Telefónica January-September 2017 Results Conference Call Transcript

26th October 2017

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In October 2015, the European Securities Markets Authority (ESMA) published guidelines on Alternative Performance Measures (APM), applicable to regulated information published from July 3, 2016. Information and disclosure related to APM used in this presentation are included in the Appendix. Recipients of this document are invited to read our condensed consolidated interim financial statements and consolidated interim management report for 2017 submitted to the Spanish National Securities Market Commission.

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Introduction

Pablo Eguirón - *Head of IR*

Good morning, and welcome to Telefónica's conference call to discuss January-September 2017 results. I am Pablo Eguirón, Head of Investor Relations.

Before proceeding, let me mention that financial information contained in this document related to the third quarter 2017 has been prepared under international financial reporting standards, as adopted by the European Union. This financial information is unaudited.

This conference-call webcast (including the Q&A session) may contain forward-looking statements and information relating to the Telefónica Group. These Statements may include financial or operating forecasts and estimates based on assumptions or statements regarding plans, objectives and expectations that make reference to different matters. All forward-looking statements, involve risks, uncertainties and contingencies, many of which are beyond the Company's control.

We encourage you to review our publicly available disclosure documents filed with the relevant securities market regulators. If you don't have a copy of the relevant press release and the slides, please contact Telefónica's Investor Relations team in Madrid by dialling the following telephone number, +34 91 482 87 00. Now let me turn the call over to our Chief Operating Officer, Mr. Ángel Vilá.

Presentation

Ángel Vilá - *Chief Operating Officer*

Q3: Solid execution on key priorities

Thank you, Pablo. Good morning and welcome to Telefónica's third quarter results conference call. With me today is Laura Abasolo, Chief Financial and Control Officer, and during the Q&A session you will have the opportunity to address us with any questions you may have.

Telefónica continues to execute on its key priorities:

First, organic growth was consistent and profitable. Revenue and revenue per access acceleration were supported by strategic KPIs, namely fibre and LTE, data monetisation and churn control. OIBDA continued to post a positive increase despite the negative drag from Roam Like at Home this quarter.

Second, thanks to cost control, simplification, synergies and investments carried out in recent years, along with a focused digitalisation programme, we are more efficient and we will continue to optimise resource allocation.

And third, our balance sheet was reinforced, with enhanced solvency and liquidity. We are committed to deleveraging, reflected in the 3.6 billion euros decline in the last 12 months, including the Telxius deal, which already closed this week.

Strong FCF is the driver of the deleverage and was 39% higher than the figure posted in January-September 2016. In addition, we continue benefitting from positive bond refinancing.

On track to deliver FY outlook

As shown in slide 3, we are well on track to deliver our full year guidance across all three metrics.

Regarding the dividend, we confirm the 0.4 euros per share in cash for 2017, consisting in two tranches of 0.2 euros per share each, with payments to be made on 14th of December of this year and June 2018.

Finally, our objective is to maintain a solid investment grade rating.

Summary: Financials

To review financial Telefonica' snapshot, please move to slide 4.

Third quarter consolidated revenues reached almost 12.8 billion euros, growing in organic terms +4.0% and OIBDA reached 4.1 billion euros, growing +2.8%, in spite of being impacted by European Roam Like at Home regulation. Reported headlines in the quarter were also affected by negative FX contribution.

Looking to the first nine-months of the year, margin stood at 31.6% and expanded 0.3 percentage points year-on-year organically, proving a strong execution. At the same time, a distinctive declining CapEx trend drove the high single-digit organic increase in OpCF, growing above 9%.

FCF and net debt are also improving, as we will explain later on.

Bottom line increased by 10%, with EPS €0.44

Moving to slide 5,

Net income grew 10% versus the January-September 2016 period, outpacing OIBDA growth by 67 basis points as financial expenses posted better performance. As such, net income reached 2.4 billion euros and Earnings per Share 0.44 euros, or 0.56 euros in underlying terms, up almost 9%.

Progressive improvement in FCF

As seen on slide 6, in the third quarter we posted a progressive improvement in FCF, leading to an increase up to September of 909 million euros year-on-year or 39.2%.

The main component of this strong FCF growth was the operating performance of the business, coupled with the lower interest payments.

We expect FCF to continue improving in Q4, maintaining a healthy growth year-on-year.

