Belgacom SA BELG (XBRU) | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
25.58 EUR	20.00 EUR	14.00 EUR	27.00 EUR	Medium	Narrow	Stable	Standard	—	Communication Services

Belgacom's cost-cutting is helping offset revenue weakness.

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The primary analyst covering this company does not own its stock.

Research as of 01 Aug 2014
Estimates as of 22 May 2014
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Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.

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Investment Thesis 01 Aug 2014

As Belgium's primary telecom operator, Belgacom faces tough competition as cable providers aggressively encroach on its fixed-line business. Increased wireless competition is also occurring. Fortunately for shareholders, Belgacom recognizes its limitations and avoids buying growth in areas where it has no competitive advantage. Instead, it returns most of its free cash flow to shareholders in the form of dividends and stock buybacks. We like this strategy, and we expect it to continue.

Bundles of services are very important in Belgium. Telenet has long been a fierce competitor in fixed-line telephone and broadband services, and in 2011, Voo also assumed greater competitive sway. Strong competition continued throughout 2012 and 2013. Telenet has marketed free fixed-line phone service for customers purchasing cable television and broadband. Belgacom has responded by marketing free television service for customers who purchase fixed-line telephone and broadband services. Both strategies have been successful at stealing customers from the other: While the cable operators have taken fixed-line subscribers from Belgacom, Belgacom has equally taken television customers from the cable operators.

Historically, Telenet's superior network allowed it to compete strongly. In 2011, Voo emerged as the more aggressive price competitor, but at the cost of profitability. Although Belgacom has lowered pricing somewhat in response, it has been more successful in maintaining margins. However, the firm increased spending for 2013 and 2014 to improve the quality of its network through the implementation of new technologies to increase the speed of its copper lines over the "last mile." The improved network allows Belgacom to compete better in broadband against the cable operators, which have higher broadband speeds. While this strategy initially hurt margins, we think it will help avoid a price war and move competition more into quality of service.

Vital Statistics

Market Cap (EUR Mil)	7,795
52-Week High (EUR)	24.94
52-Week Low (EUR)	17.83
52-Week Total Return %	41.4
YTD Total Return %	19.4
Last Fiscal Year End	31 Dec 2013
5-Yr Forward Revenue CAGR %	-1.9
5-Yr Forward EPS CAGR %	-3.6
Price/Fair Value	1.29

Valuation Summary and Forecasts

Fiscal Year:	2012	2013	*2014(E)*	*2015(E)*
Price/Earnings	9.4	9.1	*11.5*	*12.2*
EV/EBITDA	4.9	5.2	*6.0*	*6.0*
EV/EBIT	8.4	9.6	*11.1*	*11.2*
Free Cash Flow Yield %	10.1	7.8	*6.7*	*6.7*
Dividend Yield %	11.3	10.2	*6.1*	*6.1*

Financial Summary and Forecasts (EUR Mil)

Fiscal Year:	2012	2013	*2014(E)*	*2015(E)*
Revenue	6,462	6,318	*5,840*	*5,722*
Revenue YoY %	0.9	-2.2	*-7.6*	*-2.0*
EBIT	1,038	916	*876*	*870*
EBIT YoY %	-9.0	-11.8	*-4.4*	*-0.7*
Net Income, Adjusted	712	628	*565*	*560*
Net Income YoY %	-5.8	-11.8	*-10.1*	*-0.8*
Diluted EPS	2.36	2.36	*2.12*	*2.00*
Diluted EPS YoY %	—	—	*-10.0*	*-5.5*
Free Cash Flow	800	646	*671*	*571*
Free Cash Flow YoY %	-13.9	-19.3	*3.8*	*-14.9*

Historical/forecast data sources are Morningstar Estimates and may reflect adjustments.

Profile

Belgacom is Belgium's incumbent telephone operator, offering fixed-line and wireless phone services, broadband Internet access, and television service. It also owns Tango, the second-largest wireless operator in Luxembourg, and Telindus, which provides information and communication technology services in Belgium and neighboring countries. Its international carrier services division is one of the four largest in the world, with particular success in mobile, serving more than 250 operators.

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Morningstar Analysis

Valuation, Growth and Profitability 01 Aug 2014

We are increasing our fair value estimate to EUR 20 per share from EUR 19. We have reduced the amount of revenue losses we expect Belgacom to generate this year to a decline of 6% from a drop of 7.6% previously. This change is driven from lowering the reduction in revenue at the international carrier services division to a decline of 8% from a fall of 12% previously, as well as expecting the small staff and support section to have flat revenue rather than a decline. Our projection for the other divisions is unchanged. We continue to expect the consumer and enterprise divisions' revenue to decline several percentage points organically this year with the enterprise division hit further from selling Telindus France. We anticipate additional declines in the following two years, but at a reduced rate. The telecom market remains competitive in the country, but the worst of the price war after the change in the telecom law at the end of 2012 appears to be over. We estimate more reasonable behavior from the various operators going forward. Still, we don't think broadband and television subscriber growth or increased data usage will be able to offset declines in voice average revenue per user until 2017. While we expect pressure to remain on Belgacom's margins, the divestiture of Telindus actually benefits margins. Additionally, the firm has been more successful than we anticipated at cutting costs. Thus, we expect a rebound in the firm's margins this year with small improvements going forward as cost-cutting benefits come through.

Scenario Analysis

In our bull-case scenario, our fair value estimate is EUR 26 per share. In this case, we expect Belgacom to return its businesses to growth faster than in our base case. Additionally, the cable operators and Chinese company that acquired wireless licenses are unlikely to build a wireless network, and if they did, Belgacom would be able to increase its wireless market share despite their entrance. Also, the loss of fixed-line subscribers would slow, and its broadband and television customers would increase faster than modeled in our base case. To hit this valuation, BICS would also need to grow faster. Under this scenario, the Belgian economy would probably need to improve, allowing the firm to also raise prices to boost ARPU.

In our bear-case scenario, our fair value estimate falls to EUR 14 per share. In this case, the cable firms are more successful in the wireless business, which adds to an increased number of subscribers taking their bundles. The higher defection rate not only causes Belgacom's fixed-line subscriber base to decline faster, but also slows the growth in broadband additions. The increased competition also squeezes margins beyond what we project in our base case. Additionally, the BICS business struggles as mobile usage declines and other operators switch to either their own or other competing networks.

Economic Moat

The incumbent telecom operator in a relatively small country, Belgacom dominates many areas of the industry. It has 73% fixed-line voice penetration market share, 41% wireless market share, 44% broadband market share, and 25% television market share, which is one of the highest for a phone company in Europe. This significant market share means Belgacom can keep the majority of its traffic on its own network, which promotes lower costs and higher profits versus competitors. In addition, its international carrier services business, BICS, ranks in the top four worldwide for carrying voice and data traffic around the world for other carriers. This provides the firm with significant scale, as it offers other carriers access to markets where they lack a proprietary network. Additionally, its wireless spectrum and licenses are required to operate a network. The amount of spectrum is limited and licenses are controlled by the government, which reduces the ability of new entrants with full networks. Collectively, we believe these conditions provide Belgacom with a narrow economic moat. The changing nature of the telecom business and increasing competition reduces our confidence that the firm can

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Price/Fair Value Morningstar data as of Jul 31, 2014

continue to generate excess returns for 20 years, preventing a wide moat rating.

