Restructure in the Telco and Media industry – wrong time for "business as usual"

Conference Presentation

Vienna, June 27, 2017

The telco sector has to restructure – a challenging journey but with an enormous value creation potential

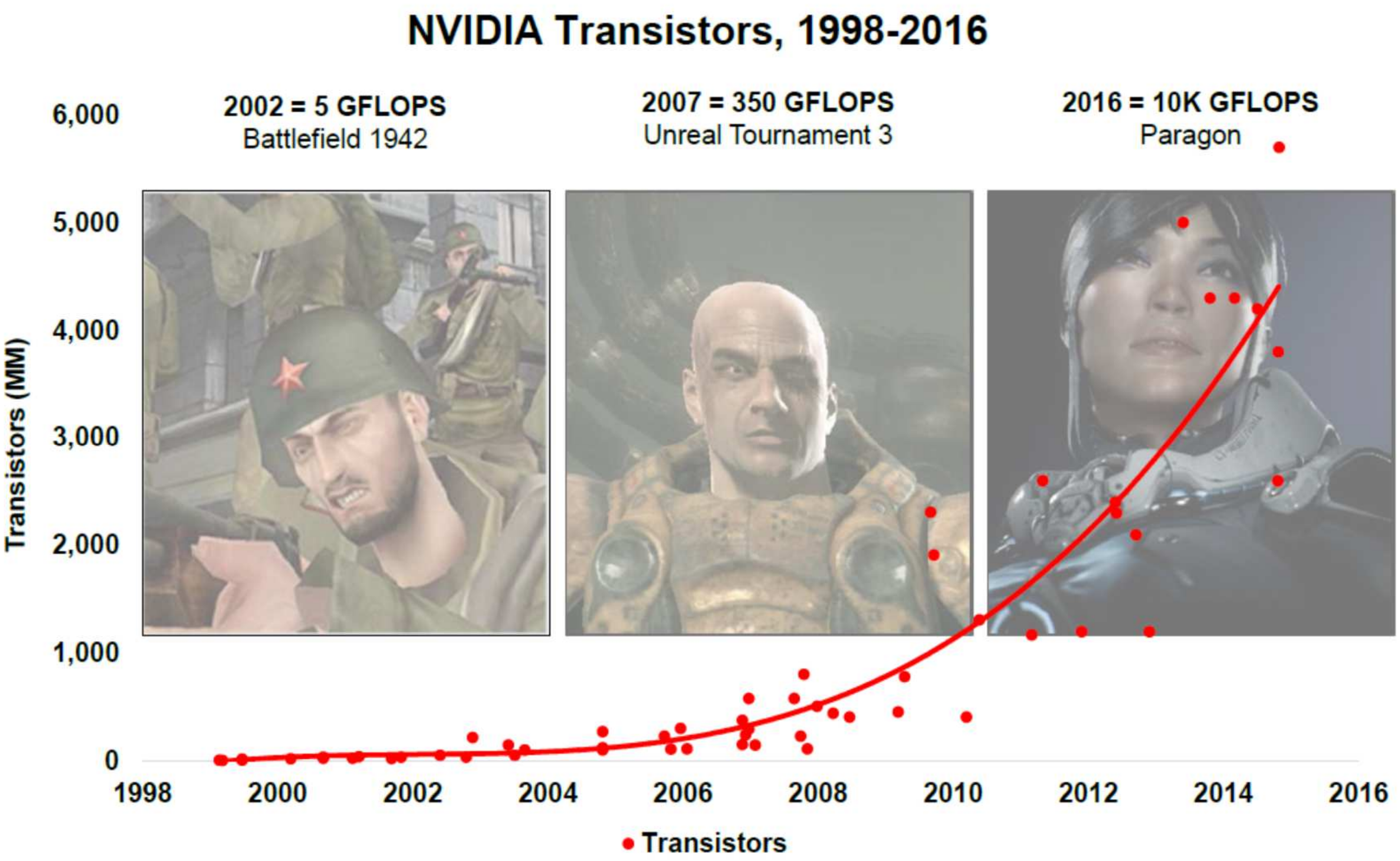
Abstract

- **Dramatic need for restructuring - Old paradigms do not prevail anymore**
- **Now : customers enjoy better, more innovative services from digital players**
- **For telcos: Costs are exploding, but returns are not**
- **Operators have to re-invent themselves: either as a lean data transportation company, or they participate in the competition for customers**
- **Irrespective of the option: operating model of the past does not fit. OM needs to be leaner, more agile, more customer centric, more digital**
- **Not every telco player can do this - some will! With better digital services, better customer experience, generating good returns**
- **Public telcos are disadvantaged, not being listed is a virtue and brings rigor for: (1) Digitizing the core operations (covering factory as well as customer interface), (2) Winning market share by superior marketing (learning from the un-carrier success), (3) Tapping into digital revenue streams**
- **No question this can be done - market leaders show the path**
- **Following is possible within 3-4 years: (1) Up to 50% lower Opex, (2) Traditional revenue increase of 20-30%, (3) Digital revenue share of 20-30% on top**

Source: AlixPartners

The root cause for the digital revolution is the persistence of Moore's law: GPU processing power ramp continues