Let me also mention that net financial debt continued its consistent declining trend fuelled by organic drivers.

Growth fuelled by organic contribution

Slide 7 takes you through the different moving parts affecting OIBDA evolution. The most remarkable is the organic contribution to total OIBDA growth in the first nine months of the year of 457 million euros, vs. a negative FX impact of 85 million.

In the third quarter, I'd also like to highlight the organic figure of 119 million euros despite approx. 70 million euros negative effect from RLAH regulation.

Negative impact of FX increased markedly in the quarter to -224 million euros or -5.4 percentage points on the year-on-year variation, mainly due to the Venezuelan devaluation and depreciation of Argentine peso, British pound and Brazilian Real.

Again it is important to highlight that the FX drag at OIBDA is naturally hedged in our business due to CapEx, interest payments and others, and thus, up to September the negative OIBDA impact was offset completely at FCF level.

Revenue trends ramped-up

To review the good quality performance of our top line, please move to slide 8.

Revenues accelerated in the third quarter 90 basis points, leading to a growth up to September of 4.0% year-on-year excluding regulation. The main contributors were Hispam and mobile data, which both grew at double-digit rates, and the return to service revenue growth in Spain.

Service revenues improved further to 3.3% in the July-September period, with all segments increasing year-on-year performance despite regulation, except Germany.

The revenue mix continued to transform, as reflected in the accelerated change from traditional services towards connectivity and new services. Finally, the strong commercial momentum built on our high value base is flowing directly to revenues.

Revenue growth based on successful data monetisation

Our strong focus on data monetisation to foster revenue growth is shown on slide 9.

We continue to develop our prepaid value proposition in Latam around recurrent plans and tiered pricing schemes.

We also continue to apply "M4M" strategies to improve value for money and ARPU, on the back of new bundles richer in mobile data, video or data sharing.

We have leveraged our digital capabilities with focus on flexibility and real-time by launching a new prepaid concept based on mobile applications in Mexico and Brazil.

The benefit of all these actions is a consistent growth in volumes and ARPU accretion that translates into a steady year-on-year increase in mobile data revenue growth.

In addition, on the fixed business, data volumes continued to post high growth driven by the higher FTTH penetration.

Generating profitability and cash

Slide 10 takes you through profitability.

During the last three months OIBDA year-on-year variation reflected the negative impact of the new Roam Like at Home framework, which deducted 1.7 percentage points, affecting our UK and German businesses. This effect, along with tougher comps in Argentina broadly explain the lower performance versus the second quarter.

OIBDA maintained positive growth in the quarter and in the first nine months of the year it reached 5.3% excluding the regulatory effect as we continue delivering efficiencies and operational improvements.

This, together with our ability to reduce CapEx (-2.3% year-on-year), led us to post an outstanding 9% OpCF growth; with all segments improving, with the exception of UK, which is focused on accelerated LTE roll out.

Upselling existing customer relationships

On slide 11, we show the revenue growth opportunities based on upselling existing customer relationships.

First, in the speed and capacity wave, we are monetising the investments made in UBB, with a price premium on fibre vs DSL and a higher ARPU uplift from LTE customers.

Second, in Services Beyond Connectivity, these functionalities add further ARPU. TV is the main driver, along with other services, such as the Sky cooperation in Germany or the Oops smartphone insurance included in UK this quarter.

Third, Aura, our "Cognitive Power", will improve cross-selling and encourage up-selling through recommendations, increasing customers' loyalty and reducing churn.

In this context, our long-term value creation strategy will be built on our customers' higher loyalty, their value and their trust in us.

Digital Services: differentiated offering

Digital services are providing a differentiated offering, as you can see on slide 12.

In Video, we continue to invest in quality and scale with differential content and technology. Thus, our IPTV base continues to grow (up to 40% of total) and revenues were up 6.8% year-on-year on higher ARPUs. We are also proud to be producing and distributing our own original content.

Our other digital pillars posted strong results in the quarter, with the exception of Security, albeit the B2B performance in this area has been impressive. In M2M we are focused on Smart Mobility and Smart Retail, while in Cloud we have new projects in Spain and Brazil.

TGR: progressing on UBB & digitalisation

Turning to slide 13, you can see the key role of Global Resources in our journey to become a Digital Company.