The three Belgian wireless operators don't separate their wireless businesses from their other operations. However, Mobistar and Base derive the vast majority of their business from wireless. These two firms generate EBITDA margins in the mid-30s, which is solid, if not spectacular, for a wireless carrier. Belgacom probably produces even higher wireless margins, given its relatively larger size. The firm breaks its revenue down by consumer and enterprise units, which produce EBITDA contribution margins of around 45% and 47%, respectively. We think these high margins are another indication of Belgacom's moat.

While a fourth wireless operator provides additional risk to Belgacom, Telenet's current base of 713,000 wireless customers is still too small to be profitable with the costs of a full network. We think Telenet views the wireless license it acquired in 2011 more as a future option, and we expect it will only build out, at most, in heavily populated areas. The license didn't cost the firm much--it split the cost with Voo and is paying over 10 years at a cost of about EUR 11.4 million annually--and the firm could merely use it as a ploy to keep wholesale pricing down. However, a Chinese company also acquired a license and may decide to join the fray. On the broadband side, Telenet's network remains significantly faster than Belgacom's. While Belgacom has increased broadband speeds to between 50 and 100 megabytes per second through a combination of dynamic line management and vectoring, this still trails Telenet, which has increased speeds to 160 to 200 MB/second. While the cable companies remain a threat to Belgacom's margins, we think competition between the firm and these rivals will remain rational, and it will remain very profitable.

Moat Trend

We think Belgacom's economic moat is stable. While the firm is losing some share in the fixed-line business, it is holding steady in wireless and broadband and taking significant share in pay television. Many of the fixed-line customers Belgacom has shed have been a result of people cutting phone service or lost to cable television operators. The firm's success in pay television is now attracting some previous customers back and keeping existing ones from leaving. Additionally, the telecom regulator in Belgium is discussing the possibility of requiring cable networks to open their network to third parties, just as telecom operators have been required to for years. We think this would help level the playing field. Finally, Telenet is controlled by Liberty Global, a company with a reputation for being very careful with its cash. We project that company will only build a network in the major cities and will pass on building out a full wireless network in Belgium. We believe Liberty would rather keep wholesale wireless pricing down than engage in a retail price war.

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Bulls Say/Bears Say

Bulls Say

- Despite increased competition, Belgacom continues to maintain the highest market share in fixed-line and wireless telephony and broadband services.
- Despite cutting its dividend, Belgacom still pays a solid dividend, with the stock boasting a gross yield (before foreign and local tax withholding) of about 5.8%.
- Belgacom sold its Telindus France unit to Vivendi for EUR 95 million. While this will reduce revenue by EUR 242 million, the unit generated very little EBITDA.

Bears Say

- Cable television firms are strong in Belgium, with more than 72% penetration in many areas. Some of these systems have also been upgraded to offer broadband speeds of up to 200 MB/second, significantly faster than the speeds that Belgacom offers.
- The Belgian telecom regulator has provisions that give newer entrants a price advantage in the wireless telephone market.
- Belgacom is 53.5% owned by the Belgian government, whose objectives may not be in alignment with minority shareholders'.

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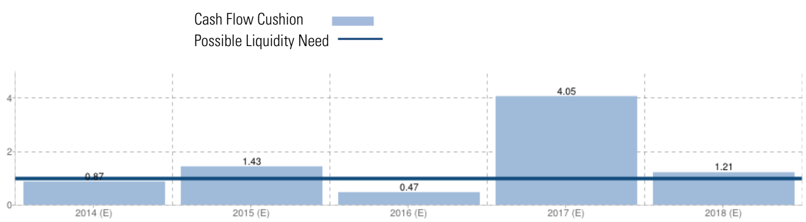
Credit Analysis

Five Year Adjusted Cash Flow Forecast (EUR Mil)

	2014(E)	2015(E)	2016(E)	2017(E)	2018(E)
Cash and Equivalents (beginning of period)	355	483	508	580	707
Adjusted Available Cash Flow	95	-27	20	60	90
Total Cash Available before Debt Service	450	456	528	641	796
Principal Payments	-316	-145	-950	-2	-500
Interest Payments	-120	-120	-120	-120	-120
Other Cash Obligations and Commitments	-83	-53	-53	-36	-36
Total Cash Obligations and Commitments	-519	-318	-1,123	-158	-656

Cumulative Annual Cash Flow Cushion



Adjusted Cash Flow Summary

	EUR Millions	% of Commitments
Beginning Cash Balance	355	12.8
Sum of 5-Year Adjusted Free Cash Flow	239	8.6
Sum of Cash and 5-Year Cash Generation	594	21.4
Revolver Availability	860	31.0
Asset Adjusted Borrowings (Repayment)	—	—
Sum of Cash, 5-Year Cash Generation, Revolver and Adjustments	1,454	52.4
Sum of 5-Year Cash Commitments	-2,774	—

Credit Rating Pillars–Peer Group Comparison

	BELG	Sector	Universe
Business Risk	4		
Cash Flow Cushion	9	—	—
Solvency Score	5	—	—
Distance to Default	5	—	—
Credit Rating	—	—	—

Source: Morningstar Estimates

Note: Scoring is on a scale 1-10, 1 being Best, 10 being Worst

Financial Health & Capital Structure

Belgacom has one of the strongest balance sheets among European telephone companies. Its net debt/EBITDA is only 1.2 times versus an average of about 2 times for the industry. The firm has historically used the majority of its free cash flow to pay a large dividend, buy back stock, and make small incremental acquisitions. In 2012's fourth quarter, it paid a special dividend of EUR 0.31 per share instead of buying back stock. With the stock trading near our fair value estimate, we think this was a better use of its cash. Going forward, we expect Belgacom's free cash flow to taper off. With its reduced free cash flow, we were not surprised to see the firm reduce its dividend for 2014 to EUR 1.50 per share from EUR 2.18. Management said this would be the dividend for the following two years as well. This brings the payout ratio down to about 85% of net income. With the shares now well above our fair value estimate, we hope the firm refrains from buying any more of its shares.

Enterprise Risk

Competition from cable operators represents the biggest risk to Belgacom. Cable firms are rolling out faster broadband service and offering fixed-line telephone service. Currently, there are three wireless networks in Belgium: Belgacom's Proximus, Orange's Mobistar, and KPN's Base. However, the government has sold a wireless license to a joint venture of cable operators Telenet (operating in the north) and Voo (operating in the south) and one to a Chinese company. While we think the license owned by the cable companies will be used more to encourage lower wholesale prices, as Telenet already operates as a mobile virtual network operator, the firms could build out a network in certain areas. As these firms already have strong brand recognition and are in most homes already due to the high penetration of cable, it is relatively easier than in most countries to add a bundle of other services. That said, it would take several years to build an entire fourth wireless network. Building its own network might make it easier for

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Credit Analysis

Telenet to control the pricing on bundles, but we think it would be difficult for the firm to recoup its costs with the high wireless penetration rates in Belgium. Telenet has become more aggressive with wireless pricing, but so far this has hurt Mobistar more than Belgacom. Belgacom's pricing remains higher than the other operators, which it has been able to justify due to its superior network, but lower pricing remains a risk. We think it would be even more difficult for a Chinese company to enter from scratch and make money, but if it did enter, it might cause a deeper price war to try and gain market share.The Belgian telecom regulator is also a concern, as it has policies in place that benefit newcomers at the expense of the incumbent. In 2012, it capped charges allowed on data services. A law was also passed that restricted the length of wireless contracts, which brought increased competition and churn into the market.

