

# VISION AND STRATEGY

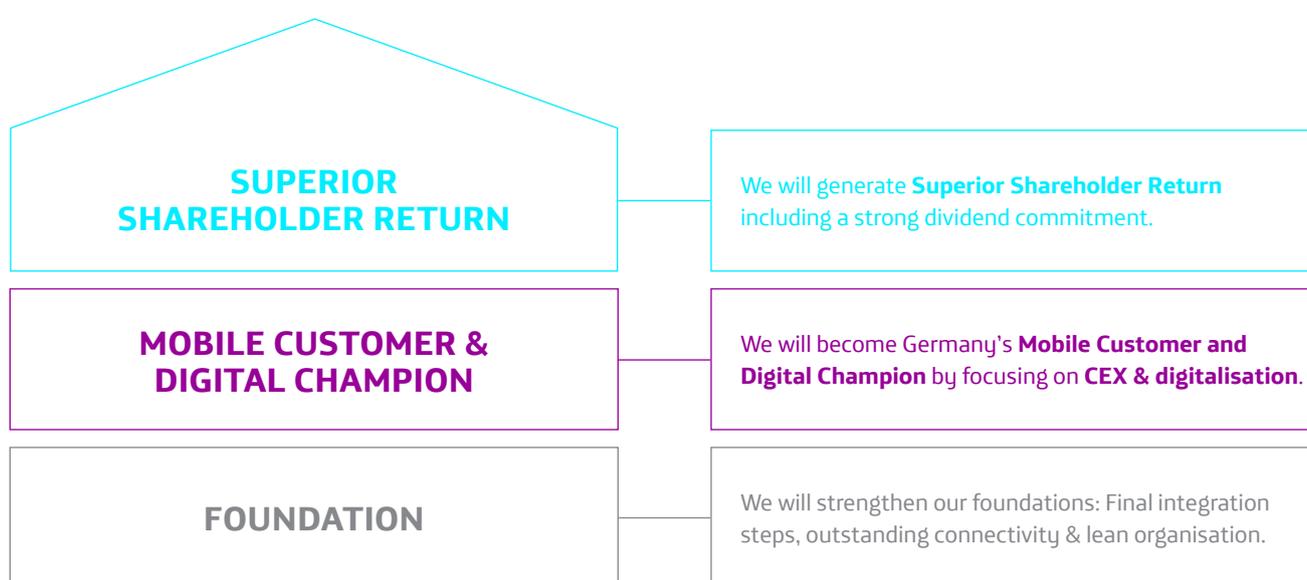
## Our vision

The merger of E-Plus and Telefónica Deutschland is the largest and most quickly executed transaction to have taken place in the European telecommunications market in recent years. As a result, we have become one of the three leading integrated network operators in Germany. No other network provider connects more people to mobile services than Telefónica Deutschland. We want to make the most of this potential, and we have defined a clear vision to do so:

*“We make the lives of our customers simpler and better, and give them mobile freedom in the digital world.”*

## Our strategic priorities

Consequently, we base our corporate strategy on this vision. To date, it has focused on quick integration and maintaining market momentum. Our company is fully on course to broadly complete integration by the end of 2018: in recent years, we have reached all planned milestones and will realise all target synergies. With competitive, innovate products, we increasingly make use of the potential of data growth and continue to support the market momentum. In order to make our vision a reality, we now require focus to be on phenomenal customer experience.



## G 01 / Strategic priorities

### Three strategic priorities emerge as a result:

- Initially, we will create the foundation for optimising the customer experience by completing integration and optimising the fundamental success factors of our business. This in particular includes very strong performance in the areas of network and customer service in addition to stable IT systems and effective organisation.
- Our second priority lies in transforming and digitalising our business so as to create a fantastic customer experience. This will allow us to position ourselves as the Mobile Customer and Digital Champion in the German market.
- This leads to our third priority: to take what makes us stand out in customer service and translate this into new growth which will continue to show a positive development and profitability in addition, finally, to strong returns for our shareholders.

## First strategic priority: Laying the foundation for optimising the customer experience

### Network

Our strong network is a key building block for the best possible customer experience. As a result of our outstanding spectrum portfolio, we are in an excellent position to drive future network developments forwards. We have access to a spectrum of 315.5 MHz in total, which allows us a balanced ratio between network coverage and capacity. It is on this basis that we are building Germany's largest and most state-of-the-art mobile network geared towards the actual needs of our customers in day-to-day digital life.

We have made good progress in consolidating our network and have already completed it in several regions in southern Germany. It should be largely finalised by the end of 2018. In parallel, we are also taking continuous measures to improve network quality. The CHIP network test<sup>1</sup> of November 2017 confirmed that we provide our customers with stable network quality despite the comprehensive integration works. The "network weather" test from the magazine connect<sup>2</sup> showed that we provide the best UMTS provision of the three network operators and win our customers over with the best LTE signal quality. Further quality initiatives such as our "Customer Experience Management Tool" (CEM) and technologies for managing network capacities allow us to further optimise network quality.

