Freenet

(MDAX, Telecom/Internet)

WARBURG RESEARCH

Buy	(Hold)
EUR 23.10	(EUR 30.00)
Price	EUR 17.90
Upside	**29.1 %**

Value Indicators:	EUR
DCF:	23.10
FCF-Value Potential 2021e:	29.80
SotP 2021e:	29.20

Share data:	
Bloomberg:	FNTN GR
Reuters:	FNTGN
ISIN:	DE000A0Z2ZZ5

Description:

Mobile communication, terrestrial and IP TV consumer services with c. 12.8m paying subs

Market Snapshot:	EUR m
Market cap:	2,291
No. of shares (m):	128
EV:	4,058
Freefloat MC:	2,291
Ø Trad. Vol. (30d):	8.36 m

Shareholders:	
Freefloat	100.0 %
Flossbach von Storch AG	*15.4 %*
BlackRock Inc.	*5.3 %*

Risk Profile (WRe):	2019e
Beta:	1.2
Price / Book:	1.7 x
Equity Ratio:	28 %
Net Fin. Debt / EBITDA:	3.7 x
Net Debt / EBITDA:	4.1 x

Stationary sales exposure proves to be sustainable USP; Upgrade to Buy

Freenet (FNTN) has come in for criticism for its heavy exposure to stationary distribution channels (WRe: 62.5% of the company's mobile sales in FY 2018) in times of momentous structural shifts in consumer behaviour towards online channels. On the contrary, we regard the company's mobile performance and its ability to fund a stable dividend as intact, considering consumer preferences for omnichannel and FNTN's stable postpaid customer base which is founded on stationary sales channels (WRe 90%) and accounted for 91.6% of service revenues in FY 2018. Omnichannel and the stable postpaid customer base are key to facing structural change, in our view, and help to sustainably fund the company's attractive dividend.

- **Mobile business:** Despite a highly competitive market environment, FNTN's mobile business proved stable (Q1 2019 MSR revenues up by 1.1% to EUR 397.2m; EBITDA adj. for IFRS 16 at EUR 92.1m, +10.4% yoy). Furthermore, we see clear evidence of protection from the shift to online distribution channels in the company's postpaid customer base as customers are increasingly showing a preference for omnichannel (42% pick-up rate in Ceconomy's online sales in FY 2017/18; +200bps yoy) as shown by the robust postpaid customer CAGR of 1.5% from 2010-2018 (vs. FNTN's total mobile customer base CAGR of -3.7% over the same period). FNTN's nofrills customer base, which is more price sensitive and consequently more online-conscious, accounted for only 3.2% of the company's mobile service revenues in FY 2018 and emphasises therefore the low structural exposure of the company towards an offline-online retail shift.
- **TV&Media:** The side business TV&Media, which tends to be overlooked, (sales of EUR 275m / 9.5% of total sales in FY 2018) offers some attractive growth potential in the scope of the increasingly popular waipu.tv IPTV solution, which is currently fully funded by the related B2B and DVB-T2 (freenet TV) business segments. An above-market sales CAGR of 78.1% until FY 2021 (WRe) based on recent strategic partnerships with Samsung and Telefónica Deutschland could turn the business cash-positive from FY 2021 onwards (WRe: IPTV with a neg. FCF of EUR 15m in FY 2019), which would free up additional and distributable funds to bolster the company's dividend distribution power.
- **Free cash flow and dividend:** The lion's share of FNTN's dividend (FY 2019: EUR 211.2m / EUR 1.65 per share) is assumed to be funded by its mobile postpaid customers (WRe: 91.5% of FY 2019's dividend). With flattish assumptions for the company's TV&Media segment ex. waipu (WRe: sales CAGR of -3.4% until FY 2021) and the anticipation of breakeven in the currently loss-making IPTV in FY 2021, we consider potential concerns regarding a dividend decline as overdone. Thus, at the current share price, FNTN's dividend amortises related acquisition costs in approx. 11 years.

In conclusion, we regard fears of a structural deterioration in FNTN's mobile business as exaggerated and see further potential in its soaring IPTV segment, a potential change in the network operator landscape, and the sale of the non-strategic Sunrise asset. Based on the attractive upside to our base case fair value and the appealing dividend yield of 9.2%, we **upgrade** the stock to **Buy** with a PT of **EUR 23.1**.

Rel. Performance vs MDAX:	
1 month:	-0.3 %
6 months:	-12.1 %
Year to date:	-10.8 %
Trailing 12 months:	-21.5 %

Company events:	
08.08.19	Q2
07.11.19	Q3

FY End: 31.12. in EUR m	CAGR (18-21e)	2015	2016	2017	2018	2019e	2020e	2021e
Sales	0.8 %	3,118	3,362	3,507	2,897	2,882	2,916	2,965
Change Sales yoy		2.5 %	7.8 %	4.3 %	-17.4 %	-0.5 %	1.2 %	1.7 %
Gross profit margin	*1.6 %*	*25.7 %*	*27.3 %*	*27.6 %*	*31.8 %*	*32.5 %*	*32.9 %*	*33.3 %*
EBITDA	-4.2 %	370	439	541	525	436	445	462
EBITDA adj.	1.5 %	370	402	409	441	436	445	462
Margin		*11.9 %*	*12.0 %*	*11.7 %*	*15.2 %*	*15.1 %*	*15.3 %*	*15.6 %*
EBIT	0.3 %	299	278	261	312	292	300	315
Margin		*9.6 %*	*8.3 %*	*7.4 %*	*10.8 %*	*10.1 %*	*10.3 %*	*10.6 %*
Net income	2.9 %	221	228	287	223	213	224	243
EPS	3.0 %	1.73	1.78	2.24	1.74	1.66	1.75	1.90
DPS	0.0 %	1.55	1.60	1.65	1.65	1.65	1.65	1.65
Dividend Yield		5.3 %	6.2 %	5.7 %	6.9 %	9.2 %	9.2 %	9.2 %
FCFPS		1.87	2.12	2.01	1.95	1.98	2.06	2.13
EV / Sales		1.3 x	1.6 x	1.6 x	1.8 x	1.4 x	1.4 x	1.3 x
EV / EBITDA		11.3 x	11.9 x	10.3 x	9.8 x	9.3 x	9.0 x	8.5 x
EV / EBIT		13.9 x	18.9 x	21.4 x	16.5 x	13.9 x	13.3 x	12.5 x
P / E		16.9 x	14.6 x	13.0 x	13.7 x	10.8 x	10.2 x	9.4 x
P / E adj.		16.9 x	14.6 x	13.0 x	13.7 x	10.8 x	10.2 x	9.4 x
FCF Potential Yield		7.2 %	6.7 %	7.8 %	8.2 %	9.0 %	9.3 %	9.8 %
Net Debt		428	1,911	1,846	2,091	1,767	1,712	1,648
ROCE (NOPAT)		14.4 %	9.6 %	6.7 %	8.5 %	7.8 %	8.4 %	8.9 %

Guidance: Revenues 19e: stable ; EBITDA 19e: EUR 420m - EUR 440m; FCF 19e: 240m-260m

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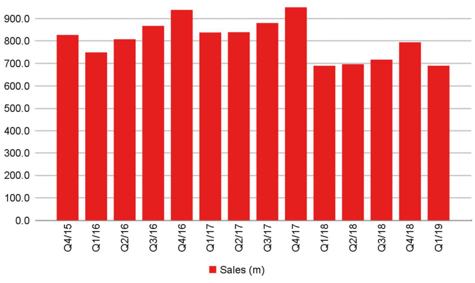
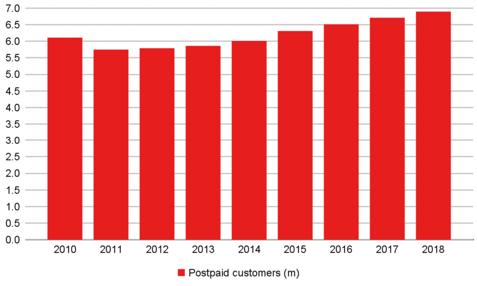
Sales development
in EUR m



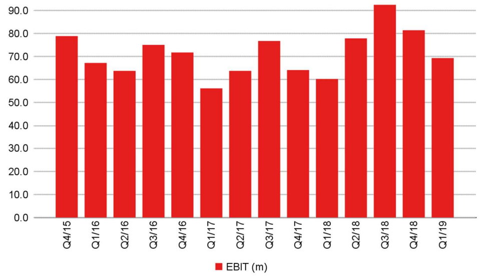
Source: Warburg Research

Contract customers
in m



Source: Warburg Research

EBIT development
in EUR m



Source: Warburg Research

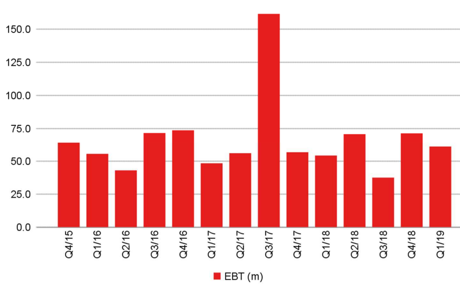
Company Background

- Freenet is a German mobile service provider with ~11m SIM cards in operation. The group operates the side arm business TV&Media with terrestrial TV (1m subs) and a growing cloud-based video and terrestrial TV services.
- In its mobile business, Freenet accesses and resells tariffs from existing German MNOs under its own brands (main brand: mobilcom-debitel)
- One of the core assets of Freenet is its strong nationwide point of sales network (530 own shops and 400 Media-Saturn POS) over which Freenet has contact to millions of end consumers each year.

Competitive Quality

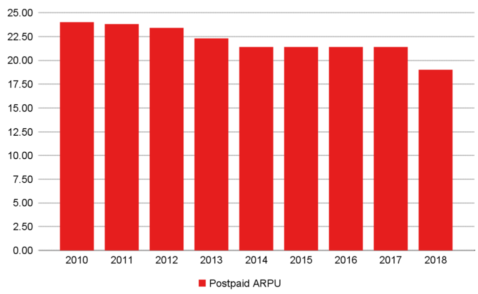
- Mobile service providers (MSP) do not operate their own mobile networks, which means that capex and technological risks are low in comparison to network operators (MNO).
- A high share of variable costs as network usage expenses and customer acquisition costs are variable meaning the cost structures can be flexibly adapted.
- Freenet's sales organization can be leveraged to sell and market other electronic and TV/video-related products.
- As an MSP, Freenet can market the contracts of currently three network operators in Germany giving Freenet the largest product range in comparison to competitors.
- Access to all MNO tariffs and access to all technologies without a time-lag.

EBT development
in EUR m



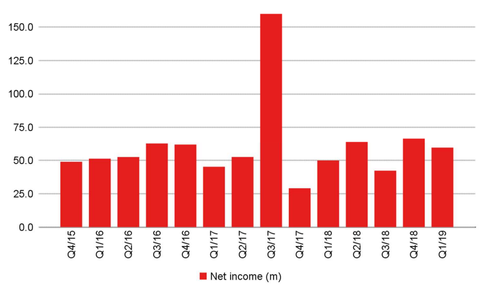
Source: Warburg Research

ARPU contract customers
in EUR



Source: Warburg Research

Net income development
in EUR m



Source: Warburg Research

Summary of Investment Case

Investment triggers

- Besides FNTN's strategic acquisition of a significant stake in Ceconomy (9.1% for EUR 277m) to strengthen its crucial distribution partner, the company's asset allocation decision regarding Sunrise (24.56% for EUR 736m) and recent reporting changes has spread confusion among its investors. While we acknowledge some level of confusion, a few quarters of stable mobile performance and the potential growth of FNTN's IPTV product waipu.tv should restore investor confidence in our view. We see potential for share price appreciation simply in a stable mobile business with the opportunity to participate in an attractive IPTV growth market.
- As evidenced by FNTN's recent Q1 reporting, the MSP business (Q1 2019 MSR revenues up by 1.1% to EUR 397.2m; EBITDA adj. for IFRS 16 at EUR 92.1m / +10.4% yoy) proved to be stable and very adjustable in terms of its cost structure, which allows FNTN to respond even to a highly competitive market environment and secure an attractive level of profitability.
- Besides FNTN's organic development, we regard a sale of the non-strategic asset Sunrise (market value of EUR 700m) to reduce leverage or a potential new partnership with 1&1 Drillisch as additional triggers to drive FNTN's share price.

