

# Sixth Investor Conference

Telefónica O2 Europe: A winning mindset

**Peter Erskine**  
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## Overview

- Telefónica O2 Europe growth has exceeded that of our combined local markets
- We see continued growth ahead, despite challenging markets, building on our strong position
- Partnerships will be critical in the future, and we have a track record of good execution
- We see a clear path back to growth in Germany
- We are making real improvements on efficiency and leveraging the scale of the Telefónica Group

**A winning mindset**

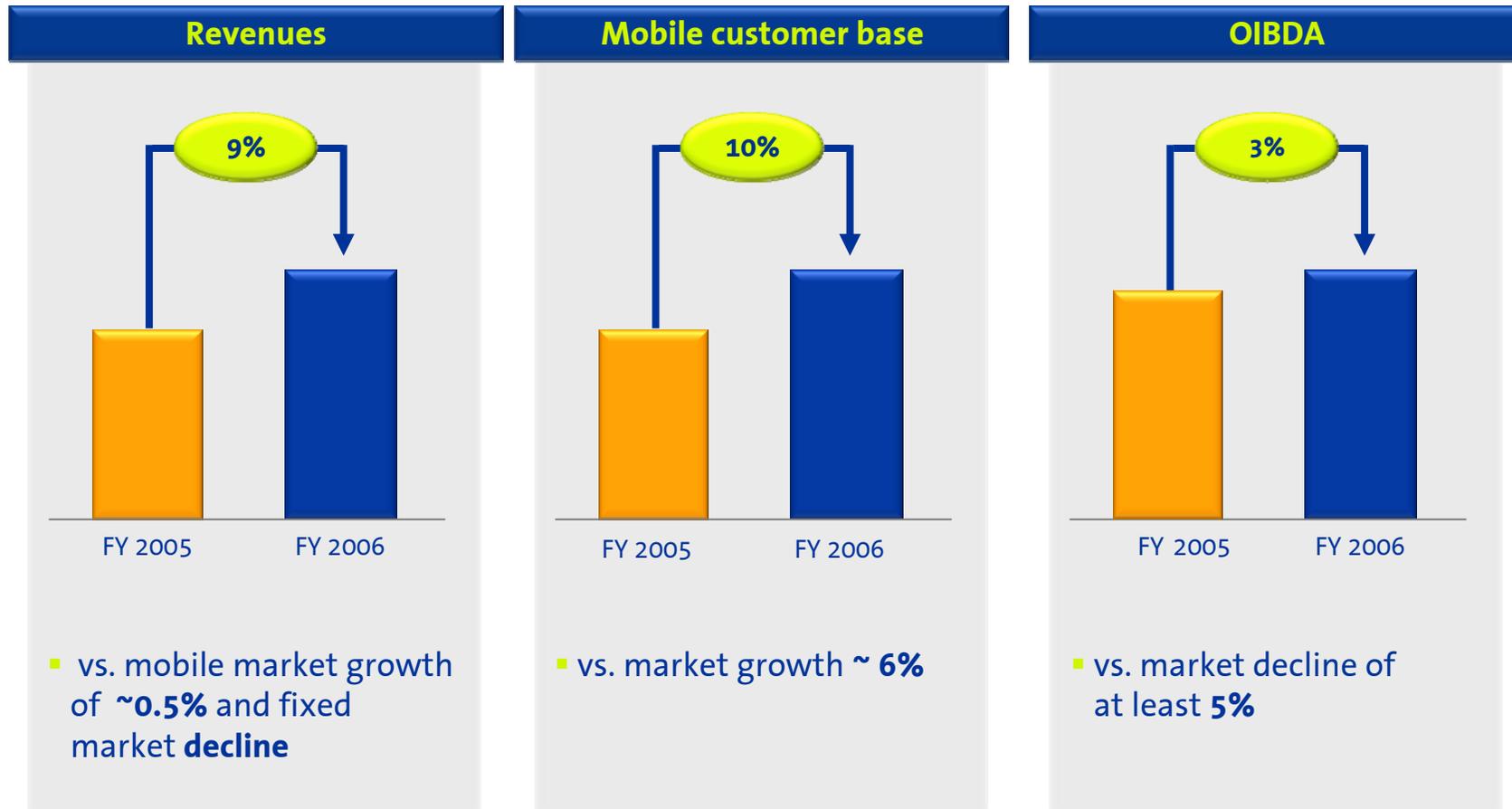
# Telefónica O2 Europe

## 1 A strong starting position

2 Opportunities for growth

3 Our strategy for continued outperformance

# 01 2006 results



Source: Company data

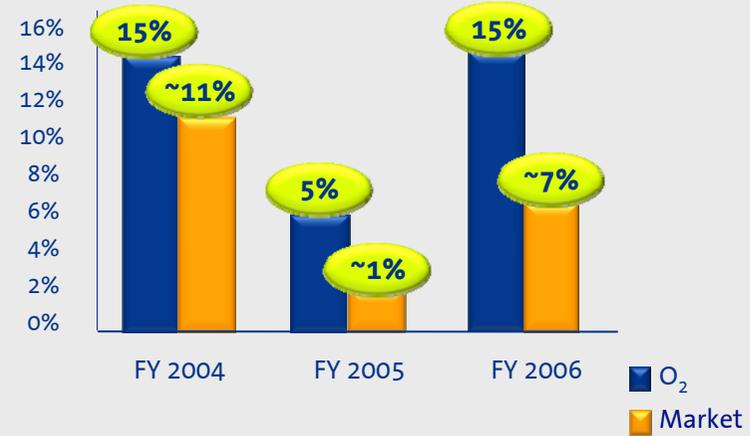
# 01 O2 UK the outstanding performer

**OIBDA change 2004 – 2006 (£ in millions)**



▪ #1 OIBDA growth

**Service Revenue growth**



▪ #1 Service Revenue growth

**GAINING SHARE**

▪ #1 Customer Satisfaction

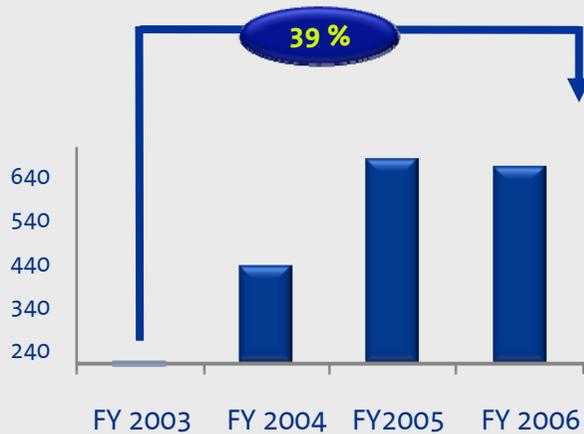
▪ #1 Active Customer Base

▪ #1 Brand