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Management & Ownership

Management Activity

Name	Position	Shares Held	Report Date*	InsiderActivity
NA	NA	NA	NA	NA

*Represents the date on which the owner's name, position, and common shares held were reported by the holder or issuer.

Fund Ownership

Top Owners	% of Shares Held	% of Fund Assets	Change (k)	Portfolio Date
iShares International Select Dividend	0.80	1.86	9	30 Jul 2014
VA CollegeAmerica Cap Income Builder	0.80	0.09	-2,500	30 Jun 2014
iShares EURO Dividend	0.58	7.05	264	30 Jun 2014
iShares EURO STOXX Select Div 30 (DE)	0.37	6.85	32	30 Jun 2014
AWI Schroder Income	0.38	1.47	—	30 Apr 2014
Concentrated Holders				
Deka EURO STOXX® Select Dividend 30 ETF	0.10	7.34	—	30 Jul 2014
db x-trackers Euro Stoxx® SelDiv 30 (DR)	0.11	7.34	—	30 Jul 2014
iShares EURO Dividend	0.58	7.05	264	30 Jun 2014
iShares EURO STOXX Select Div 30 (DE)	0.37	6.85	32	30 Jun 2014
First Trust STOXX Euro Select Div Idx	0.09	5.36	—	30 Jul 2014

Institutional Transactions

Top 5 Buyers	% of Shares Held	% of Fund Assets	Shares Bought/ Sold (k)	Portfolio Date
ARCA SGR S.p.A.	0.11	0.42	328	30 Jun 2014
BlackRock Advisors (UK) Limited	0.91	0.12	300	30 Jul 2014
Taube Hodson Stonex Partners LLP	0.09	1.07	297	31 May 2014
Daiwa Sb Investments Ltd.	0.09	0.70	285	08 Jan 2014
Sinopia Asset Management (UK) Ltd	0.08	2.02	249	31 May 2014
Top 5 Sellers				
Capital Research and Management Company	0.80	0.09	-2,500	30 Jun 2014
Government Pension Fund of Norway - Global	0.44	0.01	-1,029	31 Dec 2011
AMP Capital Investors (New Zealand) Ltd	0.01	0.06	-185	31 Mar 2014
Nuveen Fund Advisors, LLC.	0.08	1.26	-167	30 Jun 2014
Setanta Asset Management	0.16	1.66	-158	30 Jun 2014

Management 22 May 2014

There are 14 directors overseeing Belgacom. Half, including the chairman and CEO, are appointed by the Belgian government, a percentage that is aligned with its overall ownership stake. The other half are elected by the other shareholders and are independent. Chairman Stefaan De Clerck is a politician and former Minister of Justice of Belgium. He and CFO Ray Stewart ran the company on an interim basis until the appointment of Dominique Leroy as CEO in January 2014. Leroy was previously executive vice president of Belgacom's consumer business unit. Historically, management has run Belgacom fairly conservatively. The firm has avoided the costly acquisitions of many of its European peers, which has enabled it to have one of the lowest debt/EBITDA ratios in the region. When the firm has made acquisitions, they have mostly been small or strategic and management has been careful of the price paid.

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Analyst Notes

Belgacom Reported Improved Results; Fair Value Estimate Likely Going Higher, but Shares Overvalued 31 Jul 2014

Belgacom reported second quarter revenue that showed sequential improvement. Excluding numerous one-offs in the quarter and only counting one month of revenue from Telindus France, which was sold April 30, revenue was down 4% in the quarter versus our full year projection of a 7.6% drop. We're reassessing our forecast, mainly on the strength of the international carrier services division, which recovered from a disastrous first quarter to generate slight growth causing management to raise guidance for this division. Additionally, margins are holding up better than we anticipated. These tweaks to our forecast are likely to result in a slight increase to our fair value estimate, although we still believe Belgacom shares are overvalued. Our moat rating remains unchanged.

The core business continues to see improvements in the broadband and pay television base, but weak wireless average revenue per user (ARPU). The consumer division grew its broadband base 4.3% to 1.26 million and it TV base 6.7% to 1.53 million, which was partially offset by a 4.2% decline in the fixed-line base to 2.86 million. On the wireless side, the firm lost slightly more prepaid customers than it gained in contract subscribers. However, both types of customers remain under pricing pressure, with contract ARPUs declining 4.6% to EUR 26.7 and prepaid falling 10.3% EUR 12.6. In the enterprise division, the wireless subscriber base grew 11.6% to 1.72 million, but this was offset by a 7.4% ARPU decline and a 4.2% fall in the fixed-line subscriber base. Competition in the Belgian market remains intense due to changes in the telecom laws and aggressive cable operators. We expect these difficult conditions to continue, which we think will prevent Belgacom's revenue growing through at least next year. That said, the firm has cut costs better than we expected and improved its EBITDA margin to 28.8%.

Belgacom Reports Mixed Q1 Results with Weak Revenue, but Better Margins; Shares Slightly Overvalued 08 May 2014

Belgacom reported mixed first quarter results with weak revenue, but better margins. The firm's revenue fell 6.6% year over year versus our full year projection of a drop of 0.8%. The consumer business declined 3% and the enterprise business declined 2.6%, but the real culprit was the international carrier services business (BICS), which plummeted 14.3%. On the consumer side, Belgacom's mobile revenue dropped 7.2% as voice pricing continues to decline, though this is at a lower rate than the previous quarter. We expect this rate of decline will continue to reduce as the year progresses. This decline was partially compensated by slight gains in the fixed-line segment where broadband and pay television customer additions offset the drop in the fixed-line base. The firm continues to push bundles, and is increasingly selling quad play bundles that also include wireless along with fixed-line, broadband and TV. The quad play customers have lower churn and should help Belgacom's performance over time.

In the enterprise unit, the fixed-line side declined 1.8%, while the mobile dropped 4.4%. In both units, the wireless business is starting to recover from the repricing caused with the changes in the telecom law at the end of 2012. BICS was hit from lower voice usage this year and a tough comparison, as it had an extremely good year last year when it picked up a lot of Asian business on a temporary basis.

However, the lower revenue has helped margins as the BICS business has very low margins. Belgacom's EBITDA margin for the quarter was 27.8% versus our full year projection of 27.2%. We expect that the improved margins mostly offset the lower revenues. Thus, while we plan to tweak our model, we don't think it will have a meaningful change to our fair

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Analyst Notes

value estimate or moat rating.

Belgacom Reports Weak Results and Cuts Dividend; Shares Remain Overvalued 28 Feb 2014

Belgacom reported year-end results that were a bit weak, but we are maintaining our fair value estimate and moat rating for now. The firm also cut its dividend for the 2014 year (that will be paid in 2015) to EUR 1.50 per share from EUR 2.18. As we have previously discussed, Belgacom was not generating enough free cash flow to cover the dividend but had debt capacity to maintain the dividend if it chose to. Ultimately, we weren't surprised to see the dividend cut and apparently the market wasn't surprised either as the shares only dropped slightly. We continue to think the shares are overvalued.