Once integration is completed, we will continue to accelerate the expansion of our 4G network, which has already achieved coverage of over 80%. 2018 will see the continuation of the expansion of our 800 MHz LTE network, and the expansion of the 1,800 MHz LTE

network is being implemented with even greater speed. Smart investments in expansion ensure that we are developing into areas where customers most benefit from better coverage and higher transfer speed. Furthermore, we ensure that we will have sufficient access to the fibre optic infrastructure in future.

Finally, we are taking on a role as pioneer for technological innovations. We cooperate with companies like Huawei so as to build communication networks of the future and were able to achieve transfer speeds of 1.65 Gbit/s in 5G test runs in our "TechCity" testing environment in Munich. Since the start of 2018, we have also entered into cooperation with Nokia in order to make significant advancements in 4G and 5G development in our Telefónica test laboratory in Munich. During the year, a joint outdoor test network, known as the "early 5G innovation cluster", shall also be built in Berlin. Furthermore, we benefit from the progress made by Telefónica, S.A., in defining a future 5G technology standard as part of international initiatives such as NGMN and 5G PPP.

### Customer service

We aspire to offer consistent service and excellent quality at every point of customer contact. We therefore increased our resources for the hotline and chat service channels. This led to clear improvements in performance indicators like waiting times and how easy it is to reach customer service. We have been at the same level as our competitors since the end of 2017. We will also carry out targeted service initiatives in 2019 so as to continue to improve our hotline service and increase customer loyalty.

<sup>1</sup> CHIP network test of 28 November 2017 "Die Mobilfunknetze im Härtestest"

<sup>2</sup> Connect "network weather"-test of 5 January 2018

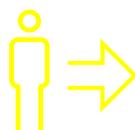
### G 02 / Milestones of integration

Largest and fastest mobile merger ever executed in the western hemisphere



>25%

OIBDA growth  
in 3 years



>25 million

Customers migrated to one  
IT stack in 2016



>14 thousand

Network sites to be  
consolidated by 2019



O<sub>2</sub> Free

First 3G unlimited  
First 4G big bucket portfolio

## Second strategic priority: Mobile Customer & Digital Champion

We also find that more and more customers prefer digital interaction and would like to be able to solve their own issues. We are therefore increasing the proportion of our digital customer contacts. We are also digitalising our internal service processes. As a result, we can, for example, process the customer's service concerns digitally and solve the customer's concerns more quickly thanks to automation and artificial intelligence. By using AURA, the intelligent user interface, customers can, for example, inform themselves about the products and services they used, ask service questions, obtain information on their favourite programmes or record them or be notified if mobile data consumption is higher than usual.

### IT and organisation

In order to guarantee a good customer experience, we ensure the stability of IT systems in the distribution and service area. Furthermore, we are transforming our IT systems by using the approach of Telefónica, S.A. Group in order to create a uniform IT landscape across all market segments and distribution paths: a standardised product catalogue ensures consistency with regard to product and price information across all distribution channels. In addition, we will standardise our ordering system and Customer Relationship Management system (CRM) so as to benefit from the advantages of efficiency and market standards.

As part of the integration, we will continue to expand our company into a dynamic and robust organisation. The focus here is on a high level of engagement with our employees, promoting continuous learning and ensuring a trusting cooperation with the company.

### Private customers

We address all the needs of our customers in the digital world. As a pioneer in the German market, we are gearing our core O<sub>2</sub> market towards the customer promise of freedom. Our customers expect that they themselves can determine and enjoy their digital lifestyle without compromises. Telefónica Deutschland offers its customers exactly that: with us, everyone can make use of the opportunities of the digital world, and we claim to offer the best price-performance ratio in doing so.

In a dynamic but rational environment, the German mobile phone market had indicated an increasing focus on larger data packages since the third quarter of 2017. With the new O<sub>2</sub> free tariff portfolio, which introduced large data packages, Telefónica Deutschland became the pioneer of this development. We are putting an end to compromises in the digital life of our customers and are setting new standards for our customers' freedom. At the same time, we are stimulating data consumption, thereby continuing our successful data monetisation strategy. Momentum in the retail business improved considerably as a result of the new O<sub>2</sub> free tariff and by the promotional tariffs on the 15th birthday of the O<sub>2</sub> brand. We also introduced the principle of freedom to the landline world: O<sub>2</sub> customers can design their digital lives not only when they are on the move but also when they are at home, with no compromises. With O<sub>2</sub> DSL, we offer the right tariff for every customer's needs – even without a contractual term if the customer so desires. In the coming years, we will continue to underpin our customer promise of freedom through innovative products.

We are also going beyond the provision of mobile and landline connectivity by offering innovation digital services under the O<sub>2</sub> brand. For example, O<sub>2</sub> TV & Video offers our customers access to live TV content from over 70 channels and to catch up TV services from public broadcasting companies, any time, anywhere. Furthermore, we are continuing our cooperation with Sky so that we can further expand our offering with attractive content. In addition, with O<sub>2</sub> banking in cooperation with Fidor Bank, we are offering an innovative mobile banking product which will enable the use of smartphones as a fully fledged bank account.