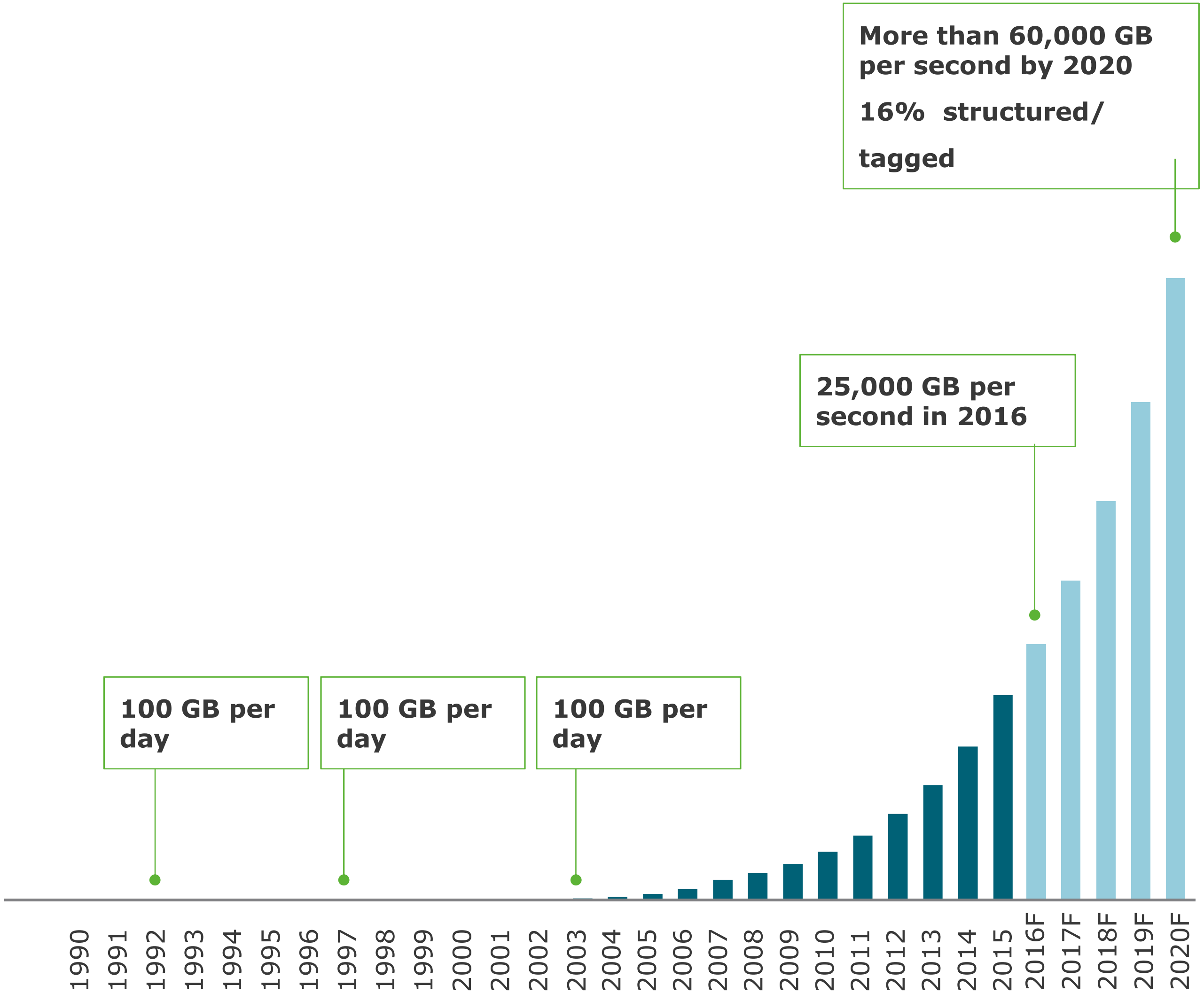
Example



Source: NVIDIA
Note: 1 GFLOP = 1B FLOPS, or "floating point operations per second."

Hence, exponential growth in data traffic shows no sign of abating – in fact it is set to grow in multiples to 2020

Global internet traffic (in GB per second)



By 2020

60 terabytes of data per second
… via fixed and mobile networks

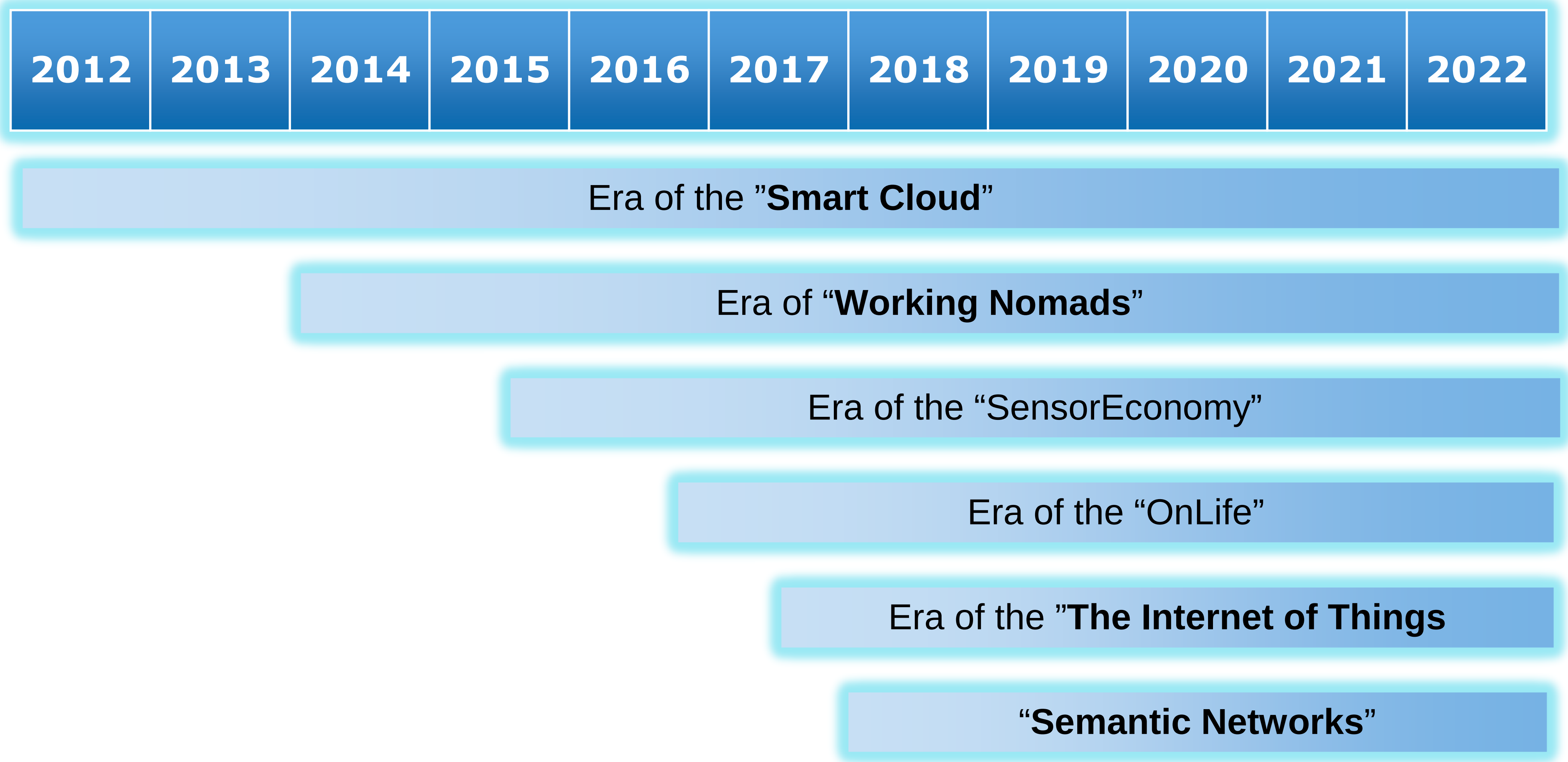
10x more mobile data
… compared to current levels

25 billion connected things
… a 5-fold increase from today

Source: Cisco

Exponential growth leads to an acceleration of new business realities –paradigms are not stable

Acceleration of Paradigm Shifts



Companies cannot afford to optimize over years

Correspondingly, value creation happens within the US/Chinese Tech-Hardware/Software/Internet scene – not within telco

Rank	Company	Region	Industry Segment	Current Market Value ($B)	2016 Revenue ($B)
1	Apple	USA	Tech – Hardware	$801	$218
2	Google / Alphabet	USA	Tech – Internet	680	90
3	Microsoft	USA	Tech – Software	540	86
4	Amazon	USA	Tech – Internet	476	136
5	Facebook	USA	Tech – Internet	441	28
6	Berkshire Hathaway	USA	Financial Services	409	215
7	Exxon Mobil	USA	Energy	346	198
8	Johnson & Johnson	USA	Healthcare	342	72
9	Tencent	China	Tech – Internet	335	22
10	Alibaba	China	Tech – Internet	314	21
11	JP Morgan Chase	USA	Financial Services	303	90
12	ICBC	China	Financial Services	264	85
13	Nestlé	Switzerland	Food / Beverages	263	88
14	Wells Fargo	USA	Financial Services	262	85
15	Samsung Electronics	Korea	Tech – Hardware	259	168
16	General Electric	USA	Industrial	238	120
17	Wal-Mart	USA	Retail	237	486
18	AT&T	USA	Telecom	234	164
19	Roche	Switzerland	Healthcare	233	51
20	Bank of America	USA	Financial Services	231	80
Total				$7,207	$2,497

