
# Telefónica's 7th Investor Conference

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# "*Continued outperformance from a broader business*" transcript

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Thanks, Maria. What I was going to do over the next 25 minutes is tell you in Telefónica Europe how we've delivered in the past and actually how we're going to deliver our commitments as part of Telefónica commitments. What I'm going to start by doing is just talking a little bit about our performance and how we performed against the competition.

So the market is fast changing. But what we've managed to do, I think, is move ahead of the market in Europe. And the key thing we do here is we make efficiency gains continuously so we don't just respond to market conditions. We continually drive efficiency gains and we continually drive in the customer experience. And we continue to invest in the customer whatever the market environment is.

What you can see on the first chart is absolute evidence of that. So if you look at the 12-month to June '09 actually we drove about 44% of the net adds across our markets. The great news is that every one of my businesses produced a higher share in the 12-month to June '09 than they did in the 12-month to June '07.

So this was a broad range performance. Everyone performed better in terms of market share. Our service revenue market share has also improved by one percentage point. This is largely driven by the UK over that period. And our OIBDA margin, again improved by 2.5 percentage points driven by the Czech Republic and Germany.

So you can see it's a broad range business that's driving on all fronts and really continuing to invest in the customer. What has that meant overall? Well, actually we've driven CAGR to about 3% in terms of service revenue growth. The market has been about 0.8%. If you take our number out of the 0.8%, our competitors are at about 0.2%, so we're outperforming the competitors by that 2.8 percentage points.

Let me tell you something about the context, how I see the context and how I think it's going to develop. The first thing and you've heard is a very common thing, a clear growth in Internet-related revenues, but also new business streams as well. The point I would pick out here is we think there's going to be a patchwork of networks across multiple platforms, multiple devices and customers will really expand their usage across those multiple platforms and devices. For us we see that as a huge opportunity as new business streams and new markets actually evolve.

Voice and text, pretty mature in my markets. Yes, usage is expanding and price is going down. But actually what you would have seen us doing in our markets is actually investing the money far closer to the customer, so we've been actively taking money out of postpaid SAC and putting it into the tariff. So the benefit is closer to the customer and we're driving joint benefits with the customer there.

Now we expect prices to continue to go down on a pence or a cents per minute basis, but it will actually slow down from where we are today versus the last two years. And in-market consolidation moves it's clear in all of our markets that the smaller and the weaker players are now either exited or looking to exit across all of our markets whether it's Perlico in Ireland, Ceske Radiokomunikace in the Czech Republic, the DSL operators in Germany or Orange and T-Mobile in the UK. It's clear that the smaller and weaker players are now starting to look to or have left the marketplace.

From a regulation and a spectrum perspective, spectrum really market-by-market approach. Some of the markets are clear what's going to happen. Some of them aren't. Clearly, we're working with the regulators actually to look at the outcomes of that. That should become clearer in each market over the coming months.

As from a regulation perspective, yes, MTRs have been going down. Our exposure is relatively low and reducing all the time. And we've got relatively good visibility as far as our markets are concerned. And actually even after the end of the visibility we've got, we assume that MTRs will continue to decrease during the period through 2012.

How are we going to succeed? What do we have to do? Well the first is, we create customer loyalty. We have to drive customer loyalty in our customer bases. Secondly, Internet as a key growth engine will drive Internet very hard both on dongles and fixed and on the phones.

New business streams, we believe that the big upside in new business streams, as people use devices and platforms for more purposes and actually we'll talk a bit more about that later, and really importantly, agility: we have to move fast, we're in a very fast moving environment, so our communication and our decision processes have to be fast and we have to anticipate what customers really want with true insight.

How do we run our business?. Well, on the left-hand side you'll see a series of bubbles. I call this is a virtual circle. This is how we basically run our business. This is our modus operandi and we go round and round that circle where we create differentiation in the customer experience, we invest in the customer experience. We drive churn down through loyalty and then we reinvest again.

Now one bubble I would like to point out here is the one that says "fans" above it. What we're trying to do is create fans. I see some of our competitors are now using the same language as us that we've been using for a few years.

A great example of fans making is "Priority ticketing". So we now have the "02" venue or "O2 world" across all of our properties whether it's in Prague, Berlin, Dublin or London. Now what we do when we do a sponsorship is we don't just put a badge on a venue, actually we drive real customer benefits, and in every one of those venues what we do is we drive priority ticketing to our customers. So our customers can buy tickets before the general public.