The firm's revenue dropped 2.2% year over year versus our expectation of a decline of 1.6%. While the pace of the core telephone unit's revenue decline eased during the fourth quarter, Belgium's economy continues to struggle, causing revenue to fall 4.1% at the Consumer Business Unit and 4.2% at the Enterprise Business Unit. Belgacom continues to slowly add customers in wireless, broadband, and pay television, but lose subscribers in fixed-line telephony. Where it is really being hurt, however, are declines in its wireless average revenue per user, which fell 8.9% in consumer and 17.6% in enterprise. While we anticipate the worst is over, we still expect revenues to fall again in 2014. Additionally, while Belgacom's international carrier services grew revenue by 1.3% for the year, its revenue declined 6.8% in the fourth quarter and was the main reason for the missed revenue.

While this division has low margins, the lost revenue had less of an impact than lost revenue elsewhere--Belgacom's EBITDA margin, excluding asset sales, only came in at 26.6% versus our projection of 26.8%. We expect margins to remain under pressure going forward.

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Morningstar Analyst Forecasts

Financial Summary and Forecasts

Fiscal Year Ends in December

Growth (% YoY)	3-Year Hist. CAGR	2011	2012	2013	*2014* (Forecast)	*2015* (Forecast)	*5-Year Proj. CAGR*
Revenue	*-1.5*	-3.0	0.9	-2.2	*-7.6*	*-2.0*	*-1.9*
EBIT	*-17.3*	-29.5	-9.0	-11.8	*-4.4*	*-0.7*	*1.7*
EBITDA	*-11.2*	-21.9	-5.9	-4.9	*-3.7*	*-1.3*	*-0.5*
Net Income	*-20.9*	-40.3	-5.8	-11.8	*-10.1*	*-0.8*	*0.4*
Diluted EPS	*-20.6*	-40.2	—	—	*-10.0*	*-5.5*	*0.4*
Earnings Before Interest, after Tax	*-20.1*	-40.1	-5.1	-10.3	*-13.2*	*-0.7*	*-0.6*
Free Cash Flow	*-24.1*	-37.0	-13.9	-19.3	*3.8*	*-14.9*	*1.7*

Profitability	3-Year Hist. Avg	2011	2012	2013	*2014*	*2015*	*5-Year Proj. Avg*
Operating Margin %	*16.1*	17.8	16.1	14.5	*15.0*	*15.2*	*16.0*
EBITDA Margin %	*28.0*	29.6	27.6	26.9	*28.0*	*28.2*	*28.4*
Net Margin %	*10.9*	11.8	11.0	9.9	*9.7*	*9.8*	*10.3*
Free Cash Flow Margin %	*12.4*	14.5	12.4	10.2	*11.5*	*10.0*	*11.3*
ROIC %	*14.5*	15.5	15.0	13.0	*11.1*	*10.9*	*11.2*
Adjusted ROIC %	*20.7*	21.9	21.5	18.6	*16.4*	*16.5*	*16.8*
Return on Assets %	*8.4*	9.0	8.6	7.5	*6.7*	*6.7*	*6.9*
Return on Equity %	*23.4*	24.5	23.9	21.9	*19.5*	*18.8*	*19.1*

Leverage	3-Year Hist. Avg	2011	2012	2013	*2014*	*2015*	*5-Year Proj. Avg*
Debt/Capital	*0.41*	0.39	0.41	0.44	*0.44*	*0.43*	*0.42*
Total Debt/EBITDA	*1.16*	1.04	1.11	1.33	*1.39*	*1.40*	*1.39*
EBITDA/Interest Expense	*14.05*	14.82	12.32	15.03	*13.62*	*13.43*	*13.57*

Valuation Summary and Forecasts

	2012	2013	*2014(E)*	*2015(E)*
Price/Fair Value	1.01	1.13	—	—
Price/Earnings	9.4	9.1	*11.5*	*12.2*
EV/EBITDA	4.9	5.2	*6.0*	*6.0*
EV/EBIT	8.4	9.6	*11.1*	*11.2*
Free Cash Flow Yield %	10.1	7.8	*6.7*	*6.7*
Dividend Yield %	11.3	10.2	*6.1*	*6.1*

Key Valuation Drivers

Cost of Equity %	11.0
Pre-Tax Cost of Debt %	5.3
Weighted Average Cost of Capital %	8.8
Long-Run Tax Rate %	28.0
Stage II EBI Growth Rate %	3.0
Stage II Investment Rate %	20.0
Perpetuity Year	10

Additional estimates and scenarios available for download at http://select.morningstar.com.

Discounted Cash Flow Valuation

	EUR Mil	Firm Value (%)	Per Share Value
Present Value Stage I	2,515	30.8	7.88
Present Value Stage II	1,570	19.2	4.92
Present Value Stage III	4,080	50.0	12.79
Total Firm Value	**8,164**	**100.0**	**25.59**
Cash and Equivalents	355	—	1.11
Debt	-2,266	—	-7.10
Preferred Stock	—	—	—
Other Adjustments	-329	—	-1.03
Equity Value	**5,924**	**—**	**18.57**
Projected Diluted Shares	319		
Fair Value per Share (EUR)	—		

The data in the table above represent base-case forecasts in the company's reporting currency as of the beginning of the current year. Our fair value estimate may differ from the equity value per share shown above due to our time value of money adjustment and in cases where probability-weighted scenario analysis is performed.

Belgacom SA BELG (XBRU) | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
25.58 EUR	20.00 EUR	14.00 EUR	27.00 EUR	Medium	Narrow	Stable	Standard	—	Communication Services

Morningstar Analyst Forecasts

Income Statement (EUR Mil)
Fiscal Year Ends in December

				Forecast	
	2011	2012	2013	*2014*	*2015*
Revenue	**6,406**	**6,462**	**6,318**	***5,840***	***5,722***
Cost of Goods Sold	2,517	2,611	2,561	*2,295*	*2,243*
Gross Profit	**3,889**	**3,851**	**3,757**	***3,545***	***3,479***
Selling, General & Administrative Expenses	1,117	1,126	1,142	*1,086*	*1,059*
Other Operating Expense (Income)	860	924	903	*864*	*847*
Other Operating Expense (Income)	15	15	14	*-41*	*-40*
Depreciation & Amortization (if reported separately)	756	748	782	*759*	*744*
Operating Income (ex charges)	**1,141**	**1,038**	**916**	***876***	***870***
Restructuring & Other Cash Charges	—	—	—	—	—
Impairment Charges (if reported separately)	—	—	—	—	—
Other Non-Cash (Income)/Charges	—	—	—	—	—
Operating Income (incl charges)	**1,141**	**1,038**	**916**	***876***	***870***
Interest Expense	128	145	113	*120*	*120*
Interest Income	22	15	17	*30*	*30*
Pre-Tax Income	**1,035**	**908**	**820**	***786***	***780***
Income Tax Expense	262	177	170	*204*	*203*
Other After-Tax Cash Gains (Losses)	—	—	—	—	—
Other After-Tax Non-Cash Gains (Losses)	—	—	—	—	—
(Minority Interest)	-17	-19	-22	*-17*	*-17*
(Preferred Dividends)	—	—	—	—	—
Net Income	**756**	**712**	**628**	***565***	***560***
Weighted Average Diluted Shares Outstanding	321	319	319	*319*	*319*
Diluted Earnings Per Share	**2.36**	**2.23**	**1.97**	***1.77***	***1.76***
Adjusted Net Income	756	712	628	*565*	*560*
Diluted Earnings Per Share (Adjusted)	**2.36**	**2.23**	**1.97**	***1.77***	***1.76***
Dividends Per Common Share	2.19	2.19	2.19	*1.50*	*1.50*
EBITDA	**1,897**	**1,786**	**1,698**	***1,635***	***1,614***
Adjusted EBITDA	**1,897**	**1,786**	**1,698**	***1,635***	***1,614***

