



Telefónica Remuneration Policy Conference Call Transcript

14th December, 2011

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Introduction

María García-Legaz - *Telefónica S.A. - Head of IR*

Good afternoon, ladies and gentlemen, and welcome to Telefónica's Conference Call to discuss our remuneration policy. I am María García-Legaz, Head of Investor Relations. Now let me turn the call over to our Chief Financial and Corporate Development Officer, Mr. Ángel Vilá, who will be leading this conference call.

Ángel Vila - *Chief Financial and Corporate Development Officer*

Good afternoon. This is Ángel Vilá.

Welcome to this call which is aimed at addressing any questions you may have related with the shareholder remuneration goals announced today.

We set our previous targets back in October 2009, where the scenario was materially different from the current situation. So, we have been listening to the feedback that we have received from investors, from analysts, from rating agencies and it became clear to us that our remuneration commitments were not been recognized by the market.

We at Telefónica continue to be a shareholder oriented company, paying dividends is in our DNA, but in the current environment our Board has considered that the best decision to enhance the value of our business would be to adapt the remuneration goals to market reality and to regain financial flexibility. Let me summarize the terms that we have just announced.

First, the dividend that corresponds to fiscal year 2011 is maintained at €1.60 per share. We already fulfilled a first payment of €0.77 per share in November. So the remaining amount which is €0.83 euros per share will be distributed in May 2012, but in a combination of a cash payment and a payment in-kind. This payment in-kind would be through the distribution of existing treasury shares of the Company for a maximum amount of €0.30 per share.

Second, total shareholder remuneration corresponding to fiscal year 2012 will amount to €1.50 per share, which is comprising the payment of a cash dividend of €1.30 per share and a share buyback for the remaining amount. The shares acquired in this share buyback structure would be amortized. And the share buyback would be completed no later than May 2013.

Third, for the year 2013, the minimum total shareholder remuneration per share will be in line with the one for year 2012 that is €1.50 per share. The mix of that remuneration will be decided considering market conditions and investor preferences at that time.

We are reiterating our target of leverage in the 2x to 2.5x range, and our objective to advance progressively towards the medium part of this range in the medium-term. Shareholder remuneration commitments will not be paid with debt and we will continue optimizing our non-core asset portfolio.

So this is what we have announced today. We believe that our new remuneration policy is very compelling and it is compatible with sustained investment to grow our business, and it enhances our financial flexibility.

So having done this introduction, we are open to any questions you may have.

Q&A session

Tim Boddy - *Goldman Sachs*

The main question was, if I understood it, so the mid-term guidance you gave in 2011 was structured in order to allow the payment of dividends of around €1.75 or more. Given obviously you now see being more prudent to pay a lower dividend, does that mean we should reconsider the framework of your guidance that you gave in 2011? Thanks very much.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thank you, Tim. This year has not obviously finished yet, but with the information we have today, and today is mid-December already, we do reiterate our 2011 guidance and as you know, our policy is to provide guidance for the following year when we announce the results of a fiscal year. So we will provide additional color on our guidance on February 24th, when we will release our fiscal year 2011 earnings.

Fabián Lares - *JB Capital Markets*

Hi, good afternoon. Thank you for taking my question. I was wondering if you could go over exactly the logic behind issuing this year, as part of your payment, some of the treasury stock that you have up to 0.3 per share. And thus next year you're carrying out a share buyback and how is it comparable that you're releasing the stock you're holding in treasury stock this year. You must obviously believe that at these levels the shares are cheap, and you stated so a number of times as the justification for not doing a scrip issue, so if you could explain the dynamics behind, that will be helpful.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Yes, well first this is not a scrip dividend because we are not planning to issue any new shares, because we certainly believe that Telefónica shares are cheap. The payment in-kind with existing treasury shares for up to €0.30 per share in May 2012 has been decided to enhance our financial flexibility, leveraging the fact that we already have a

significant amount of treasury stock which is reflected already in our debt balance. So we thought that this would clearly improve our financial flexibility for 2012.

