

# Combination of Orange UK & T-Mobile UK: *Creating a new mobile champion*

8 September 2009



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# Transaction highlights

## Key terms

- France Telecom and Deutsche Telekom plan to merge Orange UK and T-Mobile UK
  - 50:50 joint venture with balanced governance structure
  - Key transaction terms agreed, subject only to confirmatory due diligence
  - T-Mobile UK to be contributed to the JV on a cash free, debt free basis
  - Orange UK to be contributed to the JV including £1.25bn intra-group net debt in order to equalize the value of the respective contributions
  - Immediately after closing, £1.25bn JV net debt to be refinanced by two shareholder loans of £625m held by each of Deutsche Telekom and France Telecom, resulting in a cash receipt for France Telecom of £625m
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## Key conditions

- Exclusive discussions
  - Confirmatory due diligence (to start immediately)
  - Approval by relevant authorities
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## Key milestones

- Execution of definitive documentation expected by end October 2009
- Operations managed independently up to closing
- T-Mobile UK and Orange UK brands to co-exist for 18 months; brand strategy after this 18 month period to be decided by the shareholders

# Transaction rationale

## 1 Emergence of a new #1 player in UK mobile

- Creating a new champion in the UK mobile market
  - #1 player with a combined market share of 37% (2008 PF)
  - Serving key mobile market segments: from business customers to prepaid/postpaid consumers and wholesale customers
  - Best positioned for convergence offerings in the future
- Best 2G and 3G networks in terms of coverage and performance
- Serving combined pro forma 2008A customer base of 28.4m subscribers with best of both partners' products and services
- Industry leading and experienced management team to ensure smooth integration and long term leadership
- Attracting the best talent and offering outstanding career opportunities

## 2 Best customer offering in the market

- Enhanced coverage quality including indoors and in rural areas
- Leader in mobile broadband
- Providing the most innovative and widest range of handsets, products & services
- Largest distribution network among mobile operators
- Ability to build the best customer service platform in the UK
- Realising the vision of Digital Britain by investing into technology and services

# Transaction rationale (cont'd)

## Costs savings through integration and scale

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- Significant synergy potential: NPV of net opex and capex savings in excess of £3.5bn
    - Opex run-rate synergies of £445m per annum
    - Capex run-rate synergies of £100m per annum
  - Large and readily achievable synergies in network & IT
  - Quick ramp-up of savings in commercial and G&A expenses
  - Improved efficiency in distribution and customer services
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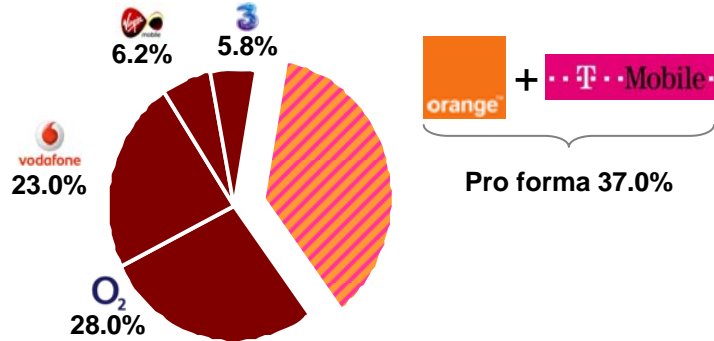
## Value creation for shareholders

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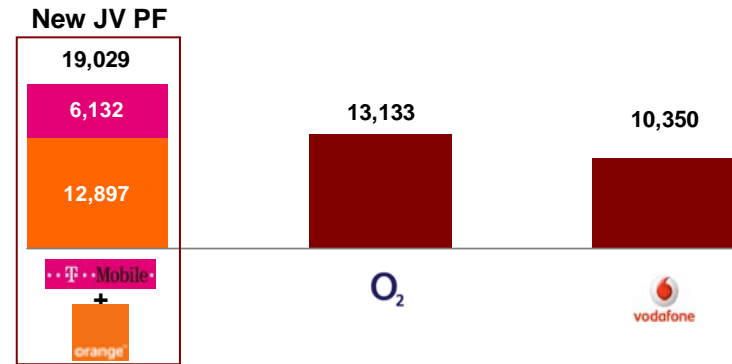
- Joint ownership of a larger, more profitable asset
- EPS accretive from first full year of JV operation (2011)
- Free cash flow per share accretive from 2010
- Maximisation of cash to the parent companies through a distribution of 90% of the JV's free cash flow
- No impact on parent companies' debt and dividend policy