# 01 O2 Germany has delivered a market beating performance in the past

CAGR 03-06

**O2 Germany EBITDA (€ in millions)**



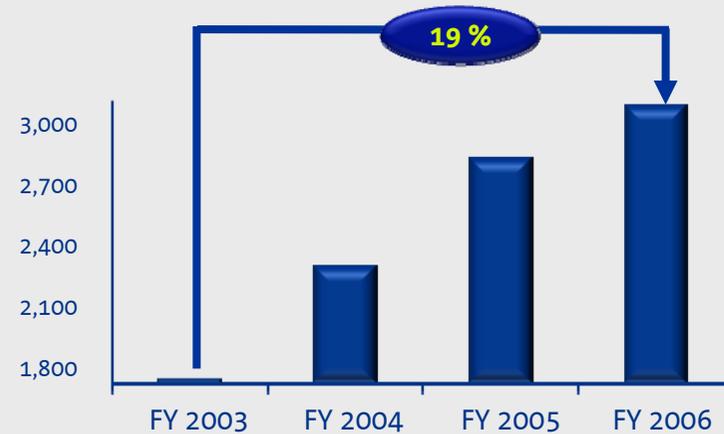
vs. market CAGR ~3%

▪ #1 for EBITDA growth

▪ #1 Customer Satisfaction

▪ #1 Post pay ARPU

**O2 Germany Service Revenue (€ in millions)**



vs. market CAGR ~4%

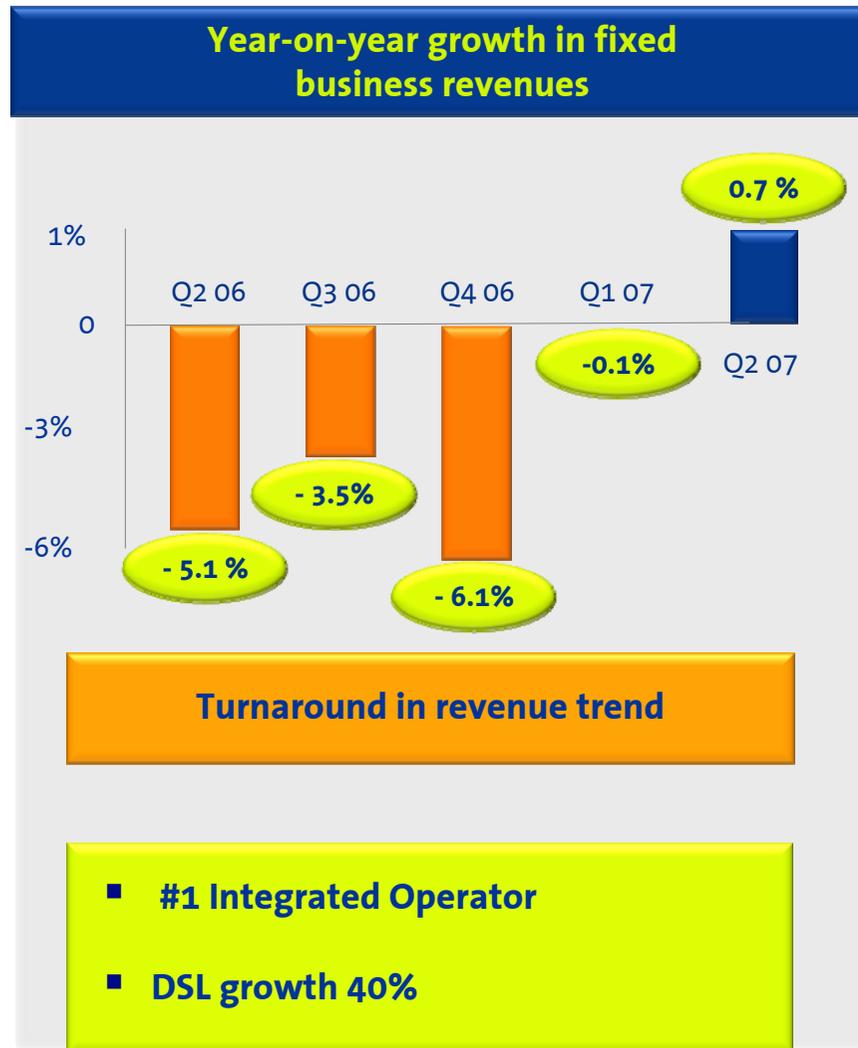
▪ #1 for Service Revenue growth

▪ #1 Customer growth 2003 - 2006

▪ #1 MoU

**GAINING SHARE**

# 01 Telefónica O2 Czech Republic turnaround



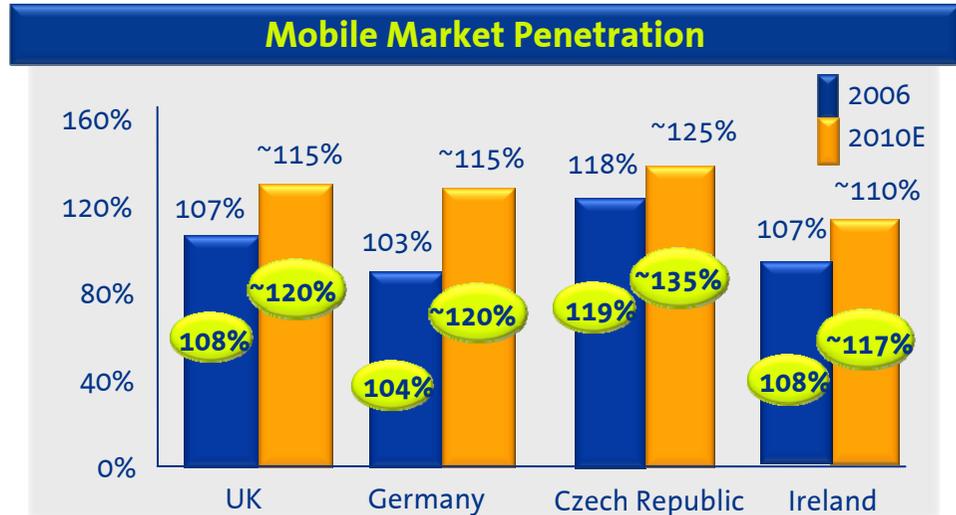
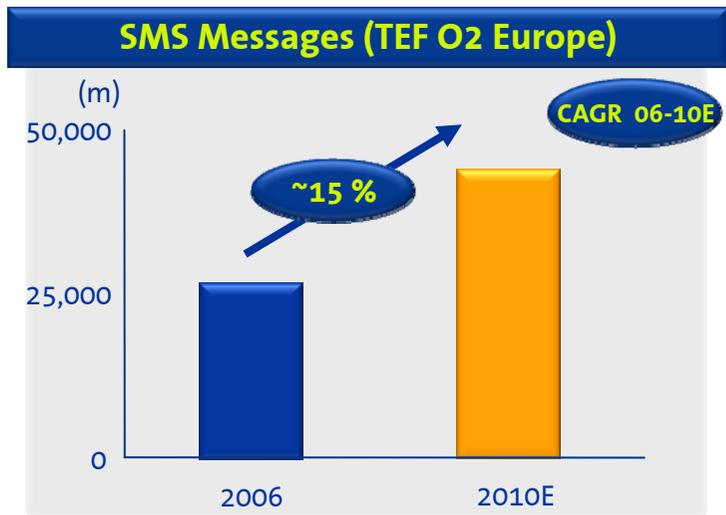
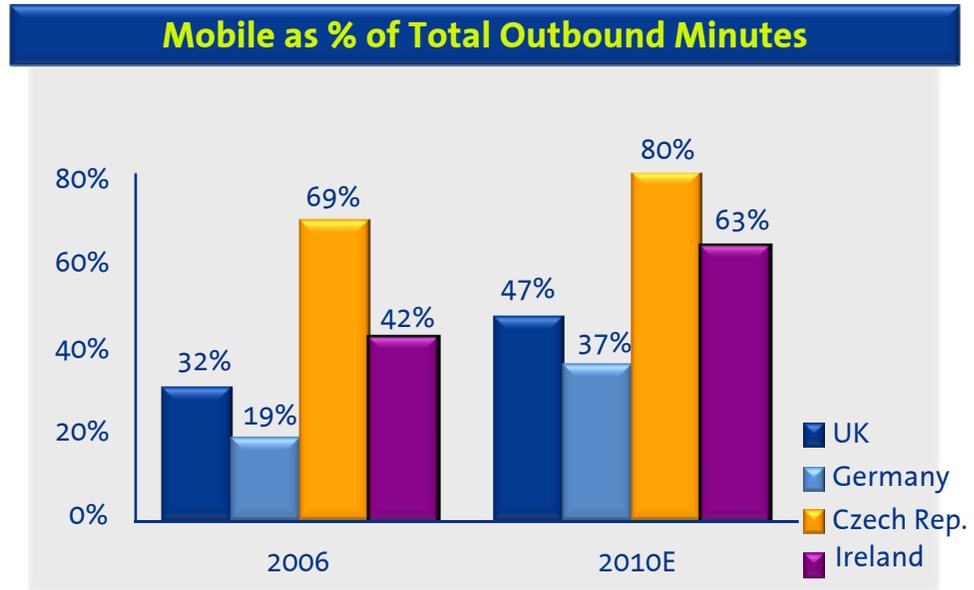
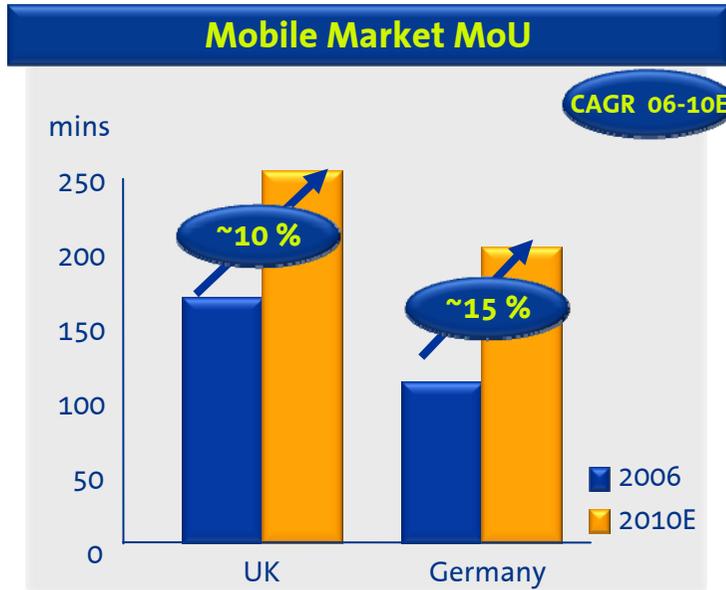
# Telefónica O2 Europe

1 A strong starting position

2 **Opportunities for growth**

3 Our strategy for continued outperformance

# 02 There are significant growth opportunities in our “core” business...



Sources: Strategy Analytics and company forecasts/analysis

Including M2M

## 02 ... as well as opportunities beyond voice and text

### Bundles and converged services



- Multi-play bundles (Duos & Trios)
- Homezone services
- Content / information access (fixed and mobile)

