[Redacted]

DIXONS CARPHONE - SUPPORTING EVIDENCE FOR MARKET IMPACT OF THE BT EE MERGER

[Redacted]

Table of Contents

1. Executive Summary

The BT/EE merger may provide the following [Redacted]:

- BT/EE propositions are in line with an expected increase in customer demand for multiplay bundled services, enabling customers to benefit from a range of complementary products
- Multiplay products should enable customers to have a single bill, complementary services and bundle discounts
- Customers may benefit from lower prices as a result of efficiencies from the merger and product bundling
- Quality of experience may improve for customers if they gain access to a wider range of content, Wi-Fi hotspots and network capability
- Customers may benefit from an improved network experience through increased investment
- Customers could be able to access the best in class FMC (Fixed Mobile Convergent) network in the UK given size of Openreach and c.45% radio spectrum
- [Redacted]
- If BT/EE move from a combined direct/ indirect channel strategy to a 'direct' only channel strategy, consumers may be faced with less choice and ease of comparison across networks and tariffs
    - Customers are faced with 50,000 simultaneous variations of offers across 2000 plans from 4 MNOs and 99 MVNOs
    - 64% of consumers use expert reviews, before purchasing and 96% of customers do some form of prior research [1]
    - 43% of customers say staff are the most influential touch point in making the final decision for phone and tariff, this is more than 2x the influence of research at this final stage [1]
- [Redacted]
    - [Redacted]
    - [Redacted]
- [Redacted]
- The BT/EE merger could drive the uptake of quad play contracts, these contracts tend to be more complex and lengthier, making it much harder for consumers to switch brands at the end of the contract
- [Redacted]

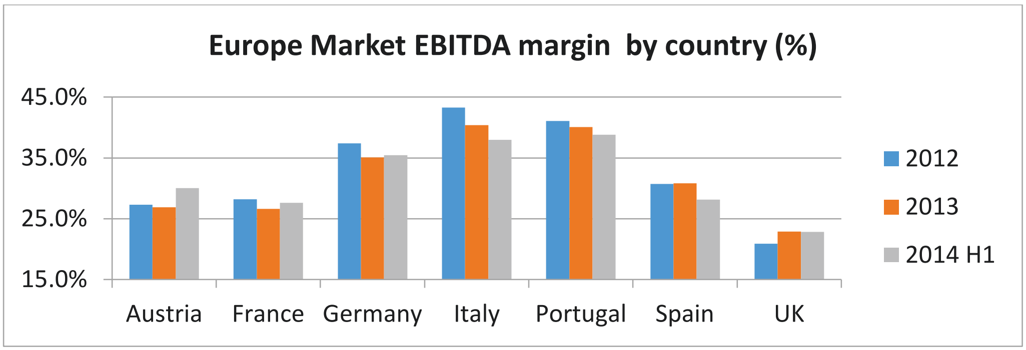
- Quad play providers may offer contracts that are heavily discounted for the first few months to attract customers, creating high barriers to entry for smaller non-quad play providers (e.g. MVNOs) reducing the choice of tariffs and brands available to the consumer
- If these quad play offerings are not made available through the indirect channel, then consumers will not be able to benefit from the associated choice, comparison, price competitiveness and assisted sale services that indirect retailers are able to provide

2. Comparison of UK and European Mobile Markets

2.1. Background on the UK market

The UK market was the first in Europe to deregulate itself in 1984. A number of other European markets did not deregulate themselves until the 1990's, therefore their markets tended to be dominated by one large provider leading to higher pricing and margins. Figure 1 shows that UK has consistently maintained the lowest mobile EBITDA margin of the leading European markets.