# 1 The Joint Venture will create the new #1 player in the UK mobile market

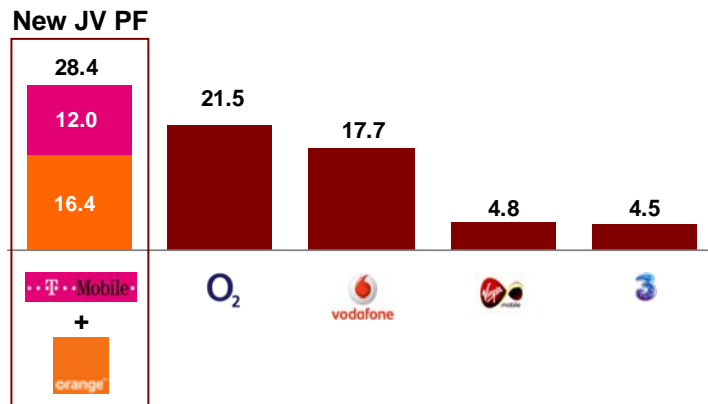
UK mobile subscribers market shares (2008PF combined)<sup>1</sup>



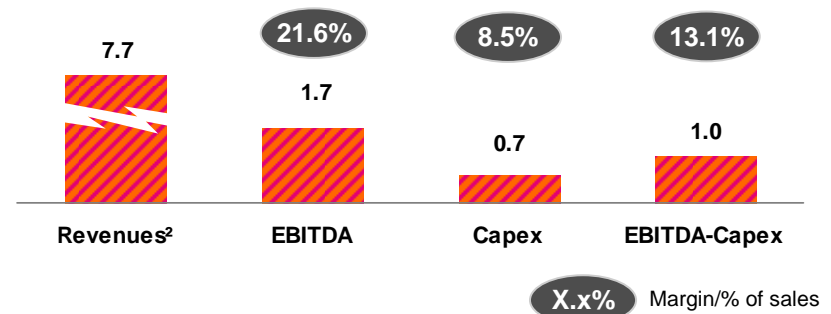
Total UK mobile employees by operator (2008PF combined)<sup>2</sup>



Total UK mobile subscribers (m, 2008PF combined)



Joint Venture financials<sup>3</sup> (£m, 2008PF combined)



Source: Ofcom "The Communications Market 2008", company filings <sup>1</sup> T-Mobile UK excluding wholesale via Virgin <sup>2</sup> Company reporting as of the respective last fiscal year end

<sup>3</sup> Adjusted for national interconnect revenues between T-Mobile UK & Orange UK

## 2 The new venture will benefit British consumers, boost innovation and enhance competition

### A new, compelling customer offer

- The biggest, fastest and widest network
- Enhanced quality of coverage including indoors and in rural areas
- Most innovative and best handset portfolio, products & services
- Notable environmental benefits through large reduction of duplicate radio sites

### Industry leading retail presence

- Higher customer proximity through largest distribution network of mobile operators
- Enhanced ability to demonstrate our new services and devices in our own environment
- Unparalleled customer access complemented by deep relationship with existing independent distributors
- Outstanding customer service