### Mobile Internet



- Music
- Internet search and advertising
- Enhanced messaging
- Moving pictures

### Retail / Wholesale Broadband



## 02 Why is the timing right for growth in non-SMS data...?

### Internet Partnerships

**YAHOO!**  
UK & IRELAND

**NOKIA**  
Connecting People

**Google**<sup>™</sup>

**flickr** LOVES YOU  
™

**facebook**

**You Tube**  
Broadcast Yourself™

### Business data



Laptop & datacards



Mobile Office

**New business models – mobile advertising, transactions**

**Flat rate data pricing – per month, per day**

### Fit for purpose internet devices



**Faster data networks – HSDPA, 3G**

## 02 Successful partnerships will be critical



### ■ Mobile Search

- Enable customers to explore the Internet on their mobiles
- Develop new revenues streams from search advertising
  - 5% of total UK advertising spend in 2010E (WPP)

### ■ Reach new segments

- Strong brands, good distribution, limited overlap with O2 base
  - 1.4m Tesco mobile subs, 1m Tchibo subs

### ■ User Generated Content

- Bring popular internet services and brands to mobile
- Increased adoption and usage of mobile internet

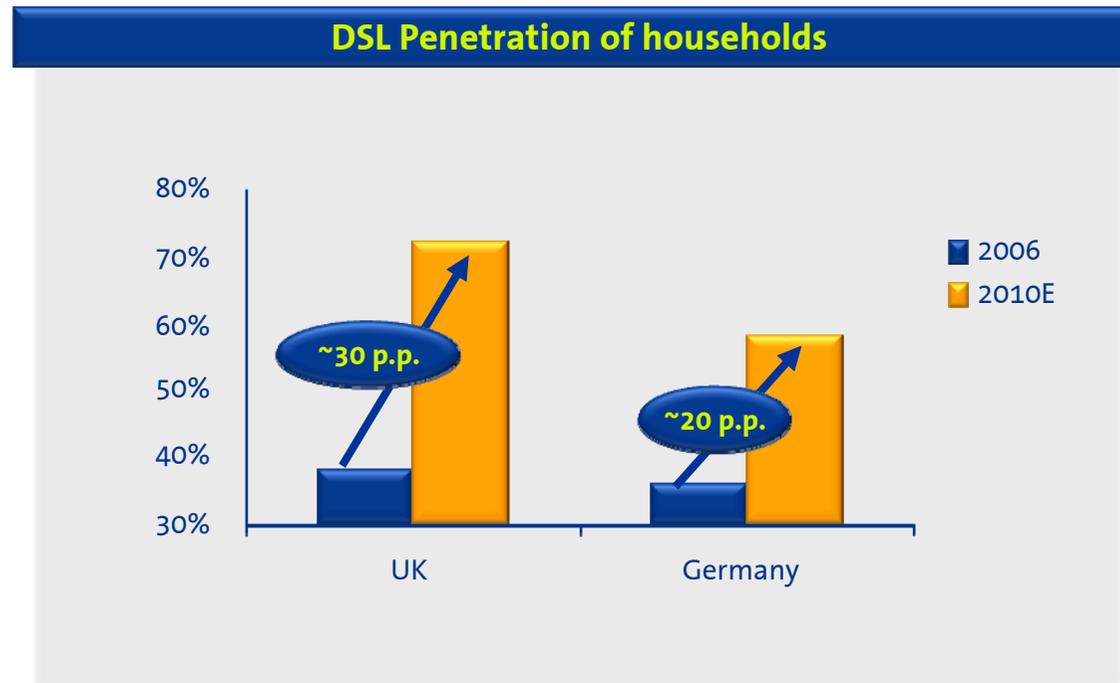
### ■ iPhone

- Apple innovation coupled with O2 brand & customer experience
- A market-changing proposition
- Exclusive to O2 in UK

### ■ TheO2 & O2 World in Berlin

- Partnering with AEG
- A range of benefits exclusive to O2 customers
- Deliver a unique customer experience, differentiate our brand & drive loyalty

## 02 Broadband gives us a platform for integrated services ...



### Today:

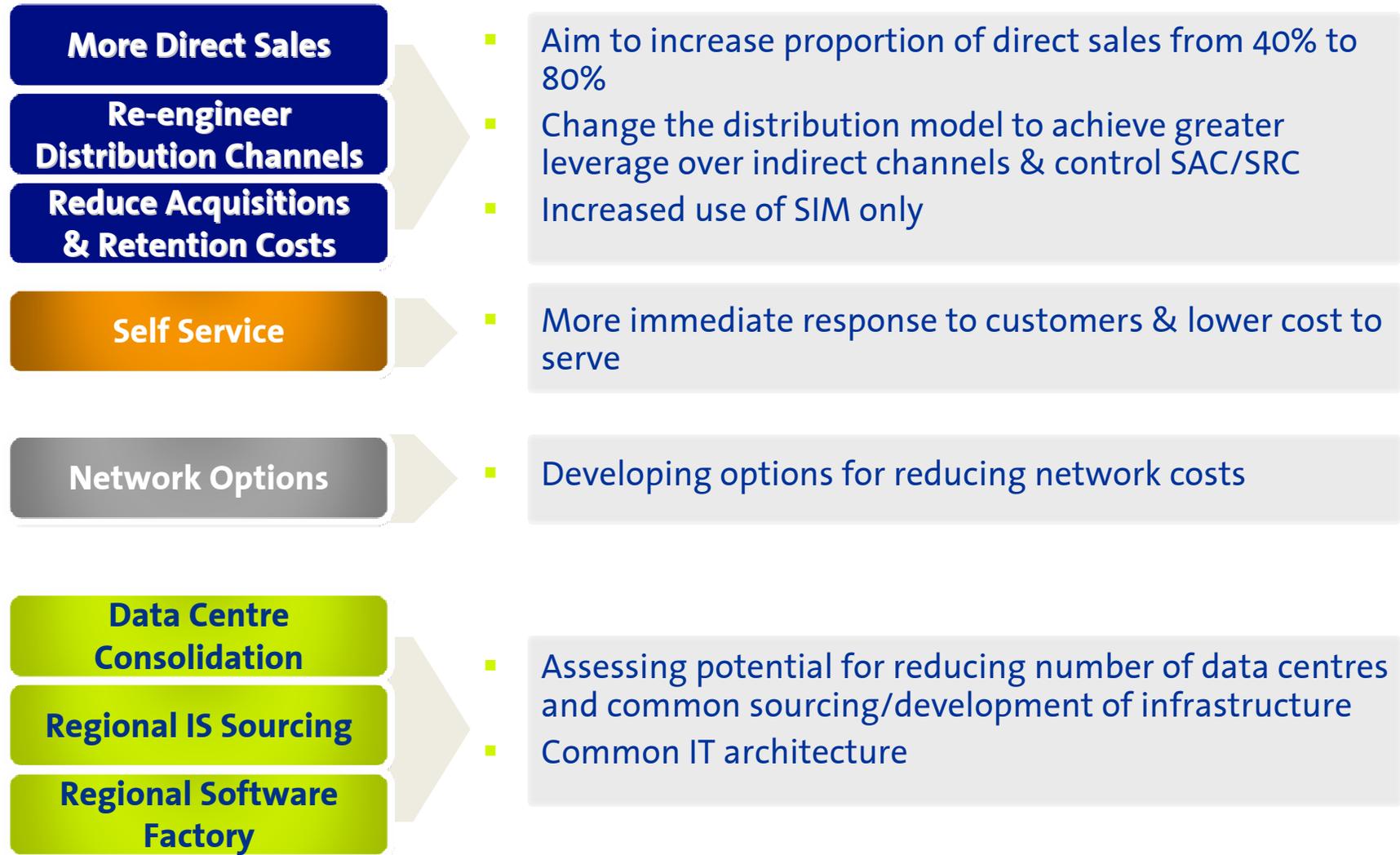
- Basic propositions
  - mobile and discount broadband bundles
- Limited integration of fixed & mobile environments



### Tomorrow:

- Country & segment specific propositions
  - Duo and Trio offers
  - VoIP, IPTV
  - Content management (Bluebook); music, pictures, messages

## 02 ...cost control is critical to growing profitability



# Telefónica O2 Europe

- 1 A strong starting position
- 2 Opportunities for growth

**3 Our strategy for continued outperformance**

## 03 Therefore our strategy is...

- 1 Drive core mobile business**
  - Address under served segments
  - Exploit elasticity & FMS opportunities
  - HSDPA, mobile internet, enhanced messaging
- 2 Become an Integrated operator**
  - Growth of broadband revenues
  - Bundled products
  - Review further diversification opportunities
- 3 Invest / develop new revenue streams**
  - Advertising, moving pictures, mobile search
  - Music
  - Partnerships
- 4 Reduce costs**
  - Reduce channel & service costs
  - Options for non-core activities
  - Telefónica synergies and learning benefits

**While keeping customers at the heart of everything we do**

## 03 ...with specific priorities for each of our businesses



- 1 Maintain growth / margin balance, increase market share
  - Potential for margin improvement
- 2 Continue to differentiate through Customer Experience
- 3 Re-engineer cost-base
  - Customer investment, Customer service
- 4 Invest in & exploit mobile Internet and DSL opportunity
- 5 Broaden product and service range

## 03 We are seeing increasing use of non-SMS...



### Consumer

- O2 has ~ 36% of total non- SMS data users in the UK market\*
- O2 Active users numbers growing 25% year on year
- Total data volumes up 1/3 year on year