Figure 1: Europe Market EBITA margin by country (%)



Source: Credit Suisse (2014) European Telecoms Factsheet: September 2014

The UK mobile market initially began with only two networks, Cellnet and Vodafone. Due to this duopoly status both companies had to sell their products through service provisions, fragmenting the power and promoting a more competitive market. Following the entrance of One2One and Orange in 1993 this rule was relaxed but allowed space for new networks to grow and set the tone and structure of the market. In the last decade, there has been much consolidation in the UK market; smaller companies such as Peoples Phone, The Link, The Phone People, The Pocket Phone Shop and Mobile Phone Centres were all purchased by larger networks. [Redacted]. Should the merger change circumstances such that the merging parties (or other MNOs) could change their terms of business with the last of the UK's large indirect retailers in any way that might impair or remove the advantages currently enjoyed by customers (including the availability of independent expert advice, and the ability to compare tariffs), we believe that it would present material competition concerns. If the changes were significant enough (e.g. resulting in the withdrawal of MNOs from the indirect channel), DC's exit from the market would result in those advantages being lost completely.

2.2. Introduction

The following section compares the UK market to other European markets. [Redacted]

2.3. Customer Demand

2.3.1. Handsets

Customer demand for SIM only versus bundled monthly plans including handsets differs between the UK and other European markets quite significantly. In the UK we see a high proportion of bundled subsidised handsets & monthly tariffs – partly due to the level of handset subsidies offered by the MNOs to customers, thereby raising the affordability of handsets from low/mid-tier to mid/high tier.

In Spain however, the macroeconomic situation in the last few years has led to lower spend in mobile services by consumers and higher range SIM free handsets [2]. Debt collection has traditionally been less efficient. Therefore mobile operators can lose money if a customer who has chosen a mid to high-end handset falls behind in their monthly payments. As a result Telefonica and Vodafone removed handset subsidy in early 2012[2]. Both the removal of subsidies from the market and handset price increases have been linked to an increased customer churn for both Telefonica and Vodafone in Spain [2].

2.3.2. Quad play

To reduce this churn, Telefonica introduced its first quad play bundled offer, called Fusion in 2012[3], enabling customers to take out contracts that provide more services than just mobile. Triple play/ quad play has now become very prominent in Spain, about 75% of fixed broadband households use convergent offers that include mobile components [4]. Therefore, a remedy that was introduced was a requirement that the merging companies, Orange and Jazztel, should divest an independent portion of its broadband network to a new player in the market. Orange was also required to provide wholesale access to its 4G mobile network to the new entrant [5].

In the UK, 40% of broadband households are triple or quad play [6] and only 10% are quad play [7]. [Redacted]. This move to multiplay/quad play will result in additional complexities for consumers in choosing the right product to suit their needs e.g. understanding the cost breakdown, bundled discounts and extended terms. Due to the differing length of broadband and phone contracts, consumers will be faced with a misalignment in contract end dates and may require more support to switch provider. Multiplay also presents concerns around individual vs. collective needs. Multiplay contracts will predominantly appeal to the family market however there may be difficulties around individual preferences for handsets and tariff deals that are included as part of the quad play deals. Handsets are currently changing ever 2 years, however TV boxes etc. do not tend to need upgrading therefore there may be little incentive to provide upgrades to customers.

The indirect channel can provide consumers with the ability to compare multiplay bundles and enjoy the assisted sale process to select the right bundle for their needs. It also plays a key role in ensuring price competitiveness across multiplay providers. Therefore it is important that consumers can access these bundled products both through the indirect and direct channels.

3. The Mobile Customer

Summary

- Customers are faced with 50,000 simultaneous variations of offers across 2000 plans from 4 MNOs and 99 MVNOs
- Customers have a long purchase cycle (typically 90 days) and have an increasing emphasis on handset, cost, tariffs and network
- 64% of consumers use expert reviews, before purchasing and 96% of customers do some form of prior research
- 65% of consumers do not have clarity when asked about the tariff details at the point of purchase, hence they need assistance in finding the right plan for them
- 43% of customers say staff are the most influential touch point in making the final decision for phone and tariff, this is more than 2x the influence of research at this final stage

3.1. Introduction

The following section provides further information on the difficulties that customers face when selecting a mobile phone due to the complexity of the UK mobile market. In addition, it also focuses on the importance of comparison and assisted sale to support customers throughout the purchasing process.