Valuation

- We derive a DCF-based price target of EUR 23.10 per share.
- A sum-of-the-parts valuation, in which we separately value FNTN's mobile and TV&Media segment, is based on historical trading multiples for the company's assumed steady-state segments (Mobile and TV&Media excl. waipu.tv) and on a set of traded peer companies from the IPTV sector (for waipu.tv). The SotP valuation reveals some further upside (FV of EUR 29.20) but does not reflect the growth dynamics of FNTN's different segments as precisely, in our view.

Growth

- Historical growth:
    - 2010-2018: +1.1% CAGR
- We forecast a sales CAGR of 0.8% p.a. over the period 2019-2021
    - Sales growth should be mostly driven by a soaring IPTV business (WRe: sales CAGR of 78.1% from 2019-2021)
    - TV&Media ex. Waipu is assumed to grow at a CAGR of -3.4% p.a. due to the sale of FNTN's ukw business (WRe: missing EUR 40m in sales from FY 2019 onwards) and the flattish growth prospects
    - Mobile is assumed to show a CAGR of 0.6% p.a. over the same period in a steady-state scenario

Competitive quality

- As a Mobile Service Provider (MSP) with a market share of 9.7% in FY 2018, FNTN purely resells tariffs from MNOs under its own brands. It is therefore not exposed to capex or technological risks but has full access to the latest technologies.
- The company boasts a strong nationwide point of sales network (ca. 530 own shops and approx. 400 shops of Media-Saturn with an exclusive distribution partnership), which offers attractive customer proximity and is therefore highly attractive for existing MNOs.
- FNTN's sales organisation is very flexible and can be further leveraged to market other electronic and TV/video-related products.

Warburg versus consensus

- **Sales:** We are slightly below consensus estimates for the FY 2019/20 (-0.6% and -0.4%, respectively) as we assume a somewhat weaker mobile postpaid and freenet.TV momentum.
- **EBITDA:** We are slightly ahead of consensus with our EBITDA estimates for the FY 2019/20 (+1.1% and +2.2%, respectively). Besides a better IPTV performance, reasons for this deviation are assumed in relation to the first-time application of IFRS 16.
- **Free Cash Flow:** We are ahead of FY 2019 FCF consensus estimate (WRe +2.7%) but are broadly in line for the following years.

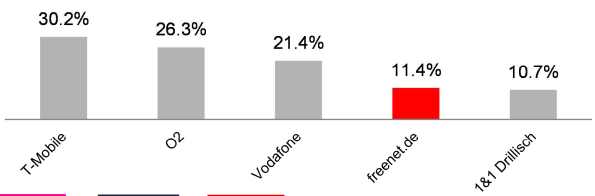
Company Overview

Segments	Mobile	TV & Media		Group
Sales 2018 in EUR m	2,607	283		2,898
in% of total	90%	9.8%		100%
EBITDA 2018 in EUR m	410.3	86.3		485.5
EBITDA Margin	15.7%	30.5%		16.8%
	Post Paid Subscribers	Revenue Generation Units		Total Customers
		freenet TV	waipu.tv	
Customers in m	9.50	1.02	0.29	10.81
Market Position	The Freenet Group is the largest network-independent telecommunication service provider in Germany. Its main business is the mobile communication segment. With the acquistion of businesses such as Exaring it has successfully gained a foothold in the TV and Media landscape.			

Competitors

Competitors in the Mobile Network Operator Segment

Market share based on postpaid subscribers



Competitors in the TV & Media segment

Holdings

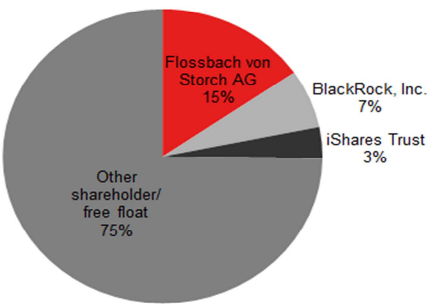
MEDIA BROADCAST
Acquisition Price: **295 m EUR**
Size of stake: **100%**

CECONOMY
Acquisition Price: **277 m EUR**
Size of stake: **9.1%**

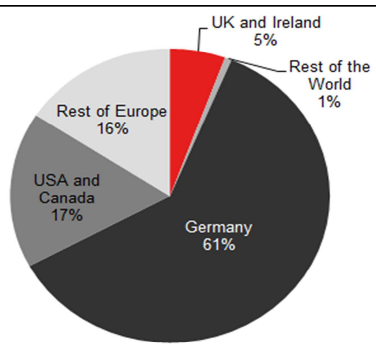
EXARING AG
Acquisition Price: **50 m EUR**
Size of stake: **50.1%**

Sunrise
Acquisition Price: **714 m EUR**
Size of stake: **23.8%**

Shareholder Structure



Shareholders Overview



Geographical Breakdown of Shareholders

Source: Company data, Warburg Research

Different points of view, same business

Freenet's subdued share price performance since 2018 (-43%) has raised questions about the operational performance and sustainability of the business.

We have identified the following reasons for the share price setback:

- **FNTN's significant stationary sales exposure:** We estimate that 62.5% of the company's sales are generated through stationary distribution channels
- **Ceconomy's operational performance as a crucial distribution channel:** The retailer recently posted three consecutive profit warnings, cut its dividend, and appointed a new management in FY 2017/18. We assume a sales contribution of 45% resulting from this mostly stationary channel.
- **Unclear future of FNTN's business model as a service provider:** In contrast to the clear legal framework for service providers linked to the UMTS spectrum auction until 2020, subsequent German spectrum auctions in 2015 and 2019 lacked a clear obligation for network operators to allow service providers access to their networks.
- **Declining trend in FNTN's customer base in the last years:** The company's customer base declined with a CAGR of *-3.7%* from 2010-2018.
- **Recent changes in the company's financial reporting:** A separation of inter-segment allocations revealed a declining EBITDA trend in FNTN's mobile business in FY 2017.
- **Questionable asset allocation decisions:** FNTN holds significant stakes in Sunrise (24.56% for EUR 736m) and Ceconomy (9.1% for EUR 277m).

Our view, however, is contrary to the above-mentioned negative aspects of FNTN's business based on:

- **Omnichannel customer preferences:** Ceconomy boasts a 42% pick-up rate among its soaring online sales (+ 12.7% yoy / 12.1% of total sales in FY 2017/18).
- **FNTN's shareholder influence on Ceconomy:** Freenet's 9.1% stake in Ceconomy bolstered Ceconomy's capital structure and gave Freenet influence over Ceconomy's restructuring efforts.
- **German 5G auction comes with updated MNO obligations:** The recent spectrum auction in Germany provided further legal clarity for FNTN's business by updating obligations for MNOs to negotiate with third parties and not to discriminate between internal and external parties.
- **FNTN's postpaid customer base has proven to be stable:** Postpaid customers account for 91.6% of FNTN's service revenues and grew by a CAGR of 1.5% between 2010 and 2018.
- **Overall transparency seen as a positive step:** We welcome FNTN's more transparent presentation of the performance of the individual segments without the consideration of inter-segment value streams.
- **Asset allocation motivation is either strategic or capital-accretive:** FNTN's sunrise stake currently yields approx. EUR 40m in dividends annually (vs. EUR 12m in interest, which covers the full asset financing) while the Ceconomy stake strengthens the sales partnership between the two retailers.

Mobile – Providing for stability

- No significant deterioration expected for Freenet's market share; steady-state postpaid momentum should secure 9.5% to 9.7% of the German mobile market
- Stationary sales exposure / Media-Saturn (Ceconomy) sales channel gives rise to concern regarding the sustainability of the business model and the potential threat that customers will opt for more transparent online distribution channels
- Negative stationary sales scenario fails to acknowledge the value of omnichannel support, the steady-state postpaid trend, and FNTN's monitoring of individual store performance – **WRe PT at EUR 23.1**

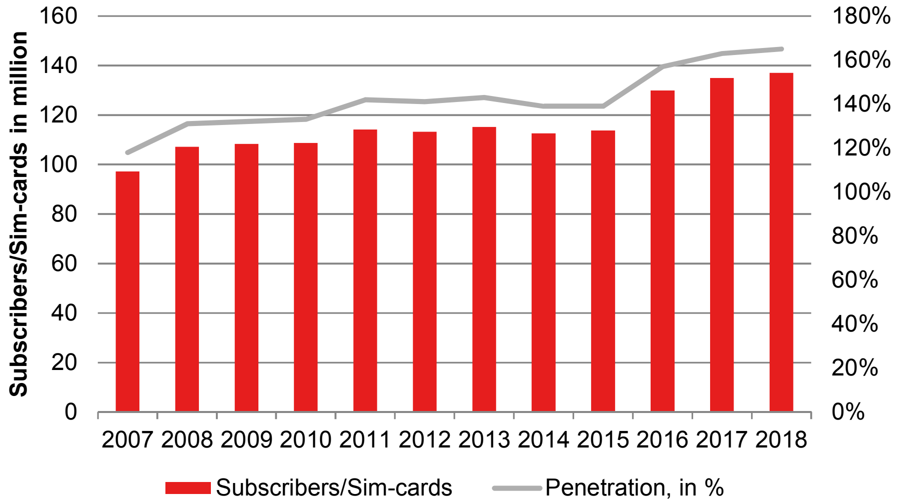
Market growth limited to new technologies & appliances

German mobile market

The German mobile market (excl. handsets) was valued at EUR 20bn in 2018 and is expected to grow by 1.6% in 2019 according to Bitkom.

While the penetration of SIM cards among 83m mobile customers already stands at 165% in 2018, further growth triggers are limited to the soaring data consumption (CAGR of 49.9% over the last five years) and future technologies such as IoT (expected 1% CAGR of mobile subscriptions in Western Europe until 2024 according to Ericsson), which require additional subscriptions per consumer.

Mobile penetration in Germany



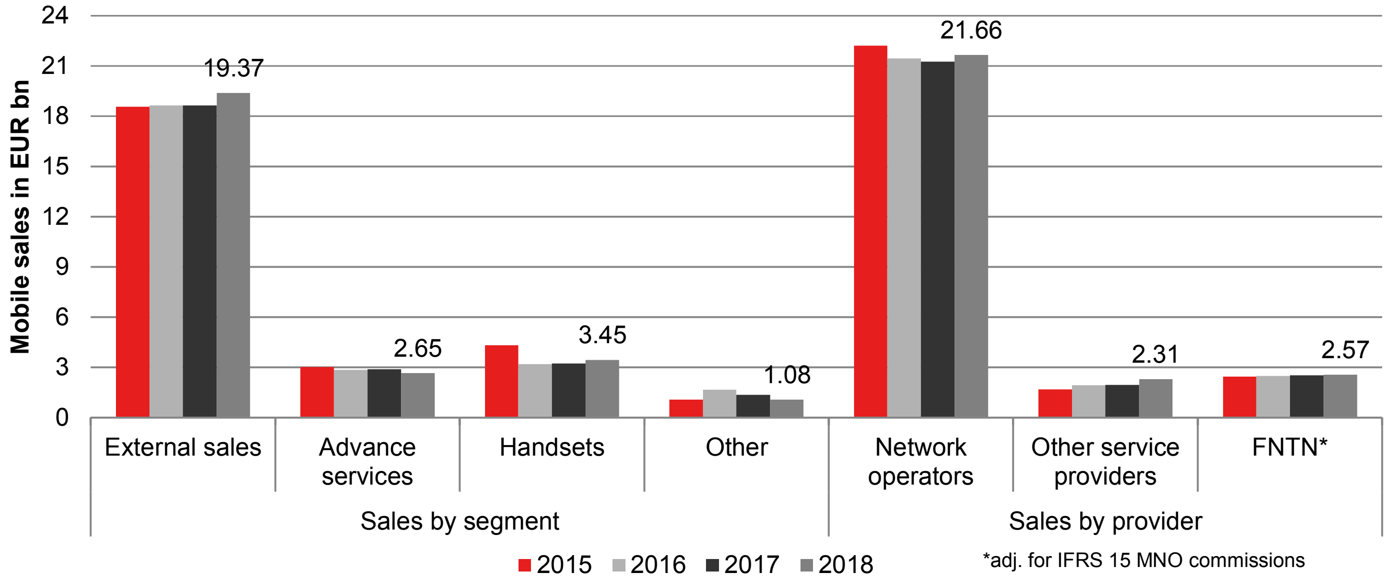
Source: Bundesnetzagentur, Warburg Research

Germany's MVNO 1&1 Drillisch shows market share gains

While the German mobile landscape is largely dominated by network operators (81.6% market share in terms of sales in 2018), service providers continuously improved their market share to 18.4% (+90 bps yoy) in 2018. As most of the growth comes from virtual network operator 1&1 Drillisch (+20.4% sales growth yoy adj. for IFRS 15 effects in 2018), FNTN's market share (adj. for IFRS 15 MNO commission recognition) was broadly stable at 9.7% (-20bps yoy).