Outstanding connectivity was enlarged to approx. 43m premises passed with fibre and cable, while LTE coverage reached 69% across our footprint and 90% in Europe.

Network transformation is being accelerated as we continue to deploy our virtualisation program UNICA across 5 countries, enabling software-driven networks to have more capabilities and function smarter.

And let me remark that digitalisation is already a reality in Telefonica with 55% of our processes E2E enabled. This is mainly the result of the E2E digital management of 19% already customer base driven by full stack projects, and the huge increase in our big data capacity.

In short, big progress has been made enabling us to better compete in the digital world.

At the forefront of digitalisation

Our vision as a Platform Company, with close to 54Bn euros invested from 2012 to September 2017, positions us at the forefront of digitalisation. On slide number 14, digitalisation is the driver of Telefónica's differentiation and efficiency.

We have built best-in-class networks and are leaders in FTTH deployment in Europe and Latam. This is being complemented by switching-off legacy networks and is the foundation for the digital revolution, which lies ahead of us. Beyond this, services like Cloud, IoT, Video and Digital Home innovation equipment, among others, are improving the customer experience.

Today, we are immersed in an E2E digitalisation programme addressing: first, transformation of key processes that support customer interactions: sales, service provisioning, payments, top-ups, post-sales and technical support. And, second, network transformation, moving towards All-IP networks, virtualising the network and using Big Data to ensure the best quality experience, while optimising ROCE.

And tomorrow, we will move towards digital customer engagement where the network adapts to the needs of our customers dynamically, offering a personalised experience. This will lead to brand differentiation, improving the customer perception and, as we have mentioned before, having new revenue streams.

E2E digitalisation programme underway

On the next slide number 15, we are currently in full deployment of an end-to-end digitalisation programme to transform customer processes and network.

We are making our processes automated and real time, fostering digital channels, reducing assisted channels interactions and improving customer experience. These initiatives have an impact on operational KPIs and will support higher revenue growth and reduce both OpEx and CapEx needs. The main impacts so far are coming from reductions in back-office costs, customer care, invoice printing, commissions & payments and the cost of technical support.

At the network level, the main initiatives are All-IP Networks (which are much more efficient and support more and better services), radical network virtualisation (optimising CapEx required and with much faster deployments) and using Big Data for network planning.

Digitalisation bearing clear benefits in Spain

Our operation in Spain, in slide 16, is a showcase of the tangible benefits of digitalisation.

Its transformation process started in 2012, so far driving benchmark efficiency and business enhancement. Let me highlight:

- On the commercial front, we started to optimise all channels and customer processes involved in the "customer journey", resulting in better Time To Market, CSI and lower commercial costs.
- At the network level, widespread FTTH deployment, IP migration and legacy switch-off are allowing us to reduce failures and improve quality of service, leading to lower maintenance costs and new revenues.
- IT & systems simplification, standardisation and automation has reduced manual tasks and enabled E2E data management, hence reducing costs and CapEx.

- Finally, digitalisation and simplification have allowed us to improve productivity and redeploy human resources in a more flexible and effective way.

And this has not ended, there is much more to come.

And tomorrow, we will move towards digital customer engagement where the network adapts to the needs of our customers dynamically, offering a personalised quality of experience. This will lead to brand differentiation, improving the customer perception and, as we have mentioned before, new revenue streams.

Digitalisation being gradually adopted group-wide

Moving to slide 17, digitalisation is gradually being adopted group-wide and we are starting to see the benefits of it in terms of self-management levels and process automation. Let me illustrate this with customer processes in the Brazilian case.

The expected impact on operations is boosted by business initiatives to become digital and supported by key technological enablers.

As you can see on the left-hand side of the slide, expectations for 2018 are promising in terms of: i) post-sales and customer care and support, providing real time information, fostering the self-assistant channel to reduce call center activity; ii) redefinition of the sales processes to improve effectiveness and work in the channel mix to boost online activity and iii) technical support improvements, working to increase remote resolutions.

Therefore, all this should be translated in a more efficient business model.

Now, I will hand over to Laura.

Laura Abasolo - *Chief Finance and Control Officer*

Spain: Recovered momentum; focus on value

Thank you, Ángel. On to slide 18.

Spain recovered commercial momentum following the launch of new convergent bundles with differential TV in July.

