

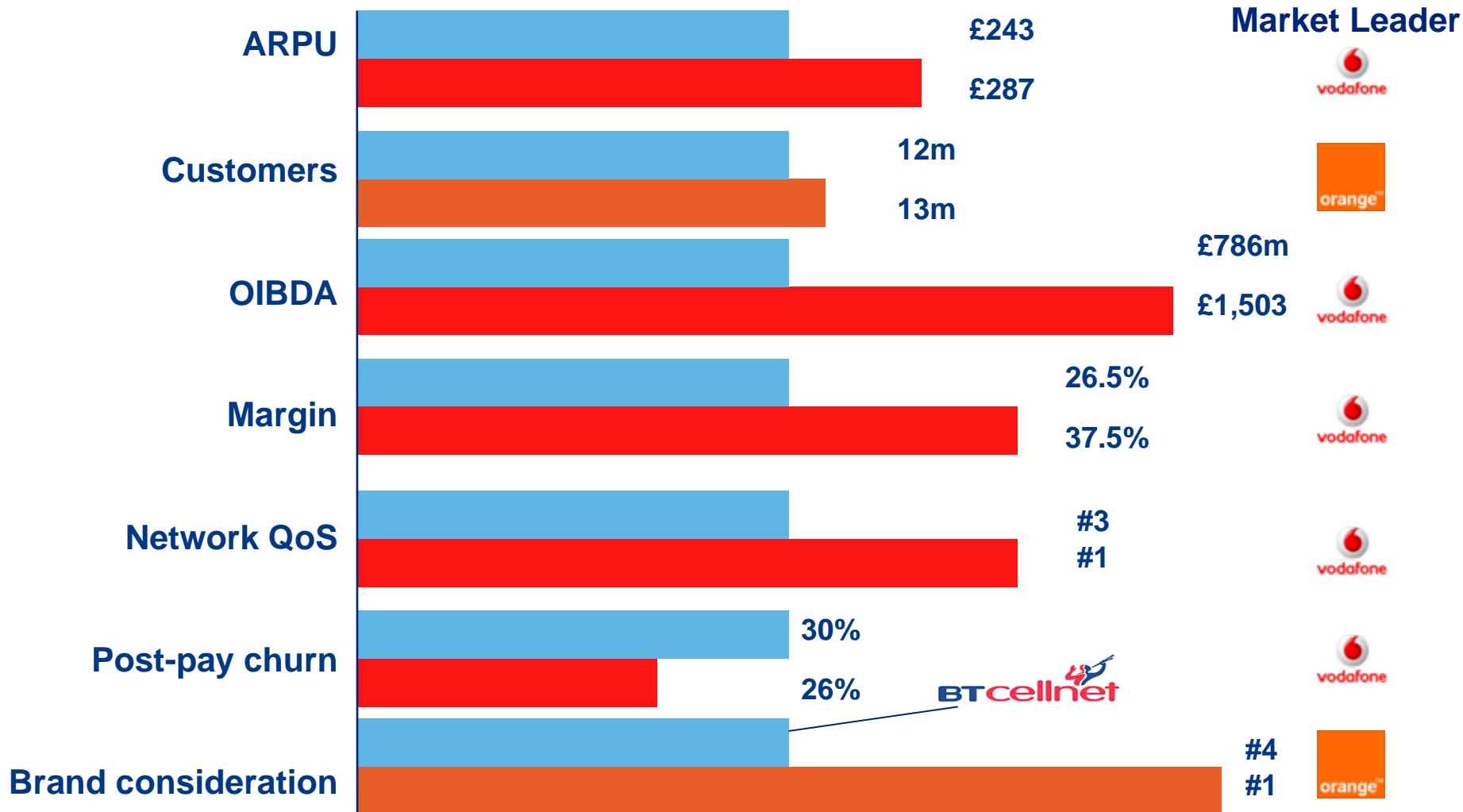
A vertical splash of water on the left side of the slide, featuring large, clear water droplets and bubbles that catch the light, creating a dynamic and refreshing visual effect against the blue background.

Telefónica O2 UK's transformation into market leader

Ronan Dunne
CEO Telefónica O2 UK

NSN Efficiency Forum
December 1, 2008

Some history.....the UK market in 2002



UK Market before 2005



Devices

The #1 factor for many of our customers

3rd Party Channels

Getting rich at our expense!

Products

Too much complexity for the customer!

Service

Unmet customer need!