Belgacom SA BELG (XBRU) | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
25.58 EUR	20.00 EUR	14.00 EUR	27.00 EUR	Medium	Narrow	Stable	Standard	—	Communication Services

Morningstar Analyst Forecasts

Balance Sheet (EUR Mil)
Fiscal Year Ends in December

				Forecast	
	2011	2012	2013	*2014*	*2015*
Cash and Equivalents	320	202	355	*483*	*508*
Investments	—	—	—	—	—
Accounts Receivable	1,328	1,341	1,289	*1,192*	*1,168*
Inventory	116	133	163	*146*	*143*
Deferred Tax Assets (Current)	—	—	—	—	—
Other Short Term Assets	331	375	356	*331*	*331*
Current Assets	**2,095**	**2,051**	**2,163**	***2,152***	***2,149***
Net Property Plant, and Equipment	2,401	2,467	2,558	*2,616*	*2,674*
Goodwill	2,323	2,339	2,320	*2,225*	*2,225*
Other Intangibles	1,155	1,097	1,185	*1,185*	*1,185*
Deferred Tax Assets (Long-Term)	121	147	105	*105*	*105*
Other Long-Term Operating Assets	214	142	86	*86*	*86*
Long-Term Non-Operating Assets	2	—	—	—	—
Total Assets	**8,311**	**8,243**	**8,417**	***8,369***	***8,424***
Accounts Payable	1,343	1,310	1,320	*1,183*	*1,156*
Short-Term Debt	41	215	316	*316*	*316*
Deferred Tax Liabilities (Current)	—	—	—	—	—
Other Short-Term Liabilities	876	947	876	*876*	*876*
Current Liabilities	**2,260**	**2,472**	**2,512**	***2,375***	***2,348***
Long-Term Debt	1,931	1,761	1,950	*1,950*	*1,950*
Deferred Tax Liabilities (Long-Term)	157	143	128	*128*	*128*
Other Long-Term Operating Liabilities	182	204	315	*315*	*315*
Long-Term Non-Operating Liabilities	479	570	473	*473*	*473*
Total Liabilities	**5,009**	**5,150**	**5,378**	***5,241***	***5,214***
Preferred Stock	—	—	—	—	—
Common Stock	1,000	1,000	1,000	*1,000*	*1,000*
Additional Paid-in Capital	100	100	100	*100*	*100*
Retained Earnings (Deficit)	2,532	2,377	2,310	*2,396*	*2,478*
(Treasury Stock)	-570	-551	-527	*-527*	*-527*
Other Equity	15	-45	-37	*-37*	*-37*
Shareholder's Equity	**3,077**	**2,881**	**2,846**	***2,932***	***3,014***
Minority Interest	225	211	196	*196*	*196*
Total Equity	**3,302**	**3,092**	**3,042**	***3,128***	***3,210***

Belgacom SA BELG (XBRU) | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
25.58 EUR	20.00 EUR	14.00 EUR	27.00 EUR	Medium	Narrow	Stable	Standard	—	Communication Services

Morningstar Analyst Forecasts

Cash Flow (EUR Mil)

Fiscal Year Ends in December	2011	2012	2013	*Forecast 2014*	*Forecast 2015*
Net Income	756	712	630	*582*	*577*
Depreciation	756	748	782	*759*	*744*
Amortization	—	—	—	—	—
Stock-Based Compensation	—	—	—	—	—
Impairment of Goodwill	—	—	—	—	—
Impairment of Other Intangibles	—	—	—	—	—
Deferred Taxes	20	-6	23	—	—
Other Non-Cash Adjustments	—	—	—	—	—
(Increase) Decrease in Accounts Receivable	-103	-3	45	*97*	*24*
(Increase) Decrease in Inventory	-8	-10	-30	*17*	*3*
Change in Other Short-Term Assets	9	13	-7	*25*	—
Increase (Decrease) in Accounts Payable	82	-31	17	*-137*	*-27*
Change in Other Short-Term Liabilities	114	62	-74	—	—
Cash From Operations	**1,626**	**1,485**	**1,386**	***1,343***	***1,321***
(Capital Expenditures)	-757	-773	-852	*-818*	*-801*
Net (Acquisitions), Asset Sales, and Disposals	-20	-20	32	*95*	—
Net Sales (Purchases) of Investments	11	—	—	—	—
Other Investing Cash Flows	1	3	5	—	—
Cash From Investing	**-765**	**-790**	**-815**	***-723***	***-801***
Common Stock Issuance (or Repurchase)	-86	19	25	—	—
Common Stock (Dividends)	-701	-798	-701	*-478*	*-478*
Short-Term Debt Issuance (or Retirement)	32	50	230	—	—
Long-Term Debt Issuance (or Retirement)	-278	-4	121	—	—
Other Financing Cash Flows	6	-76	-28	*-17*	*-17*
Cash From Financing	**-1,027**	**-809**	**-353**	***-495***	***-495***
Exchange Rates, Discontinued Ops, etc. (net)	—	—	—	—	—
Net Change in Cash	**-166**	**-114**	**218**	***125***	***25***

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Belgacom SA BELG (XBRU) | ★★

Last Price	**Fair Value**	**Consider Buy**	**Consider Sell**	**Uncertainty**	**Economic Moat™**	**Moat Trend™**	**Stewardship**	**Morningstar Credit Rating**	**Industry Group**
25.58 EUR	20.00 EUR	14.00 EUR	27.00 EUR	Medium	Narrow	Stable	Standard	—	Communication Services

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Valuation Analysis

		Price/Earnings			**EV/EBITDA**			**Price/Free Cash Flow**			**Price/Book**			**Price/Sales**		
Company/Ticker	Price/Fair Value	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*
ORANGE ORAN USA	0.78	7.3	*11.4*	*11.8*	4.5	*2.1*	*2.2*	7.0	*7.6*	*9.5*	1.0	*1.2*	*1.2*	0.6	*0.8*	*0.8*
Liberty Global PLC LBTYA USA	1.12	NM	*48.9*	*21.0*	9.1	*8.8*	*8.4*	11.2	*13.6*	*13.6*	1.4	*3.3*	*3.7*	1.1	*1.8*	*1.7*
Koninklijke KPN NV KKPNY USA	0.98	NM	*80.8*	*26.9*	7.5	*8.4*	*8.5*	NM	*18.7*	*24.3*	1.6	*1.7*	*1.6*	1.2	*1.3*	*1.3*
Average		7.3	*47.0*	*19.9*	7.0	*6.4*	*6.4*	9.1	*13.3*	*15.8*	1.3	*2.1*	*2.2*	1.0	*1.3*	*1.3*
Belgacom SA BELG BE	**1.29**	**9.1**	***11.5***	***12.2***	**5.2**	***6.0***	***6.0***	**12.9**	***14.8***	***15.0***	**2.4**	***2.7***	***2.6***	**1.1**	***1.3***	***1.4***