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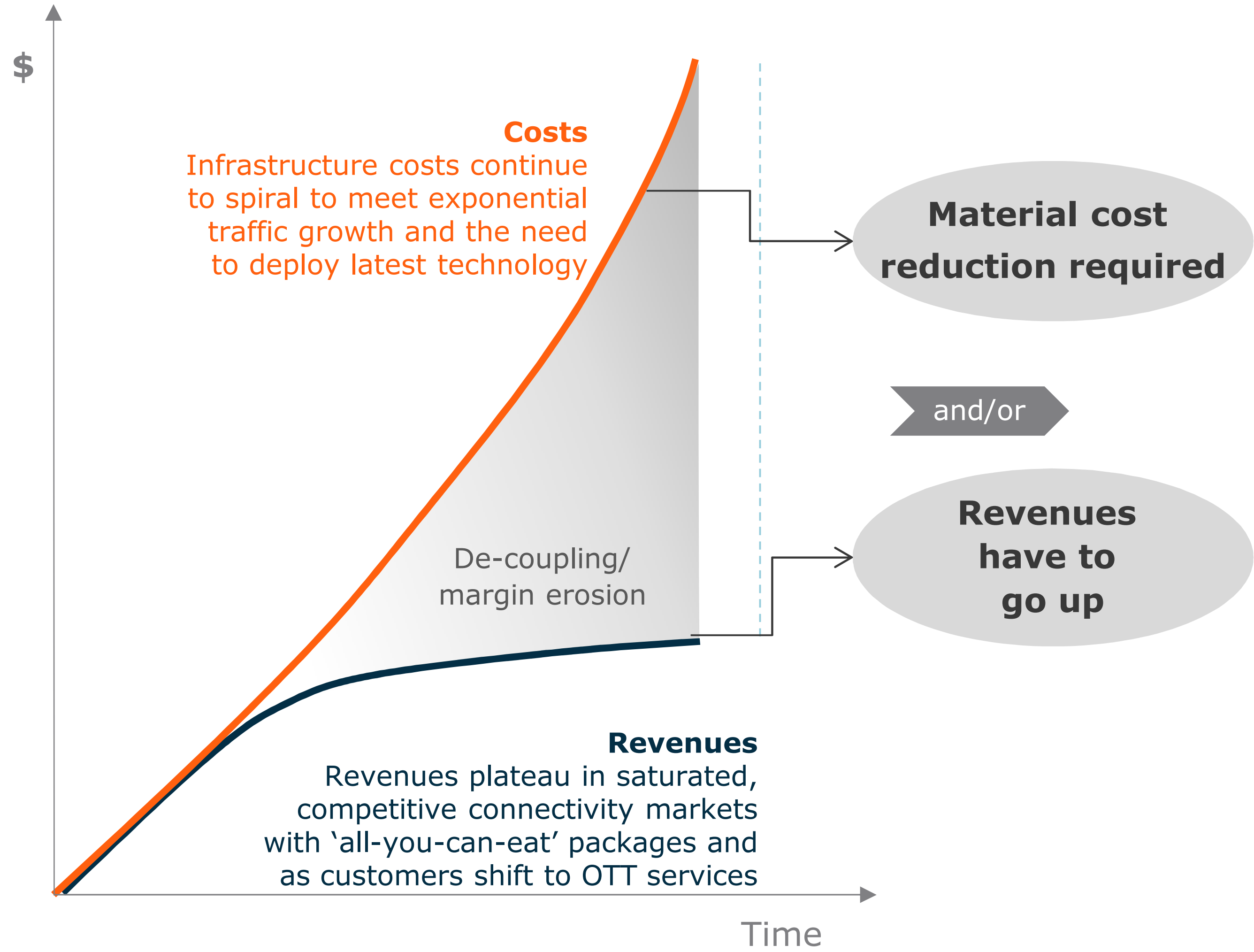
Source: CapIQ. Market value data as of 5/26/17
Note: For public companies, colors denote current market value relative to Y/Y market value. Green = higher, red = lower.

Why do telcos not benefit from the data explosion?

Source: AlixPartners

Why do telcos not benefit from the data explosion? It is the operator paradox: costs go up, revenues are flat

The network operator paradox



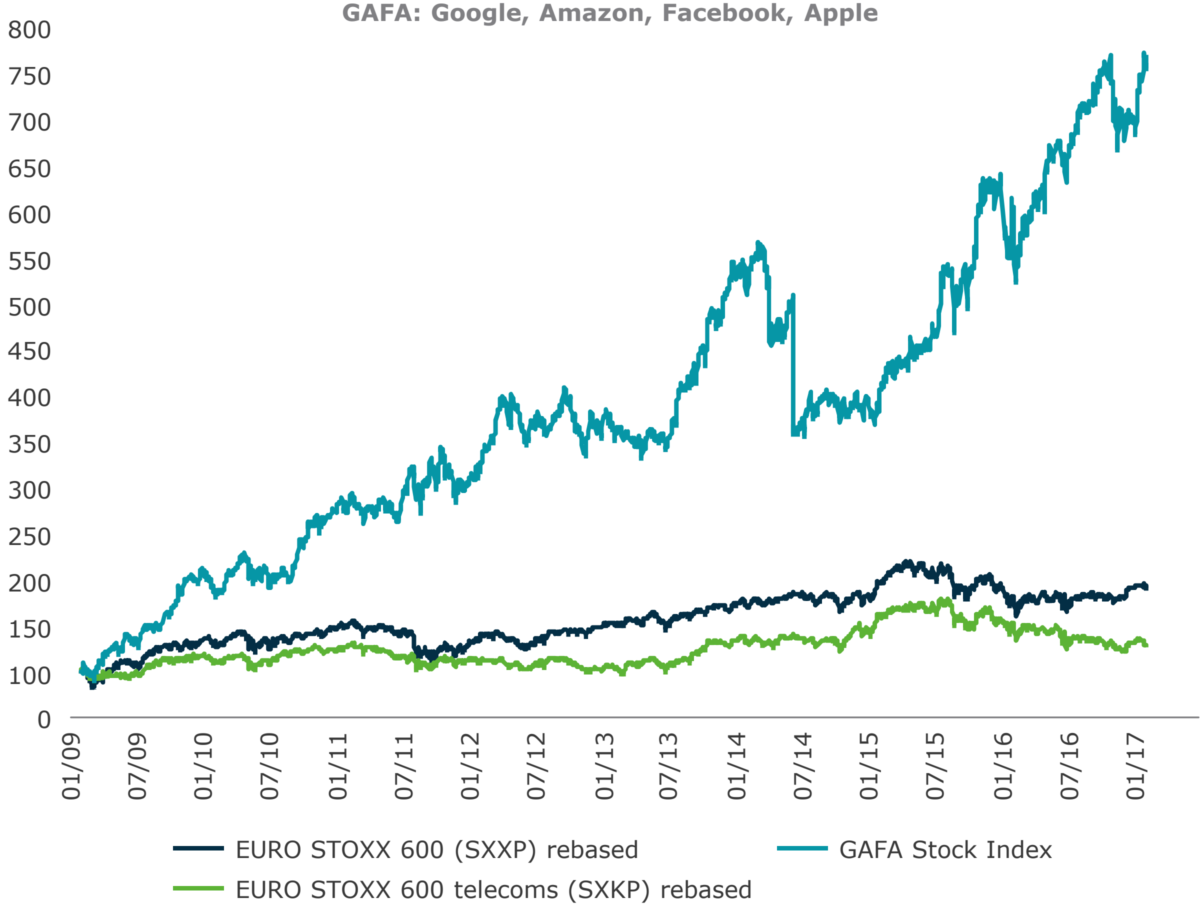
Source: AlixPartners

Investors are not favouring telco stocks – no wonder, as growth is in the "GAFA segment"