3.2. Our customers

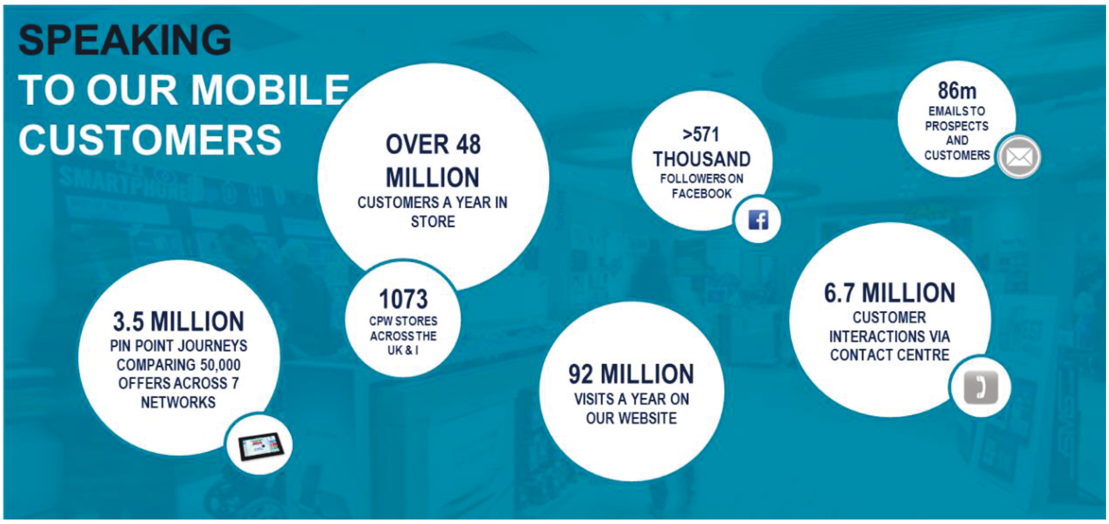
Our customers live in a fast changing world where they:

- Get challenged by the vast range of products available and how to select the best choice for them.
- Are presented with over 50,000 simultaneous variations of offers across 2000 plans from 4 MNOs and 99 MVNOs
- Try to keep ahead of ever changing device capability and technology
- Want to get the best connectivity solution to meet their needs and get the most out of the device, connection and content available to them
- Do not understand data in terms of usage e.g. downloading music
- Are learning about the next advancement and what it means to them (e.g. quad play)
- Want expert face to face advice
- Increasingly want to be able to compare all providers before making a decision
- Have an increasing number of connected devices in the home and therefore need the right broadband to activate them (on average 7.4 devices per household growing to 21 devices by 2020*)

- Require aftersales advice and guidance to get the most out of the products they have purchased
- Rely on a handheld device with huge capability- the right choice and understanding of how to use it is critical in improving the overall customer experience.

DC have learnt a lot about the customer through interacting with them across multiple channels:

Figure 2: Data from our mobile customers



Source: DC Insight

3.2.3. The importance of comparison and assisted sale

Customers have a long purchase cycle (typically 90 days) and have an increasing emphasis on handset, cost, tariffs and network. Therefore, this has been increasingly driving the customer's need to compare through detailed research of what is on offer in market. The follow points provide more information on what customers are looking for as part of the comparison process:

- Customers want the right phone and deal – 64% of consumers use expert reviews, before purchasing and 96% of customers do some form of prior research [1]
- Cost, Tariff and Network have grown in more importance compared to 3 years ago leading to more and more customers comparing to get the right deal
- Working out tariff needs – 65% of consumers do not have clarity when asked about the tariff details at the point of purchase, hence they need assistance in finding the right plan for them [1]
- 43% of customers say staff are the most influential touch point in making the final decision for phone and tariff, this is more than 2x the influence of research at this final stage [1]

3.3.3. [Redacted]

4. [Redacted]

5. UK Estate

Summary

- There are currently over 3300 mobile specialist stores (stores that sell post-pay contracts) across the 7 major indirect and direct providers in the UK
- [Redacted]
- Following the closure of Phones 4 U (P4U) in 2014, the number of indirect retail stores has declined
- P4U had 720 stores in its portfolio before shutting down operations. 358 of these stores were sold to other networks/ DC
- 362 stores were closed completely, reducing the overall number of indirect mobile shops in the UK by 22%
- [Redacted]

