

Source: Telio, Norne Securities

Lion's share of Telio's earnings comes from Norway

After the acquisition, more than 90% of Telio total revenues come from the Norwegian telecommunications market, as can be seen in the graph below. Other countries constitute less than 10% in 1Q13, but their share is going to be even smaller in the coming quarters as in 1Q13 revenues from NextGen-Tel are understated by one month (the acquisition happened at the end of January 2013). We estimate that almost 91% revenues in FY14 will come from Norway.

Revenue by country (FY14E)

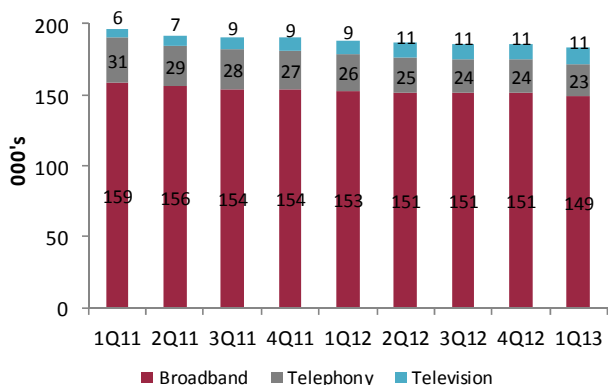


Source: Norne Securities

Largest part of revenues comes from fixed broadband

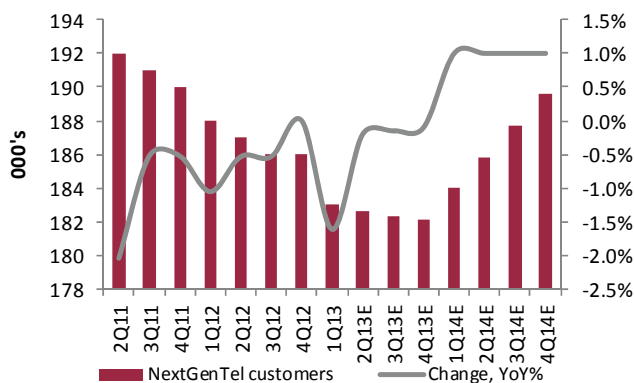
As we mentioned previously, after the acquisition the largest share of revenues will come from the Norwegian broadband market, as NextGenTel revenues are roughly twice the size of Telio's revenues. The largest part of NextGenTel's customers are fixed broadband users. Other services have much smaller number of clients. However, the number of customers of NextGenTel is declining, as can be seen from the graph below. We don't expect any breakthroughs in FY13, because Telio is preoccupied with the acquisition. Nevertheless, in 2014 we expect the trend to reverse as the number of fixed broadband users is continuously increasing in the Norwegian market. In 1H12 75% of households had broadband connection and we believe that the percentage should increase in the future. Moreover, Telio has a good track record and should help NextGenTel to reverse the trend, in our view.

NextGenTel customer breakdown



Source: Telio

Customer Base

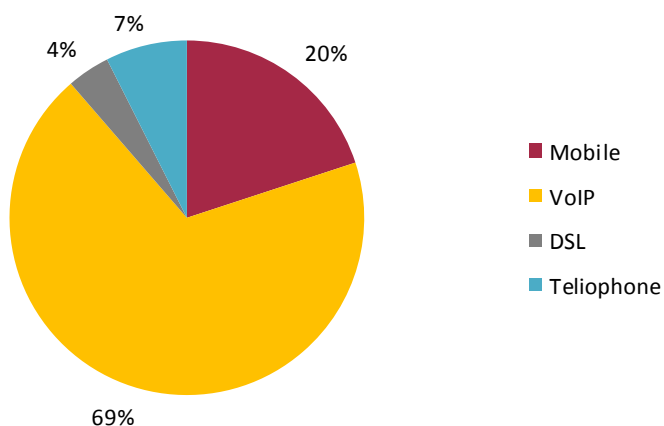


Source: Norne Securities

VoIP is still key service

The profits of Telio are dependent on the sales and margins of the VoIP since it is the second most important source of income for the company. As can be seen from the graph below 69% of Telio's customers (excluding NextGenTel) subscribe to VoIP.

1Q13 Norway customer breakdown, excluding NextGenTel

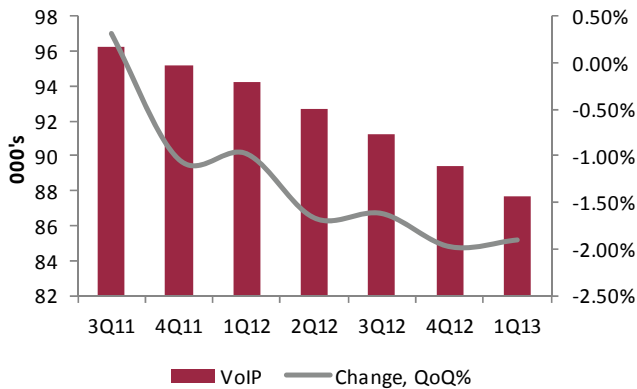


Source: Telio, Norne Securities

Notably, the number of VoIP subscribers has been decreasing steadily for the past six quarters and the company lost 8.8% of its VoIP customer base from 3Q11 to 1Q13. This was followed by ARPU (average revenue per unit) decrease of 7% for the period.