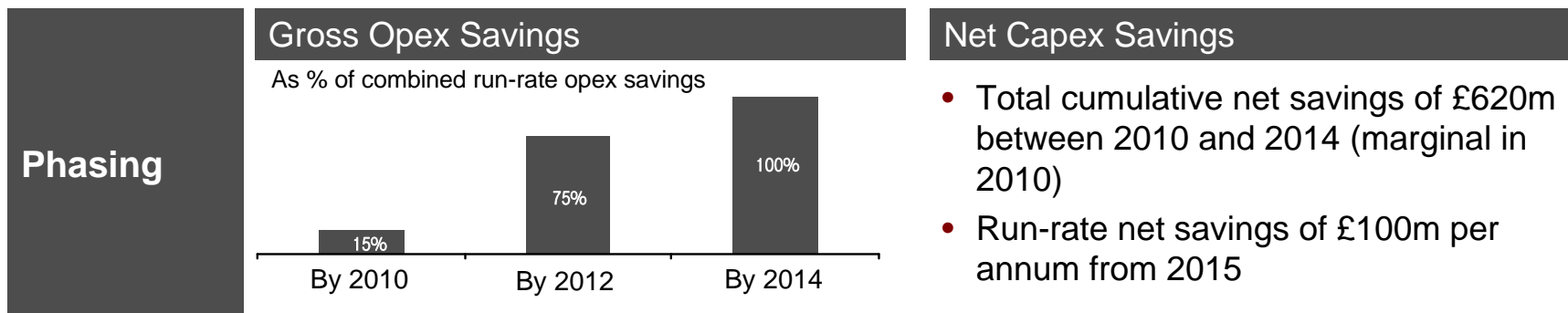
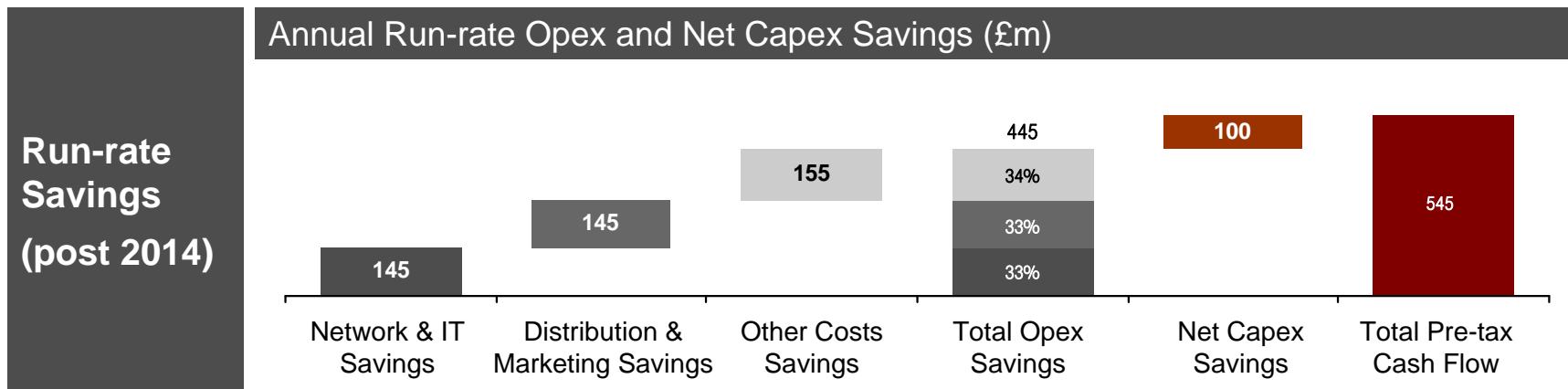
### Realising the Digital Britain vision

- Delivering the potential of multimedia devices and convergence products to consumers nationwide
- Enabling rapid deployment of mobile broadband to most parts of the country
- Creating the scale to invest in new consumer technologies and services

**The combination creates a strong national competitor, with the critical mass to accelerate the vision of Digital Britain**



### 3 Over £3.5bn NPV of synergies, net of integration costs



- Integration Costs**
- Cumulative integration costs over 2010 – 2014: £600m-£800m Opex
  - Integration capex factored into net capex savings

- Long term EBITDA margin superior to current margins of best in class operators in the UK
- Best in class capex efficiency