Recent action by the MVNO 1&1 Drillisch to become a fourth mobile network operator offer additional opportunities for FNTN in terms of both an increased number of mobile tariffs and a fourth supplier availing of the company's unique sales channels and consequently increasing the MSP's attractive MNO commission income.

German mobile sales by segment and provider



Source: Bundesnetzagentur, Company data, Warburg Research

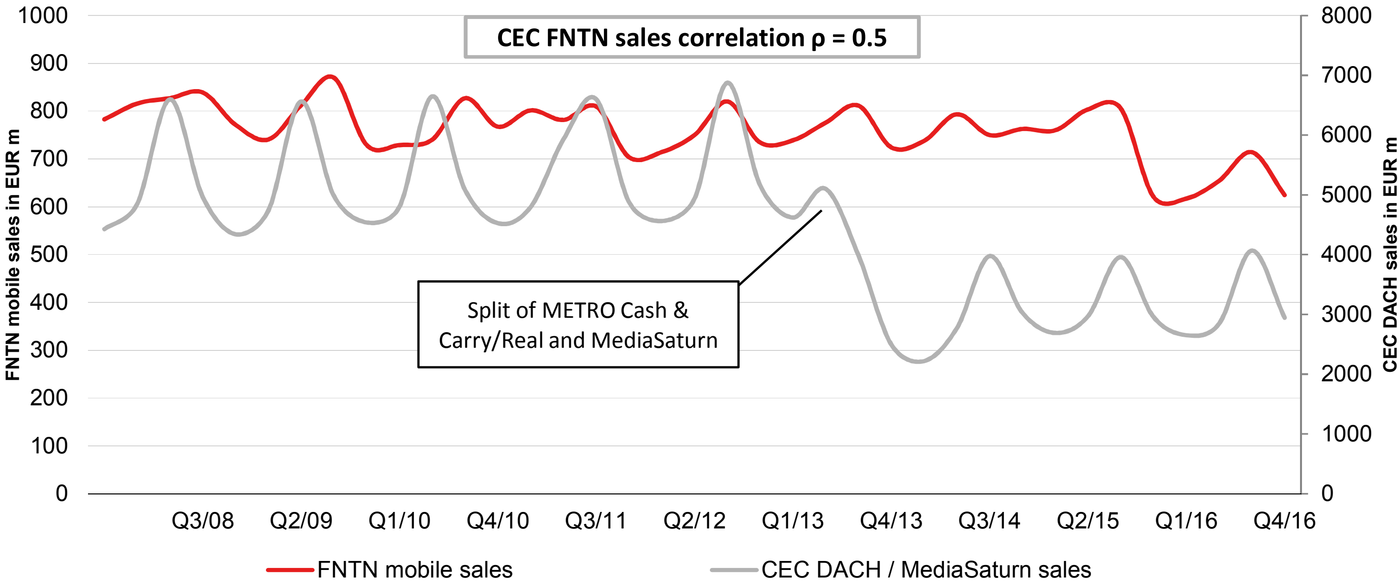
MSP business model secured by recent spectrum auction terms

Business model

As a German mobile service provider (MSP), Freenet does not operate its own network infrastructure but rather accesses and resells tariffs from existing German mobile network operators under its own brands (main brand: mobilcom-debitel). The business model is secured by recently updated obligations, legally binding MNOs to negotiate with third parties based on legacy contracts and to not to discriminate between internal and external parties. Consequently, FNTN's access to MNO tariffs and new technologies is secured until 2040. German MNOs can also take advantage of FNTN's attractive distribution channels and therefore make more efficient use of its own network capacities. The business is additionally secured by game-theory, as such, as the avoidance of FNTN by one MNO can be exploited by a competitor to benefit from FNTN's unique customer acquisition potential.

One of FNTN's core assets is its nationwide, strong point-of-sale network which reaches millions of end-consumers each year. The network comprises 530 of its own shops, 400 Media-Saturn-Deutschland GmbH (Ceconomy) consumer electronic stores, and complementary online distribution channels of both partners. We assume Ceconomy (CEC) represents one of FNTN's most crucial distribution channels with a sales contribution of 45% (WRe) of FNTN's mobile sales (compares to a FNTN mobile vs. CEC sales correlation of 0.5). Consequently, FNTN recently extended its exclusive distribution partnership with CEC until 2022. This partnership has been in place for more than 25 years, (respective capitalised distribution rights of EUR 43.8m in FY 2018, amortisation of EUR 25m yoy).

Sales correlation of FNTN vs CEC



Source: Bundesnetzagentur, Company data, Warburg Research

Stationary sales channel a focus of criticism

Stationary sales channel – An Achilles heel?

Frequently, concerns have been raised regarding FNTN's dependence on stationary trading and the uncertain outlook of this business as customers increasingly opt to purchase electronic products (incl. mobile tariffs) online.

While we stick to the current market forecast of German Handelsverband Deutschland (HDE) in our base case, which sees nominal growth of 1.2% for stationary trading (and 9% for online trading) in Germany in FY 2019, FNTN's distribution channels must be examined in greater detail to evaluate potential risks of a stationary downturn.

We estimate that 62.5% of FNTN's sales are generated in stationary sales channels (thereof 35% of CEC, in line with the HDE estimate of 11% of retail sales generated online in FY 2019). A potential downturn scenario could be derived from strategy&'s market forecast of a declining retail sales footprint for consumer electronics and appliances of -6.5% CAGR until FY 2020. In this scenario, however, the lost market share should be partly compensated for by FNTN's online exposure. Therefore, we assume a translation factor adjusted for FNTN's mobile customer market share (100% – 17.1% = 82.9%) to account for lost stationary customers opting for FNTN online tariffs relative to its market share.

Assumptions for a negative stationary sales scenario

Strategy& market forecast	2012	2020	CAGR 12-20
Shift Offline to Online Retail	1.2	0.7	**-6.5%**

FNTN (own sales channels)	**55%**
stationary	27.5%
online	27.5%
CEC	**45%**
stationary	35%
online	10%
FNTN customer market share	**17.1%**
translation factor	82.9%

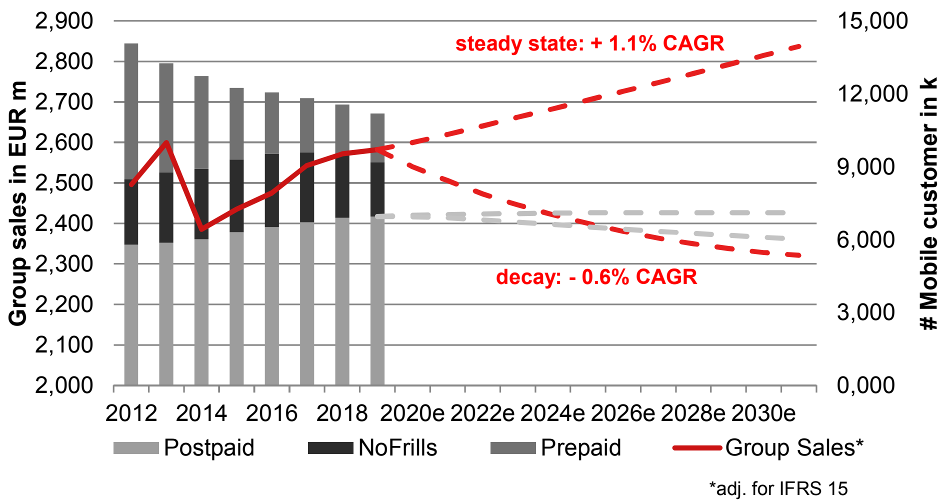
FNTN: implied postpaid gross adds deterioration	**-3.4%**

Source: Company data, strategy&, HDE, Warburg Research

We applied both scenarios of a steady-state mobile business (flat postpaid gross adds of 1.38m p.a.) and a decay in stationary trading (-3.4% p.a. decline in postpaid gross adds) to FNTN's postpaid gross adds. Derived group sales growth of either 1.1% CAGR until 2030 or negative 0.6% CAGR until 2030 result in an implied mobile market share for FNTN of either 9.5% or 7.9% in FY 2030 compared to its share of 9.7% in FY 2018.

While the base case scenario allows for attractive stable dividend streams and results in a fair value (WRe FV of EUR 23.1 per share), a deterioration of FNTN's crucial stationary distribution channel still reveals some downside to current share price (WRe FV of EUR 14.9 per share). A related decline in future dividends would be inevitable as FNTN's TV&Mobile side business is assumed to be insufficient to make up for lost cash generated by its mobile postpaid operations (WRe: mobile postpaid covers 91.5% of FNTN's FY 2019 dividend of EUR 211.2m / EUR 1.65 per share).

FNTN's outlook – mobile steady state vs. stationary decay



Source: Company data, strategy&, HDE, Warburg Research

Customers opting for omnichannel solutions provide protection

While a stationary decline clearly appears to be a major threat to FNTN's business, the protection provided by FNTN's distribution channel CEC is being overlooked, in our view. Ceconomy's online sales increased by +12.7% yoy and represented 12.1% of total sales in FY 2017/18 while some 42% (+200 bps yoy) of these online sales were picked up by customers in stationary outlets (Ceconomy description: “pick-up” rate).

Consequently, the structural consumer substitution of stationary with online channels is partly offset, as almost half of CEC’s online customers are opting for the omnichannel solution to pick up or collect their purchases. In our view, this represents solid protection for FNTN’s stationary points of sale.

Strategic measures including the clear focus on FNTN’s mobile postpaid customer base and the ability to monitor the performance of individual stores should, in our view, secure a stable revenue pillar and the flexibility to react to inefficient sales points.

Especially the negative mobile customer trend of FNTN (CAGR of -3.7% from 2010 – 2018) should not be seen as a sign of a deteriorating business as FNTN’s mobile postpaid customers accounted for 91.6% of mobile service revenues in FY 2018, grew by a CAGR of 1.5% over the same period, and is assumed to be the most profitable customer group as it funded 91.5% (WRe) of FNTN’s FY 2018 dividend. Consequently, the company needs to secure its 1.38m postpaid gross adds annually (WRe) vs. the company’s overall mobile gross adds of 2.58m in FY 2018 in order to sustain its appealing cash-generating profile. This objective should be very attainable in our view considering the significantly higher ratio of mobile postpaid customers acquired in FNTN’s stationary sales channels (WRe: 90%).

Moreover, we regard the price-sensitive nofrills mobile customers as the main target group for migration to more transparent online offers. The low share of service revenues generated by FNTN’s nofrills customer base (EUR 53.5m / 3.2% of FY 2018 service revenues) consequently makes the company less exposed to such a trend.

Therefore, we regard a steady state mobile business with an implied flattish mobile postpaid trend (postpaid gross adds of 1.38m p.a.) as most likely. The **fair share price** should consequently be seen at **EUR 23.1**.

Drillisch as a fourth MNO is favourable for FNTN’s MSP business

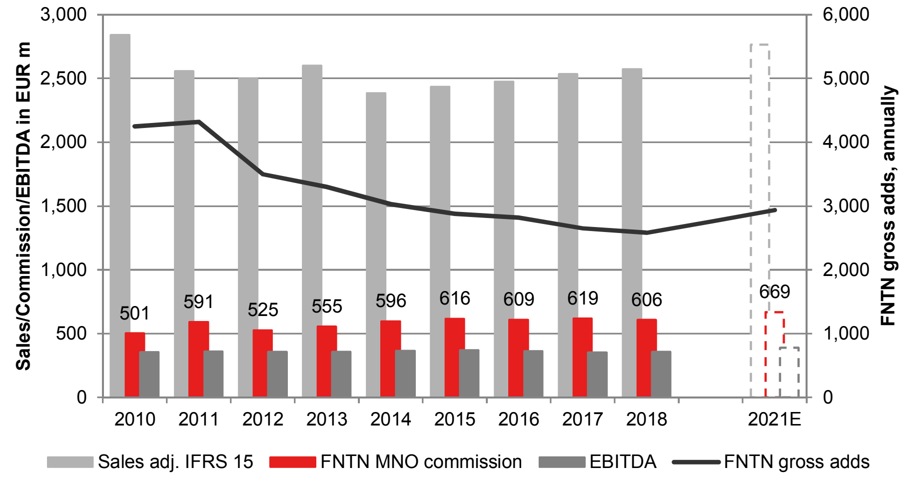
Drillisch’s potential MNO impact

FNTN’s business model relies heavily on premiums and commission (EUR 606.2m in FY 2018, -2.1% yoy) paid by MNOs to access FNTN’s distribution channels and to incentivise the company to market their mobile tariffs.

