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European mobiles: is the data opportunity big enough?

A financial market perspective

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- **Can European mobile revenues return to growth? Unsure despite data**
  - Revenues down 3.5% in Q3 due to voice (economy, regulation, competition)
  - Data adds ~2% to growth with potential for acceleration thanks to smartphones

- **Operators' role: the "efficient pipe+"**
  - Focus on Access & Enabler rather than Services or Apps
  - Data traffic not too explosive – Capex and LTE migration appear under control except in some countries

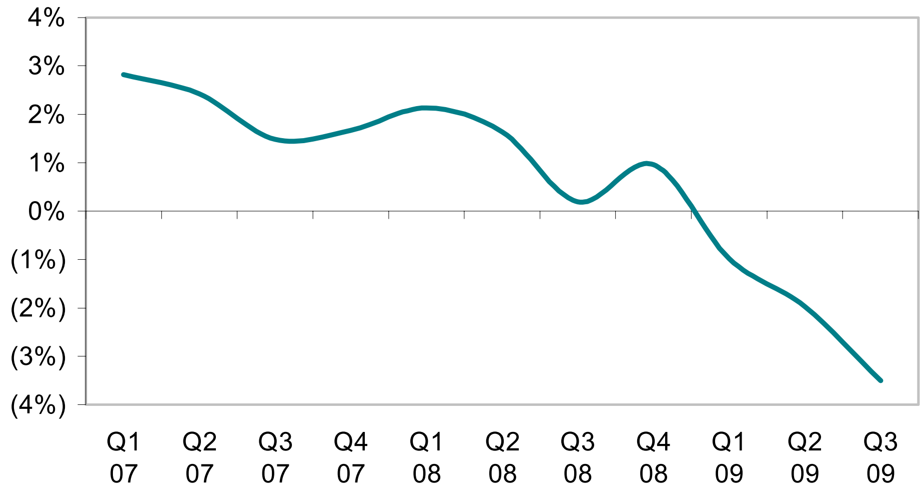
- **US benchmarking: not so positive for European mobiles**
  - Data market 40% more developed and contribution to growth 2-3x larger
  - However more upside on profitability in the US which remains more fragmented

- **Can consolidation help?**
  - Limited room for local consolidation, uncertain risk/reward from global M&A

1. Mobile data, a key revenue driver
The context: mobile revenues deteriorating

- **European mobile revenues are down 3.5% yoy (Q3 09)**
  - Driven by voice revenues, down 8% yoy
  - A mix of structural issues (market maturity, regulation, competition) and cyclicality (impact of recession on roaming usage and business customers)
  - Investors' changing mood: they thought the sector was immune (Q4 08), then realised it was not (H1 09), then hoped for a rebound (Q3 09)