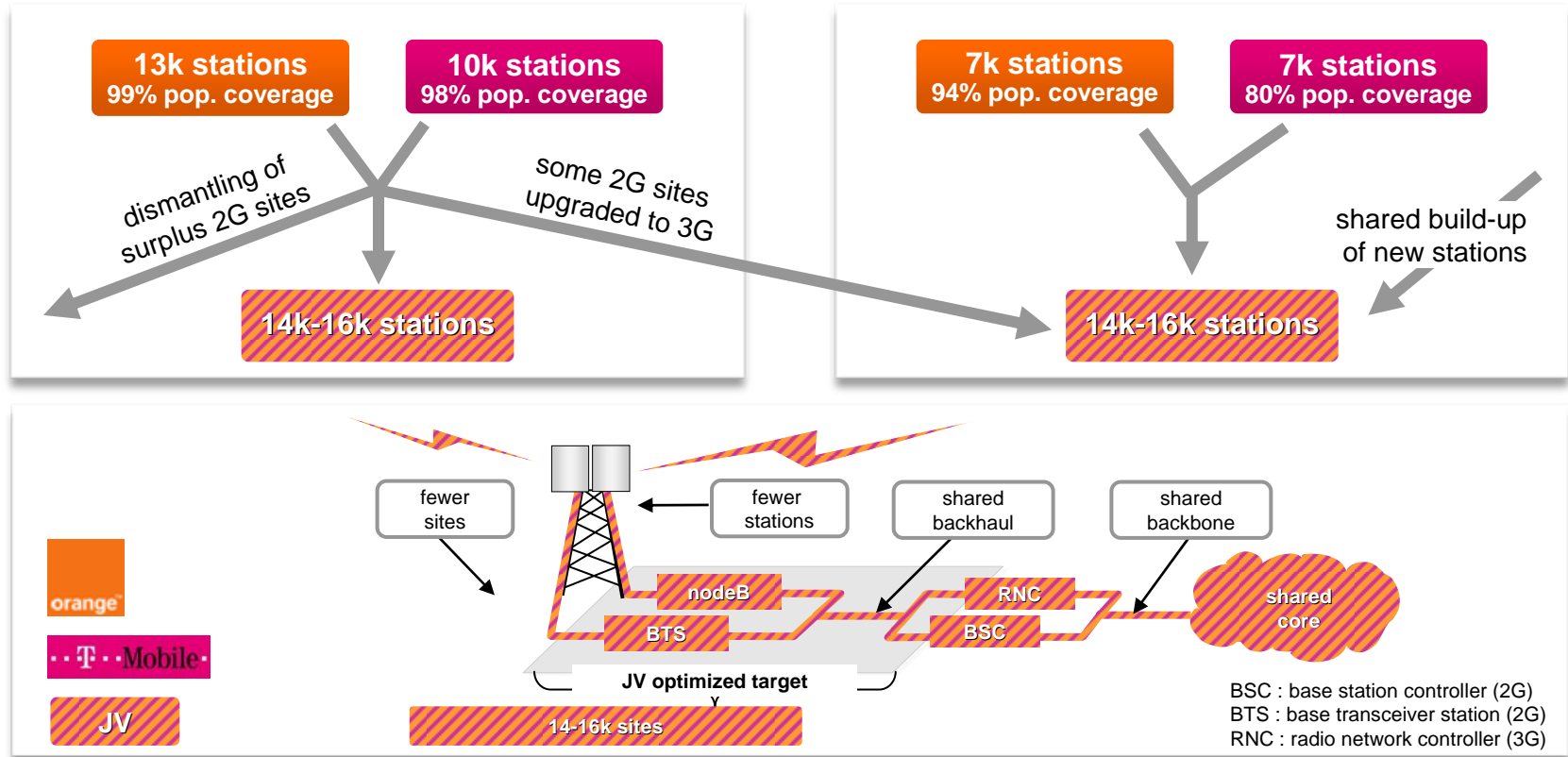
### 3 Sources of synergies and integration costs

	Sources of synergies	Related integration costs
<b>Network &amp; IT</b>	<ul style="list-style-type: none"><li>• Site rationalisation and modernisation</li><li>• Backhaul, backbone and core network consolidation</li><li>• Combining 2G and 3G network coverage and extension</li><li>• IT and back-office unification</li></ul>	<ul style="list-style-type: none"><li>• Site decommissioning</li><li>• Costs of terminating supplier contracts</li><li>• Network integration capex</li></ul>
<b>Distribution &amp; Marketing</b>	<ul style="list-style-type: none"><li>• Lower distribution costs due to enlarged own distribution network</li><li>• Rationalisation of retail network</li><li>• Reduction in marketing costs</li></ul>	<ul style="list-style-type: none"><li>• New branding strategy implementation costs</li><li>• Shop refurbishment / closures</li></ul>
<b>Other costs savings</b>	<ul style="list-style-type: none"><li>• Reduction of G&amp;A</li><li>• Optimisation of workforce</li><li>• Elimination of duplicate costs and processes</li></ul>	<ul style="list-style-type: none"><li>• Costs associated with rationalisation of processes and removing duplications</li><li>• Costs associated with optimisation of workforce and subcontracting</li></ul>

### 3 Network/IT: large savings from combining existing 2G and 3G networks and jointly extending 3G network coverage

#### 2G network

#### 3G network (co-sited with 2G)



- One single network with ~20% fewer stations and ~35% fewer sites than standalone scenario
- Best sites retained for improved coverage and quality of service
- Progressive sharing of backhaul, backbone and core

### 3 Network/IT: substantial radio access and core network synergies

**Significant synergies** are achievable given that **partners have compatible:**

- Spectrum holdings
- Network architecture
- 2G/3G coverage
- Rollout plans
- Voice/data traffic profile
- Requirements for additional spectrum