### Business

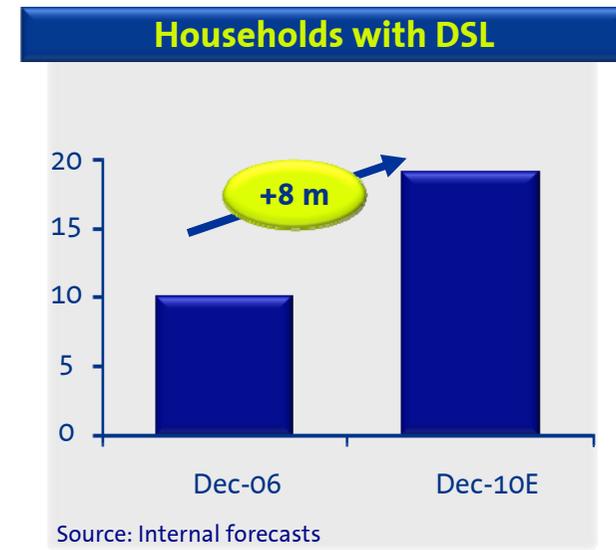
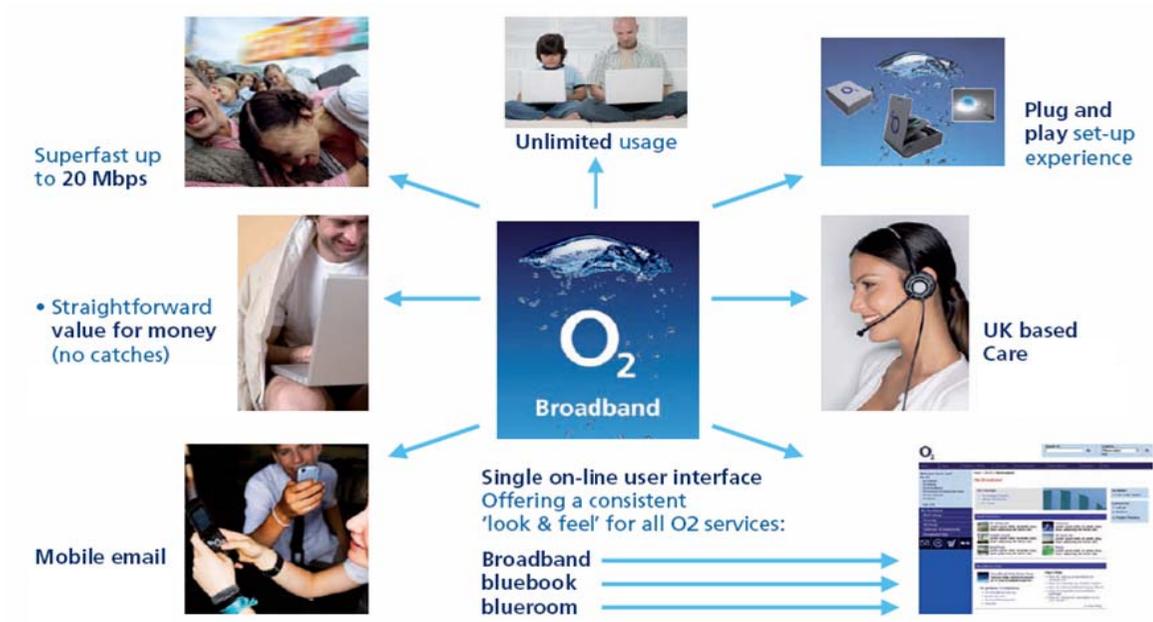
- Growth in BlackBerry
  - O2 to grow Blackberry Base by ~45% in 2007E
  - 1st to market with the Blackberry Pearl and Curve devices
  - UK Market leader for Blackberry Internet Service (~45% share)

### iPhone

- 3 products in 1
  - A Revolutionary Mobile Phone
  - The best iPod – *Music on the Move*
  - The real internet – *the best mobile user interface*
- 3 postpay tariffs, with unlimited data
- Attracts high value customers in key target segments
- A market leading mobile data proposition

\* Mobile Data Association

# 03 ...our broadband proposition offers further growth opportunities



## Targeting:

- > 1 million customers by 2010E
- CapEx <£100m 2007E – 2010E

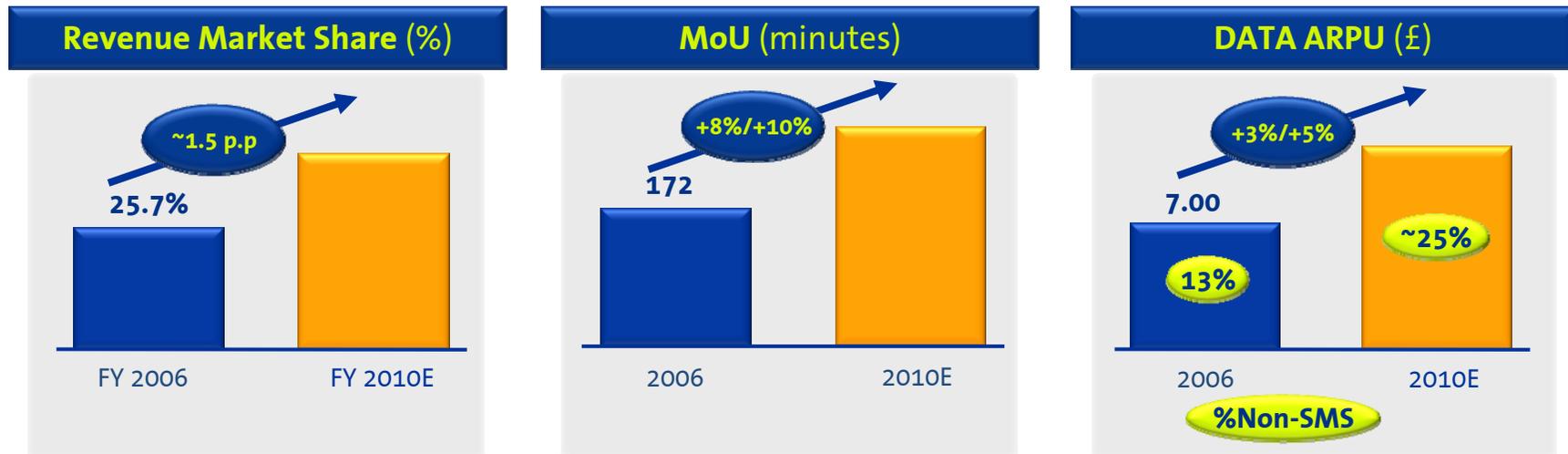
## Further opportunities

- Wholesale
- Network sharing
- Traffic management, QoS
- Femtocells

# 03 ...O2 UK will continue to grow above the market...



CAGR 06-10E



- Market share gains driven by segment focus & base growth
- Focus on execution and customer experience
- Grow share of market revenue by focus on high value customers
  - Strong relative ARPU performance
- Bigger bundles drive increased MoU
- Maintain data ARPU above market average through growth of non-sms data

# 03 ...building on success to date



## “Great value, no catch” propositions



### Simplicity

- Offering a simple VFM alternative for customers not requiring a handset upgrade
- 30 day contract
- Reduces handset subsidy costs



### Favourite Place

- Over 650,000 customers enrolled
- 25% increase in Top ups



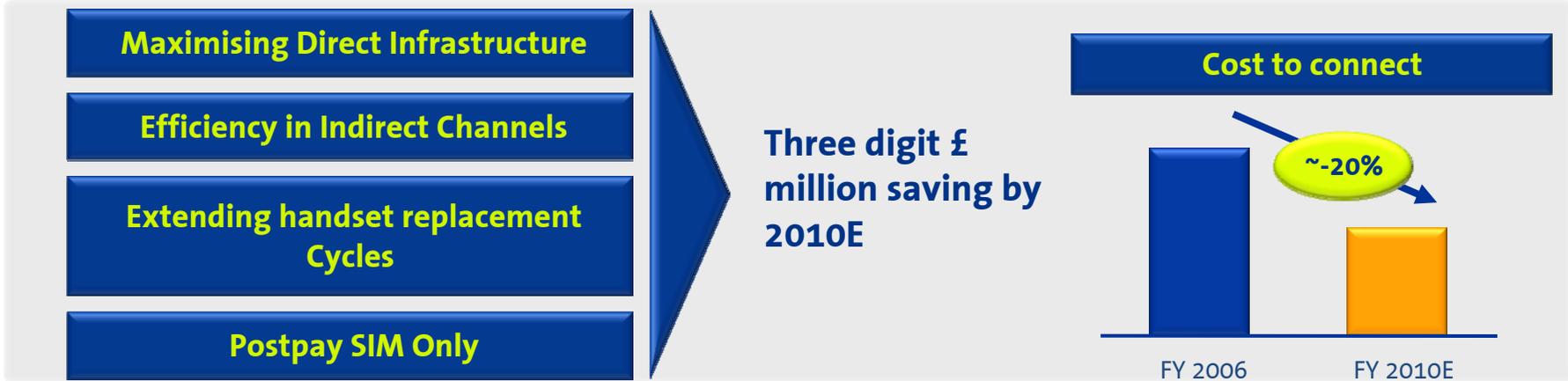
### Business customers

- Penetration of mobile email +30% so far this year
- New customer ARPU +9% year to date driven primarily by growth in mobile email