Returns Analysis

		ROIC %			**Adjusted ROIC %**			**Return on Equity %**			**Return on Assets %**			**Dividend Yield %**		
Company/Ticker	Last Historical Year Total Assets (Mil)	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*
ORANGE ORAN USA	85,833 EUR	6.1	*5.9*	*5.6*	9.6	*8.4*	*8.1*	7.7	*11.0*	*10.2*	2.1	*3.1*	*2.8*	5.5	*6.9*	*5.2*
Liberty Global PLC LBTYA USA	67,714 USD	8.0	*5.8*	*7.0*	14.2	*11.9*	*14.6*	-13.6	*3.2*	*9.5*	-1.8	*0.6*	*1.5*	—	—	—
Koninklijke KPN NV KKPNY USA	25,872 EUR	9.4	*18.7*	*9.4*	10.5	*13.3*	*7.2*	-6.8	*2.2*	*7.2*	-0.9	*0.5*	*1.8*	0.1	*1.2*	*1.2*
Average		7.8	*10.1*	*7.3*	11.4	*11.2*	*10.0*	-4.2	*5.5*	*9.0*	-0.2	*1.4*	*2.0*	2.8	*4.1*	*3.2*
Belgacom SA BELG BE	**8,417** EUR	**13.0**	***11.1***	***10.9***	**18.6**	***16.4***	***16.5***	**21.9**	***19.5***	***18.8***	**7.5**	***6.7***	***6.7***	**10.2**	***6.1***	***6.1***

Growth Analysis

		Revenue Growth %			**EBIT Growth %**			**EPS Growth %**			**Free Cash Flow Growth %**			**Dividend/Share Growth %**		
Company/Ticker	Last Historical Year Revenue (Mil)	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*	2013	*2014(E)*	*2015(E)*
ORANGE ORAN USA	40,981 EUR	-5.8	*-4.8*	*-2.5*	6.0	*-6.2*	*-2.5*	—	*-19.3*	*-3.7*	-22.8	*28.5*	*-18.3*	—	*-38.2*	*-25.6*
Liberty Global PLC LBTYA USA	14,474 USD	45.8	*27.7*	*4.4*	5.1	*58.0*	*16.8*	—	*-127.8*	*133.6*	-97.1	*NM*	*-46.7*	—	—	—
Koninklijke KPN NV KKPNY USA	8,472 EUR	-10.4	*-5.0*	*-2.3*	-26.0	*-16.1*	*4.1*	-116.0	*-152.9*	*228.4*	-115.2	*-3,710.5*	*-85.7*	—	*-75.0*	—
Average		9.9	*6.0*	*-0.1*	-5.0	*11.9*	*6.1*	-116.0	*-100.0*	*119.4*	-78.4	*-1,841.0*	*-50.2*	—	*-56.6*	*-25.6*
Belgacom SA BELG BE	**6,318** EUR	**-2.2**	***-7.6***	***-2.0***	**-11.8**	***-4.4***	***-0.7***	**—**	***-10.0***	***-5.5***	**-19.3**	***3.8***	***-14.9***	**—**	***-31.4***	**—**

Belgacom SA BELG (XBRU) | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
25.58 EUR	20.00 EUR	14.00 EUR	27.00 EUR	Medium	Narrow	Stable	Standard	—	Communication Services

Comparable Company Analysis

These companies are chosen by the analyst and the data are shown by nearest calendar year in descending market capitalization order.

Profitability Analysis

	Last Historical Year	Gross Margin %			EBITDA Margin %			Operating Margin %			Net Margin %			Free Cash Flow Margin %		
Company/Ticker	Net Income (Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
ORANGE ORAN USA	2,548 EUR	56.2	55.6	55.4	30.4	30.4	30.4	15.6	15.4	15.4	6.2	6.9	6.9	8.2	10.4	8.5
Liberty Global PLC LBTYA USA	-687 USD	62.6	63.2	63.3	44.5	45.5	45.7	15.0	18.5	20.7	-4.7	1.9	4.6	10.2	13.0	12.5
Koninklijke KPN NV KKPNY USA	-222 EUR	55.6	50.9	51.1	34.0	32.4	33.0	12.1	10.7	11.4	-2.6	1.5	4.9	-12.0	6.9	5.4
Average		58.1	56.6	56.6	36.3	36.1	36.4	14.2	14.9	15.8	-0.4	3.4	5.5	2.1	10.1	8.8
Belgacom SA BELG BE	**628** EUR	**59.5**	**60.7**	**60.8**	**26.9**	**28.0**	**28.2**	**14.5**	**15.0**	**15.2**	**9.9**	**9.7**	**9.8**	**8.5**	**9.0**	**9.1**

Leverage Analysis

	Last Historical Year	Debt/Equity %			Debt/Total Cap %			EBITDA/Interest Exp.			Total Debt/EBITDA			Assets/Equity		
Company/Ticker	Total Debt (Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
ORANGE ORAN USA	37,929 EUR	155.8	158.8	152.6	60.9	61.4	60.4	7.1	6.2	6.1	3.0	3.3	3.4	3.5	3.7	3.6
Liberty Global PLC LBTYA USA	44,704 USD	371.7	404.4	455.8	78.8	80.2	82.0	2.8	3.2	3.4	6.9	4.7	4.5	5.6	6.3	7.0
Koninklijke KPN NV KKPNY USA	13,664 EUR	218.2	128.1	123.0	68.6	56.2	55.2	3.8	3.6	6.1	4.7	3.1	3.1	4.1	3.5	3.4
Average		248.6	230.4	243.8	69.4	65.9	65.9	4.6	4.3	5.2	4.9	3.7	3.7	4.4	4.5	4.7
Belgacom SA BELG BE	**2,266** EUR	**79.6**	**77.3**	**75.2**	**44.3**	**43.6**	**42.9**	**15.0**	**13.6**	**13.4**	**1.3**	**1.4**	**1.4**	**3.0**	**2.9**	**2.8**

Liquidity Analysis

		Cash per Share			Current Ratio			Quick Ratio			Cash/Short-Term Debt			Payout Ratio %		
Company/Ticker	Market Cap (Mil)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)	2013	2014(E)	2015(E)
ORANGE ORAN USA	41,217 USD	2.24	3.68	4.30	0.61	0.77	0.84	0.58	0.75	0.82	0.81	1.33	1.55	70.2	76.2	58.9
Liberty Global PLC LBTYA USA	32,696 USD	6.87	2.85	3.45	0.71	0.69	0.72	0.71	0.69	0.72	2.64	7.37	8.48	—	—	—
Koninklijke KPN NV KKPNY USA	13,814 USD	0.92	1.15	1.25	0.98	1.14	1.22	0.96	1.13	1.21	1.97	2.44	2.66	-230.8	109.1	33.2
Average		3.34	2.56	3.00	0.77	0.87	0.93	0.75	0.86	0.92	1.81	3.71	4.23	-80.3	92.6	46.1
Belgacom SA BELG BE	**7,795** EUR	**1.11**	**1.51**	**1.59**	**0.86**	**0.91**	**0.92**	**0.80**	**0.84**	**0.85**	**1.12**	**1.53**	**1.61**	**110.7**	**84.8**	**85.5**