You might say, you're not a music business, what are you trying to do?. Well, actually experience has now shown us that customers that are aware of priority ticketing, their propensity to churn reduces by 15%. So we get the media value but we also get the churn benefit. Is that big? Well, actually now, we've had over a million customers buying priority tickets across our venues. So it's significant, but it's a way of driving customer loyalty.

What does it mean as far as the KPIs? We lead in CSI and will continue to lead in CSI and probably try to increase that gap. Churn a key measure. You heard Julio and Guillermo talk about churn. So every 0.1 of a percentage point I can drive churn down over the four years, it's worth EUR400 million. It's a big lever for support, a big lever. And you'll see at the bottom we're looking to increase our revenue share by about three percentage points, really driven by the UK and Germany over this period.

You've seen this chart from everybody actually. So what we're really trying to do is move up into that top right quadrant. But all of our businesses start from different places. For me the best example of business that we've got in the top right quadrant is currently the UK. The UK drives a great customer experience and actually has created real emotional loyalty with its customers.

The challenge for me is to get all of the other businesses up into the right-hand top corner, to do that you have to give an excellent basic service. Why do we want to do that? Well we're driving new revenues, we'll build capabilities and we'll drive loyalty into our basis. As I said, we'll use the UK to really drive that process.

And on the bottom I've just put an example of a fresh way of how we think and some of you may have seen that last month we actually launched a new proposition called, GiffGaff. GiffGaff is a Scottish word that means giving and receiving. What we've actually done is create a pure online proposition that is in the UK to start with, that we're going to run separately from O2 UK.

Pure online proposition, customers will input as far as the marketing messages are concerned. It will be member-get member schemes and it will be based around the eight neutrality principles for web 2.0 businesses. So it's a completely new business running separately from O2 UK but actually it's a completely fresh way of looking at the marketplace.

Let me talk a little bit about the Internet and how we're actually going to drive this Internet adoption that we're talking about. Well the first is we want to become the "Home of Smartphones". We've got the iPhone across all of our markets, apart from Germany, we've had the Samsung Galaxy, which is an Android based device in Germany, and the UK and Ireland that we've launched.

And as you've heard from next week we will actually launch the Palm Pre across all of our markets as well in an exclusive fashion. But I think the real opportunity in smartphones is if we can get a smartphone with a cost price of sub EUR150. If we can get a sub EUR150 smartphone we can make smartphones truly mass market.

Now we think it's about 18 months away, the key driver will probably be the chipset. And we're already talking to the manufacturers about how we do that. But for us that's a huge market opportunity. Also really important from a customer perspective, we get customers onto the best network available. The great thing about the smartphones that are now coming out is they'll automatically find the best networks available.

In all of our countries we've got agreements with the best WiFi operators whether it's Bitbuzz in Ireland, whether it's the Cloud and BT in the UK or Cloud in Germany. But we don't just drive customer benefits by that. We drive network benefits because what we're doing is offloading traffic from our wireless network onto a fixed network. So it's a win-win.

The customer gets better service and we get better network utilization. I'll talk about the Czech Republic in a little while, but we've got a unique advantage in 3G as far as that rollout is concerned. And I'm going to talk about the German network as well.

What will that enable us to do? Well actually we think as far as Internet, customers are accessing the Internet will drive it up by about four times to about 31 million. Predominance of access on the Internet on mobile phones on our base.

Yes, dongles will play a role. Yes, fixed line will play a role. But actually the driving of smartphones is really important there. Now what that enables us to do, I think, as Julio explained, is actually start to address new markets. I think what is fair to say is the value chain and who plays what role in that value chain is very much to be determined.

And actually the market is playing out in front of us at the moment. But what we do know is if we're the ones that have been a catalyst to give customers access to the Internet we're in a fantastic position to understand their behaviors, understand the impacts on the network of the devices and actually really exploit that when the market starts to take off.

The great news is we've already started to exploit that and what I'm going to do now is just take you through a couple of examples that we've actually done in the UK for the last six months of really starting to expand our business model.

So the first one I've called personalized media business. What does this mean? We've been promising mobile advertising and mobile search for many years and it hasn't really come. Personalized media business is us using the knowledge that we've got about customers with business partners to bring benefits to the customer and bring benefits to the business partners.

Three examples I put here: the first one, we know where customers are and we know the profile of customers. We know how old they are, we know their interests as long as they've opted in. We did an acquisition campaign with a High Street chain who drives annual membership and actually we got a 10% response rate. So 10% of the customers we targeted responded to the campaign and actually then took membership up with the High Street chain that we were partnering with.