Ivón Leal - BBVA

Hi, good afternoon, just a couple of ones. I would like to understand first how you come to that €1.3 dividend per share that is, have you track a specific target in terms of free cash flow coverage of dividends, this is how you get the €1.3?

And the second thing is does it change anything about CapEx perspective going forward so, are there plans of selling non-core assets for 2012?

Ángel Vilá - Chief Financial and Corporate Development Officer

Thank you, Ivón. First I want to stress that the remuneration for 2012 is €1.50, so dividend is €1.30 but then we have a share buyback of €0.20, so remuneration for 2012 is €1.50.

What we have done is that we have decided is to adapt remuneration to the market reality and to give what we believe is a very attractive remuneration policy which is compatible with sustained investments to our businesses. And this would include everything: CapEx, commercial investments, spectrum acquisitions. In such a way that we do not jeopardize or, as some people have questioned, if we were sacrificing part of our potential growth and our value growth. So we believe that with this €1.50 comprised of the €1.30 dividend plus €0.20 of buyback, we provide ample flexibility on that front.

With respect to potential monetization of non-core assets, today's announcement does not change our intention and our policy. Our idea to sell non-core assets is obviously to streamline our portfolio. And those disposals are aimed at enhancing financial flexibility and reducing our leverage. We were not thinking of paying the dividend on those divestments. So you should expect the Company to proceed with those disposals, obviously at the right times and at the right prices.

So, if anything, what this does is to take some potential pressure on when and how to execute some of those divestments. So you can be assured that we will do value creating divestments. And a clear example is the recent agreement that we announced in Mexico, to sell non-core strategic towers and we will proceed in the future with further announcements.

Mathieu Robilliard - Exane BNP Paribas

Good afternoon, thank you. Two questions. First, with regards to the change you announced today is there anything specific and in a the conjunction of factors that lead you to cut now that dividend guidance that you reiterated just few weeks ago?. So, I was wondering if something specific has happened or are you less confident in some of

the trends. I know you reiterated 2011 guidance but maybe you are more concerned about 2012 than a few weeks ago.

And then second question, you may have covered it but, with regards to deleverage, is there at any point, in your forecast do you believe you will be at any point above 2.5x net debt to EBITDA between right now and 2013, or do you believe that with the change in the dividend policy you can remain low, not higher than 2.5x net debt to EBITDA? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thank you, Mathieu. With respect to the first question there is nothing specific today that changes what was yesterday or tomorrow. What we have done is to reflect, and we have listened to investors, analyst and rating agencies; we have reflected on that feedback. We have seen, we have been watching what the market has been doing with our previous policy and we have concluded that our previous policy was not being recognized by the market. So we decided to adapt to the new conditions and increase our financial flexibility.

With respect to leverage our target remains unchanged in the 2x to 2.5x range and our aim or objective continues to be reaching the medium part of this range over the medium-term. What is so obvious is that today's announcement accelerates the process for us to reach that medium-term target.

Paul Marsch – *Berenberg Bank*

Yeah. Hi. First question, could you just clarify the number of shares in treasury?. And secondly, on non-core assets disposals should we be regarding DTS, Hispasat, ZON as non-core? Are you thinking of alternatives to the IPO of Atento and maybe you could give a little bit more detail on where you got other tower assets, how many towers, and in which markets they could be treated as non-core?

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thanks, Paul. With respect to the first question what we've disclosed is that by end of September when we did our last results announcement, we held 1.44% of our share capital in treasury stock. And we are now above the September figure and we are below 2%. That the most I can say at this point. But what's important is that most of the investment has already been done, so it's already reflected in our debt balance.

With respect to non-core assets, we prefer not to disclose specific names or targets of assets to divest. We are working on several ideas. But execution in this time is more volatile, so one needs to be very prudent when committing with respect to specific names or amounts for specific assets. So we prefer to keep this flexibility of not identifying specific assets of non-core divestment.

Paul Marsch - *Berenberg*

Do you have some idea of the central value assets that might be disposable?.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

We don't have a target that we can share with you on this. But we are working on it.