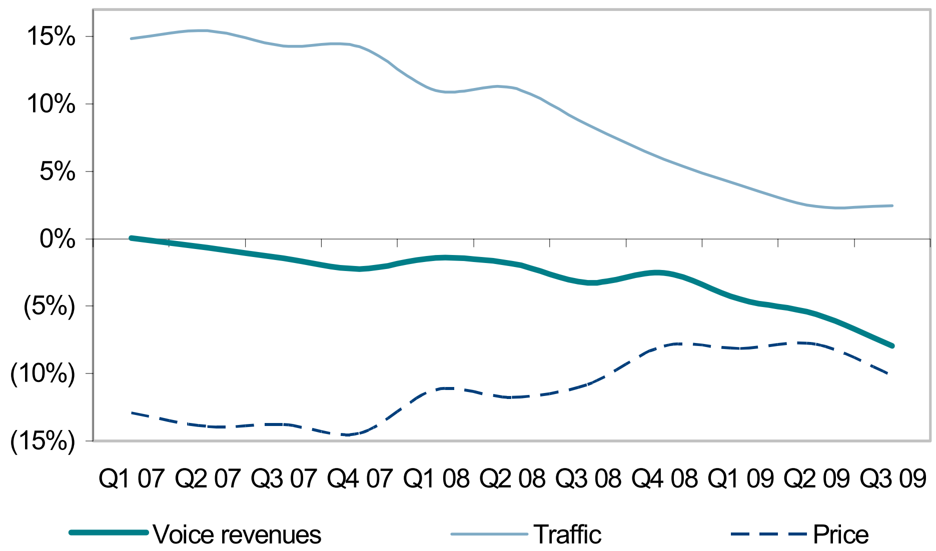
European mobile revenue trend



Vodafone relative share price performance

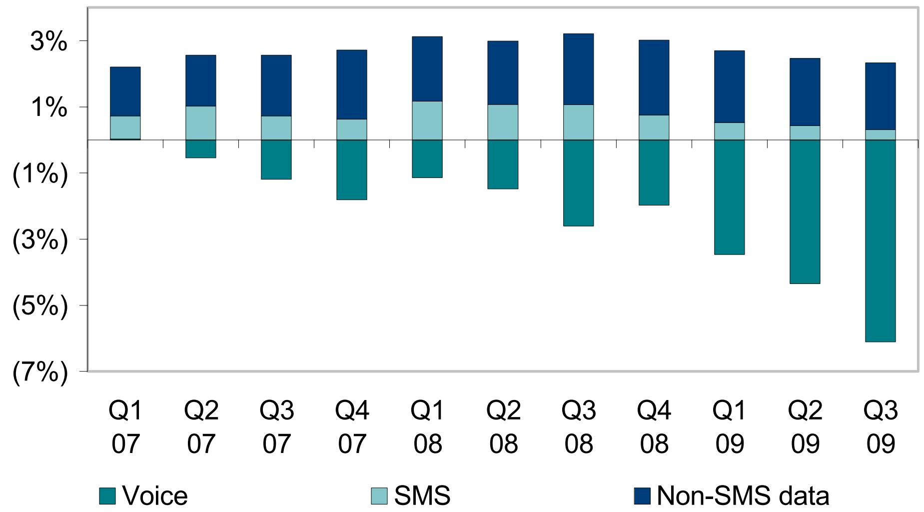
- **Mobile voice revenue decline: what are the drivers?**
  - Customer net additions have collapsed (penetration >120%)
  - Voice traffic is now flat (+2% in Q2 & Q3)
  - Average price per minute -10% yoy in Q3 versus -8% in Q2 due to further regulation (MTR, SMS roaming)
  - During the downturn, operators have been disciplined on outgoing prices
- **What happens after the recession?**
  - Voice traffic should reaccelerate: we estimate to +5/+7%
  - But we still expect -5% on voice revenues due to renewed price pressure
  - Regulation, competition, VOIP threat…

Voice revenue drivers

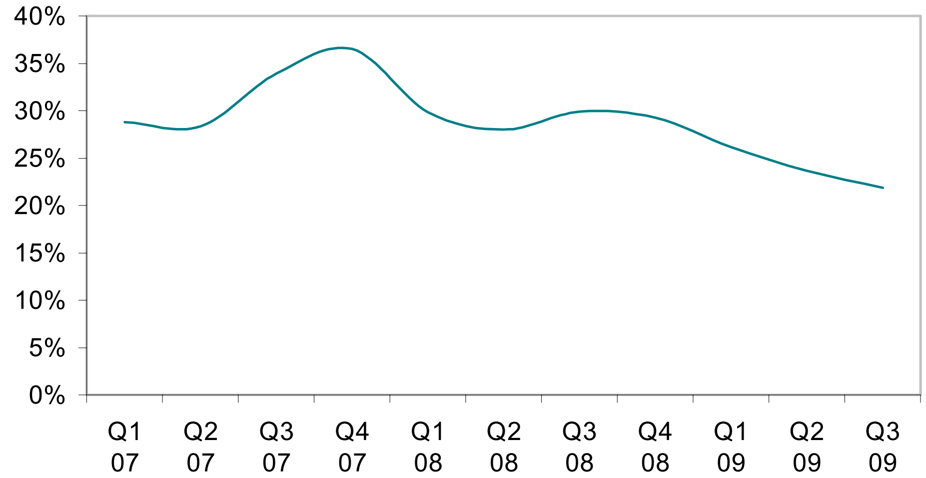


- **Non-SMS data increasingly essential**
  - SMS is maturing (+2%), could decline
- **Significant revenues, growing well**
  - Non-SMS data ARPU = EUR3.0/month
  - 12% of total ARPU, almost as big as SMS
  - Resilient revenue growth (+22% in Q3), boosting the sector by ~2%, since H2 07
- **Two drivers**
  - Mobile Internet – Smartphones
  - Mobile broadband – Dongles
- **Potential for acceleration?**