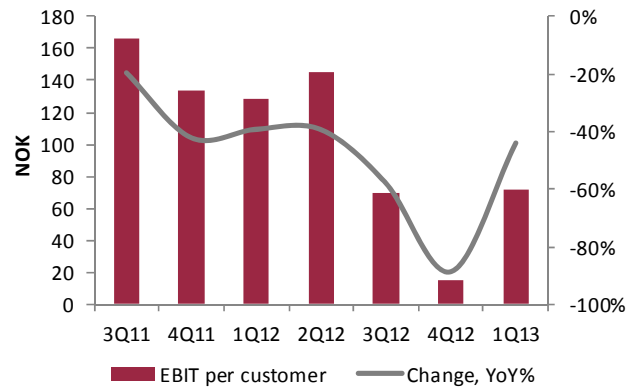
These developments along with increasing operating costs have led to deterioration of profit margins. Admittedly, the trend of diminishing profit margins is a long-term market development, likely caused by increasing competition and the decline in number of landline subscribers. The sharp decrease of profit margins in 3Q12 and 4Q12 was caused by an increase in customer acquisition costs and the VoIP cost pressures to key call destinations. As it can be seen from the graph below, the EBIT per customer (YoY) decreased for every quarter since 3Q11. But we expect reversal of this trend as Telio in the last two quarters of FY12 has spent extra resources to acquire new customers, which should start yielding results in the near future.

Norway VoIP Customers, excluding NextGenTel



Source: Telio, Norne Securities

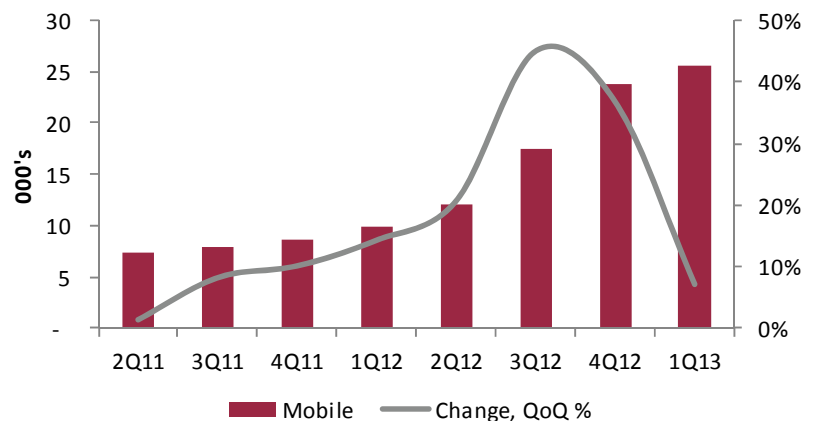
Noway EBIT per customer, excluding NextGenTel



Source: Telio, Norne Securities

The only product showing constant growth is the mobile service. As it was mentioned previously, GSM is now offered to all clients and not just the VoIP customers. However, the margins for mobile market are significantly lower than in the VoIP market. Telio's VoIP gross margin is 70%, whereas the margin for mobile is approximately 30%. The graph below demonstrates that the growth of mobile subscribers slowed down in 1Q13 as the company reduced its efforts to acquire new customers and focused on acquisition of NextGenTel. The DSL and the Teliophone services have been stagnant for the past few quarters.

Mobile Customers

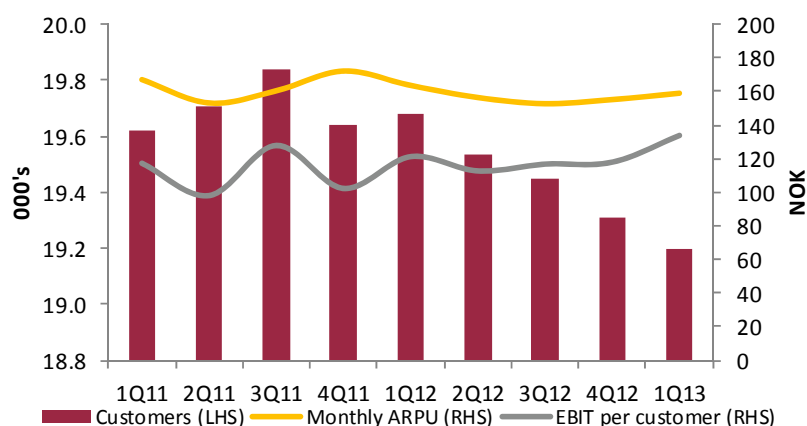


Source: Telio, Norne Securities

Denmark: High margins, but declining customer base

Sales in Denmark represented 8% of total revenues before the acquisition. Although the client base in Denmark is decreasing, the ARPU and profit margins have remained largely stable. The reasons for the customer base decline are similar to those in Norway. However, due to the small share in total revenues the impact of the shrinking client base on total Telio's revenues is modest.

Denmark

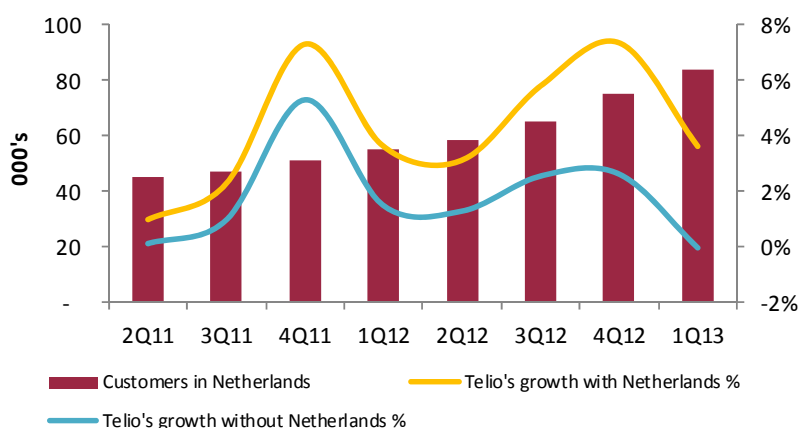


Source: Telio, Norne Securities

Netherlands: High growth at the cost of lower margins

The client base in Netherlands is largest outside of Norway (9.6 % before the acquisition). This country has also been the fastest growing market. The client base in Netherlands grew by 43% in 2012 and we expect the growth to persist in the near future, but to moderate in 2014.