Tariffs

Customers want value for money, but lack of trust



...for a better mobile life

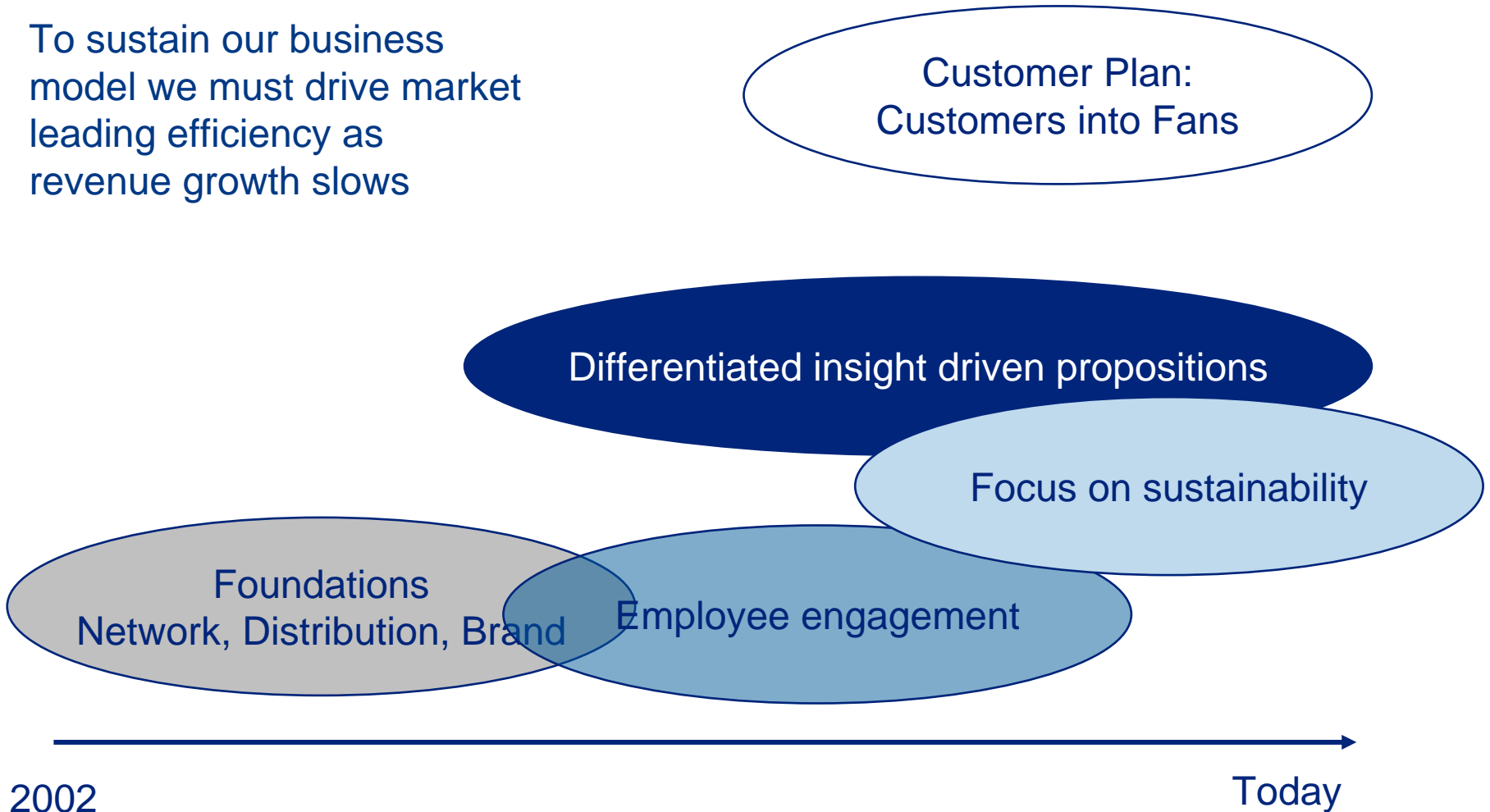
Caudwell nets £400m in sale to Vodafone



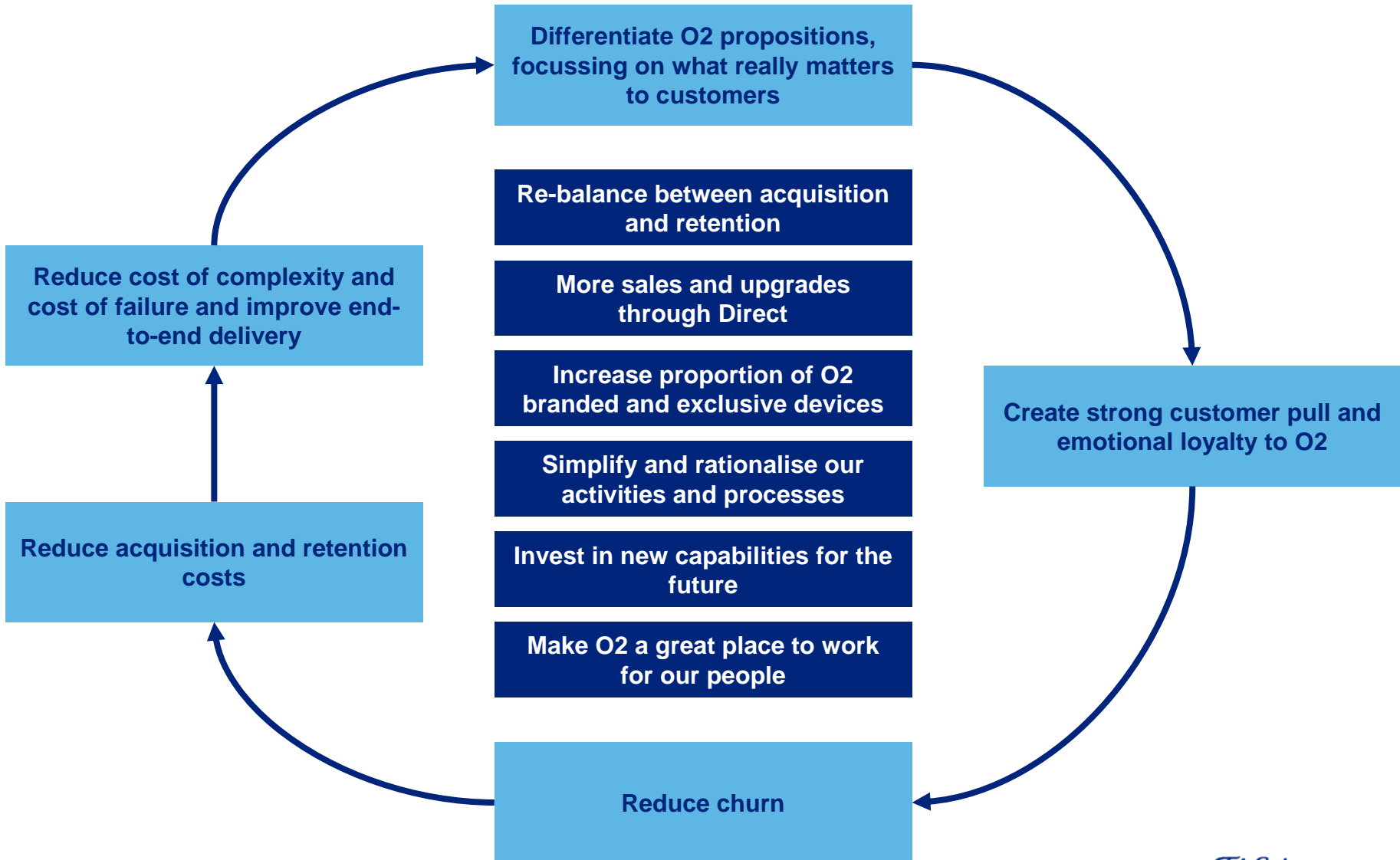
Ingredients for sustainable out-performance - O2 UK