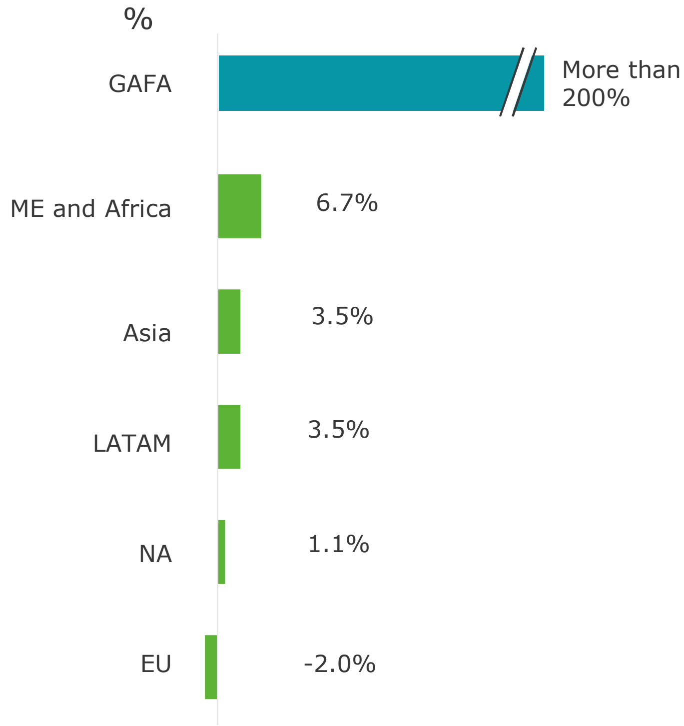
Telco stocks performance versus GAFA

EURO STOXX and EURO STOXX 600 telecom price evolution post the 2008 crisis

GAFA: Google, Amazon, Facebook, Apple



Revenue change 2011 to 2015

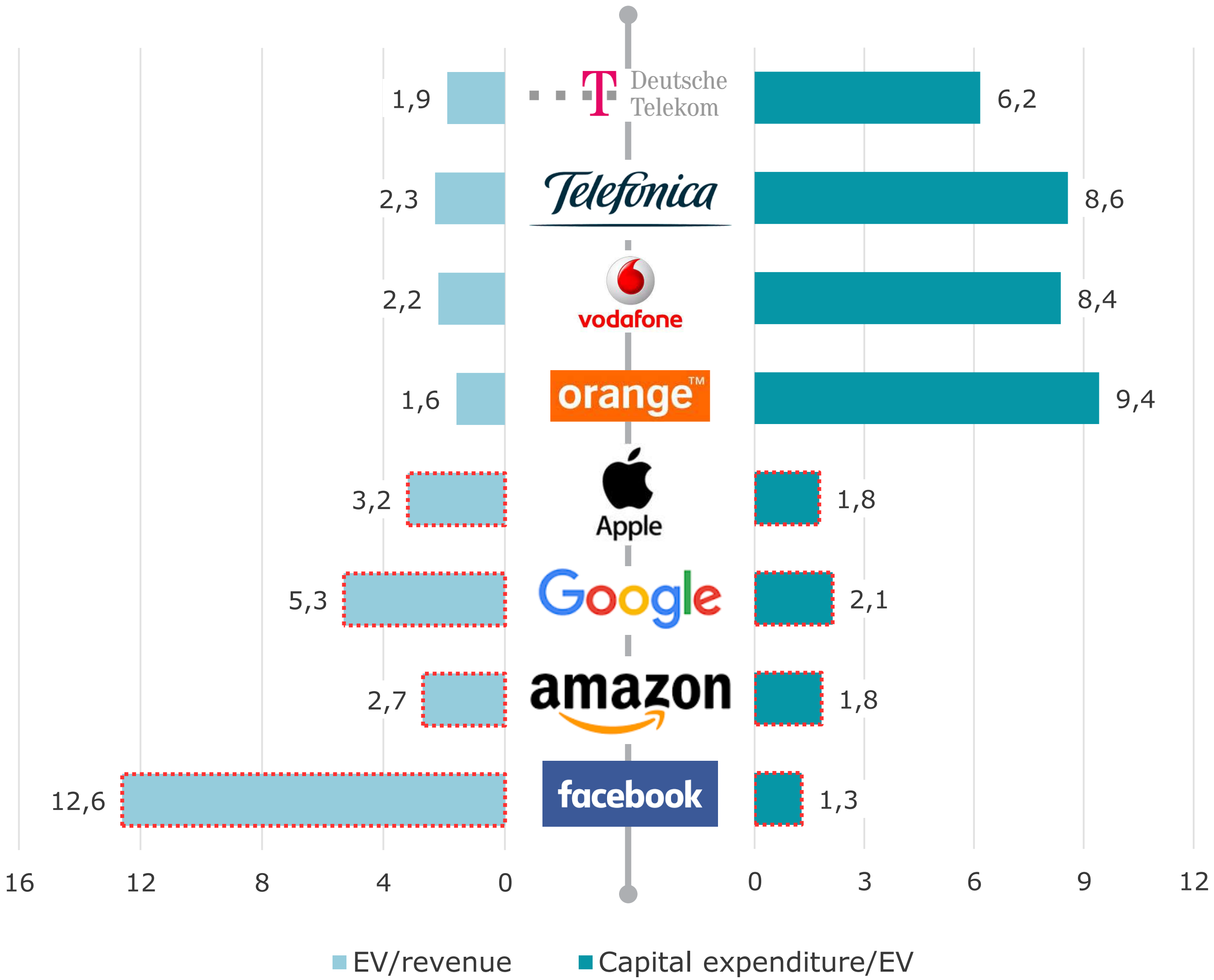


NOTE: Indexes rebased to be 100 on the 09/03/2009 (Market Bottom post financial crisis of 2007/2008);
Source: Bloomberg, statista, company reports, Citybank, AlixPartners analysis

As a consequence, investors are shying away to finance future networks but it is clear, future investment is essential

EV/Revenues (multiple)

Capital (% of EV)



Investment need is evident

A large scale FTTP programme would cost billions on top of that already invested in FTTC by DT

One kilometre of glass fibre costs approximately €70,000

Nearly $48 billion will be spent globally in the next 10 years upgrading the LTE network

Forecast for building and deploying 5G networks will cost $56 billion in addition to LTE upgrades

Source: Capital IQ, AlixPartners

We are seeing more and more telcos pursuing structural cost reduction

Telco cost cutting announcements


EDITION: UNITED KINGDOM

REUTERS

Business Markets World UK Tech Money Commentary Breakingviews Sport Life

BUSINESS NEWS | Fri Oct 17, 2014 | 12:51pm BST

Telefonica Deutschland to cut 18 percent of workforce by 2018

German telecoms operator Telefonica Deutschland O2Dn.DE said it would cut 18 percent of full-time jobs to help to achieve cost savings from its takeover of rival E-Plus.

Confirming an earlier report by Reuters Telefonica Deutschland said on Friday it planned to scrap 1,600 jobs out of a total of 9,100 by 2018.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TDC restructures management

08 December 2015

TDC's restructuring will create three Danish retail business units that will each be responsible for product development, sales, marketing and customer service

Read more: TDC retail business restructuring management

Danish operator TDC is to reorganise parts of its Danish operations in a move aimed at delivering better customer experience in the market.

The restructuring will create three Danish retail business units which will each have complete responsibility for product development, sales, marketing and customer service.