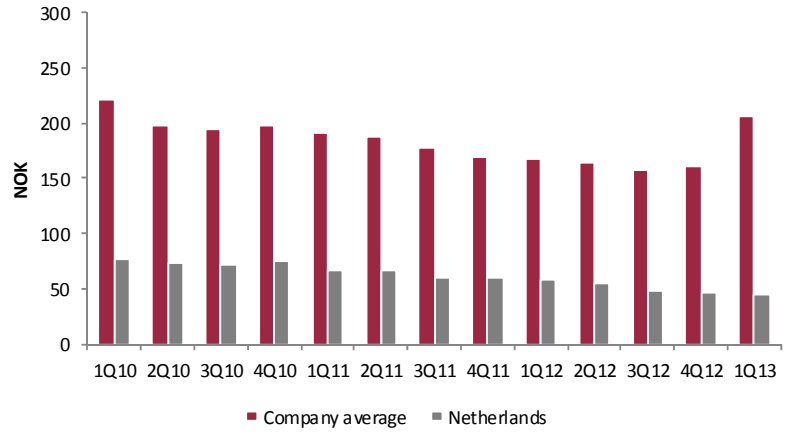
Netherlands



Source: Telio, Norne Securities

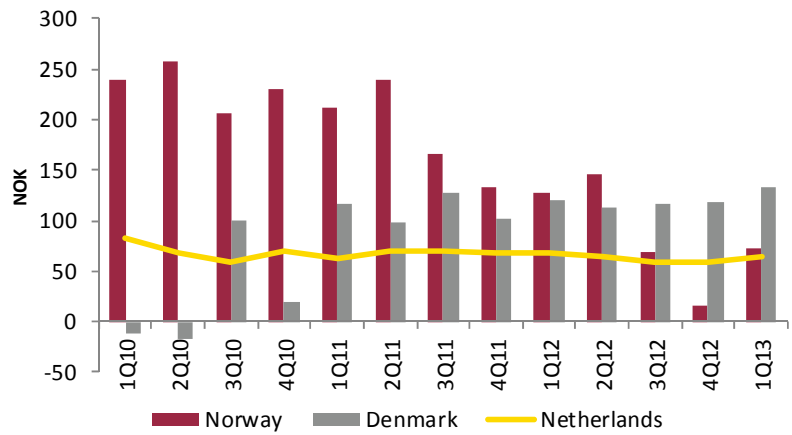
It is worth noting that Telio operates using white label agreements in Netherlands. Distribution using white label agreements is reflected in the lower monthly ARPU for the segment. As could be seen from the graph below, the monthly average revenue per customer in the Netherlands is almost 4 times lower, than Telio's monthly ARPU and this implies lower margins.

Monthly ARPU



Source: Telio, Norne Securities

EBIT per customer

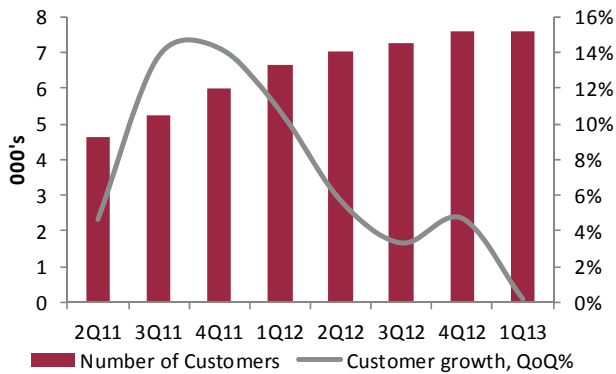


Source: Telio, Norne Securities

Switzerland: Early stage of growth

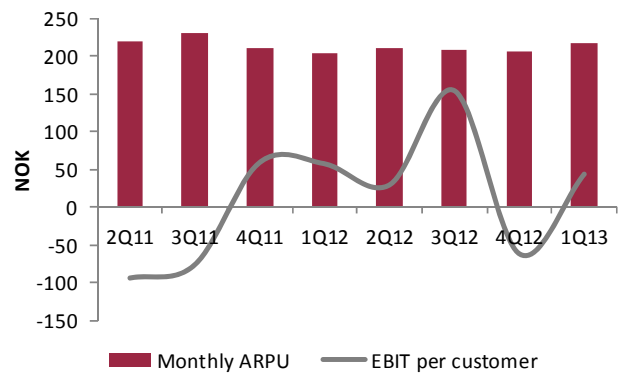
Only 2% of revenues come from Switzerland. Even though the client base of Telio is growing in Switzerland, it is still small compared to other countries and the least profitable. In our view, this is justified given brief presence in the Swiss market, but as the growth slows the prospects for the segment remain cloudy.

Switzerland



Source: Telio, Norne Securities

EBIT per customer

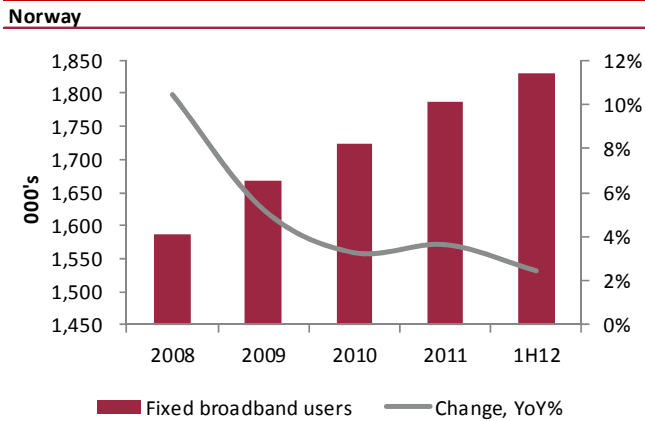


Source: Telio, Norne Securities

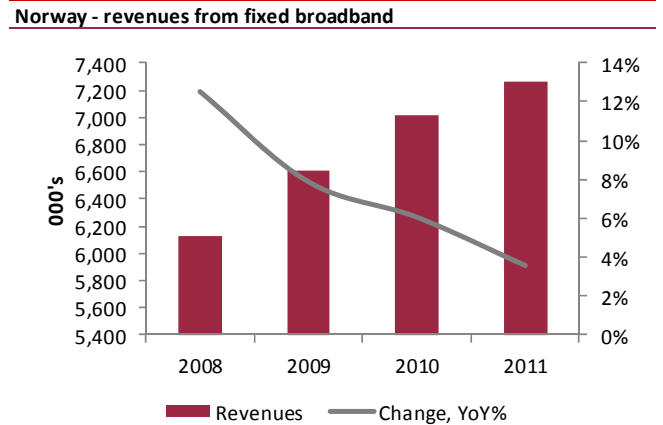
The Norwegian telecommunications market overview

Fixed broadband user base is growing in Norway

We can see from the graph below that the fixed broadband user base is growing, but at a slowing pace. We believe that overall the growth should persist in the Norwegian market and thus Telio's user base should start growing as well. The trend of revenue growth is similar to that of customers.