The second one is slightly different, in that it was industry-wide campaign; so all of the operators in the UK got together with a major FMCG brand and actually customers made a 3% response rate back to that offer. And thirdly, different again, did a customer self-selection. So actually we had an offer sitting on our website when people topped up on prepay. Customers could click onto a link and actually then go through to our partner site, again we got a 5% response rate.

The standard response rate you would normally get on these sort of campaigns, maybe 1%, maybe 2% if you're lucky. So you can see by being very targeted as far as the customer profiles are concerned we can bring benefits to customers and we can bring benefits to the business partners. That for me is a fledging business that we're now really starting to make happen.

O2 money, again fresh way for us to look at things, how do we bring technology together with the customer needs to drive benefits?. So, what we did was we actually designed a card that works with the mobile phone that you top up onto your card and every time you use the card you get a text back to your mobile phone that tells you what your balance is on your card.

Two prime audiences for us, budgeting adults and actually, teenagers. So teenagers no longer need to get pocket money or actually take cash to town. Actually, they've got a card they can use that make them feel a lot more grownup and adult instead of for security. We've had 70,000 customers in the first seven weeks. In fact, now we're over 100,000 customers. That is a huge take-up rate on this sort of card. Do we make any money out of that? Actually what we'll do is we'll drive churn down in the short term. But what are we doing?

Actually what we're really doing is buying ourselves an option for when things like near field communications come to maturity and actually there will be some money to be made out of some of these business transactions to be first there to exploit it. So we're buying our sales optionality whilst driving churn down in the medium term. For all of these streams we think by 2012 we'll be generating about 500 million of revenue at a relatively healthy margin.

Let me talk about efficiency and how we're going to drive efficiency. Well the first thing I would say about efficiency is don't try and push against customer's behaviors. Embrace customer's behaviors and the efficiency will come.

So we're going to drive our share of online transactions with our customers from 10% today to about 40% in 2012. A great example on the right-hand side, we launched an application on the iPhone called MyO2, very simple application where customers can effectively in real time see how many minutes in text they've used against their bundle, see how many they've got left to use for the rest of the month and how many charges they've incurred outside the bundle.

The top application in the first two weeks and we've not got 400,000 customers actively using that application. Customer benefits and we benefit, simple use of technology to drive efficiency into our business and, again, customer loyalty to drive churn down.

Price plan rationalization: we've got too complicated businesses and it's too complicated for customers as well as for us to run. So we're driving that down to customer benefits. And also contract SAC. You heard me talk about us driving that down. We're going to drive it down by about 25% between 2008 and 2012. Now we've done a lot of that already through simplicity, sim-only, that we've now launched across all of our markets. But we'll continue to drive it down to offset some of the tariff reductions we actually see coming.

Other efficiencies, non-commercial OpEx, so this is a real focus for us. OpEx that the customer doesn't see a benefit from, drive that down by about nine percentage points per annum. And as far as that CapEx is concerned I told you that our CapEx peaked in 2008 and it did. Our absolute level of CapEx will reduce between 2008, 2009, 2010, 2011, 2012.

You can also see we're spending far more of our CapEx on 3G, about half of our CapEx on 3G. And of that 3G CapEx about 70% is either on capacity or capability, so not coverage, capacity or capability.

Our network sharing with Vodafone, still absolutely on track and if anything, in the UK, the Orange and T-Mobile deal actually pushes it even closer together and will actually force us to do even more together to actually drive further costs out of the infrastructure for both us and Vodafone.

Let me talk to you about the UK and give you a bit of an insight into the life of me when I come and see you guys. Because every month or two months I'm probably sitting in front of some of you talking to you. I can guarantee that in the first three questions there will be a question about, how do you outperform in the UK, and how long are you going to continue to do it?

And I can guarantee that my answer is the same answer and all of you will have heard me give this answer. I say you have to get the strategy right, you have to mobilize 10,000 employees and then you have to execute. I can also guarantee that by the time I've got to the third point you're all glazed over because you're thinking its management speaking, I don't buy it.

Generally when we've been through that little process with each of you, you then ask me another question. Five years ago you said to me, Matthew, you're too slow on 3G. The other guys have built 3G. You're behind the game. What are you going to do?