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TECH

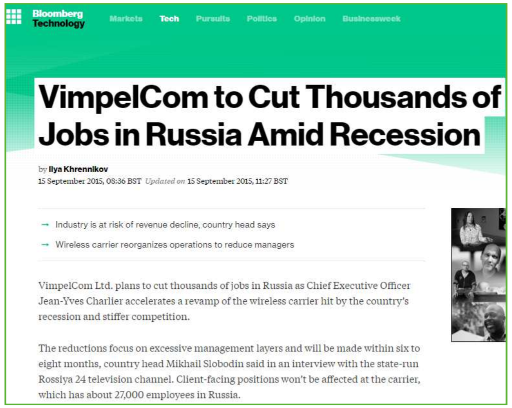
Deutsche Telekom Considers Restructuring Eastern European Operations

Strategy Discussion to Take Place Next Week

By EYK HENNING And ARCHIBALD PREUSCHAT

Updated Aug. 29, 2013 2:42 p.m. ET

Germany's Deutsche Telekom AG is working on an overhaul of its Eastern European activities, according to people familiar with the company's thinking, as a new chief executive is expected to take over by year's end.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VimpelCom to Cut Thousands of Jobs in Russia Amid Recession

by Ilya Khrennikov

15 September 2015, 08:36 BST *Updated on* 15 September 2015, 11:27 BST

→ Industry is at risk of revenue decline, country head says

→ Wireless carrier reorganizes operations to reduce managers

VimpelCom Ltd. plans to cut thousands of jobs in Russia as Chief Executive Officer Jean-Yves Charlier accelerates a revamp of the wireless carrier hit by the country's recession and stiffer competition.

The reductions focus on excessive management layers and will be made within six to eight months, country head Mikhail Slobodin said in an interview with the state-run Rossiya 24 television channel. Client-facing positions won't be affected at the carrier, which has about 27,000 employees in Russia.


KPN tweaks corporate strategy in favour of further cost savings

Written by Scott Bicheno | 07 March 2016 @ 16:53

Dutch telco KPN told its capital markets day that it plans to embark on a second wave of cost savings, which should amount to at least €300 million by the end of 2019.

As public companies are inclined to do, KPN's existing corporate strategy has a special name: Strengthen – Simplify – Grow. This new plan also has a new name, presumably to symbolise its evolution from the previous one.


Eircom to cut costs by up to €80m over the next three years

Paul O'Donoghue

PUBLISHED 19/05/2015 | 02:30

SHARE

Chief executive Richard Moat, pictured at the company's Dublin headquarters, said Eircom has 'turned a corner'

Eircom is to shave €60m to €80m off its operating costs over the next three years, as CEO Richard Moat hailed the firm for "turning a corner".


Telecom Italia Raises Cost-Cut Target to $1.8 Billion by 2018

by Daniele Lepido

13 May 2016, 21:33 BST

→ The savings will come from operational costs, capital spending

→ First-quarter Ebitda slides 16 percent, sales drop 12 percent

Telecom Italia SpA, Italy's largest phone company, almost tripled its target for reducing expenses to 1.6 billion euros ($1.8 billion) by 2018 in a move pushed by new Chief Executive Officer Flavio Cattaneo, who aims to improve profitability at the former state-owned carrier.

The cuts will include 800 million euros in operating costs and 800 million euros in capital


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Business

BT to shut EE headquarters in cost-cutting drive

Marc Allera, chief executive of EE, is planning the company's move out its current headquarters in paddington

How AI could double a country's growth rate

Discover why artificial intelligence has the potential to grow the economy of 12 developed countries by 2035 Read more

Sponsored

By Christopher Williams, CHIEF BUSINESS CORRESPONDENT

3 JUNE 2016 • 7:00PM

Britain's biggest mobile operator, EE, will abandon its headquarters to move into BT's nerve centre at St Paul's later this year, its chief executive has confirmed.

Marc Allera told The Telegraph that EE was making preparations to move from its offices in the Paddington Basin to occupy multiple floors in BT Centre, overlooking Sir Christopher Wren's masterpiece cathedral.

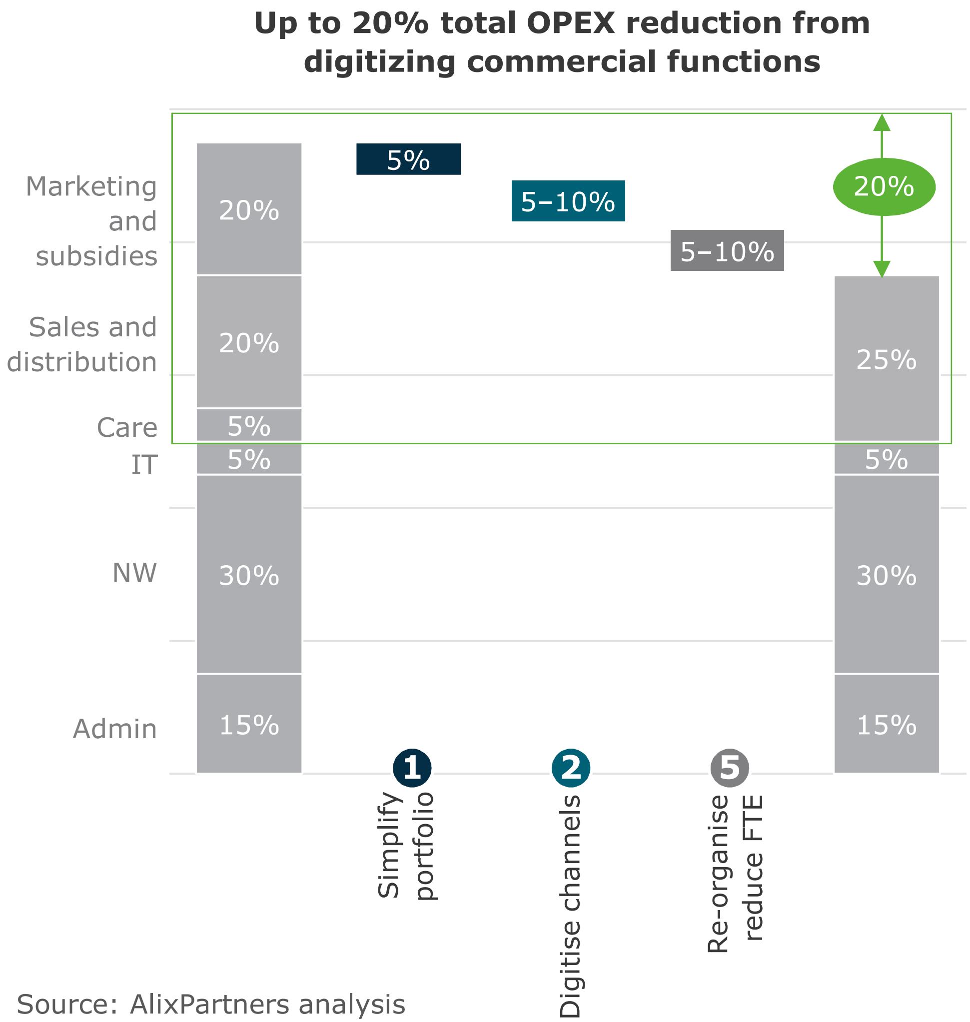
The migration is at the heart of plans by BT to save £360m a year following the completion of its £12.5bn takeover of EE and its 13,000 staff, in February. Mr Allera, promoted from EE's commercial chief to the top job as part of the integration, said it would also help the two operators design 'converged' packages of broadband, mobile and television services under the same roof.