Source: Norwegian Post and Telecommunications Authority, Norne Securities

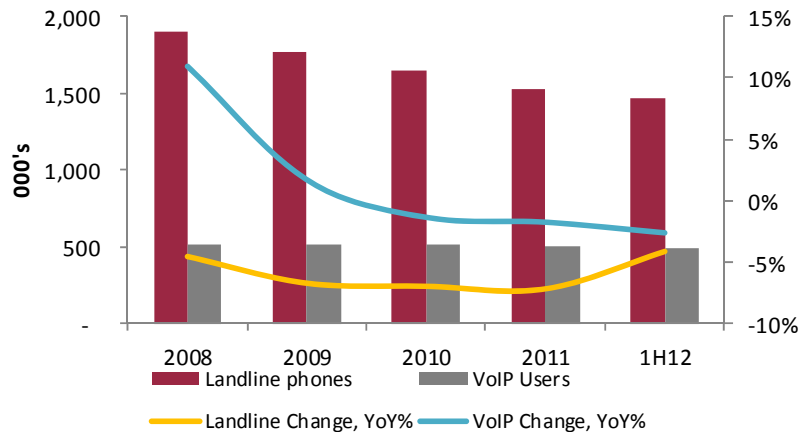


Source: Norwegian Post and Telecommunications Authority, Norne Securities

Decline of fixed telephony

The landline phone market in Norway has passed its peak and has been declining for some time now. Starting from 2007 the market has not seen increasing number of subscribers nor revenues. Revenues from landline phones have decreased by 34% from 2007 to 2011, while the total call duration from landline phones has decreased by 46% over the same period. The VoIP segment proved resilient during the crisis, but has stagnated afterwards.

Norway: subscribers

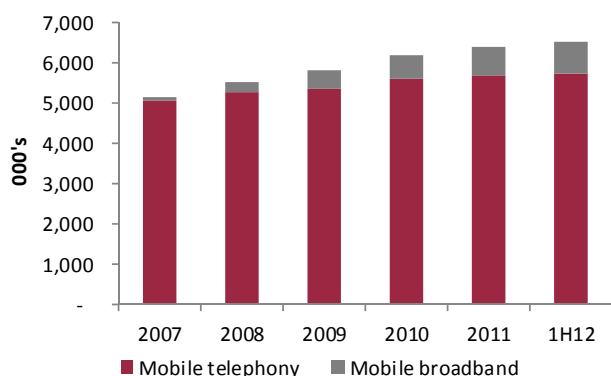


Source: Norwegian Post and Telecommunications Authority, Norne Securities

Mobile market

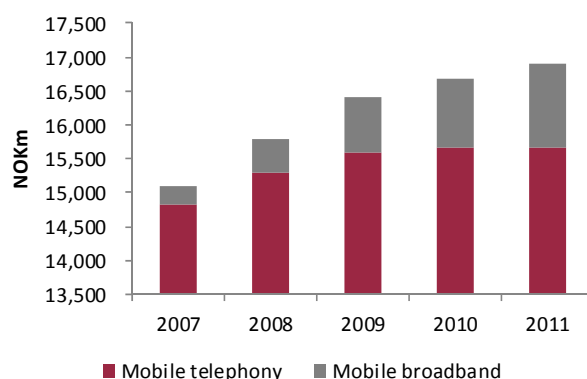
The broadband and mobile broadband services are among growing in the Norwegian telecommunications market. The expansion of Mobile market caused the decline of landline phone market. From 2007 to 1H12 the number of mobile telephony subscribers increased by 14%. Revenues from mobile segment grew by 6% over the last five years. Number of mobile broadband customers grew by 718%, over the last five and a half years, while revenues rose by roughly 350% over the last five years. Admittedly, only a small part of Telio's revenues come from mobile, but we believe that there is growth potential for Telio mobile services.

Norway Subscribers



Source: Norwegian Post and Telecommunications Authority, Norne Securities

Norway Revenues



Source: Norwegian Post and Telecommunications Authority, Norne Securities

Estimates

P&L: 2Q13 and full year 2013

Telio issued the following targets for the full-year 2013 results at its Capital Markets Day on March 5th.

- Revenues of NOK 1.342 bn
- Gross margin of 53%
- EBITDA margin 21%
- EBIT margin 8%

However, the reported revenues should be a bit smaller, because the target revenues of Telio include results of one month from NextGenTel prior to its acquisition. Based on the company's targets, long-term trends of declining ARPU's and decreasing customer base, we forecast FY13 revenues of NOK 1.264bn. For 2Q13 we forecast revenues of NOK 336m. We estimate FY13 EBITDA to be NOK 279m, based on shrinking margins and increased costs. We estimate EBITDA of NOK 73m for 2Q13. Notably, we believe there should be large synergies in the company after the acquisition. Thus, Telio has some room to surprise the market with EBITDA positively going forward, in our view.

2014

Telio has the following targets for full-year 2014.

- Revenues of NOK 1.348bn
- Gross margin of 53%
- EBITDA margin 24%
- EBIT margin 13%

We are more conservative with our forecasts and await company's actions to reverse the trend of shrinking customer base and declining ARPU margins of their VoIP segment. Due to these reasons we forecast revenues of NOK 1.292bn. However, we expect gross and EBITDA margins to be broadly in line with Telio's targets. Admittedly, these expectations might be on the conservative side.