To sustain our business model we must drive market leading efficiency as revenue growth slows



In 2005 we created The Customer Plan- a core business strategy to enable both differentiation and efficiency



The Customer Promise



**Best range
of devices**



**Great value,
no catch**



Best Place to shop



**Easy to use
products & services**



**A Network you can
rely on**



**The service
you deserve**



**People who
care**

Go to market – differentiated propositions: Great value, no catch



Pay & Go™

10% of your Top-ups back every 3 months

Text 'reward' to 50202

3p text to anyone. No daily limits

No wonder more texts are sent with O₂ than any other network.

The O₂



Bolt On:
50% off calls and texts from Europe

Europe to UK only £1.99 a month compared to standard O₂ rates

Apple iPhone

Coming 9th November.

Only on O₂

O₂ Home

Text "Home" & your postcode to 80202

o2.co.uk

Free minutes

REWARD

A 10% reward just for topping-up

Top-Up £50 or more between 1 October and 31 December 2004 and get a 10% calltime reward.

- Driven by insight
- Challenging the market norm
- Give customers something they truly value
- Understand how we can alter the business model to our advantage

Getting distribution right, focus on direct, retention and brand differentiation



**Large
Retailer of
the Year**

**Mobile News
Awards 2006**

Marketing

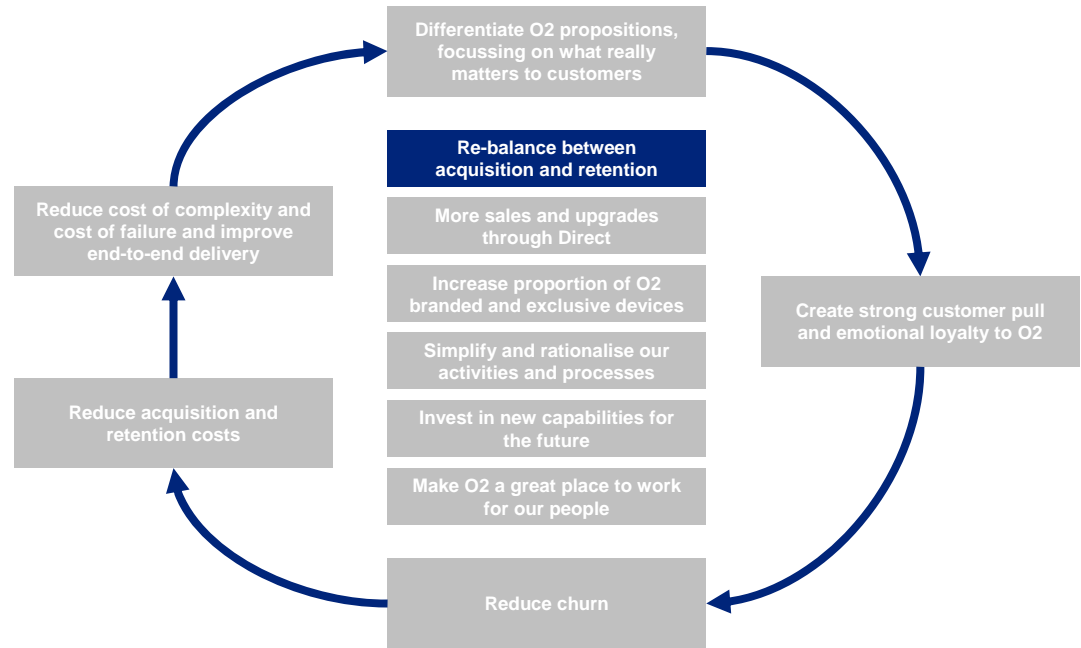
Marketing Magazine

Most Loved Mobile Brand



JD Power

**#1 for Postpay
& Prepay
Customer
Satisfaction**



Build and exploit the brand



April 07



November 07



September 08



Best Loved Brands : ranking in "Brand Love" index

NSN Benchmarking – strategic context is everything...