Current plans by 1&1 Drillisch to transform its business model to become a network operator will potentially increase competition in the German mobile market and lead to greater diversification in the choice of mobile tariffs. Both scenarios could be favourable for the MSP if 1&1 Drillisch wished to avail of FNTN’s sales force.

In a scenario analysis, we assume DRI would increase FNTN’s MNO commission income by approx. EUR 60m by FY 2021 relative to its mobile market share (DRI FY 2021 market share of 11.4%). The value is derived by anticipating a cannibalisation rate of 50% for existing contracts with the DRI tariffs and translates into an incremental operating cash flow of EUR 22.9m. The derived perpetuity then results in an NPV of EUR 263.7m or an additional FV of EUR 2.1 per share (**WRe FV of EUR 25.2** in such a scenario).

Incremental 1&1 Drillisch impact on FNTN's commission



Source: Company data, Warburg Research

TV&Media – Heading for growth

- Freenet's TV&Media side business (EUR 275m in revenues / 9.5% of total sales in FY 2018) is strategically complementary to its existing distribution expertise
- German TV market expected to grow via Pay-TV and IPTV offerings
- Freenet's IPTV offering waipu.tv expected to show attractive above-market growth rates (WRe: CAGR of 78.1% from 2019 until 2021) due to recent strategic alliances

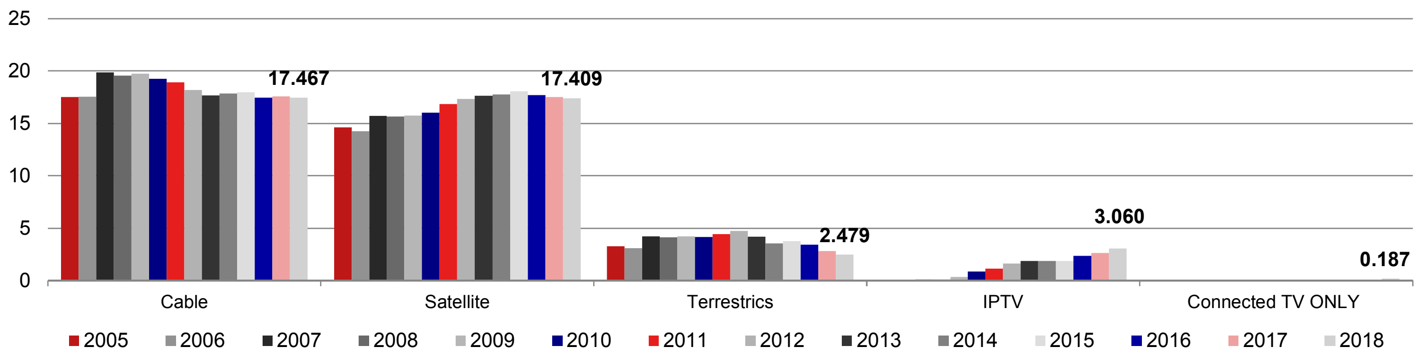
Pay-TV about to profit from VoD, "cord-cutting" and new TV hardware

German TV market

The German TV market comprises approx. 38.8m households and was valued at EUR 5,477m (satellite TV: EUR 959m, cable TV: EUR 3,300m; IPTV: EUR 1,200m; terrestrial TV: EUR 18m) in 2017. According to PwC, the market will reach a valuation of EUR 5.9bn in 2022 (CAGR of 1.3% until 2022) mainly driven by pay-TV products (pay-TV CAGR of 3% over the same period).

For several years, cable and satellite (each with approx. 45% household coverage) have been the dominant transmission channels in Germany. Terrestrial as the long-time distant third has been recently overtaken by IPTV (incl. OTT-only IPTV) as a result of both the change in transmission standards from DVB-T to DVB-T2 and the rising popularity of Video-on-Demand, so-called "cord-cutting" which describes the consumer shift towards internet-based or wireless television viewing, and smart-TV hardware.

German TV market by transmission channel (in million households)



Source: PwC GEMO, DieMedienanstalten.de, Warburg Research

Switch in transmission channels unlikely to offer any upside for FNTN

There are two changes ahead in the German television landscape: The next generations of terrestrial television (DVB-T) and satellite television (DVB-S) will be adopted but for different reasons.

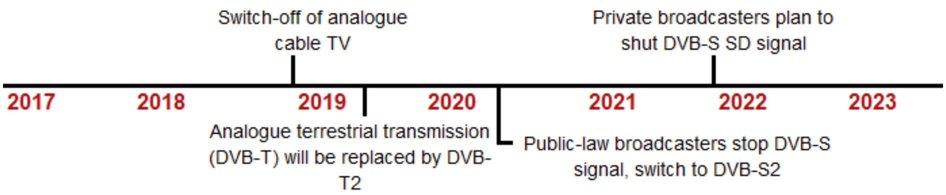
DVB-T: By mid-2019, there will be a nationwide transfer of terrestrial TV from DVB-T to the new DVB-T2 standard in order to free up the 700 MHz frequency band for mobile telecommunication and to foster data transmission to allow for higher data rates and consequently a greater number of TV channels in HD quality. The new DVB-T2 standard requires new hardware (TV or receiver) and a subscription via monopoly provider freenetTV (Media Broadcast) for private channels at the current cost of EUR 5.75 per month. The transition started in March 2017 and affects approx. 2.1 million German households of which about half are estimated to maintain the DVB-T2 standard.

In conclusion, the new standard and the defined number of potential customers are FNTN's target group for its niche DVB-T2 product freenet TV (Media Broadcast).

DVB-S: While the DVB-T transmission forms the foundation for a stable >1m household customer base for FNTN's TV business, the next generation of satellite TV in Germany will not change the demand structure drastically, as existing DVB-S customers simply face one-time purchase costs of approx. EUR 50 for additional hardware (receiver). A potential 5.3m German households might be affected by this change but we do not expect drastic changes in demand for freenet TV's new satellite product offer launched in March 2018 (selected private & public broadcasters in high definition quality via a mobile subscription or a prepaid voucher).

Initially, a switch to the new standard for private broadcasters had been anticipated by 2022 but recent industry statements revealed some resistance among industry leaders as such a transition could result in a declining viewership and consequently less ad-income.

Transition of the German TV market



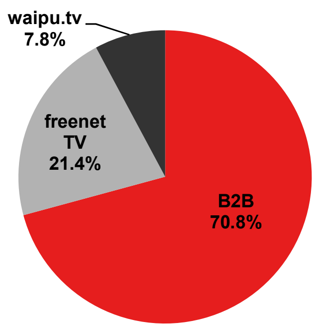
Source: Golem.de, Warburg Research

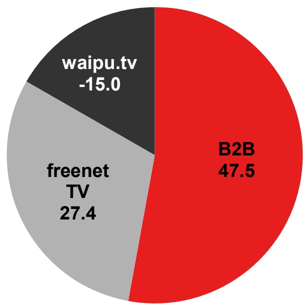
Loss-making IPTV offers appealing growth potential by 2021

Freenet's TV footprint

FNTN's side business TV&Media generated EUR 274.6m in revenues (9.5% of total sales) in FY 2018. The segment is further subdivided in B2B multimedia broadcast infrastructure for TV and radio (WRe: sales of EUR 211.1m in FY 2018), B2C freenet TV (DVBT-2; WRe: sales of EUR 50.6m in FY 2018), and B2C waipu.tv (50% IPTV joint-venture with EXARING AG; WRe: service revenues of EUR 12.8m in FY 2018).

TV&Media: 2019e Sales contribution (%) **2019e EBITDA split (EURm)**



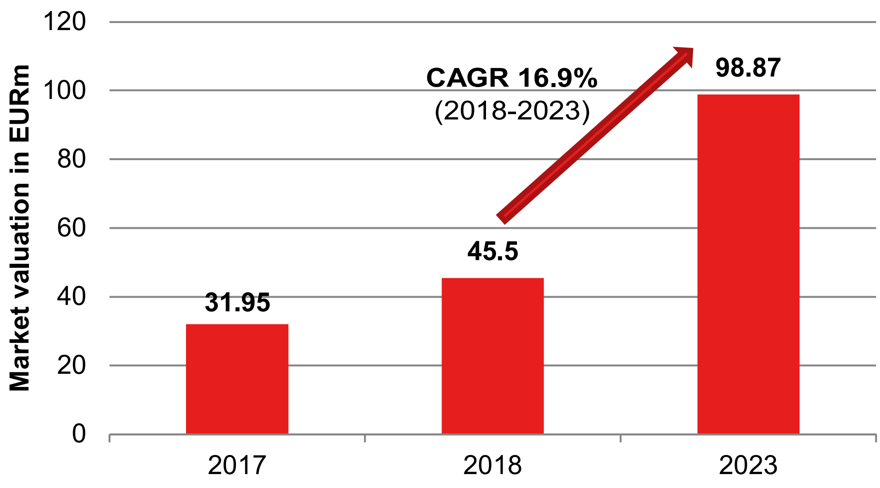


Source: Company data, Warburg Research

Given that FNTN recently scaled down its B2B segment by selling its ukw radio business (WRe: EUR 40m missing revenues in FY 2019) and that its B2C freenet TV product is limited by customer range (WRe: stable 1m RGUs in Germany), the company's sole growth driver is the IPTV product waipu.tv.

Sales in the global IPTV market grew by 42.4% in 2018 and a CAGR of 16.9% is expected until 2023, according to MordorIntelligence.

Outlook for the global IPTV market



Source: MordorIntelligence, Warburg Research

With 286.3k paying subs in Q1 2019, FNTN's waipu.tv currently holds a market share of approx. 9%, which is still relatively low compared to the biggest players in the German market (MagentaEINS ~ 4.4m German users; GIGA TV ~ 7.7m TV based global users, Zattoo ~3m customers).

However, strategic partnerships entered recently with Telefónica Deutschland and Samsung should, in our view, lead to above-market growth rates in future (WRe: CAGR of 78.1% from 2019 until 2021).

Telefónica Deutschland (O2D) IPTV partnership: FNTN and O2D entered an IPTV partnership in April 2019, which allows O2D to sell waipu.tv under its own brand "O2 TV". The partnership allows O2D to prepare for potential convergence in the German mobile market and encourage its customers' data consumption while *FNTN* gains valuable access to O2D's 22.5m mobile postpaid customer base and the opportunity for further upside from O2D's pending upfront cable remedy with Vodafone (O2D currently serves 2.2m broadband customers).

The remedy could lead to additional bundling efforts by the MNO in order to increase customer loyalty, which potentially would include a TV/IPTV product. We derive a gross add potential of 216k p.a. from this partnership based on the assumption that 50% of O2D's mobile customers will be in touch with the MNO once their contracts expire. Of these 50% are assumed to extend their relationship with O2D (implied churn of 2% p.m.) while 4% of these will take the O2-branded IPTV upselling option. Note that some IPTV subscriptions might be offered to certain O2D customers free of charge in order to retain valuable customer relationships and stimulate data consumption.

Samsung TV hardware IPTV partnership: At the beginning of 2019, FNTN entered another collaboration with Samsung TV hardware, which allows its IPTV product to be installed on all German Samsung TV hardware within the smart hub section. We regard this partnership as even more attractive than the partnership with O2D and derive a potential of 516k gross adds p.a. based on Samsung's 19% market share in TV hardware, its 6.79m units sold in Germany in 2018 and a retention rate of 40%. We see a significantly higher adoption rate than in the O2D partnership based on the straightforward nature of the application platform and the potential substitution or coexistence of IPTV with cable and satellite TV solutions.