And I said to you, actually I'm going to build to demand. I'm not going to build to supply. I'm going to build to demand. Did we get the timing on 3G right in the UK? Yes we did. Four years ago you said to me, what were you doing buying the Link? You bought the Link, everyone is going to benefit and you're going to be left with a rump of stores. What did we do in the Link? We cherry picked the stores. We got rid of the other stores to the other operators.

Three years ago you said to me, you're putting your brand at risk. Why would you rebrand the Dome to be "the O2"? What happens, "the O2" is now the most visited venue in the world. Two years ago you all said to me, you sold your soul. You've sold to Apple. Why would you do that? And actually do you know what? It's not going to sell any devices.

One year ago you said to me, Simplicity, you may have had a short-term benefit by taking SAC out but actually do you know what's going to happen now? Your churn is going to kick up. The point is that I know you challenged me hard and we love to be challenged because it improves our business thinking but to run that sort of business you have to get the big commercial decisions right and drive the continual customer experience.

And in the UK all of our competitors have been copying us to varying degrees five years. And do you know what? They've all failed to achieve it. So we still will continue to drive ahead in the UK. And you can see the results. So on the left-hand side, customer satisfaction. We're clear Number One and increasing our lead on customer satisfaction.

Churn, we've driven churn down over the last three years by ten percentage points. In the first 18 months we drove it down by five percentage points. In the second 18 months we drove it down by another five percentage points. So we've gone from 25 to 15.

Revenue market share, we've gone from 29 to 32 in three years, over one percentage point in the first 18 months; over another percentage point in the second 18 months. Why do I keep talking about 18 months? For it was about 18 months ago we launched the iPhone. And I know there's a view and the next time I see you all I know the next question is going to be actually, how do you keep performing in the UK? How long are you going to keep doing it, and your business model is going to collapse now because you've lost iPhone exclusivity?

Well we'll have the discussion but let me show you a bit about some of our stuff on iPhone. What I've done here is compare our growth, our post-paid growth in H109 versus H107. H107 no iPhone, H109 iPhone. Our growth was made up of three elements. The first is migrations, migrations from prepaid to postpaid. We made the market in the UK on Simplicity and actually it was 30% of our growth.

Secondly, better churn, 25% of the increased growth was due to better churn. Did the iPhone impact churn? Yes, it did to a point, not hugely but yes it did to a point in that period. And thirdly gross adds, we simply did more gross adds in the marketplace, key drivers, mobile broadband and the iPhone.

So has the iPhone been an important product for us? Absolutely it has, because it's market leading and it changed the paradigm of the market. Have we become a one-product company? No, we haven't. Recognize as we've told you again we launch the Palm Pre across all of our markets next week, Germany Monday and then the UK and Ireland on the 16th.

A little bit more about the UK and some key things, market consolidation, the merger of T-Mobile and Orange, personal view, joint ventures fraught with difficulties. We'll probably go through a process of 12 months to get regulatory clearance. We believe a clear impact on the outcome of Digital Britain so there was an agreement on Digital Britain when there was five players. If there's only going to four players we think we're in a different equation.

And then Orange and T-Mobile have said themselves about 18 months to put the two businesses together after that; we see some opportunities in that two and a half years actually to take some market share.

Converged, fixed and mobile sales into the business segment, we're not religious about owning the network, if we can deliver using someone else's infrastructure than we will. We've got a great position in the SME market in the UK. We're very good in corporate and actually you're now seeing us start moving MNCs and the DHL deal we did across Europe actually is a fixed and mobile deal in all markets.

And at the bottom and we don't talk much about it, Tesco Mobile. We struck it about five or six years ago with Tesco. Doing extremely well, taking more growth than anybody in the UK market on a prepay basis at the moment. Both companies very, very happy with the relationship, we cross-learn and we utilize our assets to help us both.

Let me talk about Germany. We're in a challenger position, very different position in Germany. What's your challenge to me in Germany over the last two years since the start of 2007? You lost market relevance. You're not relevant. You're never going to get the scale.

And what I've said to you is live with it because actually what we have been doing is building the foundations. Prior to 2007, we had a great business but it wasn't on solid foundations. It was built on one product, Genion. Actually what I said to you, is live with it. We're building a great network. We're building a great distribution facility and we're getting our IT right.

We're now at the point where we built the foundations and we're going to start to be aggressive in the marketplace in Germany. The top chart on net adds, you can see here that actually our net adds in H109 versus H208 were 18% higher while the market collapsed. Now to be fair in the collapse of the market there was a rewrite, I think from Vodafone, on their prepay numbers.