Contribution of voice, SMS and data

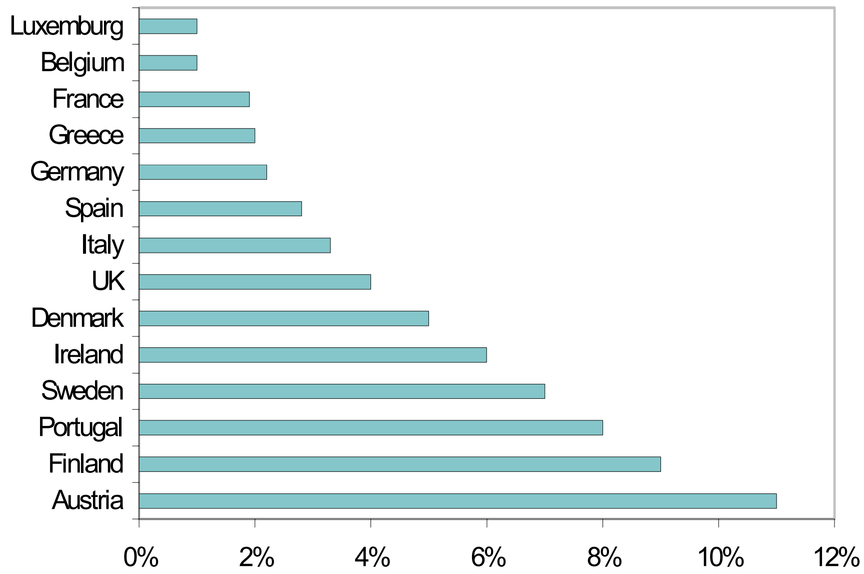


Non-SMS data revenue growth



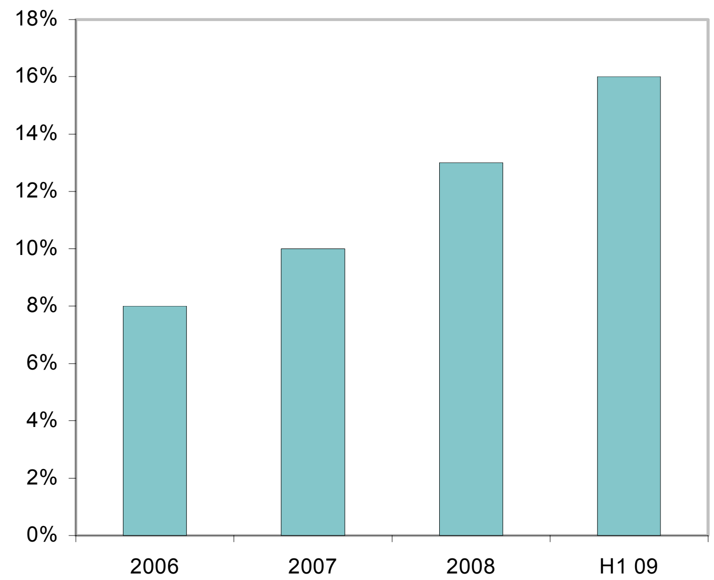
- **Varying local situations**
  - Started to accelerate two years ago
    - High laptop penetration, HSDPA networks ready, cheap HSDPA-enabled USB sticks
  - Varying pace of growth in different countries
    - Austria: population penetration now ~13% but most large countries below 5%
    - Penetration growth of ~2% yoy on average
  - Competing or complementing fixed broadband?
    - Austria: head to head competition
    - UK: ¼ of mobile BB users are mobile-only (Ofcom)
    - France: sold as a complement to triple-play
- **Contribution to revenue growth 0.5-1.5% (e)**
    - Based on ARPU range of EUR5-30/month
  - Limited revenue acceleration potential
    - Complement rather than substitute to fixed
    - We expect a relatively low ARPU (prepaid, add-on)

Mobile broadband % of pop. (Q4 08)