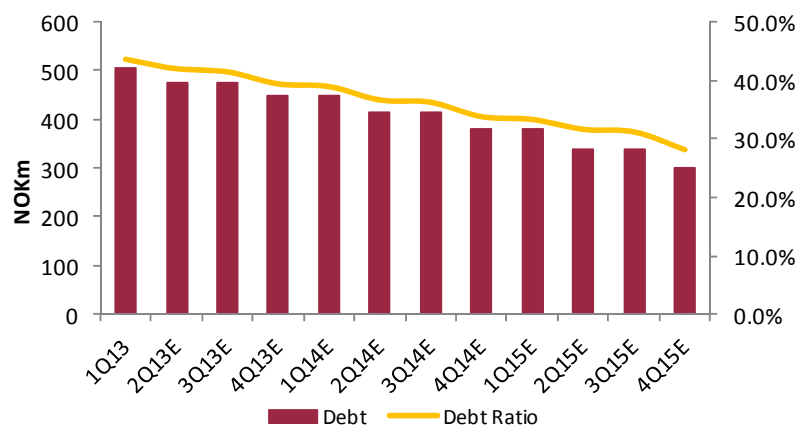
Long-term estimates

The crucial issue in the long term is how successful Telio will be in integrating NextGenTel and reversing the trend of customer decline. In our view and looking at Telio's track record, the company is well positioned to succeed, but visibility is low. Notably, we anticipate the VoIP market to continue struggling with shrinking customer base, declining margins and increasing competition. However, growth in broadband and mobile segments will likely offset the effect of VoIP decline in the Norwegian market.

Strong Balance sheet

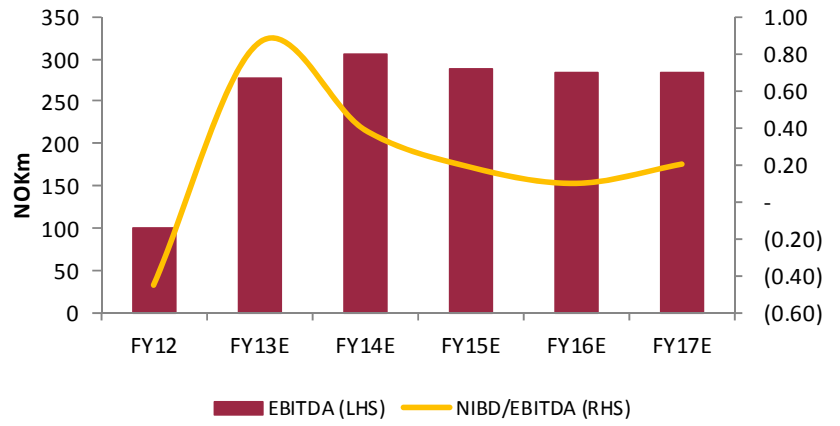
Currently, Telio has an outstanding debt of NOK 506m and cash of NOK 158m (ex NOK 103m that belong to TeliaSonera after the acquisition of NextGenTel). Net interest-bearing debt (NIBD) at the end of 1Q13 was NOK 347m. This and positive estimated cash flows imply a solid and declining debt and NIBD/EBITDA ratios over the coming years.

Debt Ratio



Source: Norne Securities

NIBD/EBITDA



Source: Norne Securities

Dividends

Telio has a dividend policy to distribute 2/3 of consolidated profits after tax to shareholders. For FY12 the company has not paid any dividends due to acquisition of NextGenTel. We expect dividend payments for FY14, albeit not higher than 50% of net income due to bond covenants. Notably, Telio has a substantial positive cash flow, implying a strong ability to pay high dividends and potentially could become an attractive dividend case in the future.

Valuation

DCF

In estimating the fair value of the company we used DCF calculations based on the assumptions above. The forecasted free cash flows were discounted at a rate of 9.3% (WACC). Our calculated fair value is NOK 1,256m or NOK 53.95 per share.

NOKm	2Q13- 2013E	2014E	2015E	2016E	2017E
Revenues	1,001	1,275	1,204	1,193	1,185
EBIT	96	144	139	139	139
<i>Tax on EBIT</i>	-27	-40	-39	-39	-39
NOPLAT (+)	69	104	100	100	100
<i>Depreciation & amortization (+)</i>	132	161	148	146	144
<i>Capital expenditure (-)</i>	-85	-113	-119	-121	-123
<i>Change in working capital (- or +)</i>	11	-6	-4	-3	-2
Free Cash Flow to the Firm	127	145	126	122	119
NPV of FCFF	119	124	99	88	78

WACC calculation		Valuation, NOKm		Assumptions	
Debt ratio	46.0%	Net debt	347	L.t. growth	2.00%
Cost of debt (after tax)	5.3%	Minority interest	0	Tax rate	28%
Risk free rate	3.0%	NPV cash flow		# shares, m	23.3
Beta	1.6	2Q13-2017E	508		
Market risk premium	6.0%	2018E-	1,095		
Cost of equity	12.6%	Total NPV cash flow	1,603		
WACC	9.3%	Equity value	1,256		
		Value per share, NOK	53.95		

DCF sensitivity										
NOK/share		L.t. growth								
		0.0%	0.5%	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%	4.0%
WACC	8.9%	45.58	48.08	50.90	54.10	57.77	62.01	66.98	72.87	79.97
	9.1%	44.30	46.67	49.34	52.36	55.81	59.78	64.40	69.86	76.39
	9.3%	43.08	45.33	47.86	50.71	53.95	57.67	61.99	67.05	73.08
	9.5%	41.91	44.05	46.45	49.14	52.20	55.69	59.73	64.44	70.01
	9.7%	40.79	42.82	45.10	47.65	50.53	53.82	57.60	61.99	67.15

Peer-based SOTP

We also looked at the company's fair value as implied by peer multiples. We used the average EV/EBIT of 2014 to value each segment. The SOTP approach returned the fair value of NOK 44.88 per share.