Research Methodology for Valuing Companies

Components of Our Methodology

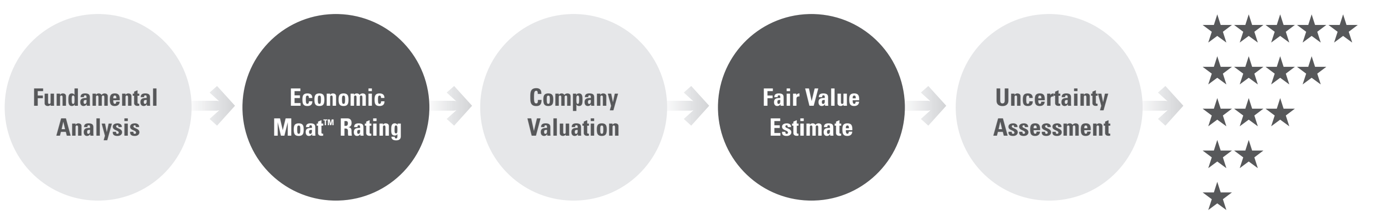
- Economic Moat™ Rating
- Moat Trend™ Rating
- Moat Valuation
- Three-Stage Discounted Cash Flow
- Weighted Average Cost of Capital
- Fair Value Estimate
- Scenario Analysis
- Uncertainty Ratings
- Margin of Safety
- Consider Buying/Selling
- Stewardship Rating

The Morningstar Rating for stocks identifies companies trading at a discount or premium to our analysts' assessment of their fair value. A number of components drive this rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's intrinsic value based on a discounted cash-flow model, (3) the margin of safety bands we apply to our Fair Value Estimate, and (4) the current stock price relative to our fair value estimate.

The concept of the Morningstar Economic Moat™ Rating plays a vital role not only in our qualitative assessment of a firm's investment potential, but also in our valuation process. We assign three moat ratings—none, narrow, or wide—as well as the Morningstar Moat Trend™ Rating—positive, stable, or negative—to each company we cover. There are two major requirements for firms to earn either a narrow or wide moat rating: (1) the prospect of earning above-average returns on capital; and (2) some competitive edge that prevents these returns from quickly eroding. The assumptions we make about a firm's moat determine the length of "economic outperformance" that we assume in the latter stages of our valuation model. We also quantify the value of each firm's moat, which represents the difference between a firm's enterprise value and the value of the firm if no future net investment were to occur. Said differently, moat value identifies the value generated by the firm as a result of any future net new investment. Our Moat Trend Rating reflects our assessment of whether each firm's competitive advantage is either getting stronger or weaker, since we think of moats as dynamic, rather than static.

At the heart of our valuation system is a detailed projection of a company's future cash flows. The first stage of our three-stage discounted cash flow model can last from 5 to 10 years and contains numerous detailed assumptions about various financial and operating items. The second stage of our model—where a firm's return on new invested capital (RONIC) and earnings growth rate implicitly fade until the perpetuity year—can last anywhere from 0 years (for no-moat firms) to 20 years (for wide-moat companies). In our third stage, we assume the firm's RONIC equals its weighted average cost of capital, and we calculate a continuing value using a standard

Morningstar Research Methodology for Valuing Companies



Fundamental Analysis	Economic Moat™ Rating	Company Valuation	Fair Value Estimate	Uncertainty Assessment	Morningstar Rating
Analyst conducts company and industry research: ► Financial statement analysis ► Channel checks ► Trade-show visits ► Industry and company reports and journals ► Conference calls ► Management and site visits	Strength of competitive advantage is rated: None, Narrow, or Wide Advantages that confer an economic moat: **High Switching Costs** (Microsoft) **Cost advantage** (Wal-Mart) **Intangible assets** (Johnson & Johnson) **Network Effect** (Mastercard) **Efficient Scale** (Lockheed Martin)	Analyst considers past financial results and focuses on competitive position and future prospects to forecast future cash flows. Assumptions are entered into Morningstar's proprietary discounted cash-flow model.	Analyst uses a discounted cash-flow model to develop a Fair Value Estimate, which serves as the foundation for the Morningstar Rating for stocks.	The analyst then evaluates the range of potential intrinsic values for the company and assigns an Uncertainty Rating: Low, Medium, High, Very High, or Extreme. The Uncertainty Rating determines the margin of safety required before we would recommend the stock. The higher the uncertainty, the wider the margin of safety.	The current stock price relative to Morningstar's Fair Value Estimate, adjusted for uncertainty, determines the Morningstar Rating for stocks. The Morningstar Rating for stocks is updated each evening after the market closes.

Research Methodology for Valuing Companies

Detailed Methodology Documents and Materials*

- Comprehensive Equity Research Methodology
- Uncertainty Methodology
- Cost of Equity Methodology
- Morningstar DCF Valuation Model
- Stewardship Rating Methodology

* Please contact a sales representative for more information.

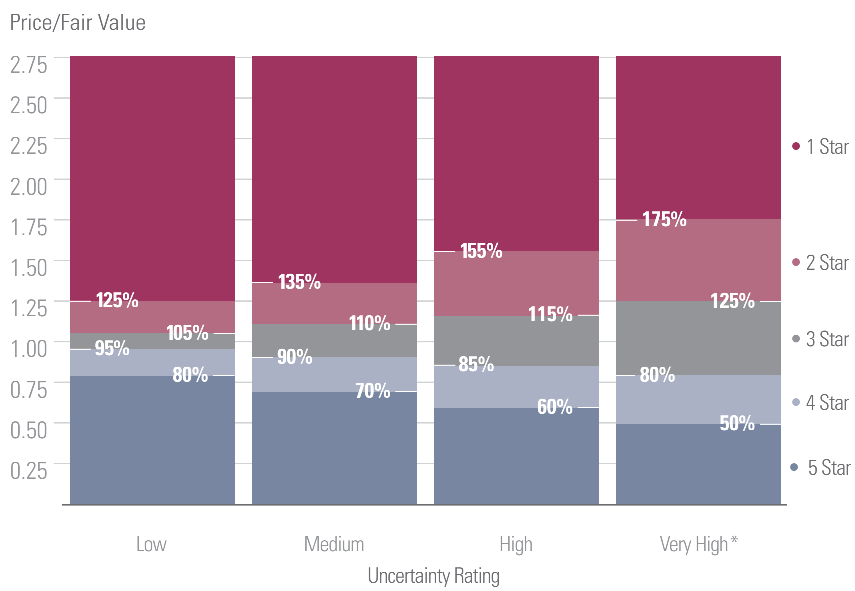
perpetuity formula. In deciding on the rate at which to discount future cash flows, we ignore stock-price volatility. Instead, we rely on a system that measures the estimated volatility of a firm's underlying future free cash flows, taking into account fundamental factors such as the diversity of revenue sources and the firm's fixed cost structure.

We also employ a number of other tools to augment our valuation process, including scenario analysis, where we assess the likelihood and performance of a business under different economic and firm-specific conditions. Our analysts typically model three to five scenarios for each company we cover, stress-testing the model and examining the distribution of resulting fair values.