Source: Press

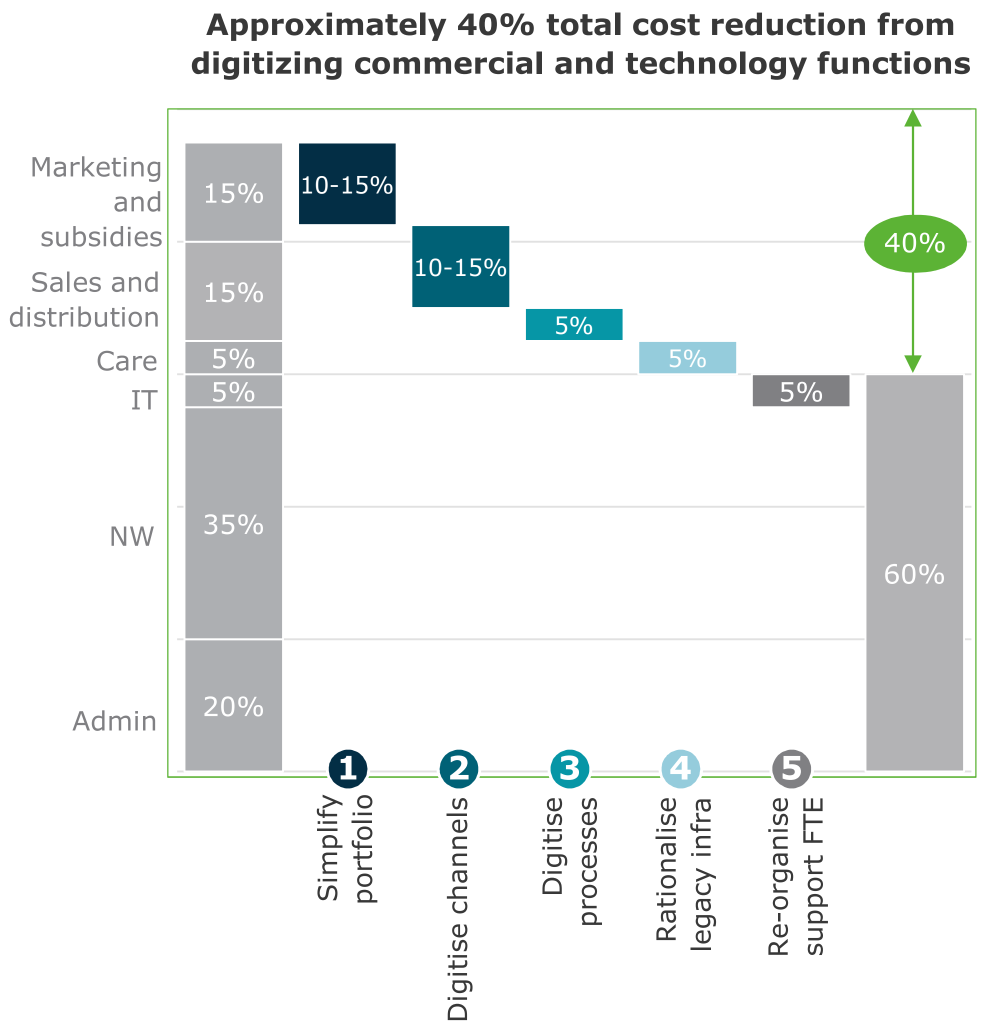
Some carriers have already lowered the cost base substantially – even -50% is possible

Telco cost base transformation: the opportunity

Case study 1: US mobile operator



Case study 2: European mobile operator

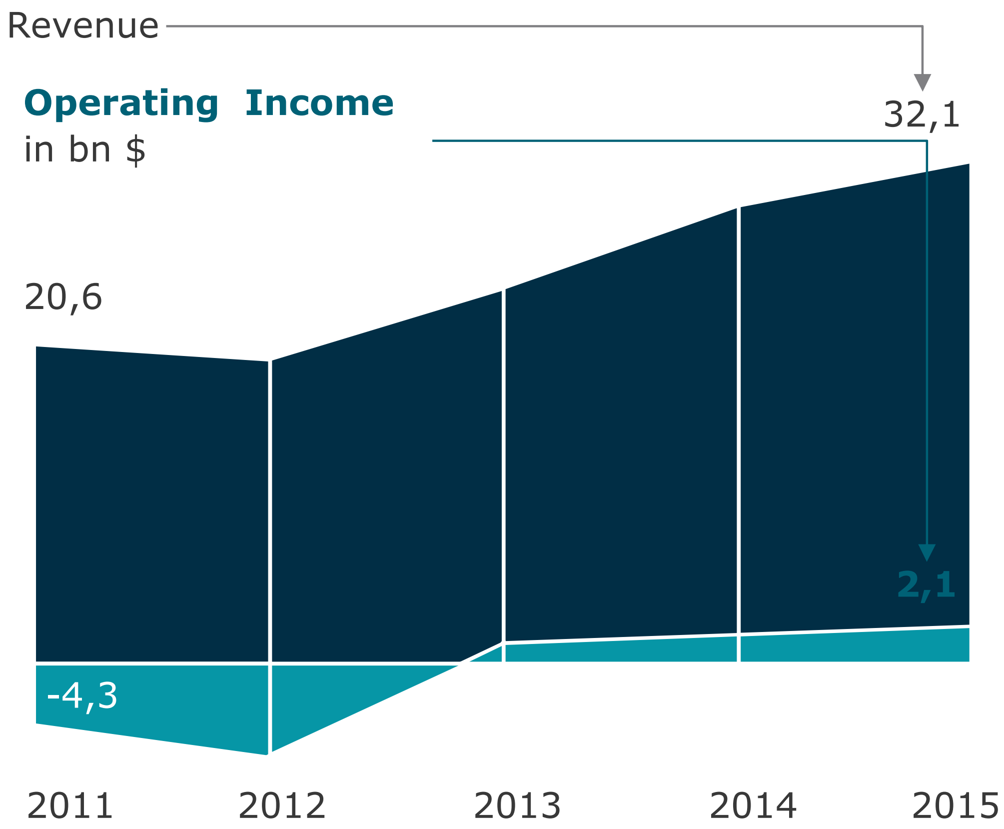


Source: AlixPartners analysis

However, aggressive marketing in a commodity market can make a huge difference – a typical weakness in the telco industry

The Un-carrier success of T-Mobile in the US

Financial Performance of the Un-Carrier Strategy



Key Elements of the Un-Carrier Strategy

- Creating a new market reputation that is anti-telco
  - By leveraging celebrieties‵ brand values
  - By surfacing incumbents unfair and mediocre services via an aggressive communication strategy
  - By taking no business paradigm for granted
- Changing the traditional marketing thinking by introducing new products/tarif schemes
  - Simple choice – no service contracts
  - Upgrades for All
  - Simple Global
  - Carrier Freedom
  - Binge On
- Direct communication to customers by extensive use of social media
- Focus on superior and fair customer service

Content moves will be another way to change the rule of the game – bringing media and telco closer together

SFR Content Moves

SFR, the French telco group owned by global giant Altice, is **ramping up its investment in French content**, leveraging SFR's international presence — notably in the U.S. via Cablevision —to export French cinema and series abroad. However, under the current regulation, SVOD services like SFR's Zive (and also Netflix) can't have access to first-run movies even if it co-finances or co-produces them.