Valuation: Sum of the parts			
	Value, NOKm	Value/sh NOK	Comment
Norway	1,241	53.29	EV/EBIT of 11.8 x 2014E EBIT
Denmark	66	2.85	EV/EBIT of 11.2 x 2014E EBIT
Netherlands	300	12.88	EV/EBIT of 12.1 x 2014E EBIT
Switzerland	11	0.47	EV/EBIT of 12.9 x 2014E EBIT
Eliminations and other	-226	-9.70	EV/EBIT of 11.8 x 2014E EBIT
Enterprise value	1,392	59.79	
Net debt	347	14.90	Last reported
Equity value	1,045	44.88	Based on 23.3m shares

Forward valuation of Telio is depressed vs. peers

As can be seen from the peer comparison table, Telio currently trades at 65% discount compared to Norwegian peers FY14 EV/EBITDA and at 39% discount to FY14 P/E.

Applying the Norwegian peer average forward P/E for 2014 we arrive at the fair price of NOK 42.17. Calculations of fair value based on average Norwegian peer FY14 EV/EBITDA multiple give us NOK 72.72 per share.

Peer comparison												
USDm		EV	EV/EBIT			EV/EBITDA			P/E			Market
Company	Source		NTM	2013E	2014E	NTM	2013E	2014E	NTM	2013E	2014E	Cap.
Telio Holding	Norne	164	6.2	7.4	5.0	2.7	3.0	2.4	8.9	10.3	7.6	104
Norwegian peers												
Telenor	Infinancials	38,459	10.2	10.7	9.7	6.3	6.5	6.1	11.4	12.0	10.8	30,768
TeliaSonera	Infinancials	37,887	11.1	11.5	10.8	7.2	7.2	7.1	10.4	10.6	10.2	28,333
Tele2	Infinancials	7,704	16.3	17.8	15.0	7.8	8.2	7.4	18.1	19.1	17.3	5,362
TDC	Infinancials	10,545	11.7	11.8	11.6	6.1	6.0	6.1	11.5	11.9	11.1	6,481
Average			12.3	12.9	11.8	6.8	7.0	6.7	12.8	13.4	12.3	
<i>Premium (discount)</i>			<i>-50%</i>	<i>-43%</i>	<i>-58%</i>	<i>-60%</i>	<i>-57%</i>	<i>-65%</i>	<i>-31%</i>	<i>-23%</i>	<i>-39%</i>	
Danish peers												
TDC	Infinancials	10,545	11.7	11.8	11.6	6.1	6.0	6.1	11.5	11.9	11.1	6,481
TeliaSonera	Infinancials	37,887	11.1	11.5	10.8	7.2	7.2	7.1	10.4	10.6	10.2	28,333
Average			11.4	11.6	11.2	6.6	6.6	6.6	10.9	11.3	10.6	
<i>Premium (discount)</i>			<i>-46%</i>	<i>-36%</i>	<i>-55%</i>	<i>-59%</i>	<i>-54%</i>	<i>-64%</i>	<i>-18%</i>	<i>-9%</i>	<i>-29%</i>	
Netherlands peers												
KPN	Infinancials	25,568	12.5	12.3	12.7	4.9	4.8	4.9	8.8	7.9	10.0	8,863
Tele2	Infinancials	7,704	16.3	17.8	15.0	7.8	8.2	7.4	18.1	19.1	17.3	5,362
Belgacom	Infinancials	9,601	8.2	7.9	8.5	4.4	4.4	4.5	9.6	9.1	10.0	7,091
Average			12.3	12.7	12.1	5.7	5.8	5.6	12.2	12.0	12.4	
<i>Premium (discount)</i>			<i>-50%</i>	<i>-41%</i>	<i>-59%</i>	<i>-53%</i>	<i>-48%</i>	<i>-58%</i>	<i>-27%</i>	<i>-15%</i>	<i>-39%</i>	
Switzerland peers												
Swisscom	Infinancials	31,695	12.9	13.0	12.9	6.9	7.0	6.9	13.1	13.2	13.1	22,663
<i>Premium (discount)</i>			<i>-52%</i>	<i>-43%</i>	<i>-61%</i>	<i>-61%</i>	<i>-56%</i>	<i>-66%</i>	<i>-32%</i>	<i>-22%</i>	<i>-42%</i>	
Total average			12.2	12.6	11.9	6.5	6.5	6.4	12.3	12.6	12.1	
<i>Premium (discount)</i>			<i>-49%</i>	<i>-41%</i>	<i>-58%</i>	<i>-58%</i>	<i>-54%</i>	<i>-63%</i>	<i>-28%</i>	<i>-18%</i>	<i>-37%</i>	

USD/NOK 5.80

Note: EV calculated as current market capitalization and last reported net debt

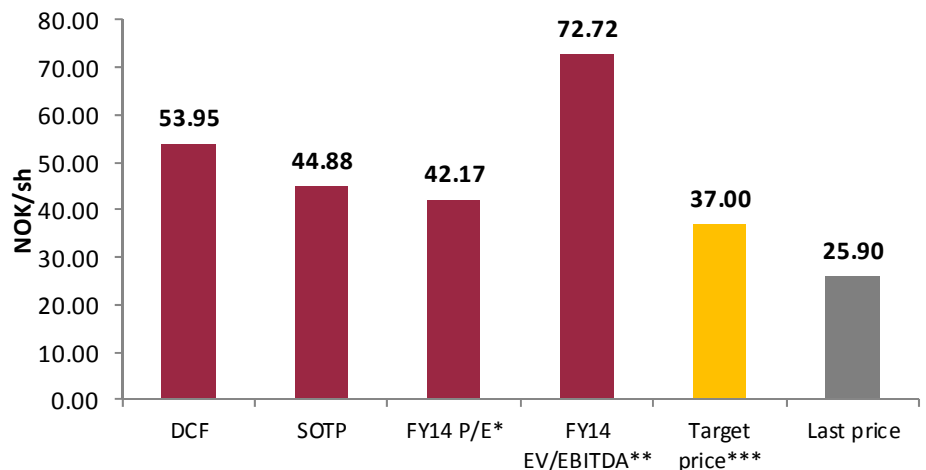
Source: Infront, updated 03.07.2013

Target price and recommendation

All four valuations indicate that Telio share is significantly undervalued. Our target price is obtained by averaging the fair values of all four approaches, applying a discount of 30% and rounding to the nearest integer. We believe that the discount is justified due to Telio's relatively small size, lack of dividends currently, uncertainty in NextGenTel integration and telecom market being in a transition period. However, the present discount to peers is too high in our view.