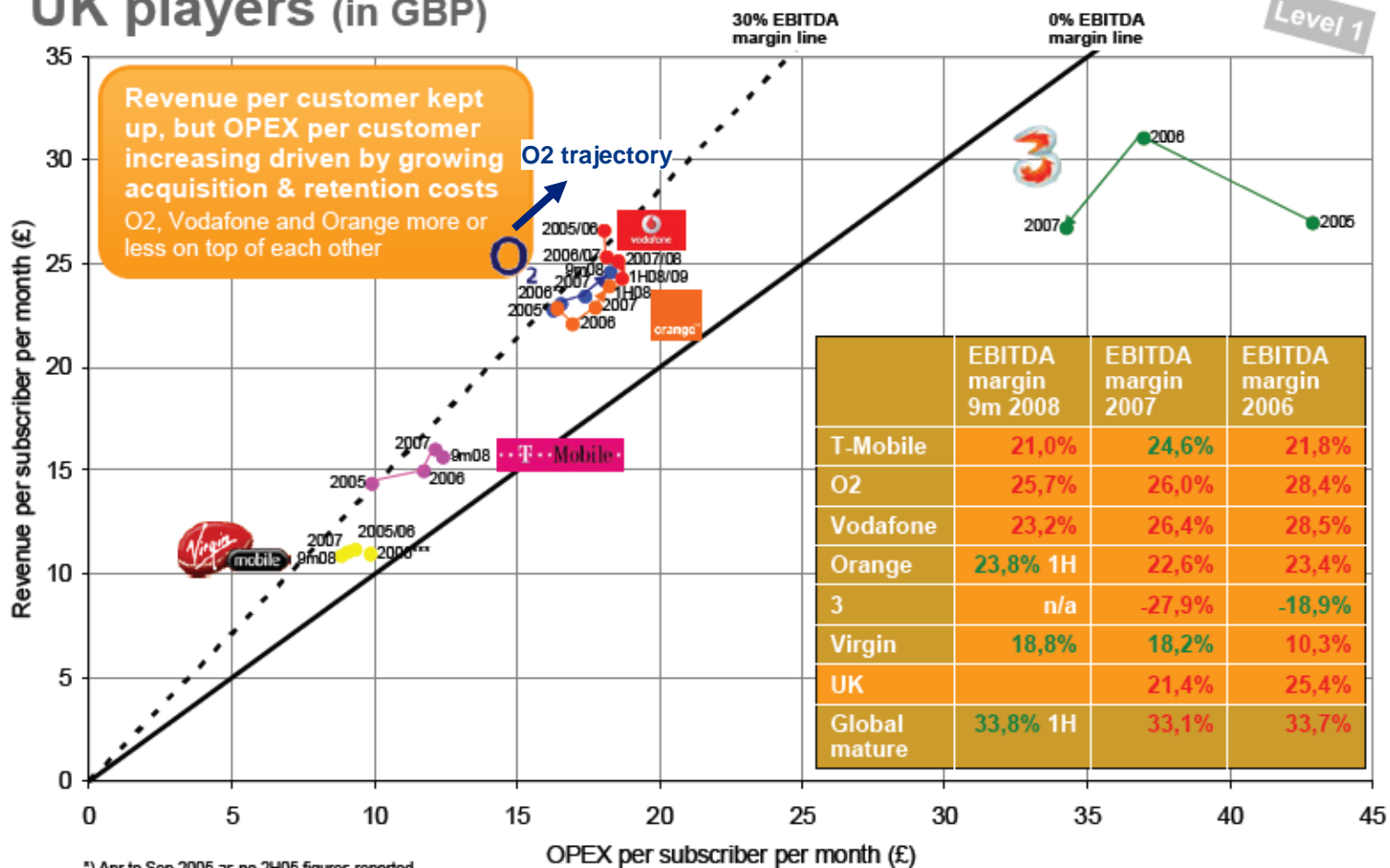
O2 and Orange have traded cost/sub for increasing revenue/sub, whereas Voda has held cost/sub at the expense of revenue/sub



Mobile: ARPU vs. OPEX per subscriber
UK players (in GBP)