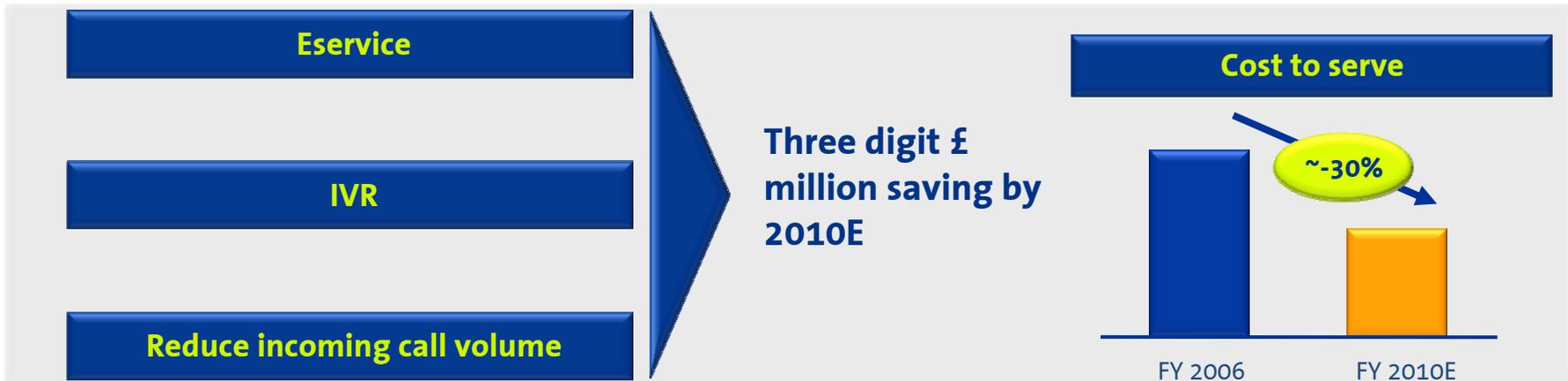
# 03 Cost control will also be a focus...



## Customer Investment Costs

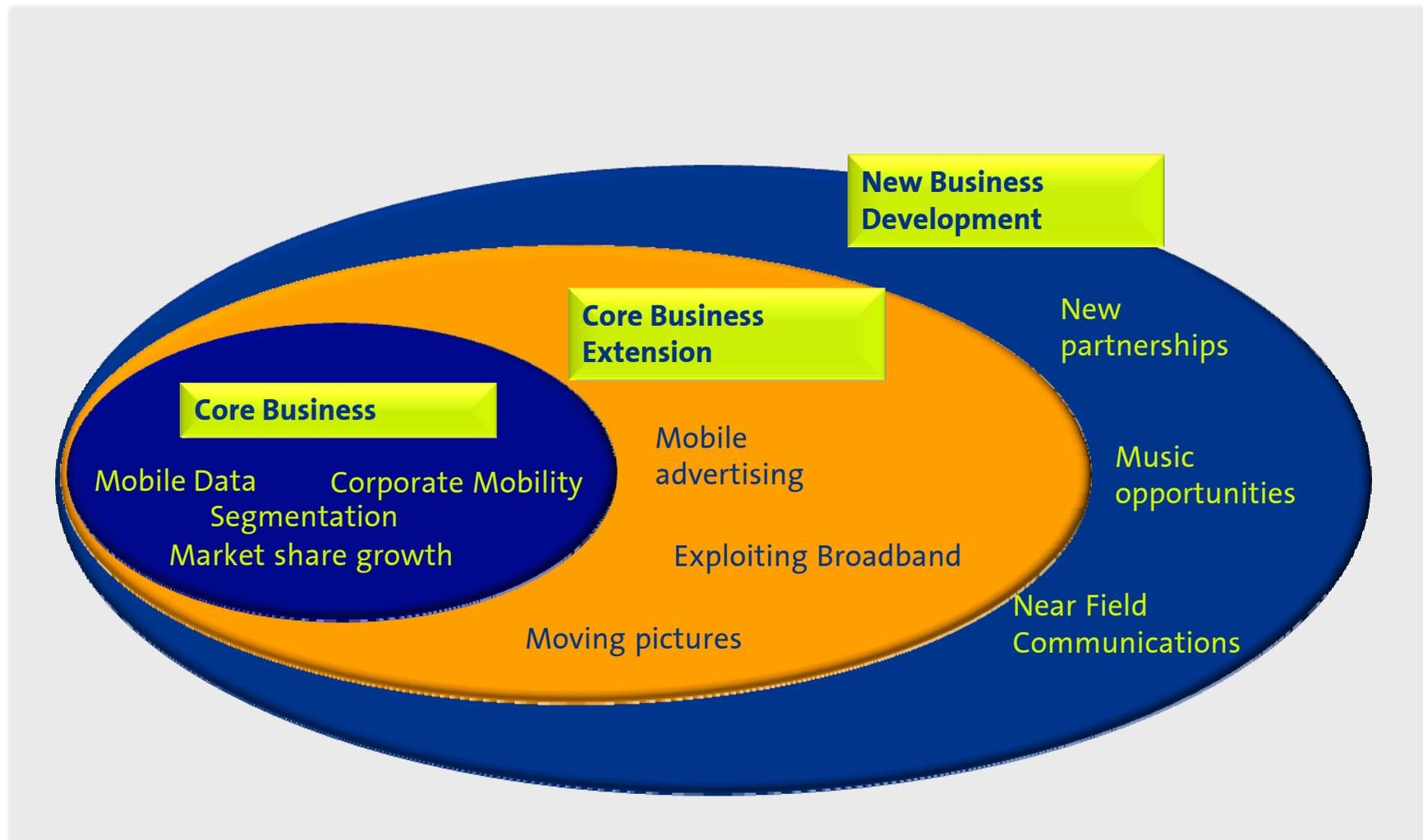


## Customer Service Costs

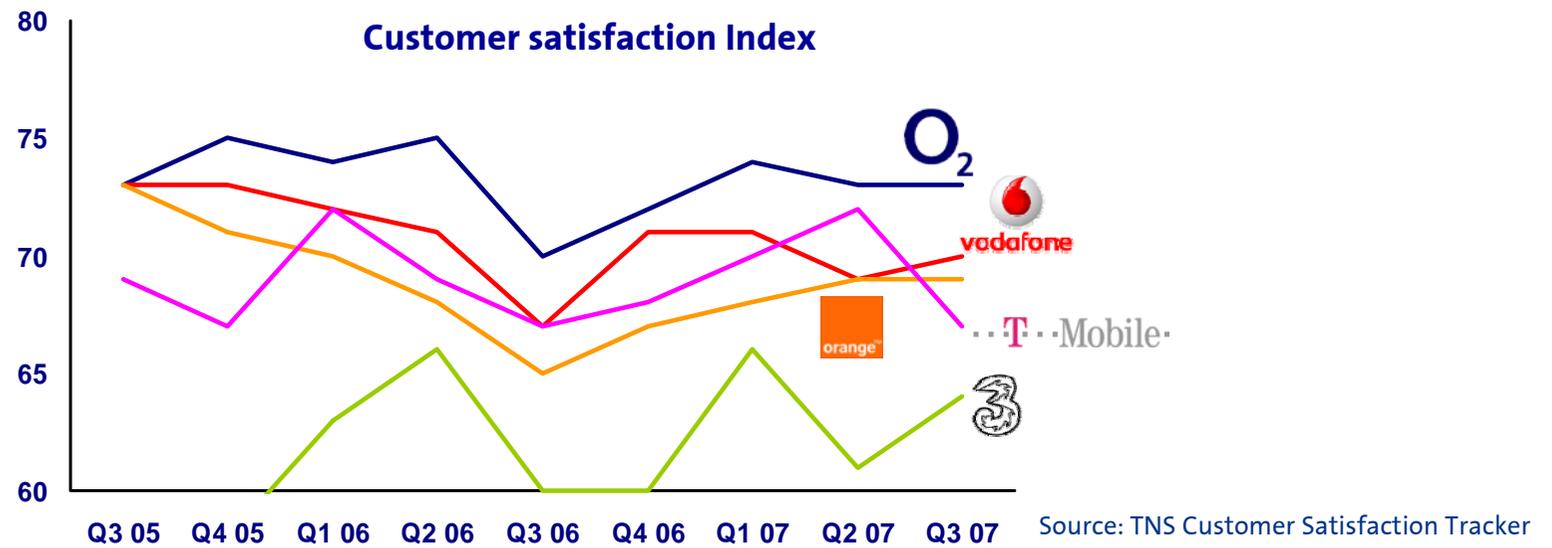


Further opportunities for savings in IT / Network

# 03 ...as well as growing new revenue streams...



# 03 ...and continuing to put our customers and people first



## 03 Specific priorities for...



- 1 Return to growth in mobile
- 2 Accelerate growth in O2 DSL and converged products
- 3 Continue growth in wholesale business (mobile and broadband)
- 4 Build future proof infrastructure
- 5 Deliver on re-structuring programme