All in all, we set the target price at NOK 37/share and issue a Buy recommendation. In addition to strong upside, we believe the share price should be driven by successful NextGenTel integration, strong balance sheet and solid cash flows.

Fair value by approach



* Based on FY14 Telio earnings estimate and the average forward P/E of Norwegian peers

** Based on FY14 Telio earnings estimate and the average forward EV/EBITDA of Norwegian peers

***Rounded, discount of 30% applied to the average of four approaches

Source: Norne Securities

P&L statement

NOKm	2008	2009	2010	2011	2012	2013E	2014E	2015E
Operating revenues	384	394	389	385	410	1,262	1,275	1,204
Operating expenses	-275	-264	-257	-261	-310	-985	-970	-917
EBITDA	109	129	132	124	99	278	305	287
Depreciation & Amortisation	-41	-43	-42	-39	-42	-164	-161	-148
EBIT (adj)	68	86	91	85	58	113	144	139
Non-recurring items	-	-	11	-50	-5	-	-	-
EBIT	68	86	101	35	53	113	144	139
Net interest & other financial effects	7	-11	-7	-1	-2	-32	-33	-30
Pre-tax profit	76	75	95	34	51	82	111	110
Minority interests	-	-	-	-	-	-	-	-
Taxes	-15	-17	-10	-4	-14	-23	-31	-31
Profit after tax	61	59	85	30	37	59	80	79
EPS rep. (NOK)	3.13	3.02	4.36	1.53	1.89	2.52	3.42	3.40
EPS adj. (NOK)	2.64	3.07	3.18	3.12	2.08	2.52	3.42	3.40
Margins								
Operating margin	18%	22%	23%	22%	14%	9%	11%	12%
ROE	59%	50%	64%	128%	221%	105%	58%	40%
ROCE	56%	70%	92%	156%	229%	37%	24%	22%
Tax rate	20%	22%	11%	13%	28%	28%	28%	28%
Growth rates (YoY)								
Operating revenues	6%	2%	-1%	-1%	6%	208%	1%	-6%
EBIT (adj)	379%	26%	5%	-6%	-32%	97%	27%	-3%
EPS (adj)	531%	16%	4%	-2%	-33%	21%	36%	-1%

Cash flow statement

NOKm	2008	2009	2010	2011	2012	2013E	2014E	2015E
Operating profit	68	86	101	85	58	113	144	139
Depreciation and amortisation	41	43	42	39	42	164	161	148
Net financial items	10	-9	-4	2	3	-22	-33	-30
Other Non-cash adjustments	-0	6	-5	-50	-4	-171	na	na
Paid taxes	-1	-2	-17	-25	-19	-26	-31	-31
Change in working capital	-19	-10	-18	75	-24	207	-6	-4
Operating cash flow (OCF)	98	114	99	127	55	265	234	223
Capital expenditures	-15	-23	-28	-34	-44	-109	-113	-119
Other investments & asset transactions	na	na	na	na	na	-435	na	na
Free Cash Flow (FCF)	83	90	71	93	11	-279	121	105
Net loan proceeds	-79	-14	-18	-8	-9	442	-70	-80
Dividend paid	-	-58	-116	-57	-48	-	-	-40
Share issues	0	-4	-10	-2	1	100	-	-
Other	-3	4	-1	-0	3	-106	-	-
Change in cash	1	18	-74	25	-41	158	51	-15

Balance sheet

NOKm	2008	2009	2010	2011	2012	2013E	2014E	2015E
Goodwill	-	-	-	-	-	67	67	67
Deferred tax asset	11	4	4	6	11	19	19	19
Licences, property, plant & equipment	51	48	44	42	44	540	493	463
Other intangible assets	-	-	-	-	-	-	-	-
Non-current Assets	62	52	48	47	56	626	579	549
Inventory	-	-	2	11	2	2	2	2
Receivables	73	63	48	56	39	304	283	269
Other current assets	-	-	-	-	-	-	-	-
Cash and cash equivalents	124	142	69	94	52	211	262	246
Current Assets	197	205	119	161	94	517	547	517
Total assets	260	257	168	209	150	1,143	1,125	1,066
Shareholders equity	115	121	72	23	14	165	245	284
Non-controlling interests	-	-	-	-	-	-	-	-
Total equity	115	121	72	23	14	165	245	284
Deferred tax liability	2	-	-	-	-	59	59	59
Long-term interest bearing debt	4	3	2	13	1	380	300	300
Other long-term liabilities	-	-	-	-	-	-	-	-
Non-current liabilities	6	3	2	13	1	439	359	359
Current interest bearing debt	14	12	8	4	6	70	80	-
Trade payables	72	64	48	131	81	395	368	350
Other current liabilities	52	57	38	39	47	74	74	74
Current liabilities	139	133	94	173	135	539	521	423
Total liabilities	145	136	96	186	136	978	880	782
Total liabilities and equity	260	257	168	209	150	1,143	1,125	1,066
Working capital	1	-1	2	-63	-40	-89	-83	-79
Net IB debt	-106	-128	-59	-78	-45	239	118	54
Capital employed	121	124	73	36	15	604	604	643
Net IB debt / equity	-92%	-105%	-82%	-340%	-330%	145%	48%	19%
Equity / total assets	44%	47%	43%	11%	9%	14%	22%	27%