Despite the attractive growth potential that comes with FNTN's IPTV solution, our **supportive growth assumptions** suggest an only slightly higher **FV of EUR 23.1** compared to a FV of EUR 21.5 without taking into consideration successful partnerships with both O2D and Samsung. Implied IPTV market shares in Germany in our two scenarios range between 6.9% (no partner growth) and 23.2% (partner growth).

Dividends – The investors' darling

- Freenet's FY2019 dividend of EUR 211.3m is assumed to be mostly funded by its mobile postpaid business (91.5% of the required FCF)
- Mobile postpaid, TV&Media ex. waipu, and breakeven IPTV (expected in FY 2021) sufficient to cover a sustainable dividend
- IPTV venture waipu.tv entirely funded within the segment TV&Media

Mobile postpaid covers >90% of the FY 2019 EUR 211m dividend (WRe)

Dividend composition

FNTN's investment case is clearly derived from its rich cash-generating profile and consequently from its attractive dividend payments, which grew at a CAGR of 9.5% from 2010-2018 to a DPS of EUR 1.65 (EUR 211.2m) in FY 2019.

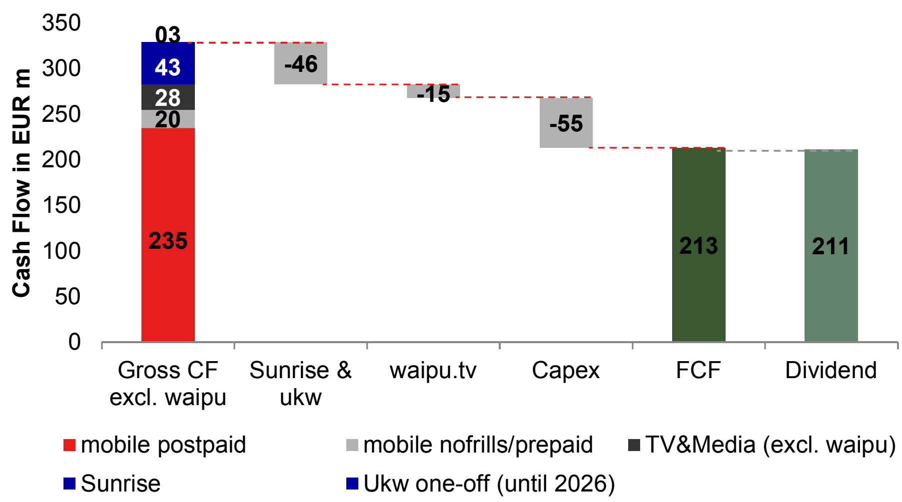
To analyse a potential erosion of FNTN's stable dividend, we examined individually the different input factors of the expected EUR 211.2m dividend payment for the FY 2019.

We estimate that mobile postpaid customers fund the lion's share of FNTN's dividend with an expected operating cash flow of EUR 235m in FY 2019 (mobile postpaid assumed to cover 91.5% of FNTN's FY 2019 dividend). Other relevant cash providers are FNTN's Sunrise asset (Op. CF of EUR 42.9m in FY 2019), and its TV&Media segment excl. waipu.tv (Op. CF of EUR 28m in FY 2019). An additional cash boost can be identified within waipu.tv, which is still loss-making (WRe: neg. EUR 15m in FY 2019, assumed to equal cash burn), but is expected to break even by FY 2021. FNTN's radio antenna sale in mid-2018 adds cash flow of EUR 3.2m p.a. until FY 2026.

According to management statements at the recent 2019 annual general meeting, it can be assumed that FNTN's dividend will remain stable in FY 2020 at EUR 1.65 per share / EUR 211.3m. This certainly highlights our view of a steady-state mobile postpaid business, which will be sufficient to fund a stable dividend while breakeven in FNTN's IPTV venture frees up additional and distributable funds from FY 2021 onwards.

FNTN's significant tax losses carried forward (EUR 1.82bn corporate tax related; EUR 1.14bn trade tax), also supports the dividend as it allows for the application of a minimum tax rate of 12.5% until FY 2027 (WRe).

FY 2019: Organic cash flow sufficient to fund stable dividend



Source: Company data, Warburg Research

Holdings – The asset manager

- Strategic asset Ceconomy fosters long-term exclusive distribution partnership
- Media Broadcast & EXARING secure Freenet's TV&Media market access with attractive cash generation (DVBT-2) and growth potential (IPTV)
- Sale of obsolete Sunrise asset offers supportive deleverage potential and should, in our view, result in an FV of EUR 24.2 for the Freenet share

Sale of non-strategic Sunrise asset provides deleverage upside

Ceconomy AG (Media-Saturn)

FNTN acquired 9.1% of the shares of Ceconomy for EUR 277m in June 2018. Media-Saturn, a majority shareholder in Ceconomy, is the leading consumer electronics retailer in Europe and distributes parts of the product portfolio of FNTN. The sales collaboration not only comprises mobile communication contracts for which Media-Saturn is an important and exclusive distribution partner, but also new products of FNTN's TV and Media segment such as internet TV or home networking. The acquisition can be regarded as strategic as it strengthens FNTN's influence over this distribution channel.

Sunrise Communications Group AG

FNTN purchased 24.56% of the shares of Sunrise Communications Group AG for EUR 736m in March 2016. Sunrise is the largest private telecommunications provider in Switzerland with more than 3 million customers. Despite the acquisition's cash accretive nature from attractive dividend payments, the initial strategic rationale of participating in a passive consolidation trend in the Swiss mobile market now appears to be backfiring as Sunrise announced the acquisition of cable operator UPC in a cash deal worth CHF 6.3bn. FNTN is consequently lobbying for better risk distribution between UPC and Liberty Global, contrary to the nature of a cash-only deal. One potential alteration to the deal could consider the ex-post participation of UPC's parent company Liberty Global via Sunrise shares as part of the purchase agreement. The pending acquisition under the current conditions needs the approval of an extraordinary general meeting for the required capital increase of CHF 4.1bn which is due to take place in autumn 2019.

Considering FNTN's high leverage (FY 2019 net debt/EBITDA of 4.0x (WRe)), the non-strategic nature of the asset, and the fully leverage-financed acquisition (accompanied by EUR 12m interest payments p.a.), we would consider a **sale of the stake at its market value** as a positive trigger for FNTN's share price. FNTN could consequently reduce its leverage to a minimum level of 2.4x net debt/EBITDA or use some of the cash proceeds to buy back shares. A subsequent reduction in FNTN's beta from 1.24 to 1.18 due to the lower level of leverage would result in a **higher FV of EUR 24.1** compared to our base FV of EUR 23.1 (incl. Sunrise asset).

Media Broadcast Group GmbH

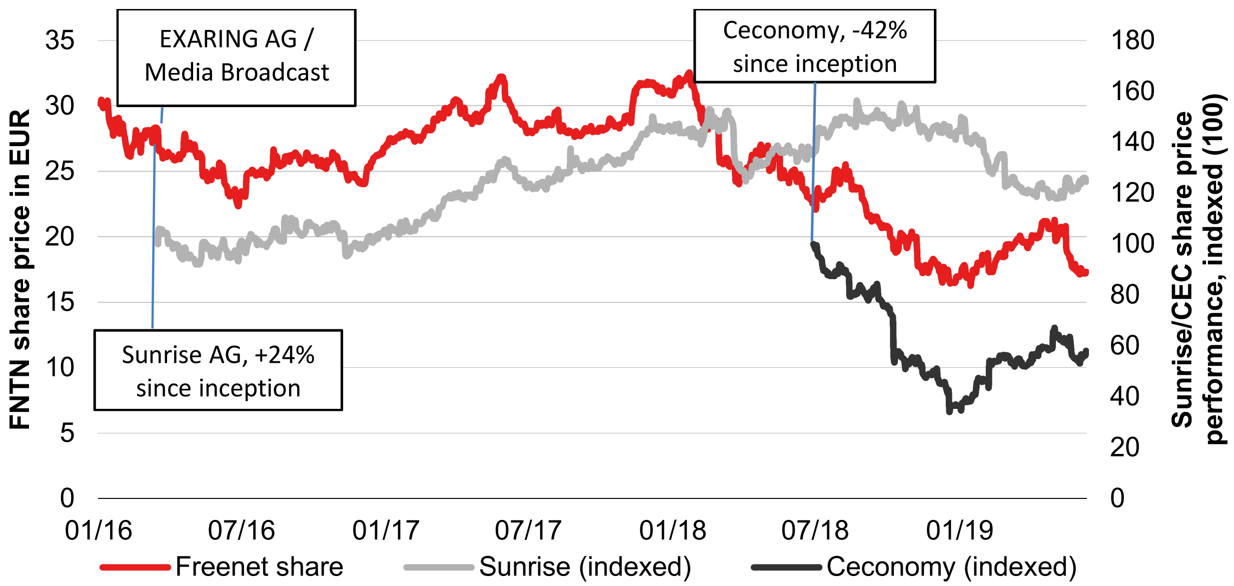
The subsidiary mobilcom-debitel acquired all shares in Media Broadcast Group in March 2016 for EUR 295m plus the related debt of about EUR 100m. The acquisition of the German market leader for transmission platforms for TV and radio, especially for terrestrial transmitter networks allowed FNTN to enter the digital TV-business for the distribution of high-definition picture quality (Full HD TV) to retail customers and to become the sole provider of DVB-T2 HD ("freenet TV") in Germany with a total addressable market of 2.1m German households.

EXARING AG

In 2016, FNTN acquired a 50.01%-stake in EXARING AG in two steps. EXARING AG is a provider of a closed IP platform for innovative entertainment and especially video services. With EXARING's fibre-optic network, FNTN is capable of reaching 23 million German households and secured the distribution rights for this closed IP platform. The asset laid the foundation for FNTN's IPTV product "waipu.tv" which addresses the rapidly expanding market of streaming and video-on-demand.

As waipu.tv's cash burn is currently assumed to equal its EBITDA at neg. EUR 15m in FY 2019 (WRe), a further capital injection by FNTN seems inevitable (WRe: EUR 10-15m) to fund further marketing and increase the IPTV prodiver's market share.

Freenet's asset management track record & share price development



Source: Bloomberg, Company data, Warburg Research

Valuation

- DCF model indicates a fair value per share of EUR 23.10
- SOTP model yields a fair value at EUR 29.20 per share based on conservative historical trading multiples

DCF model results in a FV of EUR 23.10 per share

We upgrade our recommendation for FNTN's share from Hold to **Buy** with a new price target of **EUR 23.10**. Our price target is based on a DCF model. A sum-of-the-parts valuation based on conservative historical trading multiples results in a higher fair value than our DCF valuation.

Discounted cash flow reveals attractive upside

We derive a price target of EUR 23.10 per share. This value is based on a detailed planning horizon until FY 2021, a transition period until 2031 and in perpetuity.

Sales: Following our detailed planning period until FY 2021, which is marked by an incremental increase based on favourable IPTV development (peak growth of 1.7% in FY 2022), we assume a gradual decrease in the growth rate until FY 2026, which will then equal steady-state market growth. This is due to the mature industry cycle of the German telecommunication and television market and the limited growth opportunities of FNTN within this segment.

Profitability: Over the transitional period, we assume a peak EBIT margin of 11% in FY 2023, which should be a result of the achievement of breakeven by FNTN's IPTV in FY 2021 and, consequently, lower marketing spend in the following years. The perpetuity margin of 10% (+80bps compared to FNTN's 5-year average EBIT margin) reflects a steady state in both mobile and TV&Media, while the IPTV venture, which is expected to be profitable by then, is assumed to account for the incremental increase.

Other core assumptions of the model are:

- A mid to long-term capital expenditure of 3.6% of sales to cover FNTN's maintenance and constant depreciation (5% of sales), while the gap between the two factors is accounted for by an IFRS 16 correcting factor included in the line "Others" of 1.4% of sales.
- Current tax rate of 12.5% is assumed to reach normal levels (35%) in FY 2028 after FNTN tax losses carried forward (total of EUR 3.0bn in FY 2018) are expended.
- A beta of 1.24 reflects the company's high leverage (WRe FY 2019 net debt/EBITDA of 4.0x), the liquidity of its shares, cyclicality of the business and transparency of communication.
- A WACC of 7.08% is derived for a non-cyclical but highly leveraged mature business.
- We value FNTN's holdings (Sunrise and Ceconomy) at their three-month average market valuation (EUR 864.3m).