Invest for future growth

## 03 Being part of Telefónica helps us capture the opportunities...



- CapEx investment of ~€3,500 m 2007E- 2010E to:
  - Build out of high quality 2G network and reduce reliance on national roaming
  - Build out of high quality 3G/HSPA network to support mobile Internet and our proposition for businesses
  - Rollout of ULL network to support converged service
  
- Why? Germany offers a significant opportunity:
  - Population of 82m and GDP of €2,300bn
  - Lower penetration, lower mobile minutes of use, lower % of total minutes on mobile
  - Low DSL penetration
  
- We will continue to grow our revenue and market share
  
- As part of Telefónica we benefit from
  - Savings from procurement, devices, networks, etc.
  - Leveraging products and expertise across the group
  - Best practice

# 03 The mobile market will return to growth...



CAGR 06-10E

## The market in Q2

- Mobile customer growth accelerating:
  - Total market gross adds +23%\*
  - Penetration +9p.p.\*
  - MoU +16%
- However, growth in the subscriber base has not offset price declines
  - Total Market Service Revenue: -3%
- DSL market continues to grow strongly
  - +4m lines year-on-year

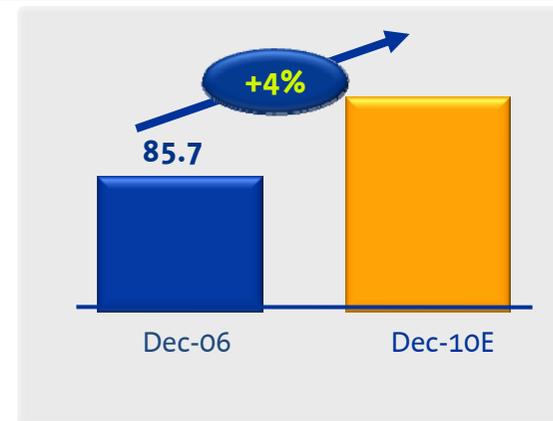
## The way forward

- We see the market returning to growth, as:
  - Price declines will slow down
  - Fixed/Mobile substitution will increase
  - Mobile data will start to gain traction

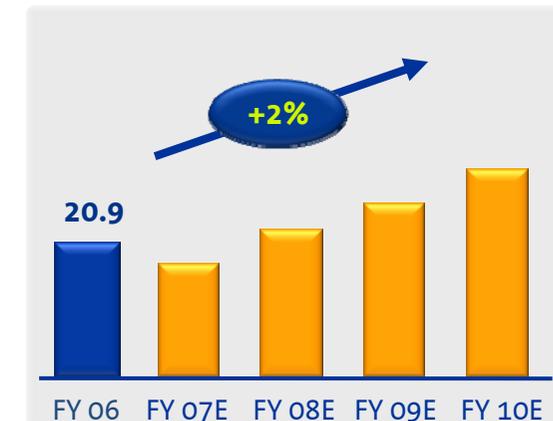
Note: \*Company data, Q2 07 vs. Q2 06

Source: Pyramid Research, IDC, internal forecasts

## Mobile Subscriptions (in millions)



## Market Service Revenue (€ in millions)



# 03 O2 Germany will return to growth in mobile through...



CAGR 06-10E

## Introduction of S/M/L product portfolio

- Introduction of S/M/L logic for entire product portfolio
- Genion XL flatrate
- Fair & transparent pricing scheme

## Genion S/M/L Customer Base development



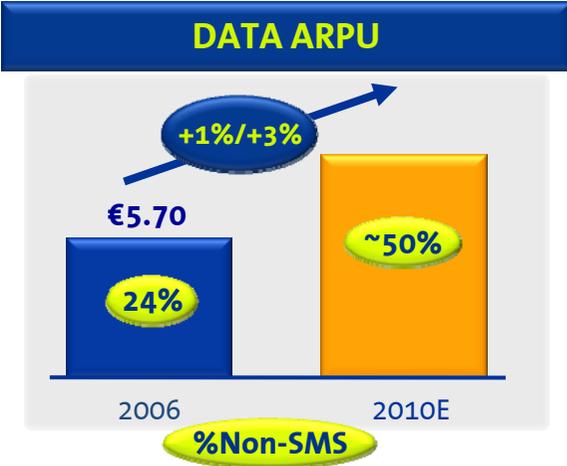
## Launch of FONIC – 2<sup>nd</sup> brand

- Own discount brand launched
- Distribution via online and Lidl (+2,700 stores)
- One very simple voice & sms offer
- Lowest price offer in the German market with 9.9 cent/min.&SMS in all networks



## Growth of mobile Internet

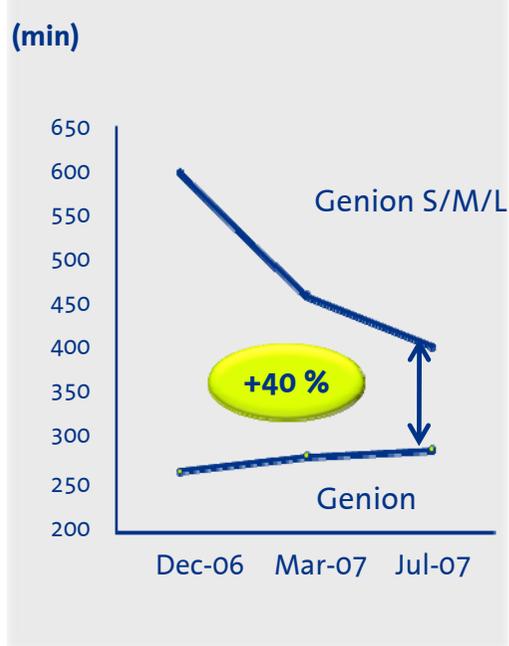
- Launch of S/M/L Data Packs
- Data ARPU growth driven mainly by non-sms data (mobile Internet)
  - New pricing introduced
  - +60% CAGR in mobile internet users by 2010E



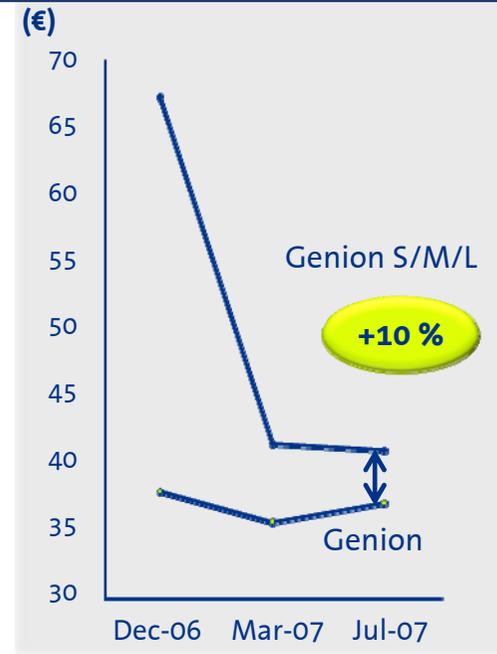
# 03 ...with improving metrics in Q2...



**Genion (S/M/L)  
minutes of use development**



**Genion (S/M/L)  
ARPU development**

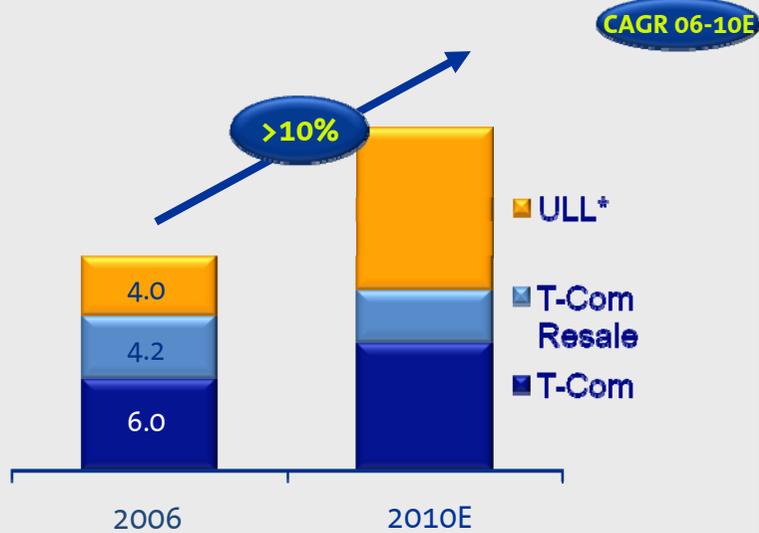


- Stronger L-mix within new Genion contracts
- Improved net adds Q2 07 vs. Q1 07
- Strong HanseNet performance