Torsten Achtmann – *JP Morgan Cazenove*

Thank you. In terms of the market environment which has changed, what were the key ingredients which made a change? Has it been the operational environment or has it been the credit environment or has it been the more harsh view of the rating agencies? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Well our previous remuneration policy was adopted in October 2009. I believe that between October 2009 and today there have been plenty of changes in the economic and operational environment and also in financial market conditions that have changed very materially. So we decided to adapt to this new market reality.

Will Milner– *Arete*

Thanks for taking the questions. Just a couple. Under what circumstances would you consider sacrificing the share buyback elements of the shareholder remuneration in the future?. And I guess I'm just sort of thinking if you're confident of being able to sustainably pay €1.50 a share going forward, why not pay it all in cash dividend? That's question one.

And secondly I think it was touched on before, but do you think the move today gives you scope to increase investments to boost growth or does this really only allow you some modest de-leverage potential?. Thanks.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Well we've included a buyback component because it provides us financial flexibility, it provides us flexibility and it is EPS accretive; reduce the number of shares and future dividend payments. And obviously it can be tactically used to capture value for our shareholders. And we believe, with all the information that we have, that these new conditions for our remuneration will be totally sustainable. With respect to investments we confirm the same guidance that we had, for instance, on CapEx. So this is not going to give scope for an increased investment in CapEx. And we also have flexibility to include spectrum payments that could come next year with respect to countries like UK or Brazil for instance.

Mandeep Singh – *Occitan Capital*

Hi. Thank you for taking the question. I really wanted to focus on your free cash flow guidance. You've been insistent over the last one or two years that your dividends were comfortably covered by free cash flow. Should we now take this as a free cash flow warning?. So the dividend levels that you've committed to now are consistent with the free cash flow generation you reflect? Thanks.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thanks Mandeep. As you know we do not provide free cash flow guidance. And clearly the remuneration restructuring that we're announcing today is a significant improvement with respect to coverage ratio, free cash flow coverage ratios which are in assumptions made by the various analyst and people that follow Telefónica. So you should be feeling more comfortable than you've been feeling in the past as has been written by many people.

Kevin Yates - *RBS*

Hi. Most of my questions have been asked but there are just two points of clarity. Can you confirm this amortizing is the same as cancelling these shares? And can you confirm that the resignation from the Board post to meeting today was unrelated to these events?

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Okay. It was not a resignation from the Board. BBVA has a policy of rotating their representatives on the Board of Telefónica. So a gentleman who had been on the Board of Telefónica as Vice Chairman for the last seven years is retiring.

So BBVA has appointed a new Board member, and the second BBVA member that we have today stays, Mr. Abril, and becomes Vice Chairman of Telefónica and we have Mr. Moreno who takes the rotation position for the BBVA Board. So it's completely unrelated, the decision by the way was taken unanimously by the Board. And sorry which was the first question?

Kevin Yates - *RBS*

Sure, you said that your treasury shares will be amortized, is that the same as cancelled?

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Yes, yes, yes. Absolutely.

Jerry Dellis – *Jefferies*

Yes. Thank you for taking the question. Two questions please. You mentioned in the press release, strategy is to sustain investments in the business. Is a particular part of the business in which you intend now to raise commercial investments going forward perhaps relative underperforming parts of the business such as O2 UK and perhaps areas which are facing some challenges such as the Spanish mobile business?

And then secondly an important element you've highlighted is the conversations that you've been having with the rating agencies which are clearly important, given the debt maturity profile sort of picks up from Q4 2012. I wonder whether you could specify what the rating agencies have been telling you in the course of the last few weeks? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thank you. With respect to rating agencies we have contacted them informally. As expected they view today's announcements very favorably but they have not issued an official position that it's up to them when they decide to make such a statement. With respect to investments what we believe is this remuneration, as I said before, is combining very attractive remuneration policy, very attractive yields if you compare across the industry and is compatible with sustained investments to grow our business. This provides us flexibility and it also is designed to reduce some questioning that we have had at least on some observers of the market of whether our remuneration policy was jeopardising our investments in the business. So we expect to assuage all those type of doubts.