"I'm ready to finance French content. What we've started doing modestly with sports (launching sports channels, buying sports rights) we want to start doing with French series and films,"

"Subscribers want local content, on top of international content. In order to rival against services like Netflix which have a global strategy, **SFR is opting to become a multi-local player and invest in homegrown content wherever we're established**."

Michel Combes, CEO SFR

Telefonica Spain Content Moves

Telefónica's **content investment is fueling its convergence strategy.** The Spanish market is dominated by multi-play.This triggered Telefónica Spain to increase investment in local content to boost its TV business.

It plans **to invest €70m** (about $75m) to produce 14 original Spanish drama series over the next two years. The Spanish business is built around convergence offerings sold under the company's Movistar Fusión brand. Its **purchase of pay TV operator Canal Plus** in 2014 fueled this strategy. There was a recent slowdown in sales of its TV product, however. Between June and September 2016, Telefónica's pay TV customer base declined by 44,000 due to a price increase in the bundled service offering and for the stand-alone TV service. But Telefónica remains committed to TV and multi-play, and its ambition is **to be the largest producer of Spanish TV content globally**.

Source: 451 Research

Tengo FUSIÓN+

Many telcos extend their FMC activities by introducing multi-play content bundles – see also BT's sports rights acquisition…

BT's acquisition of TV sports rights aims to target key household individuals through bundling

Case Study: BT Sport

Rationale

- **Growing customer demand for triple play offers…**
- **…sport rights seen as key factor to win/retain customers against competition**
- Live football as a **key way to attract pay TV subscribers**

Business Model

BT Sport venture launched in summer 2013

- **Annual £550m investment in Premier League and European football** – £740m for share of Premier League rights for three seasons and £900m for Champions League and Europa League rights
- **Free subscriptions to sport channels** with selected internet connections – targeting men in the household for their BB products
- **Additional revenue streams:** Extra charge for European soccer and live TV in pubs/clubs, plus extra advertising income

Synergies

- Success in supporting core business (BB, fibre, fixed voice) **via bundling of sport content,** either for free or as premium **triple play bundles**

TV + Infinity 2 + Calls
(Available in the UK)

$ 79.18/m
(18 month contract)

Fixed Voice	***Mobile***	***TV***	***Fixed Data***
Unlimited landline weekend calls	*N/A*	*Free BT Sport*	*Unlimited usage Up to 76 Mb/s*

Initial Results

- **~5m subscribers of BT Sport** (9 months after launch)
- **+179k BB subscribers in Q1 2014 (+3%)**
- **Smallest drop in landlines in five years**
- **B2C sales +4% in 2013**
- **Positive impact on customer perception of BT** ('created a buzz')

Sources: BT releases; Press; Expert interviews;

Telco operators can generate a digital revenue stream in two fundamentally different plays

Digital telco archetypes

	Connectivity Play	Enabler/Platform Play	Experience/Service Play
Market positioning	Efficient provider of secure, reliable connectivity bundles	Enable seamless access to an array of ICT/digital services	Comprehensive best-in-class digital service provider
Sector focus	• Primarily B2C • Focus on value-seekers	• Mass market • Scalable B2C and B2B	• All sectors • Focus on high-spenders
Product and service mix	100% Connectivity	Services; 80% Connectivity	Services; 60% Connectivity
Innovation level	• Minimal/defocus • Selected partners only	• Enabling focus • Broad partner approach • Digital revenue share. 10%	• Leading-edge innovation • Proprietary and partners • Digital revenue share. 30%
Financial metrics	30%+ EBITDA	20 to 40%+ EBITDA	Approximately 20% EBITDA
Example operators	TELE2, 3	TDC, Deutsche Telekom	SK telecom, NTT docomo
		Digital Plays	

Source: AlixPartners

But is the integrated telco model combining network and customer business fit-for-purpose? Most likely not…

Telecom operators are composed of two businesses with different dynamics

1 ServCo

Trading & Customer relationship management

+

2 NetCo

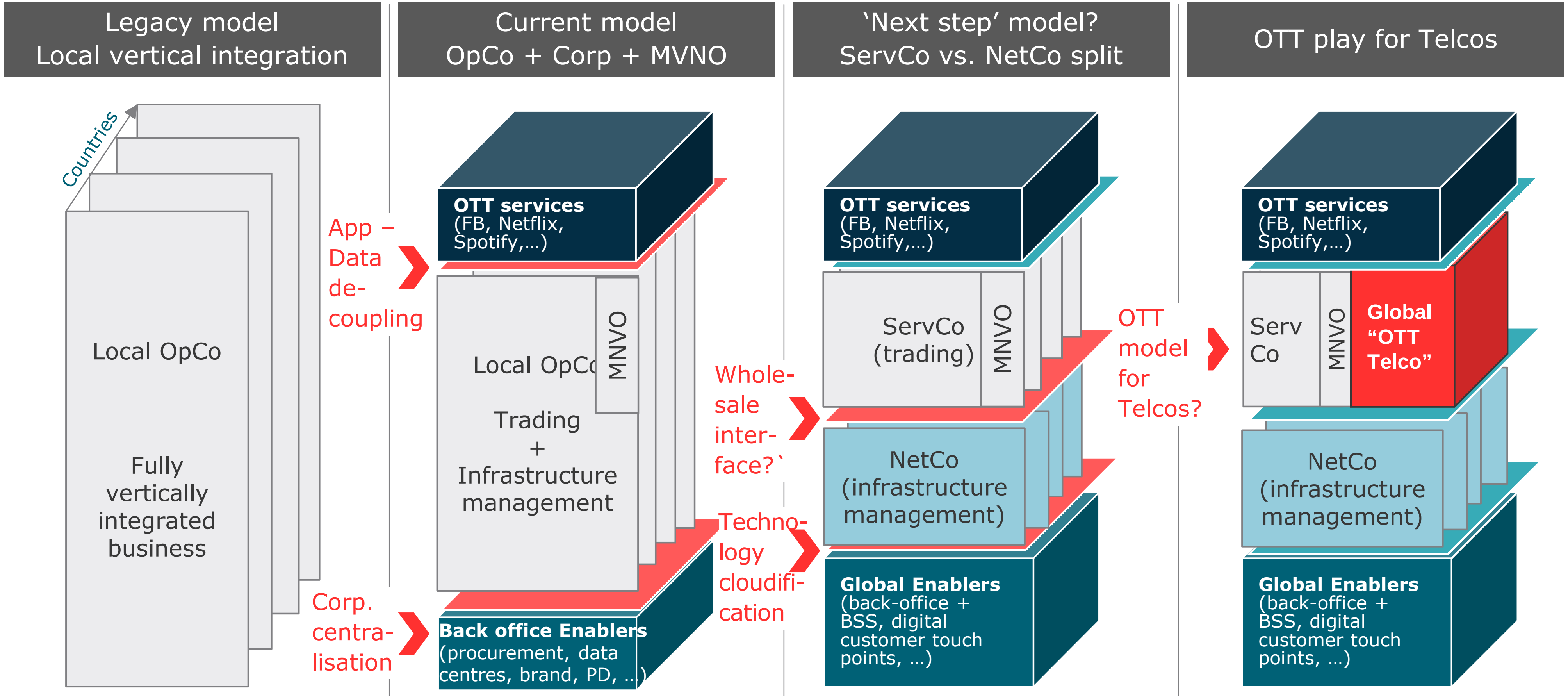
Infrastructure management

Different Requirements and Key Success Factors

ServCo	NetCo
• Fully digital Journeys and interfaces – buy, pay and consume digitally • Full self-service • Real-time, cross-device • Personalized interaction based on history and preferences (Big-Data effect) • Socially networked consumption • Plug-and-play services	• Always-on – always available • 100% network coverage - available everywhere • Top quality – e.g., data speeds, latency sufficient for service consumption • Make Big-Data available for analytics • Ability for online, self-configuration of network services (e.g. leveraging SDN)