# 03 The Broadband market offers significant growth..



## Total Market Development (in millions)

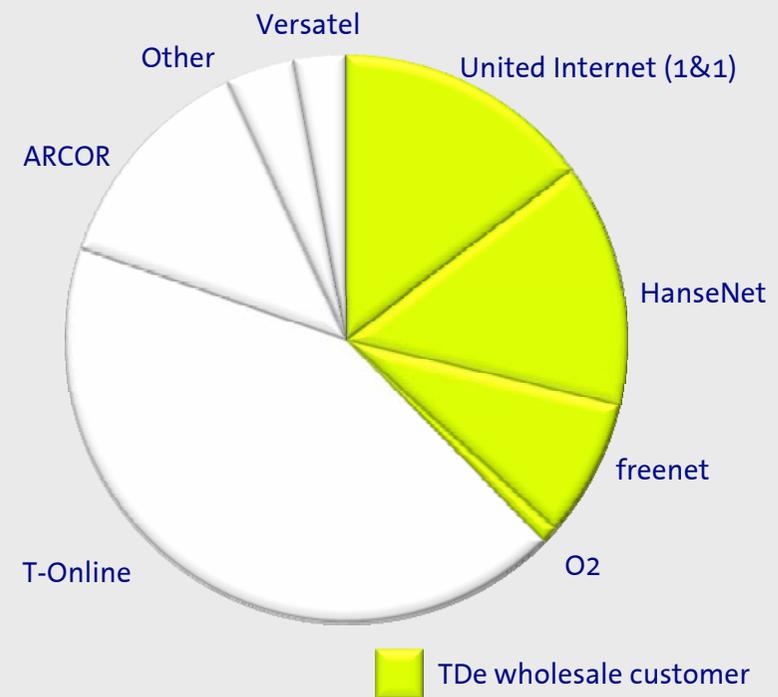


\*Partly and fully unbundled not including T-Com Wholesale lines

Source: Internal forecasts

- German DSL market growth – approx. 8.5 m net additions expected 2007E-2010E with around 70% from ULL

## Retail shares German broadband market Q2 07



- Five players make up ~90% of the retail market: T-com, UI, HanseNet, Arcor & freenet

# 03 O2 broadband and FMC



## Consumer Broadband

- Competitive pricing of O<sub>2</sub> DSL with triple flat rate
- Easy installation
- One bill for broadband and mobile



## FMC Services

- Launch of Communication Center with synchronisation of address book, emails and calendar
- Bundled offerings, e.g. family pack for O<sub>2</sub> DSL customers



## Business DSL

- One stop: Broadband DSL, inter / intra company networking and mobile solutions
- ADSL2+ and SDSL broadband



# 03 Strong wholesale partnerships will support Germany's growth story

## Leverage wholesale models (fixed & mobile)

- Primary ULL provider of all major alternative ISPs
- AOL/Alice launched
- First products with freenet launched
- United Internet ULL



## Further expand retailer business

- Tchibo gross adds growth accelerated
- 1 million customers



## FONIC - 2nd brand

- Own discount brand launched
- Distribution via online and Lidl (+2,700 stores)



## 03 Building future proof network infrastructure is vital to deliver our growth ambitions



### Improve quality of GSM network

- Continue roll-out of GSM network to reduce dependency on National Roaming
- Significantly improved network quality through reduction of handovers

### Continue investments in 3G and HSPA

- Continue roll-out of 3G network – coverage, density and HSPA
- Supporting mobile internet and data propositions and future converged propositions
- Ongoing evaluation of sharing / partnership opportunities

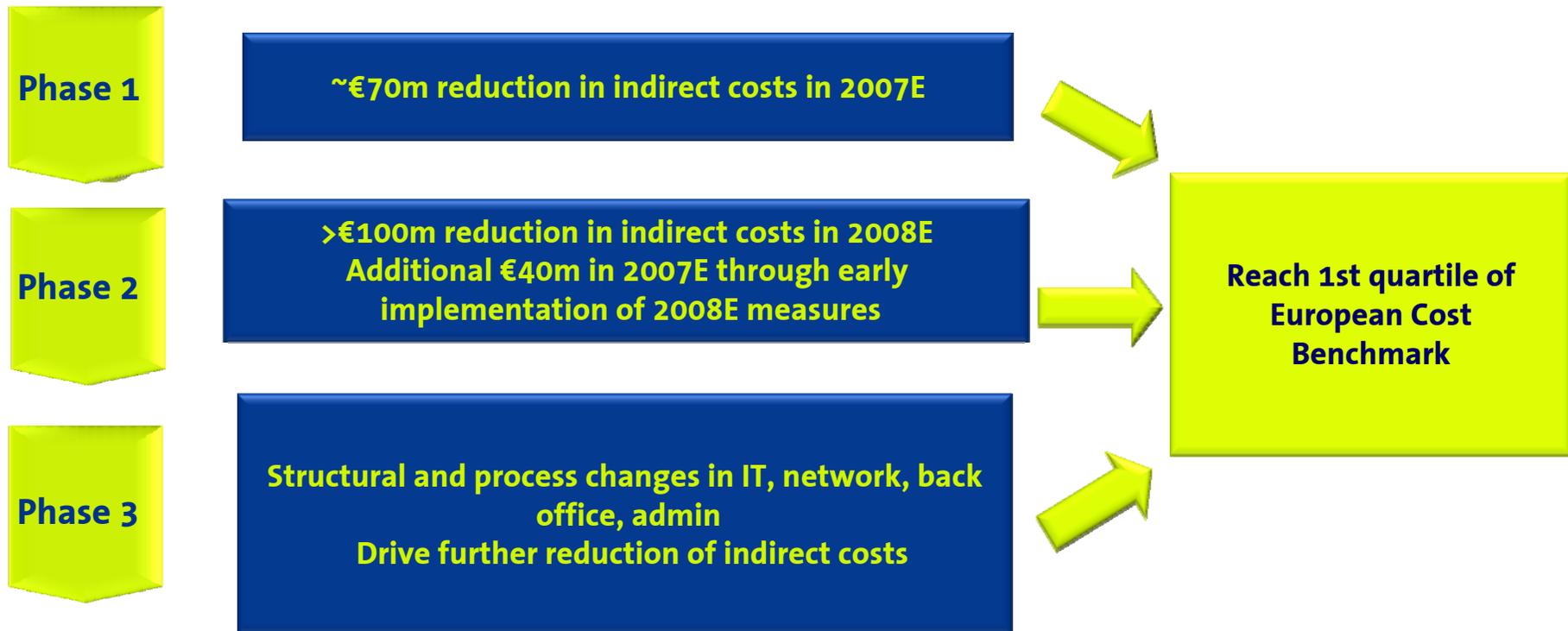
### Leading ULL wholesale network

- Telefónica Deutschland already the leading ULL wholesaler
- Strong basis for O2's DSL offer for consumer and business customers
- Key supplier of all large ISPs in Germany
- 40% - 50% CAGR 2006 to 2010E in DSL lines

# 03 Cost control will again be a focus...



- **Short term**
  - Achieve a 20% reduction in indirect costs
  - Manage cost in line with average for European benchmark
- **Mid term**
  - Manage cost in line with 1st quartile of European benchmark

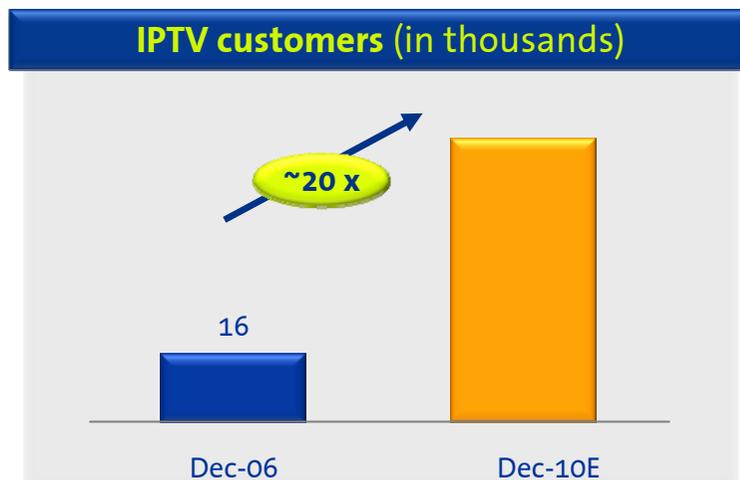
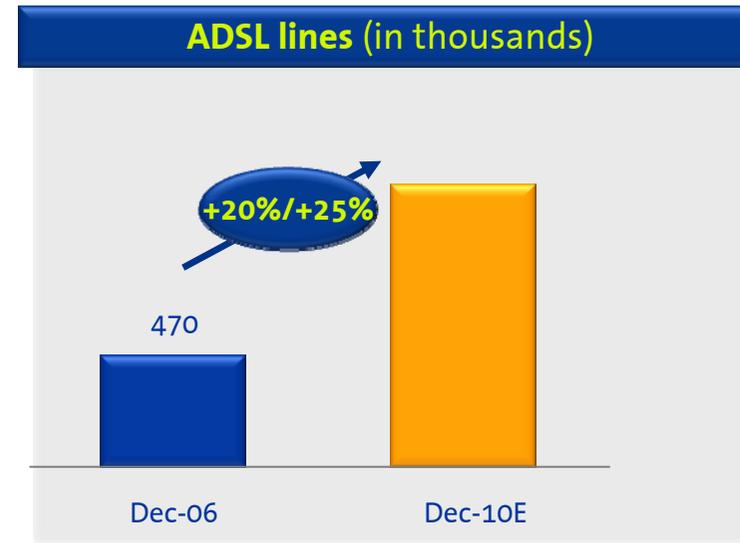