If you strip that out and talk post-pay we took more than 50% of the growth in the post-pay market in H109 in Germany. We're starting to get on a row. We're using O2o as our basis, which is a real challenging relatively disruptive proposition into the market.

Mobile broadband, as you look at the share of mobile broadband in Germany, it's become a three-player market, us, T-Mobile and Vodafone, and we're taking about 30% market share. Now last week Connect, which is one of the leading magazines in Germany, actually did a very in-depth, thorough independent review of everyone's networks in Germany. Let me read you a couple of the conclusions.

O2 is now at par with T-Mobile. O2 has definitely become a first division player in 2009. On data O2 is three times faster and world's apart from e-Plus. I said live with me because we'll build the foundations. We're now there. We've built the foundations. But it's true that there's no use having the right technology if you don't convince consumers.

We've got a big job in Germany to change the perception of our network and that's where our focus is now going to go to. What else in Germany? We've grown up. We've become a big company. We've become cash positive, cash positive in H109 and we'll be cash positive through 2009.

Also you would have seen our OIBDA really start to motor and it started in Q4 last year. We drove 40% OIBDA growth Q4 last year. Over the first half this year we've driven 27%. Recognize we're going to start lapping some more difficult comparators in Q4, which I said on the last analyst call. But actually from a financial and a customer proposition and a foundations basis we're now a very different business in Germany than we were two or three years ago.

Let me tell you something about the segments in Germany. We're going to split the consumer, SoHo and SME and corporate and MNC. Consumer clearly the biggest segment, EUR14 billion market revenue. We're sitting on an 18% market share. O2o will be our key driver into this marketplace, really important. But also the channel approach.

Up until last year we simply didn't play in the ISP market, which is about 25% of the market in Germany. Now we're dealing with the likes of Debitel and we're driving good market share through there. SoHo and SME a relatively big market of EUR5 billion; a very poor 7% market share in truth, do you see that as a poor performance or do you see that as an opportunity? I'd like to see it as an opportunity.

We'll use data as the Trojan Horse to get in there. But we're not underestimating the challenge here because to succeed in a SoHo and SME market what we have to do is get over that emotional hurdle because it's about people's livelihoods. They don't want to take risks with their mobile communications so actually really important for us to get over that emotional hurdle. Corporate and MNC, we can't do everything. We've got to prioritize in Germany, so we'll just selectively address those opportunities.

Let me just move to the Czech Republic. The first thing to say in Czech is we've got a unique proposition. We've got the broadest product range, mobile voice, fixed voice, DSL, WiFi, IPTV. We've got a really broad range of products but what we've got to do is exploit those products.

Now it's also fair to say that the Czech economy has really suffered during 2009. It looked okay up until 2009 but during 2009 has really suffered. Then made worse by the fact that we've led now an interim government and it looks as though the interim government is going to be in place until mid 2010.

Disproportionate impact on us because we are very strong in corporate, we're very strong in business and we're very strong in government as well, so from our perspective actually a disproportionate impact. On the flip side when the economy recovers and the government starts re-spending again actually we'll rebound very quickly in that marketplace.

For example, we think there are some real opportunities in e-Health and we'll use the capabilities that Guillermo is developing in Spain actually to exploit the product set in the Czech Republic.

I spoke about the 3G network advantage. We've continued to invest during the downturn and we now think we're about 12 or 18 months ahead of the opposition in that marketplace. And that's something that actually we're going to continue to spend on and continue to exploit. And Slovakia it's moving along very nicely, about 50,000 growth every quarter. We've done that for the last three quarters and it looks as though we've got a great customer proposition that's now really starting to get some consumer relevance.
What does that mean across all the products in the markets? Actually we're a lot broader business. 25% of our revenue will come from Internet access or

applications. Of our growth, half from the UK, half from Germany. We've been too reliant on the UK up until now but it's now starting to change.

From a cash perspective it's going to change even more. In 2008, 90% of the cash in Europe was driven from the Czech Republic or the UK. By 2012 we'll drive 25% from Germany, 25% from the Czech Republic and about 40% from the UK, a lot broader business.

So, in summary, we've demonstrated clear outperformance by basically how we operate our businesses. In the UK, less reliant but we'll continue to outperform and extend into new business areas. In Germany we've now built the foundations and there's a clear upside in that market from where we start. And in the Czech Republic it's all about exploiting our unique propositions in the marketplace due to our broad range of products. Thank you very much, and back to Maria.