Share data, growth rates, ratios and multiples

NOKm	2008	2009	2010	2011	2012	2013E	2014E	2015E
Shares outstanding, year end (mill.)	19.4	19.4	19.4	19.4	19.4	23.3	23.3	23.3
Share price, year end (NOK)	16.50	38.50	32.40	26.20	24.50	25.90	25.90	25.90
Market cap (NOKm)	320	747	628	508	475	603	603	603
Enterprise value (NOKm)	214	619	569	430	430	842	721	657
EPS rep. (NOK)	3.13	3.02	4.36	1.53	1.89	2.52	3.42	3.40
EPS adj. (NOK)	2.64	3.07	3.18	3.12	2.08	2.52	3.42	3.40
DPS. (NOK)	3.00	6.00	3.00	2.50	-	-	1.71	2.27
Dividend payout ratio	96%	199%	69%	164%	0%	0%	50%	67%

Valuation	2008	2009	2010	2011	2012	2013E	2014E	2015E
EV/Sales	0.57	1.63	1.53	1.18	1.10	0.67	0.57	0.55
EV/EBITDA	1.96	4.79	4.31	3.48	4.32	3.03	2.37	2.28
EV/EBIT (adj)	3.14	7.19	6.29	5.06	7.46	7.42	5.00	4.71
P/E (adj)	6.3	12.5	10.2	8.4	11.8	10.3	7.6	7.6
P/B (excl. goodwill)	2.78	6.16	8.76	22.24	34.84	6.16	3.39	2.78

Growth (YoY)	2008	2009	2010	2011	2012	2013E	2014E	2015E
Revenues	5%	2%	-2%	-2%	7%	219%	2%	-6%
EBITDA	71%	19%	2%	-6%	-20%	179%	10%	-6%
EBIT (adj)	379%	26%	5%	-6%	-32%	97%	27%	-3%
Pre-tax profit (rep)	571%	0%	26%	-64%	50%	60%	36%	-1%
Net profit (adj)	708%	-3%	44%	-65%	24%	61%	36%	-1%
EPS (rep)	708%	-3%	44%	-65%	24%	34%	36%	-1%
EPS (adj)	531%	16%	4%	-2%	-33%	21%	36%	-1%

Margins	2008	2009	2010	2011	2012	2013E	2014E	2015E
EBITDA	28.4 %	32.8 %	34.0 %	32.1 %	24.3 %	22.0 %	23.9 %	23.9 %
EBIT (adj)	17.7 %	21.9 %	23.3 %	22.1 %	14.1 %	9.0 %	11.3 %	11.6 %
Pre-tax profit	19.7 %	19.1 %	24.3 %	8.8 %	12.4 %	6.5 %	8.7 %	9.1 %
Net profit	15.8 %	14.9 %	21.7 %	7.7 %	8.9 %	4.7 %	6.3 %	6.6 %

Profitability	2008	2009	2010	2011	2012	2013E	2014E	2015E
ROE	59.2 %	50.4 %	64.0 %	127.9 %	221.1 %	105.3 %	57.8 %	40.1 %
ROCE	56.0 %	70.4 %	91.8 %	156.3 %	228.6 %	36.7 %	23.9 %	22.4 %
Dividend yield	18.2 %	15.6 %	9.3 %	9.5 %	0.0 %	0.0 %	6.6 %	8.8 %

Recommendation, valuation, risk and updates

Recommendation and target price

Recommendation history for Telio Holding during the last 12 months:

Date	Recommendation	Target price (NOK)
04/07/2013	BUY	37.00

Valuation

To arrive at our share price target we have used the rounded average of peer-based SOTP, DCF analysis and relative valuations.

Risks

The main risks to our target price on Telio Holding are the following:

- Sharper than our forecast decline of VoIP subscribers,
- Faster than anticipated decrease in VoIP margins,
- Tougher competition in mobile market,
- Lack of growth in the broadband segment.

Planned updates

We plan to update the Telio Holding valuation based on the following events:

- The price target is achieved,
- Release of new accounting figures,
- Any significant news from the industry is announced.

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RECOMMENDATION STRUCTURE

GENERAL RECOMMENDATIONS

Norne Securities' general recommendations are based on a twelve-month time horizon and on expected absolute performance adjusted for risk. The table below shows guidelines for determining our recommendations. The percentages in the table below represent the expected return, which consists of an upside to our price target plus dividends within the next twelve months.

Risk	Buy	Hold	Sell
Low	> 10%	2% - 10%	< 2%
Medium	> 15%	3% - 15%	< 3%
High	> 30%	5% - 30%	< 5%

Price targets are based on a combination of several valuation methods. The most frequently used are the Discounted Cash Flow (DCF), Sum Of The Parts (SOTP) and relative valuation methods, depending on the nature of the company.

Our risk assessments range from high risk to medium risk and low risk and are based on a subjective assessment of the following factors: 1) volatility in the share price, 2) liquidity in the share, 3) strength of the balance sheet, 4) absolute earnings level and trend and 5) estimate risk.

TRADING RECOMMENDATIONS

In addition to the above general guidelines, the recommendations "Trading Buy" and "Trading Sell" can be used in the case where the analyst predict a short term share price performance different from the twelve-month general recommendation.

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Distribution of Norne Securities' recommendations during three months up till June 30, 2013:

	Buy	Hold	Sell
Total	31	11	1
% of total	72%	26%	2%
Corporate clients	14	6	1
% of total	67%	29%	5%

Trading Buy recommendation is treated as Buy, and Trading Sell is treated as Sell in the table above.

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Please note that Norne Securities AS operates as a market maker in the shares of Telio Holding and may have holdings for this purpose.

Share holdings of Norne employees in Telio Holding:

Responsible analyst(s)	0
All Norne analysts	0
All Norne employees	0
Norne Securities AS	0

Share holdings of employees are updated continuously. Holdings as a part of Norne Securities' investment services activities such as market making are not included. A list of share holdings of the Norne Securities' employees can be found on <https://www.norne.no/no/Om-Norne-Securities/Ansattes-egen-beholdning/>.

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