#### Opex savings

- Fewer radio sites in combined network
  - Reduced rental expenses
  - Better leverage to negotiate site locations and rental fees
  - More opportunities for co-siting (reuse of existing sites)
  - Reduced operations and maintenance expenses through better use of field staff

**Annual Run-rate opex savings (from 2014)**  
**£145m**

#### Capex savings

- Network sharing results in shared costs for 2G and 3G coverage and capacity extension
  - Radio access
  - Backhaul
  - Backbone
  - Core network

**Annual Run-rate capex savings (from 2015)**  
**£100m**

# 3 Distribution/Marketing: Gradual integration

## Transition period (2010-2011)

### Initial co-existence of two strong brands ...



- Both brands are maintained separately for a period of 18 months after closing
- Initial co-existence mitigates churn
- Period for management to assess both operations and review branding alternatives

### ... and progressive convergence of marketing activities

**Proactive activities to enhance loyalty**

**Intensify dialogue with independent distributors**

**Coordinate marketing actions & product offerings to reduce cannibalisation**

**Leverage broadband product**

## Integrated branding strategy (from 2012)

### Roll-out of branding strategy in H1 2012...

- Decision on branding strategy will be made in H2 2011 for implementation in H1 2012
  - JV management to make recommendation on branding strategy
  - Shareholders will decide the branding strategy

### ... allowing full integration of marketing and distribution activities

- More effective marketing spend
- Restructuring of own shops network to create the most powerful distribution network in the UK among the mobile network operators
  - Largest network, with all shops rebranded in line with new brand strategy
  - Highest quality network: best locations, best store formats
- Scope for deeper relationships with independent distributors

### 3 Distribution/Marketing: Improved distribution platform and more efficient commercial spend

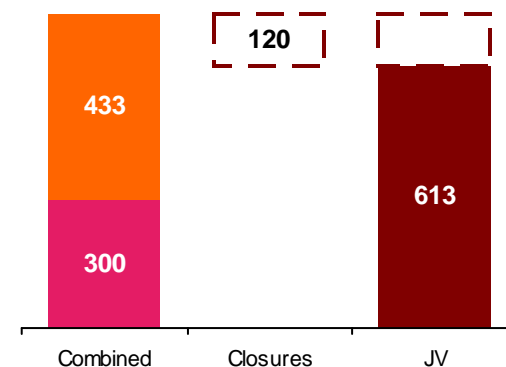
#### Distribution network strengthened by integrating best store formats & locations

- Significant rationalisation of overlap in premium locations
  - Savings of c. £35m per year
- Reduction in distribution costs through increased share of distribution of own shops
  - Increased scale and quality of own shops network
  - Savings of c. £50m per year
- Implementation costs of c. £65m to be spread over 2012-2013 period
  - Closed shops: termination costs
  - Retained shops: refurbishment costs

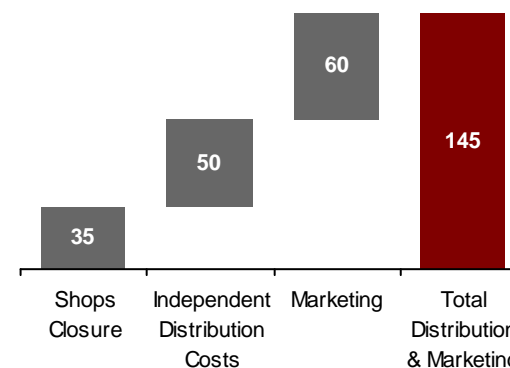
#### Significant savings in marketing costs

- During integration phase: cost reductions due to combined negotiating power for buying advertising space and rationalisation of marketing costs
- Post decision on branding strategy: reduction of c. 30% of combined marketing costs (c. £40m in 2012 and c. £60m per year from 2014)

#### Own shops network<sup>1</sup>



#### Annual Run-rate synergy breakdown<sup>2</sup>



<sup>1</sup> Estimated 2009 shops

<sup>2</sup> Run-rate opex post 2014

### 3 JV strategic direction and future ambition – become the #1 for customer experience in the UK

#### Network & IT

##### Direction

- Implement one network platform & deliver network synergies
- Continued progressive migration of 2G traffic to 3G
- Network JV with 3UK maintained to deliver attractive savings from 3G site sharing
- Demand driven LTE strategy incremental to 3G deployment

##### Ambition

- **Become #1 in network quality of service**
  - A powerful driver for reinforcing customer attraction and retention
- **Become #1 in efficiency**
  - Ensure highest network efficiency amongst MNOs in the UK