While we stick to our base case of a steady-state mobile business (**FV of EUR 23.10**) combined with some attractive growth potential as a result of FNTN's recent IPTV expansion efforts, different valuation scenarios reveal potential downside. Negative scenarios, however, are solely accompanied by a deteriorating mobile business leaving a safety cushion for FNTN's valuation in terms of its IPTV performance (FNTN without IPTV partner growth at EUR 21.50). Our base case does not yet take into account the positive impact of a sale of the non-strategic Sunrise asset as the potential Sunrise-UPC deal in Switzerland might delay potential divestment prospects for FNTN.

Base Case Customer / ARPU evolution assumptions (steady state mobile & IPTV partner growth)

	2016	2017	2018	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
Mobile postpaid customers	5,790	6,711	6,896	6,950	7,000	7,030	7,055	7,075	7,090	7,100	7,105	7,105	7,105	7,105	7,105	7,105
Postpaid ARPU	21.4	21.4	19.0	18.8	18.9	18.9	18.9	19.0	19.0	19.0	19.1	19.2	19.2	19.3	19.4	19.5
freenet TV RGUs	-	902	1,014	1,015	1,010	1,005	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
freenet TV ARPU	-	4.5	4.4	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
waipu.tv RGUs	8	102	252	393	1,134	1,416	1,516	1,547	1,549	1,549	1,550	1,550	1,550	1,550	1,550	1,550
waipu.tv ARPU	5.1	5.4	5.6	5.2	3.7	4.1	4.3	4.6	4.9	5.2	5.3	5.4	5.5	5.5	5.5	5.5

Source: Company data, Warburg Research

Bear Case Customer / ARPU evolution assumptions (decay in mobile & no IPTV partner growth)

	2016	2017	2018	2019e	2020e	2021e	2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e
Mobile postpaid customers	5,790	6,711	6,896	6,950	6,945	6,897	6,819	6,725	6,625	6,524	6,427	6,337	6,258	6,172	6,091	6,015
Postpaid ARPU	21.4	21.4	19.0	18.8	18.9	18.9	18.9	19.0	19.0	19.0	19.1	19.2	19.2	19.3	19.4	19.5
freenet TV RGUs	-	902	1,014	1,015	1,010	1,005	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
freenet TV ARPU	-	4.5	4.4	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
waipu.tv RGUs	8	102	252	393	450	464	466	462	460	459	459	459	459	458	458	458
waipu.tv ARPU	5.1	5.4	5.6	5.2	5.3	5.4	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5

Source: Company data, Warburg Research

Freenet valuation scenarios

with Sunrise		**TV&Media**	
		IPTV partner growth	IPTV no partner growth
Mobile	DRI 4th MNO	**25.20**	**23.60**
	Steady state	**23.10**	**21.50**
	Stationary decline	**14.90**	**13.80**

w/o Sunrise		**TV&Media**	
		IPTV partner growth	IPTV no partner growth
Mobile	DRI 4th MNO	**26.20**	**24.50**
	Steady state	**24.10**	**22.40**
	Stationary decline	**15.60**	**14.50**

Source: Warburg Research

DCF model

Figures in EUR m	Detailed forecast period 2019e	2020e	2021e	Transitional period 2022e	2023e	2024e	2025e	2026e	2027e	2028e	2029e	2030e	2031e	Term. Value
Sales	2,882	2,916	2,965	3,015	3,060	3,100	3,137	3,172	3,204	3,236	3,268	3,301	3,334	
Sales change	*-0.5 %*	*1.2 %*	*1.7 %*	*1.7 %*	*1.5 %*	*1.3 %*	*1.2 %*	*1.1 %*	*1.0 %*	*1.0 %*	*1.0 %*	*1.0 %*	*1.0 %*	*1.0 %*
EBIT	292	300	315	326	337	338	342	343	346	346	343	340	337	
EBIT-margin	*10.1 %*	*10.3 %*	*10.6 %*	*10.8 %*	*11.0 %*	*10.9 %*	*10.9 %*	*10.8 %*	*10.8 %*	*10.7 %*	*10.5 %*	*10.3 %*	*10.1 %*	
Tax rate (EBT)	*12.5 %*	*12.5 %*	*12.5 %*	*12.5 %*	*12.5 %*	*12.5 %*	*12.5 %*	*12.5 %*	*12.5 %*	*35.0 %*	*35.0 %*	*35.0 %*	*35.0 %*	
NOPAT	255	263	275	285	295	296	299	300	303	225	223	221	219	
Depreciation	144	145	147	151	153	155	157	159	160	162	163	165	167	
in % of Sales	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	*5.0 %*	
Changes in provisions	0	0	0	2	2	2	2	-2	1	1	1	1	-2	
Change in Liquidity from														
- Working Capital	-7	1	1	5	0	0	0	0	0	0	0	0	0	
- Capex	55	56	57	57	58	65	72	79	87	97	108	112	120	
Capex in % of Sales	*1.9 %*	*1.9 %*	*1.9 %*	*1.9 %*	*1.9 %*	*2.1 %*	*2.3 %*	*2.5 %*	*2.7 %*	*3.0 %*	*3.3 %*	*3.4 %*	*3.6 %*	
Other	37	38	39	39	40	41	41	42	45	45	45	46	46	
Free Cash Flow (WACC Model)	314	314	325	337	351	347	344	336	333	246	234	229	217	219
PV of FCF	304	283	274	265	258	238	221	201	186	128	114	104	92	1,532
share of PVs	20.49 %			43.04 %										36.47 %

Model parameter

Derivation of WACC:		Derivation of Beta:	
Debt ratio	30.00 %	Financial Strength	1.70
Cost of debt (after tax)	4.2 %	Liquidity (share)	1.00
Market return	7.00 %	Cyclicality	1.00
Risk free rate	1.50 %	Transparency	1.20
		Others	1.30
WACC	**7.08 %**	**Beta**	**1.24**

Valuation (m)

Present values 2031e	2,669		
Terminal Value	1,532		
Financial liabilities	2,081		
Pension liabilities	136		
Hybrid capital	0		
Minority interest	20		
Market val. of investments	864		
Liquidity	126	No. of shares (m)	128.0
Equity Value	**2,955**	**Value per share (EUR)**	**23.08**

Sensitivity Value per Share (EUR)

		Terminal Growth						
Beta	WACC	0.25 %	0.50 %	0.75 %	**1.00 %**	1.25 %	1.50 %	1.75 %
1.50	8.1 %	18.41	18.68	18.97	19.29	19.62	19.98	20.37
1.37	7.6 %	19.98	20.31	20.67	21.05	21.46	21.91	22.39
1.30	7.3 %	20.85	21.21	21.60	22.03	22.49	22.99	23.53
1.24	7.1 %	21.77	22.17	22.61	**23.08**	23.60	24.15	24.77
1.18	6.8 %	22.76	23.21	23.69	24.22	24.80	25.43	26.12
1.11	6.6 %	23.82	24.32	24.87	25.46	26.11	26.82	27.60
0.98	6.1 %	26.21	26.84	27.52	28.28	29.11	30.04	31.07

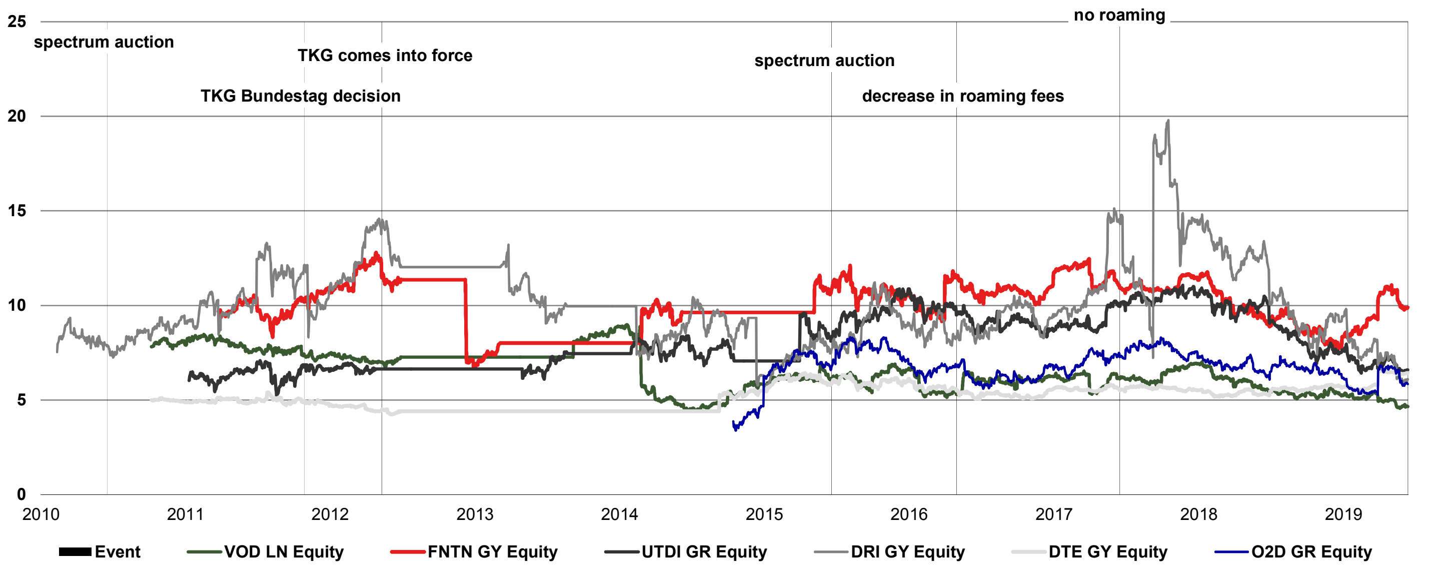
		Delta EBIT-margin						
Beta	WACC	-1.5 pp	-1.0 pp	-0.5 pp	**+0.0 pp**	+0.5 pp	+1.0 pp	+1.5 pp
1.50	8.1 %	15.48	16.75	18.02	19.29	20.56	21.82	23.09
1.37	7.6 %	16.99	18.34	19.70	21.05	22.40	23.76	25.11
1.30	7.3 %	17.83	19.23	20.63	22.03	23.43	24.83	26.23
1.24	7.1 %	18.73	20.18	21.63	**23.08**	24.53	25.98	27.43
1.18	6.8 %	19.71	21.21	22.72	24.22	25.73	27.23	28.74
1.11	6.6 %	20.76	22.33	23.89	25.46	27.02	28.59	30.16
0.98	6.1 %	23.17	24.88	26.58	28.28	29.98	31.68	33.38

- Others accounts for non-cash effective IFRS 16 impact
- Sunrise and Ceconomy stake are valued at 3 month average market price

Sum-of-the-Parts

In addition to our DCF-based price indication, we also conduct a SOTP valuation, in which we individually value FNTN's mobile and TV&Media business units with respective historical trading multiples (FNTN historical trading multiple of 10.0x FY EV/EBITDA over the last seven years) minus a discount for the steady-state assumption for FNTN's mobile and TV&Media business (excl. waipu.tv).

Historical FY1 EV/EBITDA multiples of German telcos



Source: Bloomberg, Warburg Research

SOTP indicates significant upside potential; FV of EUR 29.20

By taking the average of trading EV/sales multiples for FNTN's IPTV business based on a global peer group of public companies with IPTV related operations, we derive a fair EV/sales multiple of 3.0x for FNTN's waipu.tv.

With respect to a holding discount applied with a 7.0x EV/EBITDA multiple in line with the mobile and TV&Media segment (excl. waipu.tv), we end up with a fair value of EUR 29.20. Despite the positive deviation of our SOTP approach, we stick to our DCF valuation as it is more suitable, in our view, to account for the expected growth dynamics of FNTN.