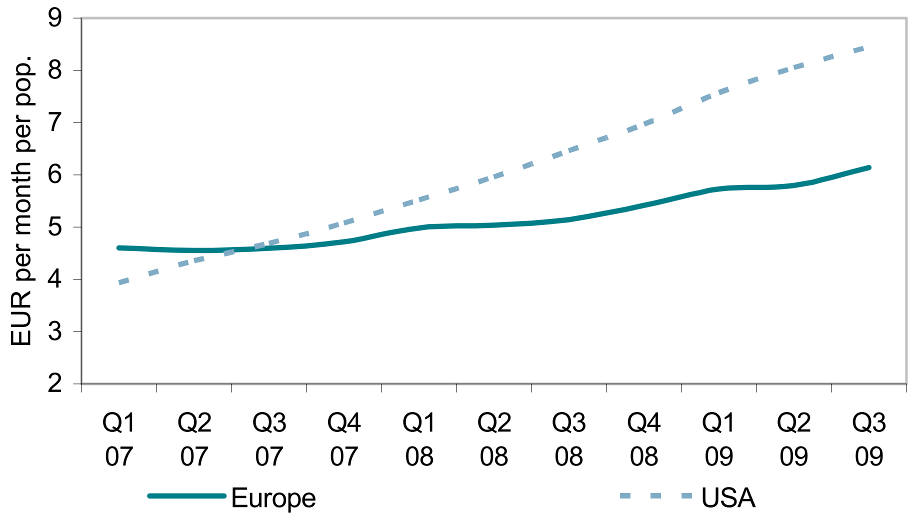
- **iPhone changed the game**
  - 3G handsets penetration did not help revenues
  - Apple's double impact on the handset market
    - Direct: strong & growing sales of iPhone
    - Indirect: boosting the market (quality & quantity)
  - Smartphones a growing share of handsets sold…
    - Worldwide = 16% in H1 09, up from 13% in 2008
    - Vodafone Europe = 20%, targets 30-40% next year
  - …finally driving usage and revenue growth
    - UK: 16% of adults accessed the Internet on their mobile in Q1 09 (Ofcom)
    - Only ~10% of customers pay a data bundle
    - Vod. Europe mobile Internet rev. +30% yoy in H1
- **Current contribution to revenue growth ~1% (e)**
  - Acceleration potential with smartphone sales
  - Need to monitor incremental ARPU versus incremental subsidy

Smartphone sales % of handsets



- **A large & 'simple' opportunity on mobile Internet access**
  - US benchmark: mobile data = EUR8.4/pop. per month, +40% versus Europe
  - If captured in four years, could add 2% to the sector's top line
  - In line with operators' core competencies

Total mobile data revenue per pop.



- **Services: for operators, it's not worth it**

1. A myriad of services

- Digital content: music, video…
- Personal communication: contacts, social networks…
- Maps, location-based services
- Applications…

>> Each is small versus operators' revenues

2. Different business models

- Pay-by-click
- Subscription
- Advertising

>> More complex to handle for operators

3. Many new competitors with established brands

- Web/software players
- Hardware players
- Content owners
- …

>> Operators' market share will be small

- **Opportunity to become “enabler” of 3rd party services & applications**
- **Potential for operators to leverage their specific assets**

Billing	Yes, although advertising and iTunes are partial alternatives
CRM capability	Yes
Location data	Limited: GPS provides location data to handsets
Large reach	Limited: software & hardware giants have a larger reach

- **Revenue impact?**
  - Direct revenue opportunity impossible to assess (a fraction of the services’ market)
  - Clear indirect benefit as more services will drive take-up, hence access revenues

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3. Will networks handle it?
Is traffic growth strong or explosive?