#### Marketing & Distribution

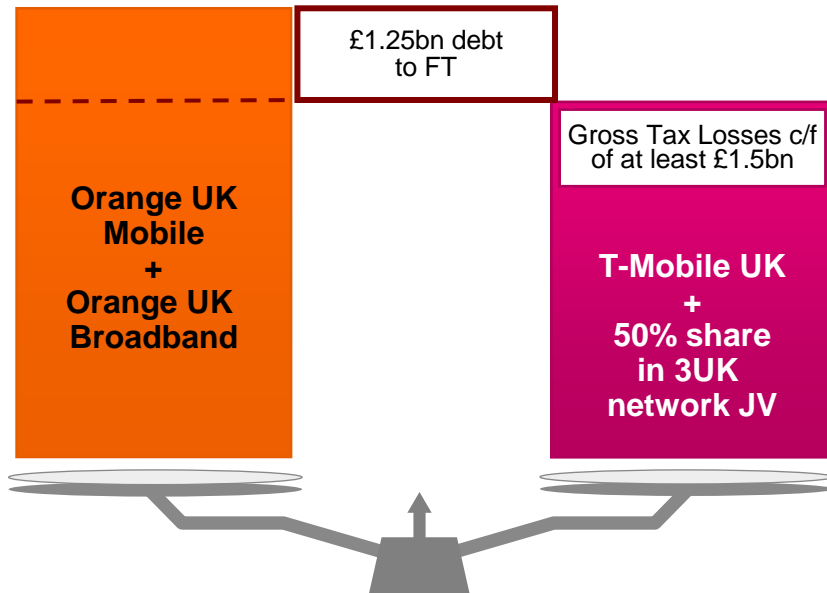
- Exploit marketing synergies
- Maximize direct channel strategy
- Optimize SRCs and SACs
- Deepen relationships with indirect distribution partners
- Leverage online & customer service sales capabilities

- **Become #1 for sales and services on the high street**
  - Optimizing the balance between direct and indirect distribution
  - Key factor for improving EBITDA margin
- **To retain #1 position in wholesale**
- **Become #1 for customer service**
  - Improve customer lifetime by creating loyal happy customers

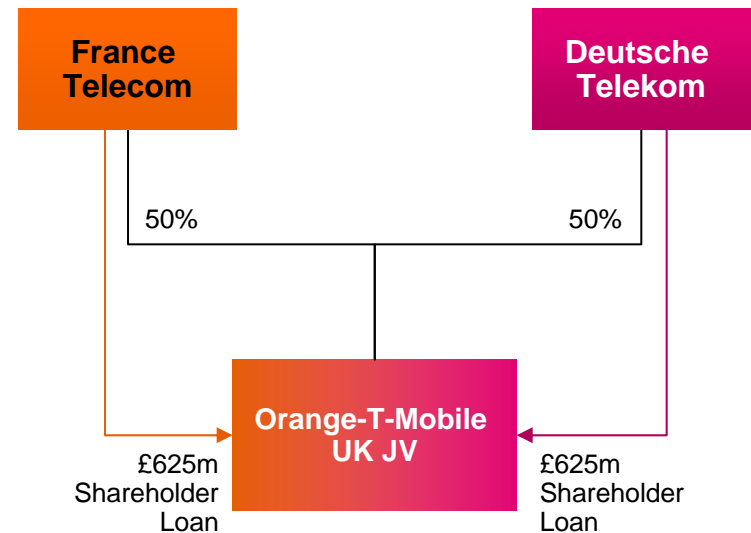
Creating a winning environment for our people

# Transaction structure designed to achieve 50/50 JV

## Balanced contributions to JV



## Post closing structure



### Step 1: Contributions to JV

- France Telecom contributes Orange UK Mobile and Orange UK Broadband with intra-group net debt of £1.25bn
- Deutsche Telekom contributes T-Mobile UK, including its 50% stake in the network JV with 3UK, on a cash free and debt free basis

### Step 2: Partial reimbursement of debt to France Telecom

- Immediately after closing, Deutsche Telekom grants a £625m shareholder loan to JV
- Simultaneously, JV reimburses £625m to France Telecom

### Post closing:

- JV indebtedness of £1.25bn
- Represented by two equal shareholder loans of £625m each, borne by each of the two parent companies



# Key governance principles – joint control and streamlined decision making

## Board of directors

- Equal representation from France Telecom and Deutsche Telekom
  - 2 representatives from France Telecom, 2 representatives from Deutsche Telekom
  - 2 executive directors (CEO and COO)
- Deutsche Telekom nominates first Chairman of the Board