Sum-of-the-parts valuation of Freenet AG

SotP Freenet

*EBITDA adj. for IFRS 16

1. Fair Value segment mobile (in EUR m)

EBITDA Business Applications 2021e*	371
fair EV / EBITDA multiple	7.0 x
fair EV mobile	**2,598**

2. Fair Value segment B2B TV&Media (in EUR m)

EBITDA consumer Applications 2021e*	32
fair EV / EBITDA multiple	7.0 x
fair EV B2B TV&Media	**227**

3. Fair Value segment freenet TV (in EUR m)

EBITDA consumer Applications 2021e*	23
fair EV / EBITDA multiple	7.0 x
fair EV freenet TV	**160**

4. Fair value waipu.tv (in EUR m)

Sales waipu.tv 2021e	63
fair EV / sales multiple	3.0 x
fair EV Applications	190
debt	26
EXARING minorities	82
fair equity value waiput.tv	**82**

5. Fair value calculation Freenet in EUR m		**Contribution to EV**
Fair enterprise value mobile	2,598	45%
Fair enterprise value B2B TV&Media	227	4%
Fair enterprise value freenet TV	160	3%
Fair equity value waipu.tv	82	1%
Holdings Sunrise and Ceconomy	864	15%
Net Debt	2055	35%
Holding discount (7x FY 2021e EBITDA)	-188	-3%
Fair EV freenet	**5,797**	**100%**

fair equity value freenet	**3,742**
fair value per share in EUR	**29.2**

Source: Company data, Warburg Research

Free Cash Flow Value Potential

Warburg Research's valuation tool "FCF Value Potential" reflects the ability of the company to generate sustainable free cash flows. It is based on the "FCF potential" - a FCF "ex growth" figure - which assumes unchanged working capital and pure maintenance capex. A value indication is derived via the perpetuity of a given year's "FCF potential" with consideration of the weighted costs of capital. The fluctuating value indications over time add a timing element to the DCF model (our preferred valuation tool).

in EUR m	2015	2016	2017	2018	2019e	2020e	2021e
Net Income before minorities	221	216	276	212	213	224	243
+ Depreciation + Amortisation	71	161	280	174	144	145	147
- Net Interest Income	-44	-34	62	-78	-49	-45	-37
- Maintenance Capex	35	60	60	40	40	40	40
+ Other	0	0	0	0	0	0	0
= Free Cash Flow Potential	**302**	**351**	**434**	**424**	**366**	**374**	**387**
FCF Potential Yield (on market EV)	7.2 %	6.7 %	7.8 %	8.2 %	9.0 %	9.3 %	9.8 %
WACC	7.08 %	7.08 %	7.08 %	7.08 %	7.08 %	7.08 %	7.08 %
= Enterprise Value (EV)	**4,163**	**5,237**	**5,577**	**5,136**	**4,058**	**4,003**	**3,939**
= Fair Enterprise Value	**4,260**	**4,959**	**6,128**	**5,981**	**5,162**	**5,272**	**5,461**
- Net Debt (Cash)	1,954	1,954	1,954	1,954	1,631	1,576	1,512
- Pension Liabilities	136	136	136	136	136	136	136
- Other	0	0	0	0	0	0	0
- Market value of minorities	0	0	0	0	0	0	0
+ Market value of investments	0	0	0	0	0	0	0
= Fair Market Capitalisation	**2,169**	**2,868**	**4,037**	**3,890**	**3,395**	**3,560**	**3,813**
Number of shares, average	128	128	128	128	128	128	128
= Fair value per share (EUR)	**16.94**	**22.41**	**31.54**	**30.39**	**26.52**	**27.81**	**29.78**
premium (-) / discount (+) in %					48.2 %	55.4 %	66.4 %

Sensitivity Fair value per Share (EUR)

	10.08 %	7.05	10.88	17.30	16.49	14.52	15.56	17.09
	9.08 %	9.62	13.88	21.00	20.10	17.64	18.74	20.39
	8.08 %	12.83	17.61	25.62	24.61	21.53	22.72	24.51
WACC	**7.08 %**	**16.95**	**22.41**	**31.54**	**30.39**	**26.52**	**27.81**	**29.78**
	6.08 %	22.42	28.77	39.40	38.07	33.15	34.58	36.80
	5.08 %	30.04	37.65	50.37	48.77	42.39	44.01	46.57
	4.08 %	41.39	50.86	66.70	64.71	56.15	58.07	61.12

- …

Valuation

	2015	2016	2017	2018	2019e	2020e	2021e
Price / Book	2.8 x	2.4 x	2.6 x	2.4 x	1.7 x	1.7 x	1.6 x
Book value per share ex intangibles	-2.24	-4.27	-4.00	-5.04	-8.15	-8.03	-7.74
EV / Sales	1.3 x	1.6 x	1.6 x	1.8 x	1.4 x	1.4 x	1.3 x
EV / EBITDA	11.3 x	11.9 x	10.3 x	9.8 x	9.3 x	9.0 x	8.5 x
EV / EBIT	13.9 x	18.9 x	21.4 x	16.5 x	13.9 x	13.3 x	12.5 x
EV / EBIT adj.*	13.9 x	18.9 x	21.4 x	18.8 x	13.9 x	13.3 x	12.5 x
P / FCF	11.9 x	8.5 x	9.7 x	8.2 x	9.2 x	11.8 x	11.8 x
P / E	16.9 x	14.6 x	13.0 x	13.7 x	10.8 x	10.2 x	9.4 x
P / E adj.*	16.9 x	14.6 x	13.0 x	13.7 x	10.8 x	10.2 x	9.4 x
Dividend Yield	5.3 %	6.2 %	5.7 %	6.9 %	9.2 %	9.2 %	9.2 %
FCF Potential Yield (on market EV)	7.2 %	6.7 %	7.8 %	8.2 %	9.0 %	9.3 %	9.8 %

*Adjustments made for: -

Company Specific Items

	2015	2016	2017	2018	2019e	2020e	2021e
Postpaid customers (m)	6.31	6.51	6.71	6.90	6.95	7.00	7.03
Postpaid ARPU	21.40	21.40	21.40	19.02	18.78	18.85	18.90

Consolidated profit & loss

In EUR m	2015	2016	2017	2018	2019e	2020e	2021e
Sales	**3,118**	**3,362**	**3,507**	**2,897**	**2,882**	**2,916**	**2,965**
Change Sales yoy	2.5 %	7.8 %	4.3 %	-17.4 %	-0.5 %	1.2 %	1.7 %
Increase / decrease in inventory	0	0	0	0	0	0	0
Own work capitalised	11	19	19	18	18	18	18
Total Sales	**3,129**	**3,381**	**3,526**	**2,916**	**2,900**	**2,934**	**2,983**
Material expenses	2,327	2,464	2,558	1,994	1,964	1,973	1,995
Gross profit	**3,118**	**3,362**	**3,507**	**2,897**	**2,882**	**2,916**	**2,965**
Gross profit margin	*25.7 %*	*27.3 %*	*27.6 %*	*31.8 %*	*32.5 %*	*32.9 %*	*33.3 %*
Personnel expenses	195	220	226	220	232	234	237
Other operating income	51	61	55	101	73	71	68
Other operating expenses	288	355	388	362	341	352	357
Unfrequent items	0	0	0	0	0	0	0
EBITDA	**370**	**439**	**541**	**525**	**436**	**445**	**462**
Margin	*11.9 %*	*13.1 %*	*15.4 %*	*18.1 %*	*15.1 %*	*15.3 %*	*15.6 %*
Depreciation of fixed assets	11	60	88	71	81	81	82
EBITA	**359**	**342**	**321**	**370**	**355**	**364**	**380**
Amortisation of intangible assets	60	64	60	58	63	64	65
Goodwill amortisation	0	0	0	0	0	0	0
EBIT	**299**	**278**	**261**	**312**	**292**	**300**	**315**
Margin	*9.6 %*	*8.3 %*	*7.4 %*	*10.8 %*	*10.1 %*	*10.3 %*	*10.6 %*
EBIT adj.	**299**	**278**	**261**	**273**	**292**	**300**	**315**
Interest income	0	1	1	0	0	0	0
Interest expenses	45	56	51	56	71	71	71
Other financial income (loss)	0	21	112	-22	22	26	34
EBT	**255**	**244**	**323**	**234**	**243**	**256**	**278**
Margin	*8.2 %*	*7.3 %*	*9.2 %*	*8.1 %*	*8.4 %*	*8.8 %*	*9.4 %*
Total taxes	33	28	47	22	30	32	35
Net income from continuing operations	**221**	**216**	**276**	**212**	**213**	**224**	**243**
Income from discontinued operations (net of tax)	0	0	0	0	0	0	0
Net income before minorities	**221**	**216**	**276**	**212**	**213**	**224**	**243**
Minority interest	0	-12	-11	-11	0	0	0
Net income	**221**	**228**	**287**	**223**	**213**	**224**	**243**
Margin	*7.1 %*	*6.8 %*	*8.2 %*	*7.7 %*	*7.4 %*	*7.7 %*	*8.2 %*
Number of shares, average	128	128	128	128	128	128	128
EPS	**1.73**	**1.78**	**2.24**	**1.74**	**1.66**	**1.75**	**1.90**
EPS adj.	1.73	1.78	2.24	1.74	1.66	1.75	1.90

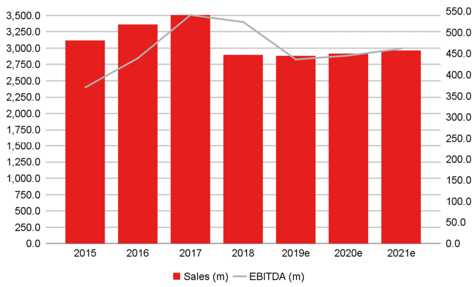
*Adjustments made for:

Guidance: Revenues 19e: stable ; EBITDA 19e: EUR 420m - EUR 440m; FCF 19e: 240m-260m

Financial Ratios

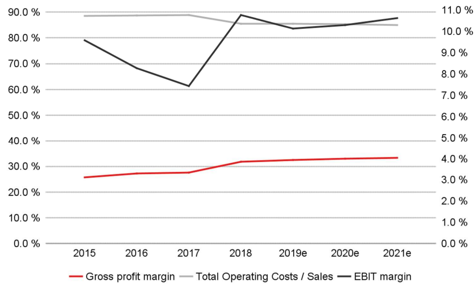
	2015	2016	2017	2018	2019e	2020e	2021e
Total Operating Costs / Sales	88.5 %	88.6 %	88.9 %	85.4 %	85.5 %	85.3 %	85.0 %
Operating Leverage	-0.3 x	-0.9 x	-1.4 x	-1.1 x	12.4 x	2.4 x	2.9 x
EBITDA / Interest expenses	8.3 x	7.9 x	10.6 x	9.4 x	6.1 x	6.3 x	6.5 x
Tax rate (EBT)	13.0 %	11.3 %	14.6 %	9.3 %	12.5 %	12.5 %	12.5 %
Dividend Payout Ratio	89.6 %	94.6 %	76.6 %	99.6 %	99.4 %	94.4 %	86.9 %
Sales per Employee	713,967	688,172	852,726	692,677	703,033	707,801	717,884

Sales, EBITDA
in EUR m



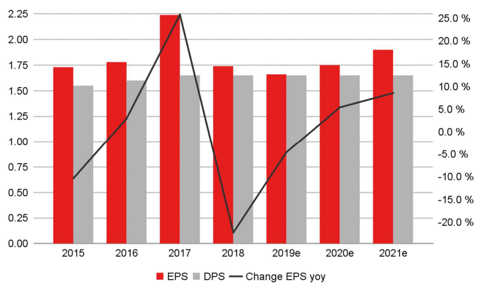
Source: Warburg Research

Operating Performance
in %



Source: Warburg Research

Performance per Share



Source: Warburg Research

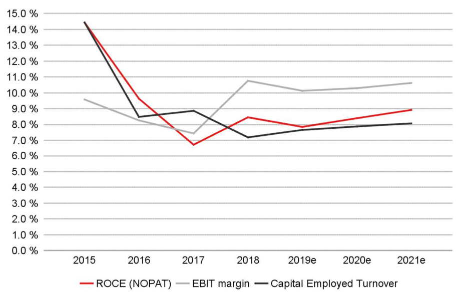
Consolidated balance sheet

In EUR m	2015	2016	2017	2018	2019e	2020e	2021e
Assets							
Goodwill and other intangible assets	1,612	1,906	1,943	1,905	2,401	2,397	2,392
thereof other intangible assets	458	526	564	525	1,015	1,010	1,005
thereof Goodwill	1,154	1,380	1,380	1,380	1,386	1,386	1,386
Property, plant and equipment	33	493	436	399	148	132	126
Financial assets	3	783	833	973	1,102	1,081	1,063
Other long-term assets	12	0	9	432	432	432	432
Fixed assets	**1,660**	**3,182**	**3,222**	**3,709**	**4,083**	**4,042**	**4,012**
Inventories	79	75	76	106	105	106	108
Accounts receivable	515	520	533	306	237	240	244
Liquid assets	270	318	323	126	172	227	291
Other short-term assets	199	190	160	387	392	392	391
Current assets	**1,064**	**1,103**	**1,092**	**925**	**905**	**964**	**1,034**
Total Assets	**2,724**	**4,285**	**4,314**	**4,635**	**4,989**	**5,006**	**5,046**
Liabilities and shareholders' equity							
Subscribed capital	128	128	128	128	128	128	128
Capital reserve	738	738	738	738	738	738	738
Retained earnings	475	505	586	535	591	604	636
Other equity components	-15	-10	-20	-140	-100	-100	-100
Shareholders' equity	1,325	1,360	1,432	1,261	1,357	1,369	1,401
Minority interest	54	42	31	20	20	20	20
Total equity	**1,379**	**1,402**	**1,463**	**1,281**	**1,377**	**1,390**	**1,421**
Provisions	79	181	164	163	163	163	163
thereof provisions for pensions and similar obligations	59	151	115	136	136	136	136
Financial liabilities (total)	639	2,078	2,054	2,081	1,803	1,803	1,803
thereof short-term financial liabilities	421	60	7	23	23	23	23
Accounts payable	444	516	517	523	458	463	471
Other liabilities	183	108	116	587	1,187	1,187	1,187
Liabilities	**1,345**	**2,882**	**2,851**	**3,354**	**3,611**	**3,617**	**3,624**
Total liabilities and shareholders' equity	**2,724**	**4,285**	**4,314**	**4,635**	**4,989**	**5,006**	**5,046**