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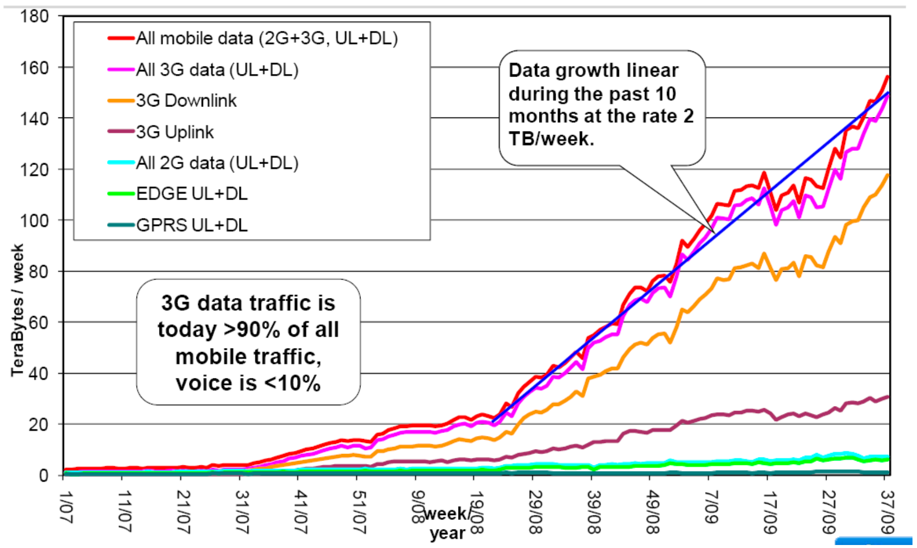
- **Mobile data traffic x2-4 yoy**
  - Most recent data points closer to 2x (Elisa, Tele2, Vodafone)
- **Growth in devices will go on**
- **What about growth in traffic per device?**
  - (+) User-friendliness (touch, new interface, attractive apps)
  - (+) Macro trend (rise of video like on fixed broadband)
  - (+) Device mix (dongles to drive >80% of data traffic)
  - (-) Pricing: capping the “unlimited” tariffs
  - (-) Dilution by new users beyond the early adopters

Mobile data traffic growth at European operators

Company	Country	Reference period	YoY growth in mobile data traffic	Traffic per device (Gb/month)	YoY growth in traffic per device
T-Mobile	Europe	H1 09	x2.81	n/a	Growing
Elisa	Finland	Sep-09	x1.65	2.0	Stable
TeliaSonera	Nordics	Q2 09	x3.75	1.0	Growing
Tele2	Sweden	Sep-09	x2	iPhone: 0.2	-
-	-	-	-	dongle: 1.0	Declining
France Telecom	Europe	FY08	x5.5	iPhone: 0.25	Growing
-	-	-	-	residential dongle: 0.8	Growing
-	-	-	-	business dongle: 0.5-0.6	n/a
Vodafone	Europe	Q3 09	x1.67	n/a	n/a
Ericsson			Strong growth	n/a	Growing



Source: Elisa

3. Will networks handle it?
Core scenario: capex seems under control

- **In core scenario, current capex level (~11% of sales) seems sustainable**
  - Many “cheap” options: switch-on carriers, HSPA upgrades, WiFi, femtocell, cell splitting…
  - …before switching to more expensive options (new spectrum, LTE)
  - Core scenario assumes linear growth in traffic per device (circa x4 by 2015e)
- **However, capex risk if continued exponential traffic growth**
  - Risk higher in countries with rapid dongle adoption: Austria, Nordics, UK, Portugal
- **LTE rollout: will start in 2010, full scale adoption from 2013-2014**
  - Important hurdles to overcome: handset availability, spectrum allocation
  - Large operators see no “capex bump” but some Nordic operators do (e.g. Telenor)

Country	Company	Expected 4G launch	Comments
Sweden, Norway	TeliaSonera	2010	Launch in Oslo and Stockholm in 2010
Sweden	Tele2, Telenor	End 2010	4G network JV between Tele2 & Telenor; Initial product = mobile broadband
Europe	Vodafone	Late 2011 or 2012	Makes a lot of sense to push HSPA upgrades to the maximum first
France, UK, Spain	France Telecom	2012	Rollout starting in 2011, real growth not before 2013
Finland	Elisa	No yet decided	Focusing on a wide rollout of HSPA900, LTE is a “heavy investment”
Europe	Ericsson	2010 - 2013/2014	Will start in 2010 in some countries but will grow in earnest in 2013-2014