## Key management functions

- All appointments according to principle of “best person for the job”
- CEO: Tom Alexander
- COO: Richard Moat

## Stability and long term commitment

- Shareholders’ interests aligned in all respects
- Governance designed to create a stable, long term ownership structure

## Operational autonomy awarded to JV

- Governance designed to allow management to focus on operations
- Extensive operational decision making with JV management

## Dividend policy

- Maximum cash flows to be channeled to the parent companies
- Distribution of 90% of cash flow to shareholders

## 4 Pro forma impact – France Telecom

### Key principles

- Orange UK will be accounted for as discontinued operations by signing at the latest
- After closing, the JV will be accounted for using the equity method
  - Deconsolidation of UK operations increases Group EBITDA margin
- Current guidance of €8.0bn of Organic Cash Flow for 2009 unchanged
- France Telecom Organic Cash Flow will include contribution from JV through payment of dividends
- Transaction reduces group indebtedness by £625m at closing; no impact on leverage ratios

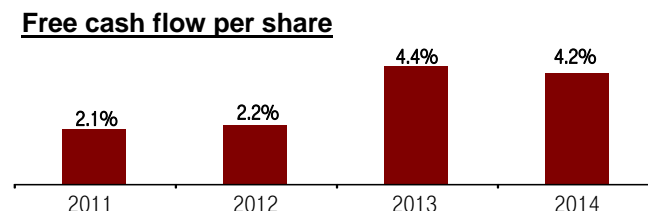
### Financial impact

#### Impact on Key Financial Metrics

	2008A	2008 Pro Forma
Revenues	€53.5bn	€47.6bn
EBITDA <sup>1</sup>	€19.4bn	€18.4bn
EBITDA Margin <sup>1</sup>	36.3%	38.6%
Capex	€6.9bn	€6.4bn
Capex as % of Revenue	12.8%	13.5%
Net Debt	€35.9bn	€35.1bn
Net Debt/EBITDA	1.85x	1.91x

#### EPS and FCF per Share Accretion<sup>2</sup>

- EPS accretion from 1<sup>st</sup> full year of operation (2011)
  - c. 4% accretion by 2014
- Free cash flow per share accretive from 2010



<sup>1</sup> Assuming, on a preliminary basis, that the share in the JV net income will be incorporated in group EBITDA. Assuming transaction closing in H1 2010

<sup>2</sup> Based on Broker consensus estimates. Estimates factor in JV integration costs, but exclude any potential effect from one-off transaction-related accounting impacts and from Purchase Price Accounting. 18

# 4 Pro forma impact – Deutsche Telekom

## Key principles

- T-Mobile UK will be accounted for as discontinued operations by signing at the latest
- After closing, the JV will be accounted for using the equity method
  - Deconsolidation of UK operations increases Group EBITDA margin
  - Share in JV net income will be shown as financial income
- Current full year 2009 guidance unchanged
- Future net debt positively impacted by free cash flow distribution from JV
- Shareholder loan from DT to JV (£625m) is net debt neutral

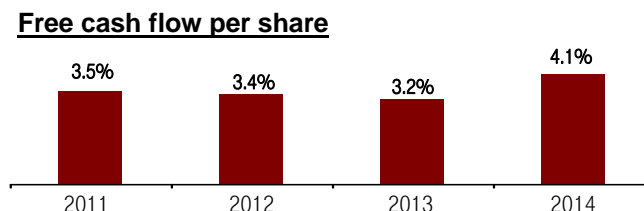
## Financial impact

### Impact on Key Financial Metrics

	2008A	2008 Pro Forma
Revenues	€61.7bn	€57.6bn
EBITDA	€19.5bn	€18.6 bn
EBITDA Margin	31.6%	32.2%
Capex	€3.7bn	€3.3bn
Capex as % of Revenue	14.1%	14.5%
Net Debt	€38.2bn	€38.2bn
Net Debt/EBITDA	1.96x	2.05x