Financial Ratios

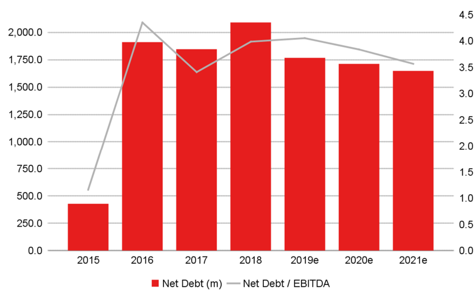
	2015	2016	2017	2018	2019e	2020e	2021e
Efficiency of Capital Employment							
Operating Assets Turnover	17.0 x	5.9 x	6.6 x	10.1 x	90.6 x	203.3 x	501.4 x
Capital Employed Turnover	1.7 x	1.0 x	1.1 x	0.9 x	0.9 x	0.9 x	1.0 x
ROA	13.3 %	7.2 %	8.9 %	6.0 %	5.2 %	5.5 %	6.1 %
Return on Capital							
ROCE (NOPAT)	14.4 %	9.6 %	6.7 %	8.5 %	7.8 %	8.4 %	8.9 %
ROE	16.9 %	17.0 %	20.5 %	16.6 %	16.2 %	16.4 %	17.5 %
Adj. ROE	16.9 %	17.0 %	20.5 %	16.6 %	16.2 %	16.4 %	17.5 %
Balance sheet quality							
Net Debt	428	1,911	1,846	2,091	1,767	1,712	1,648
Net Financial Debt	369	1,760	1,732	1,954	1,631	1,576	1,512
Net Gearing	31.1 %	136.3 %	126.2 %	163.2 %	128.3 %	123.2 %	115.9 %
Net Fin. Debt / EBITDA	99.8 %	401.0 %	320.0 %	372.5 %	374.1 %	353.8 %	327.6 %
Book Value / Share	10.3	10.6	11.2	9.8	10.6	10.7	10.9
Book value per share ex intangibles	-2.2	-4.3	-4.0	-5.0	-8.2	-8.0	-7.7

ROCE Development



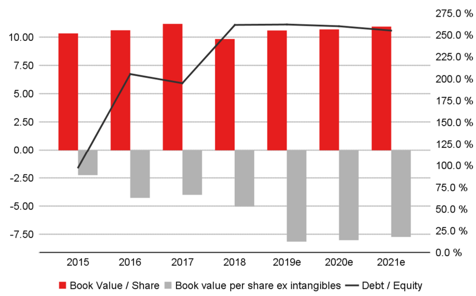
Source: Warburg Research

Net debt
in EUR m



Source: Warburg Research

Book Value per Share
in EUR



Source: Warburg Research

Consolidated cash flow statement

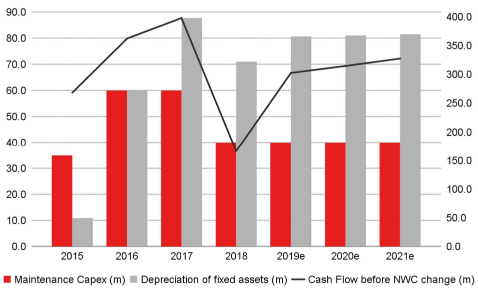
In EUR m	2015	2016	2017	2018	2019e	2020e	2021e
Net income	221	216	276	212	213	224	243
Depreciation of fixed assets	11	60	88	71	81	81	82
Amortisation of goodwill	0	0	0	0	0	0	0
Amortisation of intangible assets	60	64	60	58	63	64	65
Increase/decrease in long-term provisions	-9	92	-36	22	0	0	0
Other non-cash income and expenses	-15	-70	11	-196	-54	-54	-62
Cash Flow before NWC change	**269**	**363**	**398**	**167**	**303**	**315**	**327**
Increase / decrease in inventory	1	5	-1	-30	1	-1	-2
Increase / decrease in accounts receivable	-27	-4	-13	226	69	-3	-4
Increase / decrease in accounts payable	73	72	2	6	-65	5	8
Increase / decrease in other working capital positions	0	-45	0	0	0	3	0
Increase / decrease in working capital (total)	46	27	-13	203	5	4	2
Net cash provided by operating activities [1]	**315**	**390**	**385**	**369**	**308**	**319**	**329**
Investments in intangible assets	0	0	0	0	-60	-60	-60
Investments in property, plant and equipment	0	0	0	0	0	-65	-75
Payments for acquisitions	-3	-816	0	0	0	0	0
Financial investments	-1	-1	-1	277	0	0	0
Income from asset disposals	4	15	19	1	3	3	3
Net cash provided by investing activities [2]	**-28**	**-862**	**-42**	**-333**	**-52**	**-53**	**-54**
Change in financial liabilities	98	788	-91	19	0	0	0
Dividends paid	-192	-198	-205	-211	-211	-211	-211
Purchase of own shares	0	0	0	0	0	0	0
Capital measures	0	0	0	0	0	0	0
Other	-35	-68	-43	-41	0	0	0
Net cash provided by financing activities [3]	**-129**	**521**	**-339**	**-233**	**-211**	**-211**	**-211**
Change in liquid funds [1]+[2]+[3]	**158**	**48**	**5**	**-196**	**45**	**55**	**64**
Effects of exchange-rate changes on cash	0	0	0	0	0	0	0
Cash and cash equivalent at end of period	**270**	**318**	**323**	**126**	**172**	**227**	**291**

Financial Ratios

	2015	2016	2017	2018	2019e	2020e	2021e
Cash Flow							
FCF	239	272	258	250	253	263	272
Free Cash Flow / Sales	10.1 %	11.6 %	11.0 %	12.8 %	8.6 %	6.7 %	6.6 %
Free Cash Flow Potential	302	351	434	424	366	374	387
Free Cash Flow / Net Profit	142.2 %	170.6 %	134.4 %	165.6 %	116.8 %	86.8 %	80.0 %
Interest Received / Avg. Cash	0.2 %	0.3 %	0.3 %	0.1 %	0.1 %	0.1 %	0.1 %
Interest Paid / Avg. Debt	7.6 %	4.1 %	2.5 %	2.7 %	3.7 %	3.9 %	3.9 %
Management of Funds							
Investment ratio	0.0 %	0.0 %	0.0 %	0.0 %	2.1 %	4.3 %	4.6 %
Maint. Capex / Sales	1.1 %	1.8 %	1.7 %	1.4 %	1.4 %	1.4 %	1.3 %
Capex / Dep	0.0 %	0.0 %	0.0 %	0.0 %	41.6 %	86.1 %	92.0 %
Avg. Working Capital / Sales	5.6 %	3.4 %	2.4 %	-0.3 %	-3.9 %	-4.0 %	-4.0 %
Trade Debtors / Trade Creditors	116.2 %	100.8 %	103.0 %	58.6 %	51.7 %	51.7 %	51.7 %
Inventory Turnover	29.3 x	32.9 x	33.5 x	18.8 x	18.7 x	18.6 x	18.5 x
Receivables collection period (days)	60	56	55	39	30	30	30
Payables payment period (days)	70	76	74	96	85	86	86
Cash conversion cycle (Days)	3	-9	-7	-38	-36	-36	-36

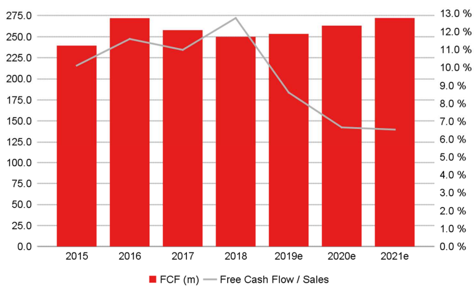
CAPEX and Cash Flow

in EUR m



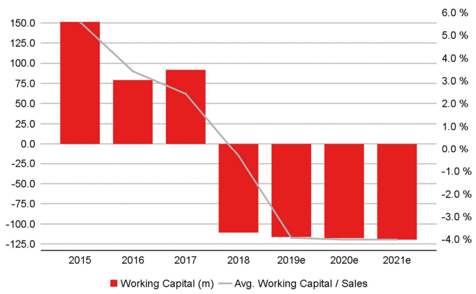
Source: Warburg Research

Free Cash Flow Generation



Source: Warburg Research

Working Capital



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Company	Disclosure	Link to the historical price targets and rating changes (last 12 months)
Freenet	6	http://www.mmwarburg.com/disclaimer/disclaimer_en/DE000A0Z2ZZ5.htm

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-H-	**Hold:**	The price of the analysed financial instrument is expected to remain mostly flat over the next 12 months.
-S-	**Sell:**	The price of the analysed financial instrument is expected to fall over the next 12 months.
“-“	**Rating suspended:**	The available information currently does not permit an evaluation of the company.

WARBURG RESEARCH GMBH – ANALYSED RESEARCH UNIVERSE BY RATING

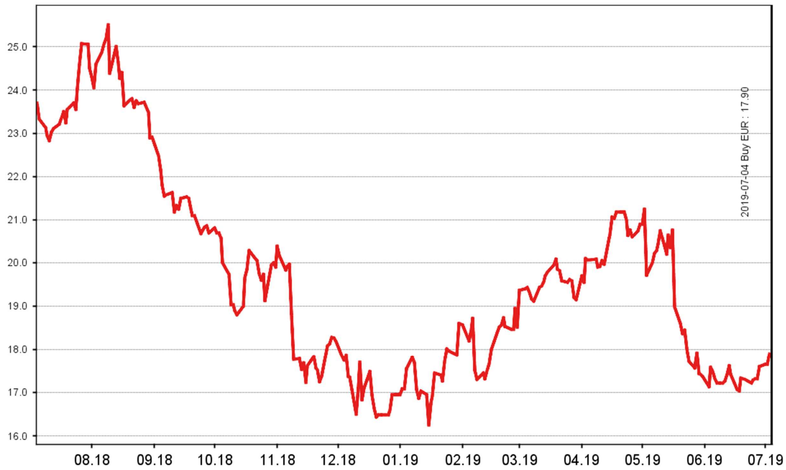
Rating	Number of stocks	% of Universe
Buy	119	60
Hold	71	36
Sell	4	2
Rating suspended	6	3
Total	**200**	**100**

WARBURG RESEARCH GMBH – ANALYSED RESEARCH UNIVERSE BY RATING …

… taking into account only those companies which were provided with major investment services in the last twelve months.

Rating	Number of stocks	% of Universe
Buy	32	78
Hold	7	17
Sell	0	0
Rating suspended	2	5
Total	**41**	**100**

PRICE AND RATING HISTORY FREENET AS OF 04.07.2019



Markings in the chart show rating changes by Warburg Research GmbH in the last 12 months. Every marking details the date and closing price on the day of the rating change.

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