4. Europe versus US
Q3: US market +3%, Europe -3.5%

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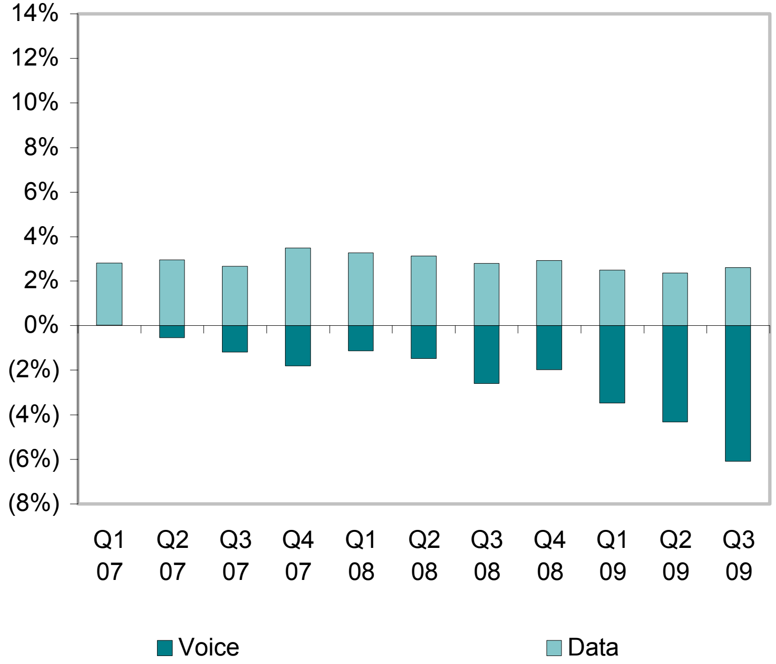
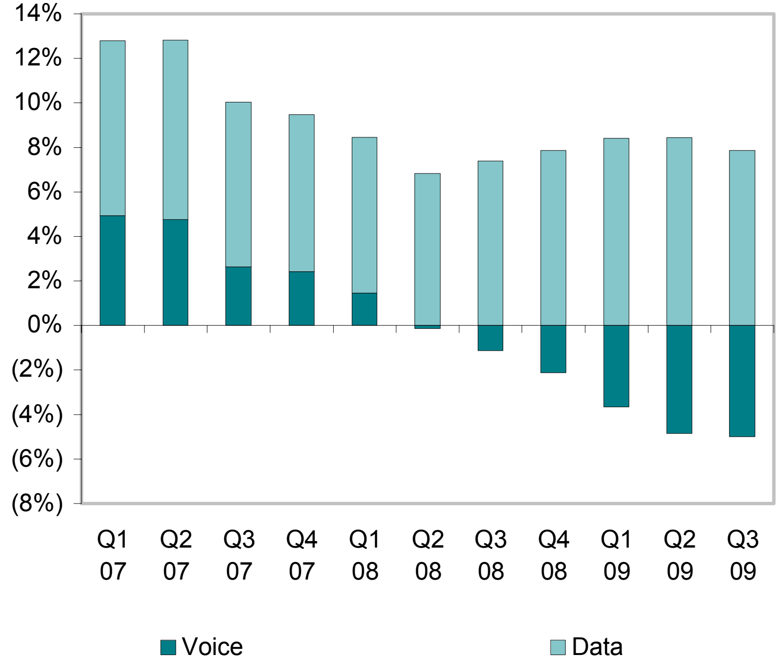
- **Voice revenues have historically grown more in the US**
  - Penetration catch-up
  - This seems over: trend now similar to Europe (recession, competition)

- **The US is now leading thanks to data: contribution 2-3x larger**
  - Smartphones = 40% of handsets sold by Verizon Wireless in Q3 09
  - Leaders' data bundles $30/month