2005 → 9m 2008

Level 1



*) Apr to Sep 2005 as no 2H05 figures reported

**) Feb to Dec 2006

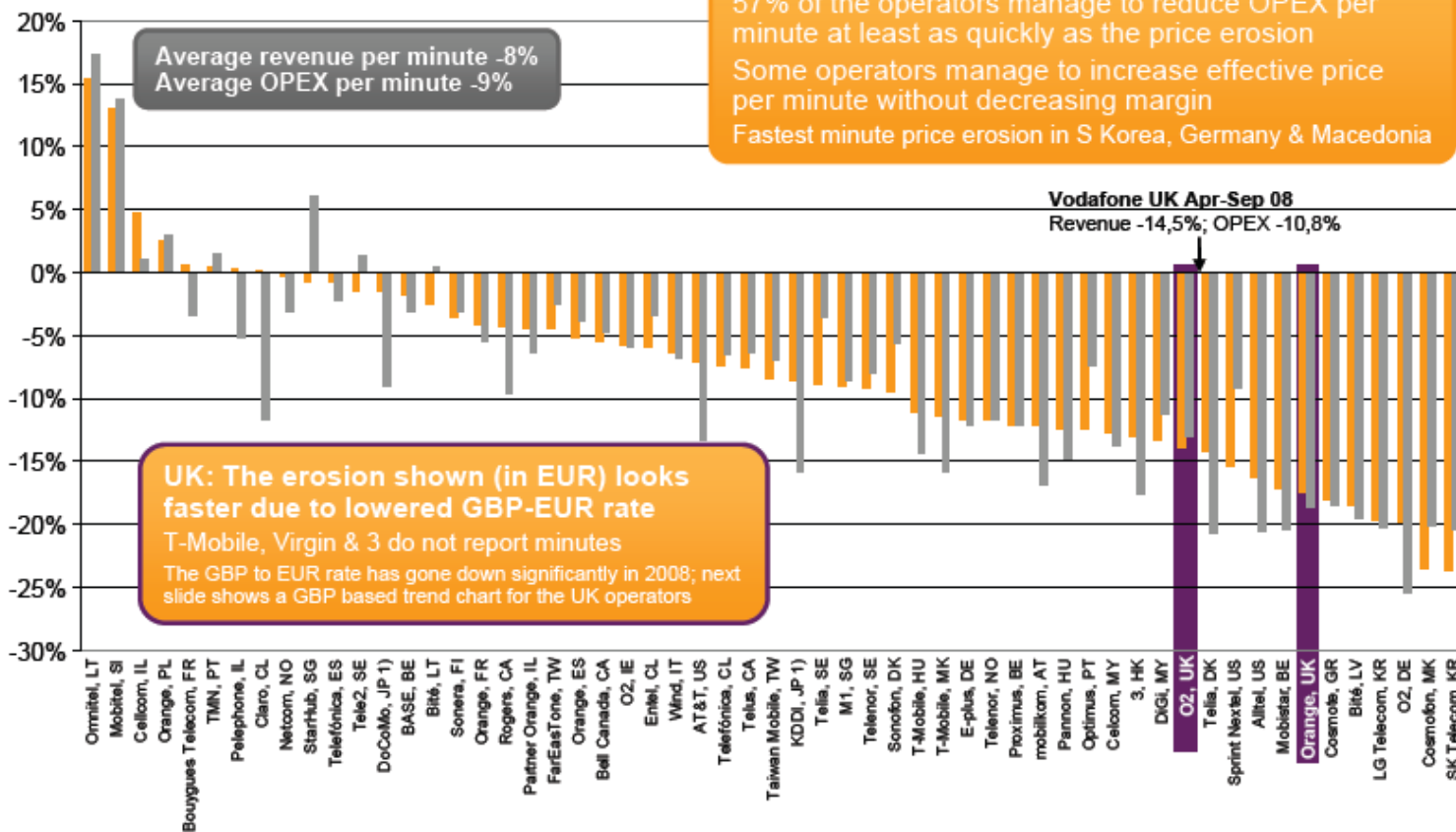
***) 2H 08 annualised as no figures reported for 1H

O2 and Vodafone's opex efficiency has not kept pace with price erosion



Mobile: Total revenue and OPEX per call minute – trend FY 2007 to 1H 2008

Mature markets



■ Total revenue per minute, change 2007->2008 ■ Total OPEX per minute, change 2007->2008

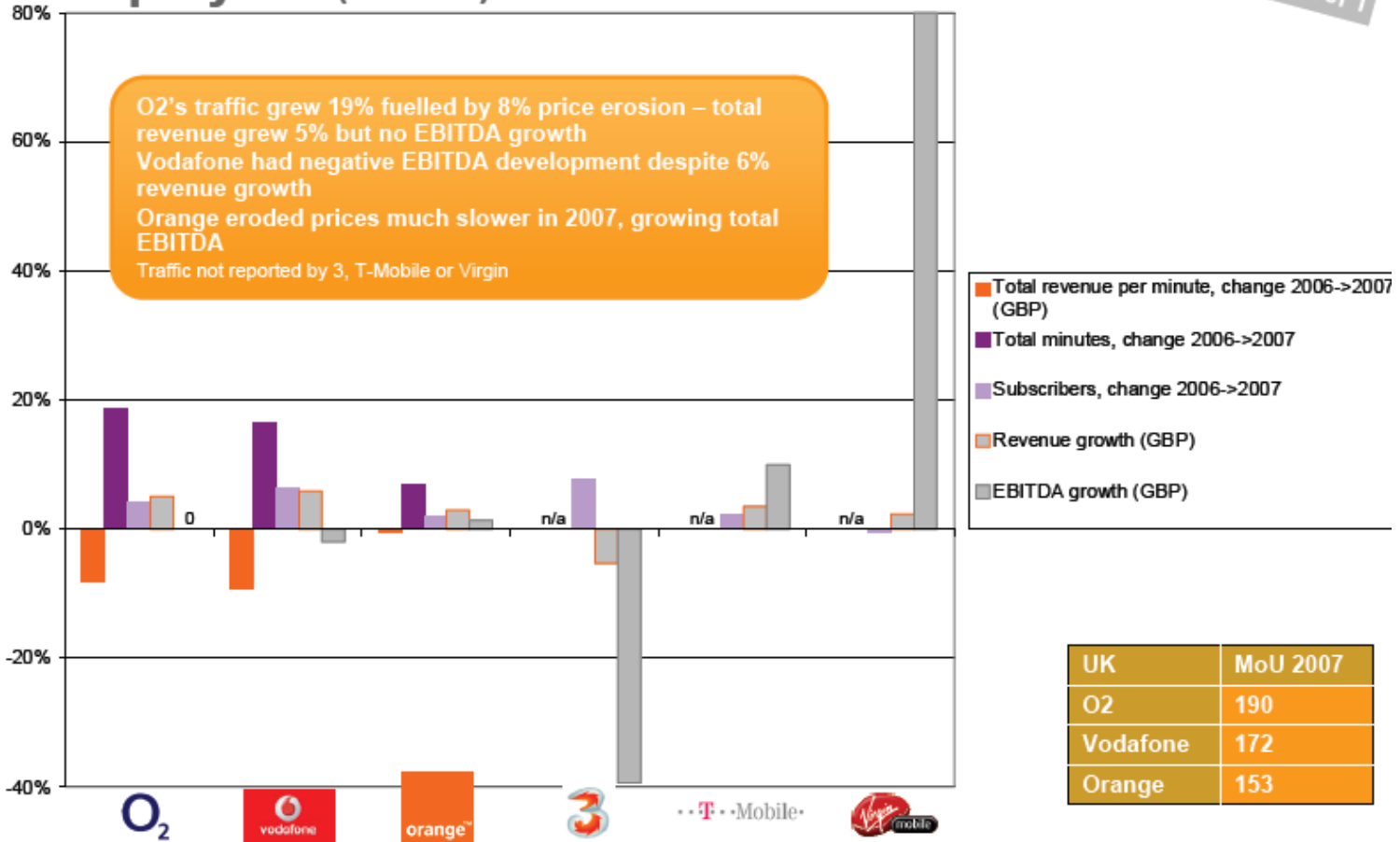
Source: 1H08 reports for operators with fiscal year ending December, Q108 reports for operators with fiscal year ending March – all to the degree reported 1 September