Source: AlixPartners

Hence, we expect the telco model to dis-integrateand horizontalize…



…allowing for different investor types per horizontal layer

Source: AlixPartners

The dis-integration of the telco value chain will also foster the development of a new culture

Cultural transformation to a digital telco

	Typical Telco Culture Today	Digital Culture
Customer focus	• Focus on educating the customer • Inability to use customer insights and customer data (regulation)	• Customer centric • Pull ideas from the market
Organization	• Slow decision making • Process and task orientation • Data used for justification	• Fast decision making • Data used for issue identification and solution development
Ways of working	• Big teams who want to be consulted • Reluctance to achieve company targets	• Mixed teams on a needs-basis with clear tasks and responsibilities • Personal interest in overall success
Product development	• Long go-to-market duration (month/years) • Inability to adapt 'on the go'	• Develop, pilot, correct → focus on rapid launch and learn • Adaptability and scalability count
System infrastructure	• Legacy SAP/ERP systems • Lack of flexibility and adaptability; 'business to follow IT'	• Modular system interface with customer focus • 'IT enables business'

Source: AlixPartners analysis

However, all stakeholders have a part to play in order for successful restructure in the telco industry to be achieved

Key stakeholder roles

Management	…must embrace the urgent need for digital transformation, ensure distractions are minimized, and retain focus on delivery
Staff	…must accept the need for change and new ways of working, helping to develop new capabilities
Shareholders	….must encourage change, accepting different financial metrics and approving transformation investments
Regulators	…should review applicability of USO, pricing regulation and understand that the digital era requires new regulatory policies
Governments	…should support and encourage new regulatory policies (including review of pricing for new spectrum)
Competition authorities	…should be more open to enabling telco scale via consolidation

No matter which strategy will be picked, it will be a huge challenge - in particular for larger telcos

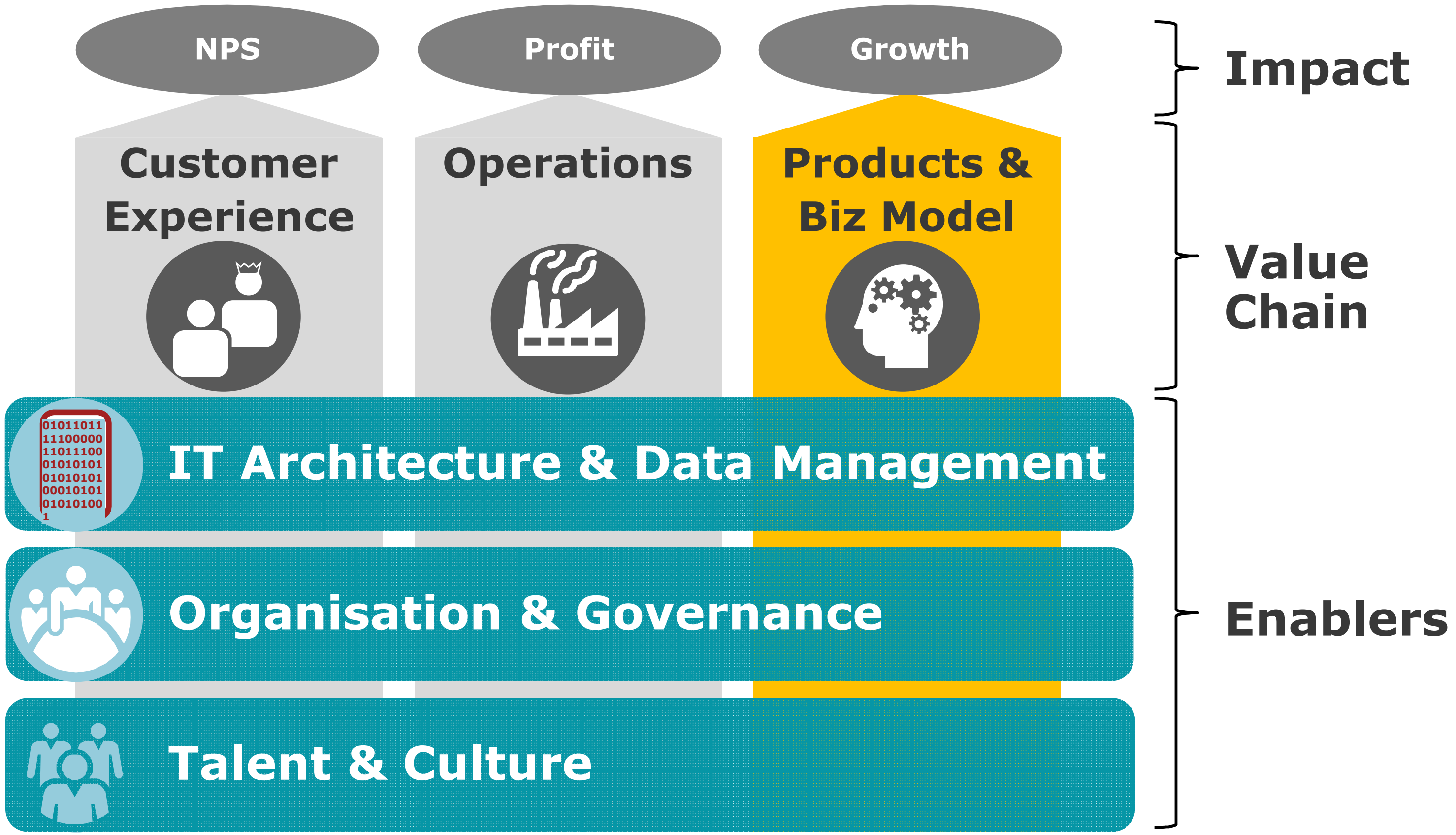
John Chambers (ex-Cisco CEO) on digital revolution: "…This digital era will dwarf what's occurred in the information era and the value of the Internet today. As leaders, if you don't transform and use this technology differently - **if you don't reinvent yourself, change your organization structure; if you don't talk about speed of innovation - you're going to get disrupted. And it'll be a brutal disruption, where the majority of companies will not exist in a meaningful way 10 to 15 years from now….**

…How do you change your culture to be able to think in terms of outcomes for your customers…**The majority of companies will be digital within five years, yet the majority of their digital efforts will fail, which speaks to what a CEO has to do differently**…"

The Digital Revolution will be a challenge for any (large) Telco!

The best advice we can give: plan the digital re-structuring!

Digital Re-Structuring Framework



Only do when you have prepared the ground („Digitization of the core business")

For telcos this leads to a clear roadmap: before focusing on new business streams they first need to restructure the telco core

Operator transformation priorities

1. Simplify: Step-change cost of operations by radically simplifying product and services portfolio
2. Digitize Channels: Transform CX with personalized, differentiating digital-first interactions
3. Digitize Factory: Leverage digital technology to streamline processes, automate operations
4. Rationalize: Focus ongoing investments on cost-effective infrastructure, rationalizing legacy
5. Re-organize: Define a digital operating model to support digital talent and ways of working
6. In parallel: **Aggressive “un-carrier” type of marketing**
7. LASTLY… **Innovate: Tap into the digital service revenue pool**

Source: AlixPartners analysis

AlixPartners
when it really matters