Voice & data contributions – Europe



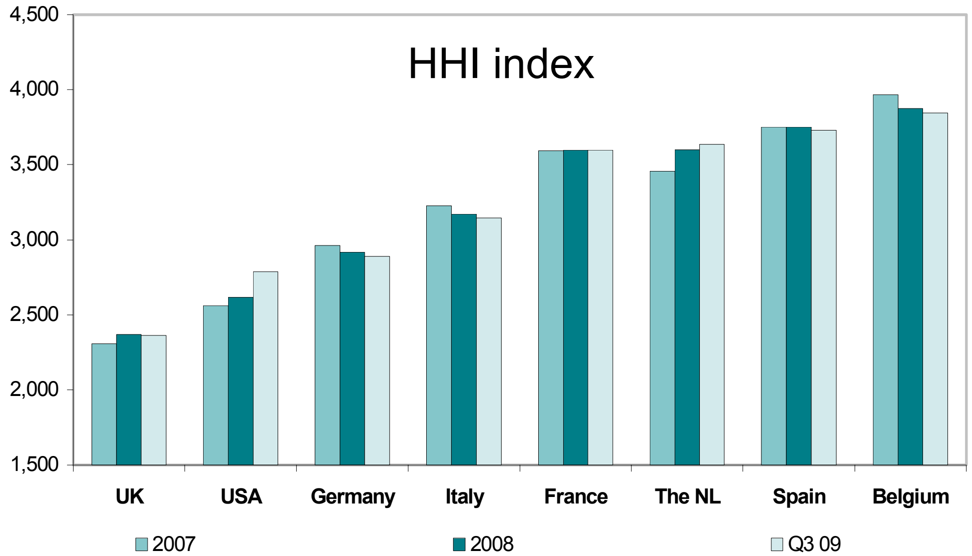
Voice & data contributions – USA



4. Europe versus US
US still less profitable & more competitive

- **Similar revenue ~EUR30/month/pop**
- **The European mobile market remains more profitable**
  - EBITDA margin 36% vs 32%
  - Capex/sales 11% vs 13%
  - Post-tax ROIC higher ~20% vs ~15%
- **Different usage/price patterns**
  - Price per minute 0.11 vs 0.05
  - Voice usage (MOU) 165 vs >800
- **Regulation hitting European voice**
  - MTR: large direct & indirect impacts
  - Virtually no MTR in the US
- **US ops. differentiate on network**
- **Geographic & cultural differences**

- **Different competitive dynamics**
  - US still more fragmented than most European markets
  - US concentrating via consolidation and leaders gaining market share

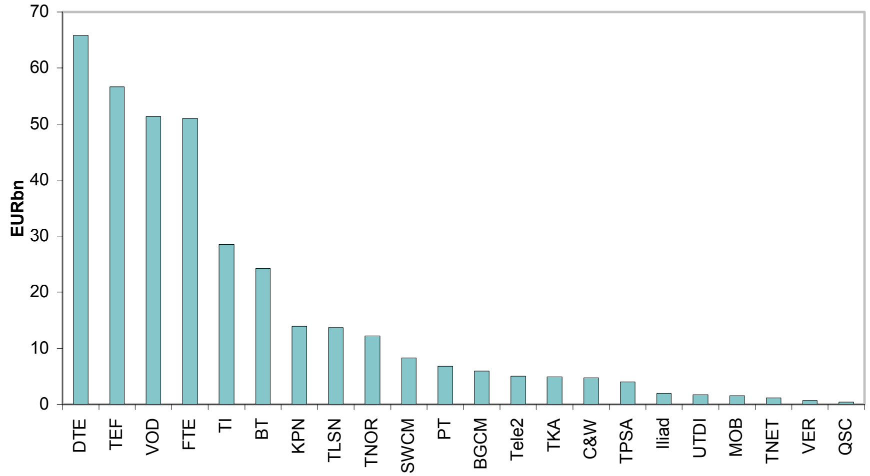


- **Conclusion: still upside in the US and downside in Europe?**

5. Preparing for the new world
Towards European consolidation?

- **In-country consolidation?**
  - Rationalising competition, optimising costs – Evidence in the Netherlands
  - But after the UK, not many opportunities: most European markets highly concentrated
- **Pan-European consolidation?**
  - Limited benefits on the core “pipe” business
  - Benefits on position in the value chain?
    - Bargaining on hardware, handsets, content, software, applications, advertising, etc. with global leaders such as Google, Nokia, Microsoft, Apple…
    - Small telcos say that large telcos have more bargaining power with global counterparts
- **Investors buy the targets (cf. KPN chart)**
  - Cautious on potential acquirers (DTE, FTE, TEF, VOD): execution risk > benefits

European telcos by conso. rev. (2009e)



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