....but, O2's top-line growth allows it to increase absolute margin, whereas Vodafone's is in decline

Mobile: Total revenue & OPEX per call minute and traffic trend
UK players (in GBP)

FY06 to FY07

Level 1



UK	MoU 2007
O2	190
Vodafone	172
Orange	153

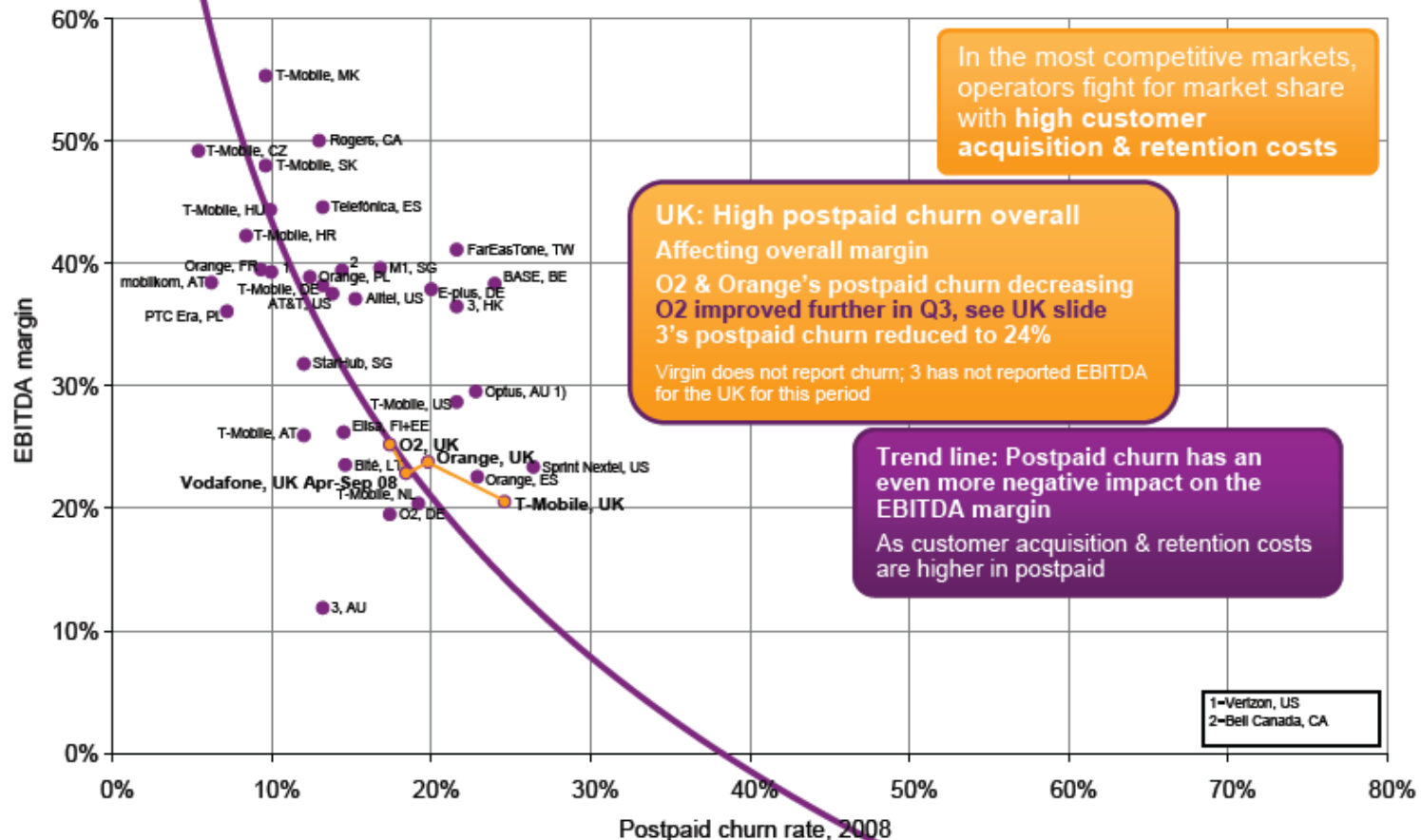
The UK's high handset subsidies amplify the benefits of lowering churn. O2 leads the market, providing a further contribution to our market leading margin performance.