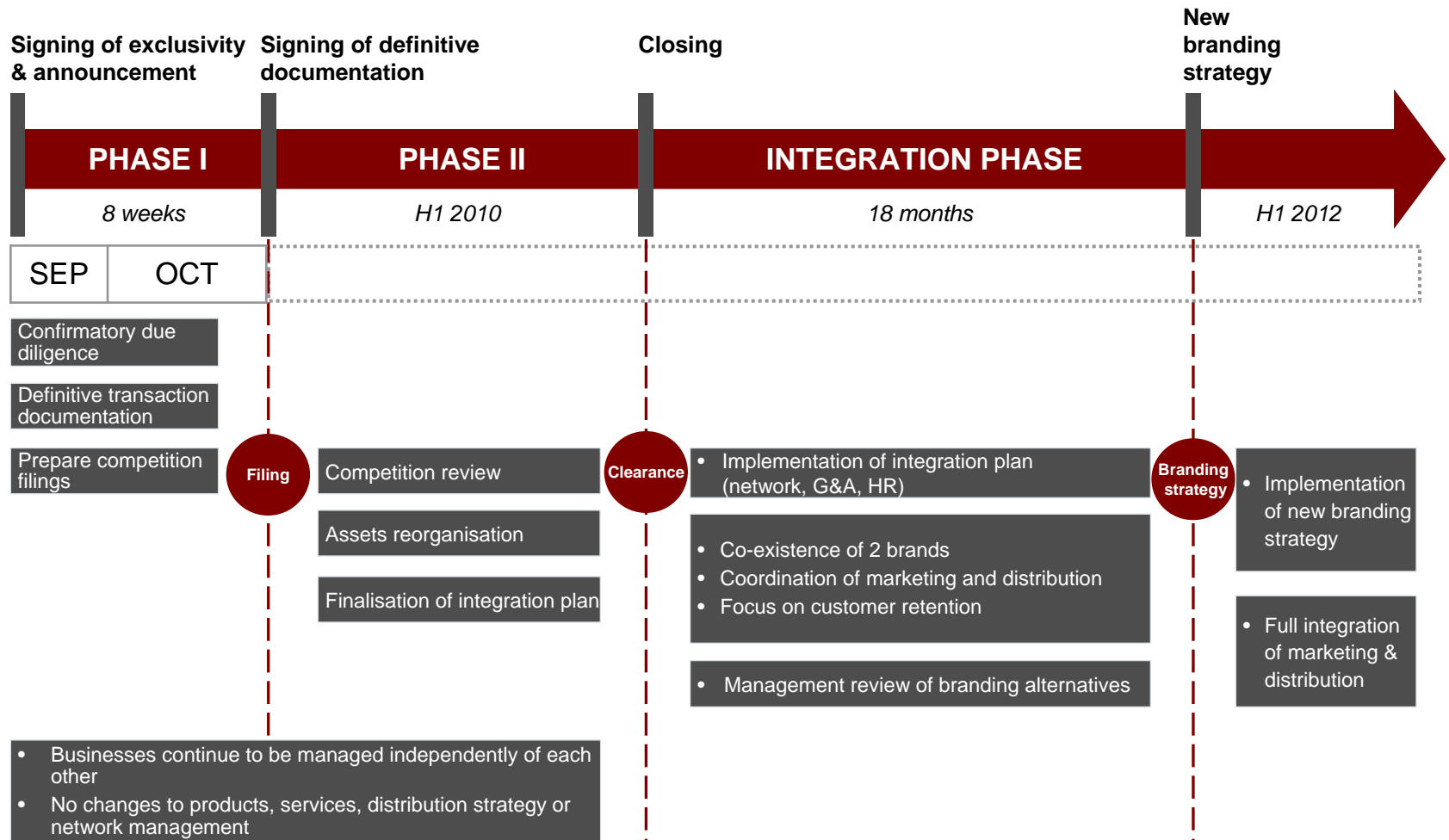
### EPS and FCF per Share Accretion<sup>1</sup>

- Double digit EPS accretion from 1<sup>st</sup> full year of operation (2011)
  - c. 11% accretion by 2014
- Free cash flow per share accretive from 2010



<sup>1</sup> Based on Broker consensus estimates. Estimates factor in JV integration costs, but exclude any potential effect from one-off transaction-related accounting impacts and from Purchase Price Accounting. Assuming transaction closing in H1 2010

# Expected transaction timetable



# Summary: Creating a new mobile champion in the UK

- ✓ Clear market leader with pro forma subscriber market share of 37%
- ✓ World class management team committed to deliver #1 market profitability
- ✓ Significant benefits and the most innovative services for UK consumers
- ✓ Best 2G and 3G networks
- ✓ Significant value creation due to synergies with an NPV of £3.5bn
- ✓ EPS accretive from first full year of JV operation (2011)
- ✓ Free cash flow per share accretive from 2010
- ✓ Distribution of 90% of the JV's free cash flow to its shareholders