### **Partner customers**

With a focused multiple-brand strategy, we successfully operate in all market segments. Thanks to our wholesale channels with partner brands, we reach a bigger customer base that we are not addressing with our core O<sub>2</sub> brand and our secondary brands. We aspire to grow our entire core O<sub>2</sub> brand with these wholesale partners as a complement. We will therefore flexibly and quickly meet the needs of our wholesale partners and support them in improving the customer experience.

### **Business customers**

Telefónica offers sleek, tailor-made mobile and landline products for its business customers. We service small and medium-sized enterprises in particular with our core O<sub>2</sub> brand. In September 2017, we brought the new O<sub>2</sub> Free Business tariffs to the market that also offer business customers more freedom thanks to an excellent price-performance ratio with even more high-speed data. For companies whose employees only need a small volume of data, we also introduced the O<sub>2</sub> Business Basic portfolio with flexible talk tariffs for those who make frequent phone calls and individual options.

Innovative services like machine-to-machine (M2M) and the Internet of Things (IoT) that are close to our core product of connectivity will continue to increase the customer experience. At this year's Funkschau readers' choice awards, we were able to take first place in the M2M services/platforms category with our IoT smart centre platform. Our platform provides automated data transfer between objects and machines and the simple management of IoT connection technologies. Furthermore, since 2017 we have offered a holistic, modular security solution in CyberThreats, which enables companies to react quickly and effectively to possible dangers from the network.

### **Intelligent data analysis, Internet of Things and innovation**

We are developing new growth fields close to our core business which help us to improve the customer experience across the board. By using intelligent data analysis (ADA: Advanced Data Analytics), we are able to offer services in the area of traffic, trade and advertising. With the anonymisation platform we developed, we ensure the security of our customers' data. In the area of transport analytics, we use anonymised data from the largest mobile network customer base in Germany in order, for example, to analyse air pollution or optimise traffic in towns and cities.

We will develop the IoT growth environment for all market segments which we already address with our core business. We are taking the opportunities that arise from the exponential growth of devices and things connected to the Internet by means of mobile technologies. As part of Telefónica, S.A. Group, innovation is one of our fundamental values. For example, we benefit from the innovative, voice-based user interface AURA which is operated by Telefónica, S.A. Group and which we implement. Our internal departments develop innovative products and services to optimise the customer experience. Moreover, our venture department Wayra honed in on the "venture client approach" in 2017: it helps more mature start-ups from the areas of IoT, data analytics, cybersecurity and artificial intelligence to gain direct access to our Group.

### **Transformation to the digitalisation of the company**

In addition to completing the integration and optimisation of the existing business, digitalisation is the crucial lever for creating a phenomenal customer experience and making us stand out from the crowd. We will therefore transform our company: We are initially creating a high-performing and flexible IT infrastructure. Building on this, we will establish a way of working digitally in our company. Finally, we are improving the customer experience by optimising our interaction with the customer by means of digitalisation.

With a dedicated transformation programme, we are improving the three crucial dimensions of the customer experience. First of all, we want to achieve new simplicity in customer interaction. In order to do so, we are implementing a cross-channel distribution and service concept (omnichannel). In addition, the "My O<sub>2</sub>" app simplifies the digital life of the customer. It will considerably simplify the management of devices, tariffs and service parameters for individuals or several users. Furthermore, it will offer the customer new opportunities to quickly and easily solve their problems themselves.

## Third strategic priority: Growth and profitability

Through digitalisation, we will also interact more quickly with our customers and be able to meet their desires in real time. We are therefore modularising and digitalising our products in order to shorten the time from development to market launch. End-to-end processes with far-reaching automation will accelerate our interaction with customers considerably. We will also use intelligent data analysis to best meet the needs of the customer and make the best use of our internal resources.



*“The ‘My O<sub>2</sub>’ app simplifies the digital life of the customer.”*

We do not just want to be simpler and faster but also better in the eyes of the customer. To do so, we are relying on support in identifying and solving customer problems using intelligent data analysis, accompanied by digital tools for the customers to solve problems themselves. Additional digital tools will improve interaction with the customer in the shop.

By optimising fundamental success factors and creating a fantastic customer experience through transformation and digitalisation, we will stand out from our competitors and be able to enable new growth. When it comes to customer service, standing out allows us to return to sales growth. We will continue our data monetisation strategy and develop new sales potential through digitalisation, meaning that we can grow in a similar way to the German market.

We are therefore making intelligent investments in our network and transforming our company where we are keeping the amount of our expenses for investments stable. In particular, transformation to a digital company enables us to constantly increase efficiency, meaning that we can consistently reduce our operating costs. We are also tapping into the sales potential arising from the transformation in order to support the development of our cash flow and dividends.

Overall, we are therefore able to ensure the continuous, positive development of our profitability. Last but not least, we are keeping our promises to our shareholders: we are firmly convinced that we are able to generate a solid free cash flow and continue to support above-average shareholder returns with an increased dividend payment in proportion to the free cash flow.

### G 03 / Full steam ahead for our transformation programme: Digital4Growth

How to become a Mobile Customer and Digital Champion?  
We want to be simpler, faster and better and transform our business.