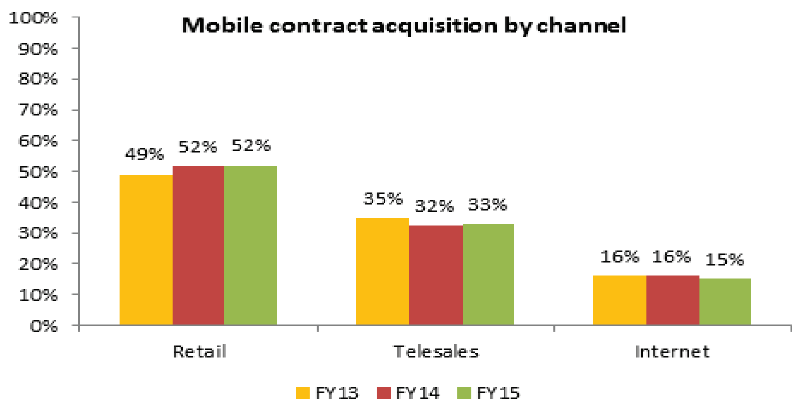
5.1. Introduction

The following section provides an overview of the changing retail comparison landscape over the last 20 years. Whilst the indirect store footprint reached a similar level to that of direct stores, the number of indirect stores has now decreased following the closure of Phones 4 U (P4U) in 2014. [Redacted]

5.2. The importance of retail estate in the UK

Sales trends between 2013 and 2015 show that the proportion of mobile contracts sold through physical shops has increased by 3%. Today, the UK retail channel accounts for 52% of post-pay connections, whilst telesales and online account for 33% and 15% respectively; this highlights the fact that the retail channel is the primary channel of choice for consumers.

Figure 3: Mobile contract acquisition by channel



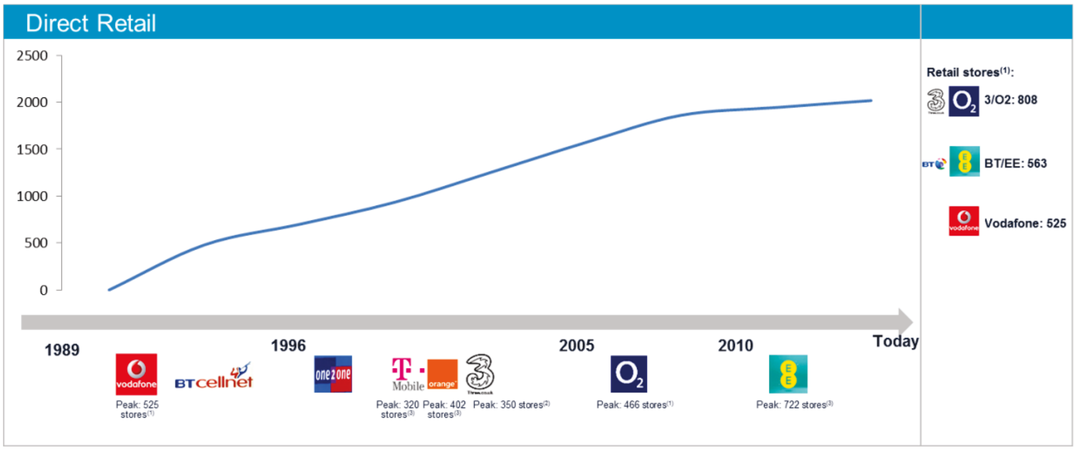
Source: GFK Data 2015

5.3. Change in the retail comparison landscape

Since the early 1990s, mobile retail estate has been growing in the UK in line with market growth, increasing competition.

This trend can be seen in Figure 4 for direct retail stores, reaching a plateau in 2008 at just over 2000 UK stores and only slightly declining in 2013 when EE consolidated its Orange/T-Mobile estate from 722 stores to 563.