## 03 Specific priorities for...



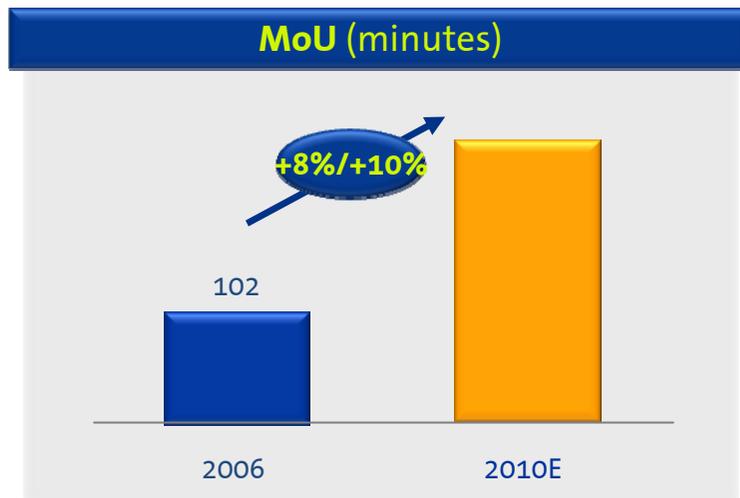
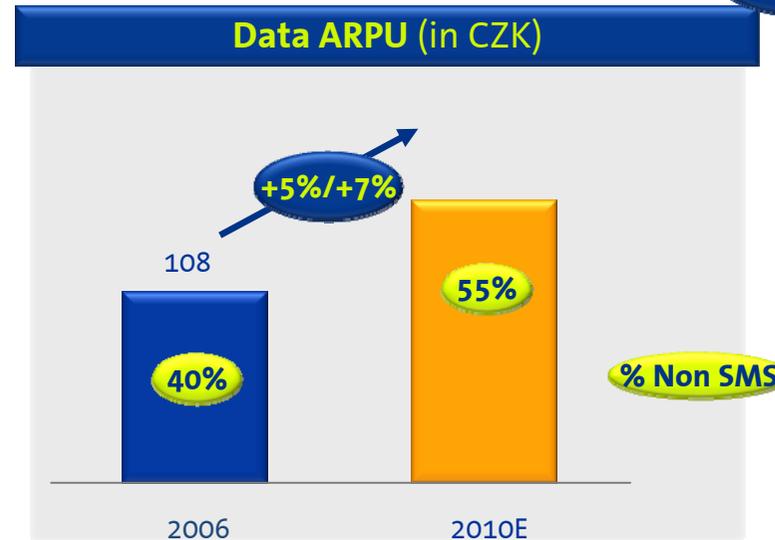
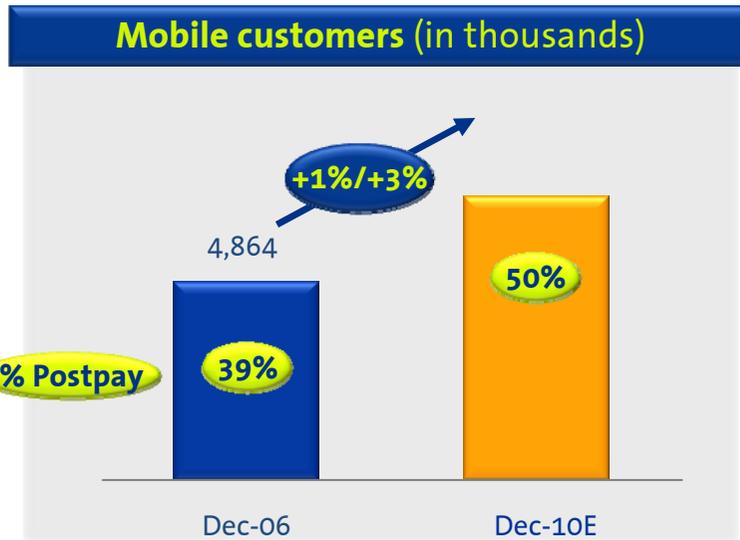
- 1 Accelerate DSL uptake & slow down line loss
  - 2 Develop IPTV and ICT businesses
  - 3 Launch additional converged services
  - 4 Build on success in Slovakia
  - 5 Exploit mobile data opportunity
  - 6 Continue to drive MoU through migration strategy
- Fixed
- Mobile

# 03 DSL will continue to drive growth in the fixed business...



- Negative revenue trend reversed in Q2 07 (+0.7%)
- Internet, IPTV and IT & Business Solutions the key drivers of growth
- Continue ADSL growth
  - Bundles support growth of DSL
  - Develop a strong position in IPTV
- Fixed line disconnections to improve significantly from 2006 peak of -519,000 net adds
- Develop a trusted, network centric ICT integrator position
  - DELTAX purchase

# 03 ...and data driving the mobile business in Czech Republic



- Revenues continue growing strongly
- Driven by customer base growth and ARPU
- Voice ARPU growth driven by migrations to contract (~50% of base in 2010E) and MoU increases
- Non-voice ARPU growth driven by non-SMS data

## 03 ...with continued growth in Slovakia...



- Highly successful launch
  - 455,000 customers at end Q2 07
  
- Market share of 8% after 5 months of operations
  - Initial target of 5%
  - Now targeting 14% - 17% by end 2010E
  
- Continuing to build own network
  - 500 base stations
  - 34% population coverage
  - Postpaid launch
  
- Cumulative CapEx investment over 4 years expected to be CZK 4.5-7.2bn

## 03 Investor Guidance...

(€ in millions)

	TELEFONICA O2 Czech Republic and Slovakia		
	FY2006 <sup>(1)</sup>	FY2006 (Adj.) <sup>(2)</sup>	CAGR 06-10E <sup>(3)</sup>
<b>REVENUES</b>	2,148	2,148	+1%/+4%
<b>OIBDA</b>	985	994	+1%/+3%
<b>CAPEX</b>	229	229	<b>1.0 - 1.4</b> bn Cum (07E-10E)

1) Base 2006 reported numbers include three months of start-up losses in Slovakia

2) OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007E-2010E. For comparison purposes the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures.

3) CAGR 06-10E guidance assumes constant exchange rates as of 2006 and excludes changes in consolidation, other than Deltax

## 03 O2 Ireland has delivered in a competitive market ...



### SUBSCRIBER BASE (in thousands)



- 13.5% growth in PostPay base vs. 2006
- Broadband sales significantly exceeding target since launch in July – 14,000 to date

### SERVICE REVENUE



- Blended ARPU €46.7 (+2% y-o-y)
- 10% premium over Vodafone on prepaid ARPU
- MoU 249 mins, up from 237 minutes last year (+5%)

## 03 ...with a focus on growth & cost control for the future



### Opportunities for growth

- Growth in postpaid base and ARPU
- Leverage growth in SME/Corporate segment to capture fixed minutes
- Differentiate O2 brand through focus on customer loyalty & service
- Build on the successful launch of HSDPA Mobile Broadband and introduce additional Broadband value added services
  - fixed/mobile convergent services
- Moving pictures
  - successful DVB-H trials
- Maximise Mobile Search and Advertising opportunities

### Cost control

- Technology & Network options
  - 15% - 30% targeted savings
- Maximise the use of Online and Direct Channels

## 03 Investor Guidance...

(€ in millions)	TELEFONICA O2 EUROPE		
	FY2006 <sup>(1)</sup>	FY2006 (Adj.) <sup>(2)</sup>	CAGR 06-10E <sup>(3)</sup>
<b>REVENUES</b>	13,159	12,842	+4%/+8%
<b>OIBDA</b>	3,708	3,601	+5%/+9%
<b>CAPEX</b>	2,553	2,380	<b>8,000 – 8,500</b> Cum (07E-10E)

- 1) Base 2006 reported numbers include eleven months of O2 Group (consolidated since February 2006) and three months of start-up losses in Slovakia
- 2) In terms of guidance calculation, Airwave results are excluded from base 2006. OIBDA excludes other exceptional revenues/expenses not foreseeable in 2007E-2010E. For comparison purposes the equivalent other exceptional revenues/expenses registered in 2006 are also deducted from reported figures
- 3) CAGR 06-10E guidance assumes constant exchange rates as of 2006 and excludes changes in consolidation, other than Deltax in the Czech Republic

## Our vision for 2010...

### Growing Above Industry Average

- Guidance achieved
- Increased our share of total communications spend across our combined markets
- An integrated business with major new revenue streams

### Highly Efficient Business

- Best in class cost benchmarks
- Delivering full synergy and learning benefits from Telefónica

### Fully Engaged Customers and Employees

- Highest customer satisfaction
- Top 5 employer
- Top 5 brand

*Telefonica*

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