Guy Peddy - *Macquarie*

Good afternoon everyone. I just wanted to understand whether you consider taking the dividend even lower to give yourself some flexibility, given that in the current market environment asset sales are difficult. And why essentially you picked €1.30 as the cash element going forward? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thank you. We have been doing obviously numbers and scenarios and we are setting conditions that make our remuneration totally sustainable. Obviously, if we had reduced it further we would have much more leeway but Telefónica is a very shareholder remuneration driven company. So we want to maintain a very competitive remuneration compared to our peers, compared to other players in the indices as well where Telefónica is present. So we believe that with the 1.30 plus the 0.20 share buyback we achieve all these objectives.

Madeleine King - *Credit Suisse*

Hello. I was wondering if you could talk about to what extent this announcement was driven by liquidity, and then how confident are you that you can issue as much as you would like given the situation of the bond markets in 2012?

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thank you. This was not driven by liquidity. As we expressed when we had the results conference call of the third quarter back in November, we have a very manageable schedule of maturities in 2012; it's very much weighted to the end of the year.

We have our preferred shares maturing at the end of December. We have bank loans which are maturing in December. These two concepts are €4.4 billion out of the €7.1 billion of maturities. We have €1.8 billion of Latin American debt which is in markets that are open clearly and we have been issuing in Chile to cover part of this. And then, the remaining that would be €1 billion that was covered by the bond issue that we did back in October. And, in addition to this, we have available credit lines for over €9.2 billion of which €6.4 billion are long-term. So zero liquidity concern and liquidity was not the rationale for doing this. What we saw is that our previous policy was not being recognized or valued by the markets, so we have decided to adapt to this reality and create financial flexibility for Telefónica while still being very attractively compensating our shareholders.

Luigi Minerva – *HSBC*

Yes, thank you and good afternoon. I just wanted to go back on the CapEx and the investments point. Because you said that in your new dividend guidance, you are incorporating in a way the feedback received from investors about under investments in some areas, but at the same time today you are reiterating your CapEx guidance. So I just wanted maybe if you can explain a bit the two dimensions of this area and maybe if there was an under investment concern which you believe was justified in the comments you have received; in which areas was it, was it in Spain, in Latin America if you can please elaborate on that? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thanks Luigi. First what I would like to say is that this call is to clarify the issues that are related to shareholder remuneration. But let me address the points that you are asking. We are sticking on the same objective of CapEx that we've communicated to the market in the Investor Day, that we've been reiterating, that's around €9 billion of CapEx per year, over three years €27 billion. One third of that would be in mobile broadband and fixed broadband, at least one third of that. And obviously then we also have investments in spectrum which in 2012 will be higher than the ones that we have seen in 2011. So, basically this is not changed by this new announcement. This new announcement provides more headroom, more flexibility for Telefónica, but it's not that we are going to use this flexibility to increase investments. We are going to stick to

the commitment that we have already given to the market and obviously as always we are going to try to improve on that commitment.

Georgios Ierodiconou – *Citi*

Yes, hello. I just have a clarification regarding the guidance for the three years that you gave to us at the Investor Day; I know you just commented on the CapEx numbers. But whether you could confirm that for revenue and EBITDA guidance for the three years to 2013 still stands?. And if that is the case and you will meet the numbers that you are expecting why did you see the need to adjust the dividends so early in the process? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Thank you, Georgios. What I can say with respect to this is that on February 24th, when we announce, we release our 2011 earnings, we are going to provide additional color on our guidance. We confirm that with all the information we have now, and we are very much advanced in the year, we reiterate our 2011 guidance and we'll be informing on the call, on the presentation of results in February.

David Wright – *Deutsche Bank*

I think my questions have been answered if you want to quiz one more, thanks.

María García-Legaz – *Head of IR*

I thank you very much for joining us for this conference call. And we expect to join you at the end of February when we release our full year results. Thank you very much.