Mobile: EBITDA margin vs. postpaid churn

Mature markets

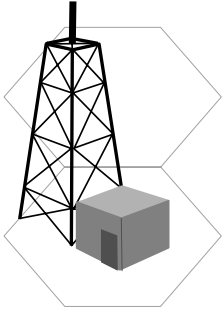
1H 2008 *Level 1*

As many operators have not yet reported Q3 08, this picture shows 1H08



Source: 1H08 reports for operators with fiscal year ending December, Q108 reports for operators with fiscal year ending March – all to the degree reported 1 September

Benchmarking informs our drive for step function improvements in efficiency



❑ **Field force consolidation**

- single sourcing technology and property services

❑ **Transmission**

- Future proofing for data / volume growth



❑ **Simplifying our business model reduces contact rate**

- Lower cost to serve / re-invest in quality of contact

❑ **Optimising our contact centre applications**

- Reducing our handling time
- Reducing time to answer



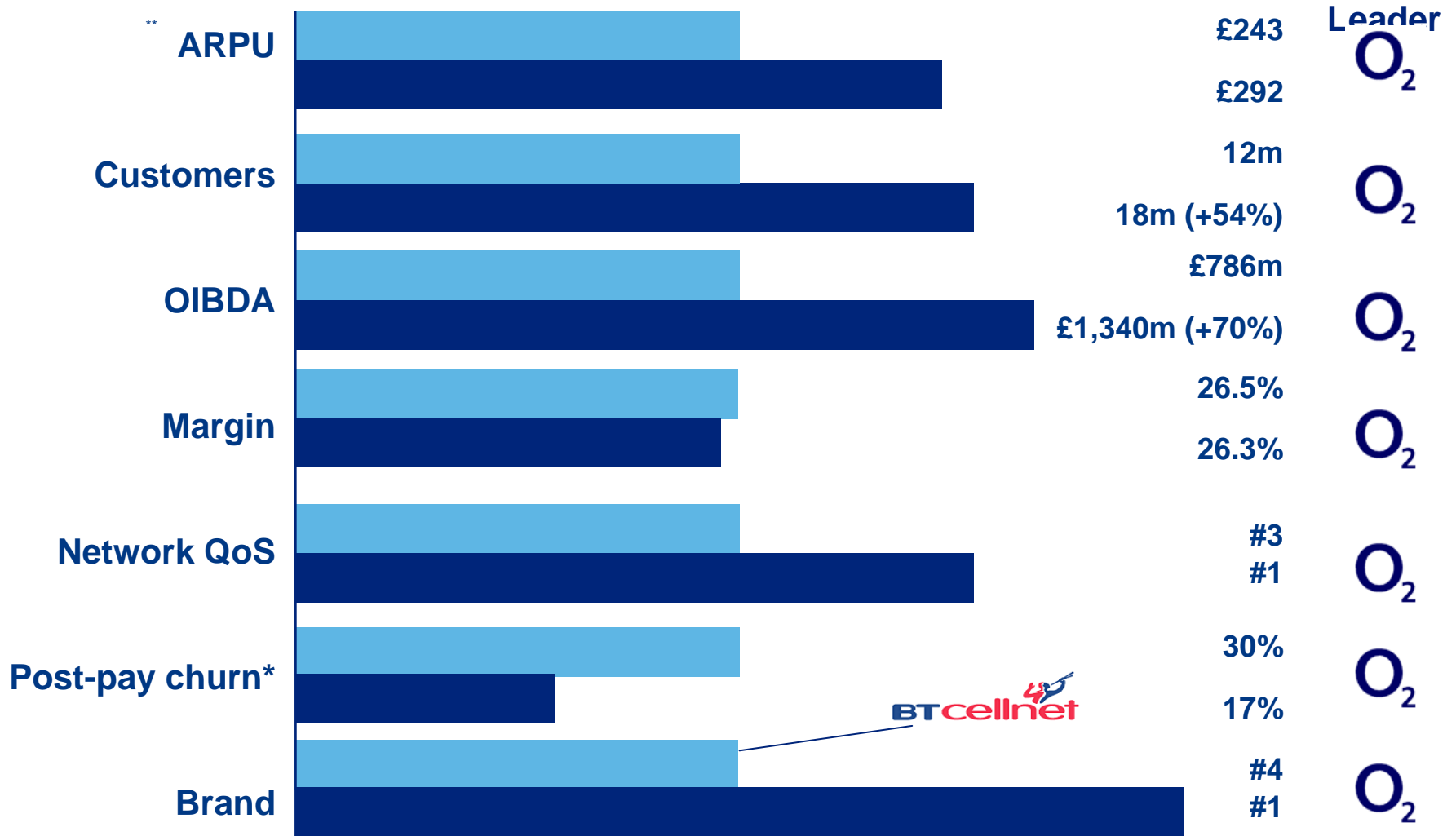
❑ **Control the distribution model**

- Move to direct
- Return value to customers if they don't want a new handset

Results – we've come a long way from 2002 to 2008

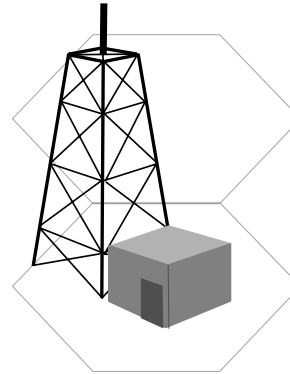


Market



* 12 month rolling average
 ** inc. inbound roaming revenue

What are we famous for now?