The Morningstar Uncertainty Rating captures the range of these potential fair values, based on an assessment of a company's future sales range, the firm's operating and financial leverage, and any other contingent events that may impact the business. Our analysts use this range to assign an appropriate margin of safety—or the discount/premium to a fair value we apply in setting our consider buying/consider selling prices. Firms trading below our consider-buying prices receive our highest rating of five stars, whereas firms trading above our consider-selling prices receive our lowest rating of one star.

Our corporate Stewardship Rating represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

Morningstar Margin of Safety and Star Rating Bands



* Occasionally a stock's uncertainty will be too high for us to estimate, in which case we label it Extreme.

Morningstar's Approach to Rating Corporate Credit

- Offers a proprietary measure of the credit quality of companies on our coverage list.
- Encapsulates our in-depth modeling and quantitative work in one letter grade.
- Allows investors to rank companies by each of the four underlying components of our credit ratings, including both analyst-driven and quantitative measures.
- Provides access to all the underlying forecasts that go into the rating, available through our institutional service.

Purpose

The Morningstar Corporate Credit Rating measures the ability of a firm to satisfy its debt and debt-like obligations. The higher the rating, the less likely we think the company is to default on these obligations.

The Morningstar Corporate Credit Rating builds on the modeling expertise of our securities research team. For each company, we publish:

- Five years of detailed pro-forma financial statements
- Annual estimates of free cash flow
- Annual forecasts of return on invested capital
- Scenario analyses, including upside and downside cases
- Forecasts of leverage, coverage, and liquidity ratios for five years
- Estimates of off balance sheet liabilities

These forecasts are key inputs into the Morningstar Corporate Credit Rating and are available to subscribers at select.morningstar.com.

Methodology

We feel it's important to perform credit analysis through different lenses—qualitative and quantitative, as well as fundamental and market-driven. We therefore evaluate each company in four broad categories.

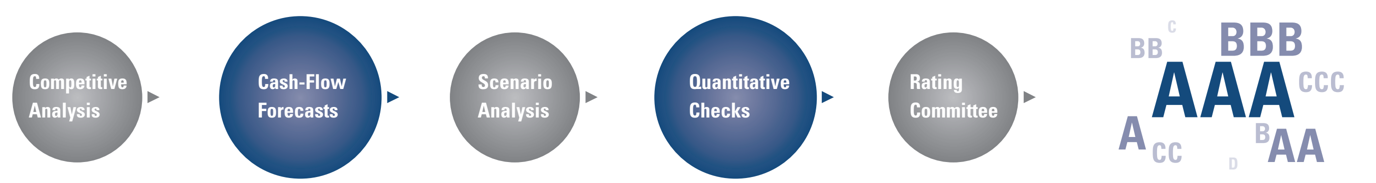
Business Risk

Business Risk captures the fundamental uncertainty around a firm's business operations and the cash flow generated by those operations. Key components of the Business Risk rating include the Morningstar Economic Moat™ Rating and the Morningstar Uncertainty Rating.

Cash Flow Cushion™

Morningstar's proprietary Cash Flow Cushion™ ratio is a fundamental indicator of a firm's future financial health The measure reveals how many times a company's internal cash generation plus total excess liquid cash will cover its debt-like contractual commitments over the next five years. The Cash Flow Cushion acts as a predictor of financial distress, bringing to light potential refinancing, operational, and liquidity risks inherent to the firm.

Morningstar Research Methodology for Determining Corporate Credit Ratings



Analyst conducts company and industry research:

- Management interviews
- Conference calls
- Trade show visits
- Competitor, supplier, distributor, and customer interviews
- Assign Economic Moat™ Rating

Analyst considers company financial statements and competitive dynamics to forecast future free cash flows to the firm.

Analyst derives estimate of Cash-Flow Cushion™.

Analysts run bull and bear cases through the model to derive alternate estimates of enterprise value.

Based on competitive analysis, cash-flow forecasts, and scenario analysis, the analyst assigns Business Risk.

We gauge a firm's health using quantitative tools supported by our own backtesting and academic research.

- Morningstar Solvency Score™
- Distance to Default

Senior personnel review each company to determine the appropriate final credit rating.

- Review modeling assumptions
- Approve company-specific adjustments

AAA	Extremely Low Default Risk
AA	Very Low Default Risk
A	Low Default Risk
BBB	Moderate Default Risk
BB	Above Average Default Risk
B	High Default Risk
CCC	Currently Very High Default Risk
CC	Currently Extreme Default Risk
C	Imminent Payment Default
D	Payment Default
UR	Under Review
UR+	Positive Credit Implication
UR-	Negative Credit Implication

Morningstar's Approach to Rating Corporate Credit

The advantage of the Cash Flow Cushion ratio relative to other fundamental indicators of credit health is that the measure focuses on the future cash-generating performance of the firm derived from Morningstar's proprietary discounted cash flow model. By making standardized adjustments for certain expenses to reflect their debt-like characteristics, we can compare future projected free cash flows with debt-like cash commitments coming due in any particular year. The forward-looking nature of this metric allows us to anticipate changes in a firm's financial health and pinpoint periods where cash shortfalls are likely to occur.

Morningstar Solvency Score™

The Morningstar Solvency Score™ is a quantitative score derived from both historical and forecasted financial ratios. It includes ratios that focus on liquidity (a company's ability to meet short term cash outflows), profitability (a company's ability to generate profit per unit of input), capital structure (how does the company finance its operations), and interest coverage (how much of profit is used up by interest payments).

Distance to Default

Morningstar's quantitative Distance to Default measure ranks companies on the likelihood that they will tumble into financial distress. The measure is a linear model of the percentile of a firm's leverage (ratio of Enterprise Value to Market Value), the percentile of a firm's equity volatility relative to the rest of the universe and the interaction of these two percentiles. This is a proxy methodology for the common definition of Distance to Default which relies on option-based pricing models. The proxy has the benefit of increased breadth of coverage, greater simplicity of calculation, and more predictive power.

For each of these four categories, we assign a score, which we then translate into a descriptive rating along the scale of Very Good / Good / Fair / Poor / Very Poor.

Overall Credit Rating

The four component ratings roll up into a single preliminary credit rating. To determine the final credit rating, a credit committee of at least five senior research personnel reviews each preliminary rating.

We review credit ratings on a regular basis and as events warrant. Any change in rating must be approved by the Credit Rating Committee.

Investor Access

Morningstar Corporate Credit Ratings are available on Morningstar.com. Our credit research, including detailed cash-flow models that contain all of the components of the Morningstar Corporate Credit Rating, is available to subscribers at select.morningstar.com.

Belgacom SA BELG (XBRU) | ★★

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Moat Trend™	Stewardship	Morningstar Credit Rating	Industry Group
25.58 EUR	20.00 EUR	14.00 EUR	27.00 EUR	Medium	Narrow	Stable	Standard	—	Communication Services

The Morningstar Rating for stocks identifies stocks trading at a discount or premium to their intrinsic value. Five-star stocks sell for the biggest risk-adjusted discount whereas one-star stocks trade at premiums to their intrinsic value. Based on a fundamentally focused methodology and a robust, standardized set of procedures and core valuation tools used by Morningstar's Equity Analysts, four key components drive the Morningstar Rating: 1. Assessment of the firm's economic moat, 2. Estimate of the stock's fair value, 3. Uncertainty around that fair value estimate and 4. Current market price. Further information on Morningstar's methodology is available from http://global.morningstar.com/equitydisclosures.

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