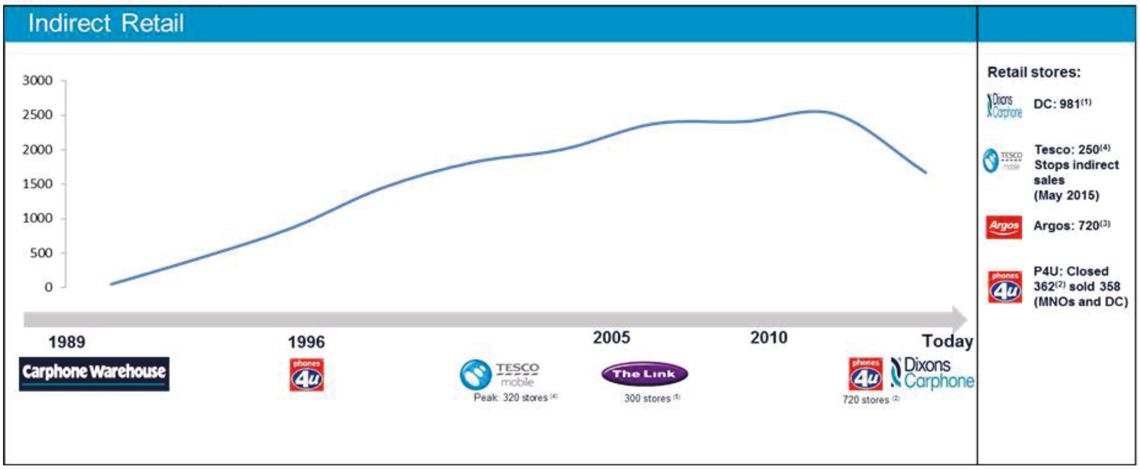
Figure 4: Change in the retail comparison landscape – Direct Retail



Sources: (1)DC Insight; (2) Enders 2014 UK Mobile User Survey; (3) EE Interim report 2012

Similarly, indirect retail stores have continuously increased their footprint over the past 20 years [Redacted] – reaching a similar number of stores as direct (Figure 5). However, this number has declined significantly over 2014 due to the closure of P4U, despite 160 of the P4U stores moving to DC. [Redacted].

Figure 5: comparison landscape – Indirect Retail



Sources: (1) DC Insight; (2) BBC (15.9.14): "Phones 4U shops closing down across UK"; (3) ft.com (1.5.15): "Highlights from this week's Investors Chronicle" ; (4) Tescomobile.com; (5) http://news.bbc.co.uk/1/hi/business/5101016.stm

5.4. Current Telecom landscape in the UK – retail estate

The current mobile retail estate landscape is shown in Table 1. [Redacted].

Today, the UK physical retail channel accounts for 52% of post-pay connections, highlighting the importance of retail estate in the mobile market. However, the retail landscape is changing and the number of stores is decreasing (P4U went into administration, the Orange/T-Mobile merger). [Redacted].

Table 1: UK specialist mobile retail store comparison

Brand	Number of UK retail stores	Direct Channel	Indirect Retail Channel
EE	563	Yes	
Vodafone	525	Yes	
O2	466	Yes	
H3G	342	Yes	
Virgin Media	122	Yes	
Dixons Carphone	981	Yes	Yes
Tesco Mobile	320	Yes	
Total	**3319**		

Sources: External data from providers' websites included in the table

P4U had 720 stores in its portfolio before it closed. 358 of these stores were sold to other networks and DC. 362 stores were closed completely, reducing the overall number of indirect mobile stores in the UK by 33% [8].

[Redacted]

6. Glossary

Abbreviation	Full Form
DC	Dixons Carphone
P4U	Phones 4 U
[Redacted]	[Redacted]
[Redacted]	[Redacted]
MVNO	Mobile Virtual Network Operator
MNO	Mobile Network Operator
SAC	Subscriber Acquisition Costs
M2M	Machine to Machine

7. References

[1] DC Data (2015) [Accessed 5th June 2015]

[2] DEWAR, C (2012). European operators look to cut smartphone subsidies to preserve data gains. [Online]. Available from: https://gsmaintelligence.com/research/2012/03/european-operators-look-to-cut-smartphone-subsidies-to-preserve-data-gains/327/ [Accessed 28th May 2015]

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[8] GOODLEY, S. (2014). Phones 4u: 2,400 staff set to lose jobs as mobile phone retailer shuts up shop. The Guardian. [Online] 22nd September. Available from: www.theguardian.com/money/2014/sep/22/phones-4u-closure-job-cuts-announce [Accessed 28th May 2015]