Leading Mobile Operator
in the UK

Multi award winner



BEST MOBILE ISP
O2



Marketing
O2 is a strong,
respected brand



A Telefonica company

Looking forwards....



The recession – mobile is resilient, but not immune

US recession fear slams FTSE



House prices still tumbling

New Rock boss cuts 2,000 jobs

Refocused Vodafone to boost sales staff as 450 middle managers lose their jobs

► Fifth of senior head office managers to go

Russia warns US naval build-up may lead to war

WORST HOUSE PRICES FALL FOR 18 YEARS

Downturn will pile pressures on family life, says Bank boss

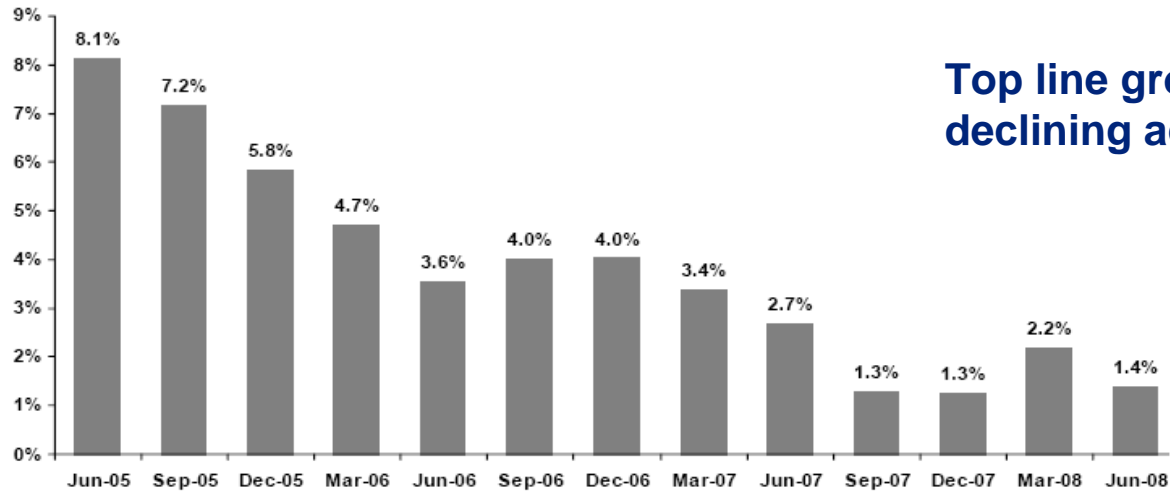
There is no longer enough growth in the market to mask underlying problems with the industry's cost base. O2's focus on profitable net growth has delivered to date.

Q3 2008 YoY%				
Total Revenue	£1,432m +9%	£1,361m -1%	£1,153m +6%	£794m -7%
EBITDA	£380m +6%	£316m -12%	n/a	£175m -30%
EBITDA margin	26.5% -1%pt	23.2% -3%pt	n/a	22.0% -5%pt
Post-pay net adds	278 +74%	159 +11%	161 -28%	96 +118%
Post-pay rolling churn	16.9% -5%pt	17.1% +1%pt	20.7% -2%pt	25.2% +2%pt
Customer Base	19.1m +7%	16.3m +2%	15.8m +3%	11.9m 0%

However, the industry business model is no longer sustainable



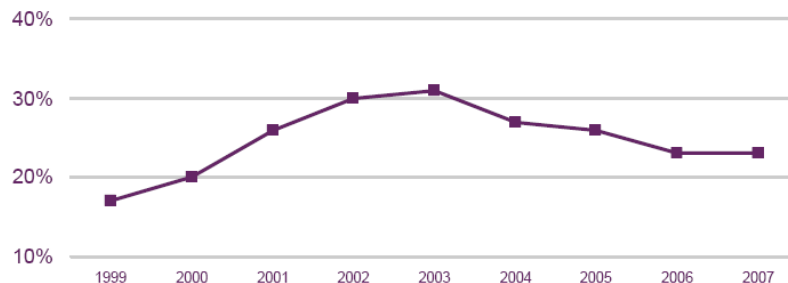
Year-on-year service revenue growth – top 5 EU markets



Top line growth is declining across Europe

Source : Enders Analysis

UK Mobile Operator EBITDA margin %



The fight for scale and share may lead to margin deterioration overall

Source : Ofcom

Transformation – fundamental not incremental change



- **Following years of incremental efficiency improvement our industry needs to transform its operating model**
- **Benchmarks are an important tool but transformation may require greater change than benchmarks may imply**
- **Beware of losing your strategic vision and direction**
 - transformation is a tool of delivery not an end in itself
- **Understand why you vary from the benchmark before you act**
 - is there a strategic rationale or off-setting benefit?
- **Set ambitious transformational goals:**
 - Incremental improvement is not enough, aggressive goals require a new way a new way of thinking about change
 - Not all plans need to deliver to achieve your goals, but if they do then you are even better positioned going forwards.