TV net adds doubled quarter-on-quarter, FBB gained traction heading in the right direction and mobile contract posted best quarterly net adds of the last 10 years.

Moreover, our focus on value continued to sustain a value mix improvement in “Fusión”. High-value packages increased to 26% of customer base and ARPU increased 7.1% year-on-year to almost 88 euros.

Segmentation of the offering and our best-in-class assets brought about this positive dynamic.

Spain: Improved revenue trends; strong OpCF

Continuing with Spain financials turn to slide 19.

Service revenues were back to growth year-on-year (+0.4%), a sequential improvement of 1.2 percentage points, driven by improvements in all segments.

Thus, cost containment led to an improvement in the OIBDA trend in the quarter, declining 0.6% year-on-year, excluding real estate gains, while margin reached 41.0%, +0.7 percentage points vs. Q2. RLAH regulation had a marginally positive impact in the quarter.

CapEx declined sharply, -14.5% year-on-year in the first nine months, and translated into a robust cash flow generation of €2.6bn, up 4.7% year-on-year ex-real estate sale.

Germany: Data monetisation opportunity ahead

On slide 20, T. Deutschland remained increasingly focused on the data monetisation opportunity in a competitive environment.

Bigger data buckets fuelled mobile data growth, close to +49% year-on-year, with “O2 Free 15” customers’ usage of more than 5GB; the new O2 Free portfolio is setting new standards for mobile freedom with ARPU-up potential.

The mobile service revenue trend improved this quarter to almost flat year-on-year, excluding regulation. OIBDA was 0.1% down mostly reflecting regulation, a 28 million euros drag, mainly related to RLAH. Nonetheless, incremental synergy savings of 40 million euros were achieved and margin expanded 0.3 percentage points.

Finally, OpCF reached €630m in the first nine months, growing by 12.9% year-on-year reflecting lower CapEx intensity.

UK: Sustained top line growth in spite of RLAH

Moving to our UK business on slide 21, where we continue to post strong operational results.

Our innovative offerings, focused on our customers’ needs, are driving our sustained market-leading contract churn levels. Contract customers now account for 63% of our total base, LTE reached 58% penetration and we are successfully driving data adoption with usage up 55% year-on-year.

O2 UK’s financial performance this quarter reflects the impact from RLAH, as expected. However, it must be noted that we continued to grow both in revenues and mobile service revenues as our customers spend more with us.

OIBDA was down 4.7% in organic terms, reflecting the roaming impact and leaving margin at 25.7% this quarter.

Operating Cash Flow in the first nine months was slightly down 0.9% year-on-year, improving sequentially as CapEx levels gradually eased as our LTE network rollout nears completion.

Brazil: Enhancing best-in-class value positioning

Moving on to Brazil now, on slide 22, during this quarter, Telefonica Brazil widened its quality gap, reaching 76% 4G coverage and connecting 18 million premises with fibre.

Throughout the year we have increased our fibre reach to 12 new cities where we are already capturing 82% of UBB market with an impressive take-up of 40% out of the premises we have passed.

Moreover, in mobile, we are also growing in the most profitable segments, grabbing 46% of contract net adds share from January to August, while, with the new portfolio we announced in recent days, we reinforce our position with unique and innovating features, fully aligned with our Group-wide "M4M" strategy.

Brazil: Delivering growth; expanding profitability

On slide 23, we show how this commercial positioning is consistently delivering top line positive growth, with service revenues up 1.7% year-on-year.

On top of that, synergies, end-to-end digitalisation benefits and other cost control measures drove operating expenses down 1.1%.

And, in yet another quarter, it resulted in expanding profitability, with OIBDA margin up 1.7 percentage points to almost reach 35% in Q3, fuelling OIBDA growth to 6.0%.

Finally, OpCF posted a solid double-digit growth of 11% in January to September.

HispAm: Improved commercial traction

In Hispanoamerica, as shown on slide 24, our continuous network improvements are driving record quarterly net adds in LTE, 2.8m, and FTTx and cable, with 249k new connections.

But let me also highlight the unparalleled opportunity ahead of us, as penetration rates remain in the twenties for contract, 4G accesses and fibre connections.

This continuous focus on value led to a significant growth in mobile, FBB and Pay TV ARPU, which in turn drove total revenue per access up 18% in the quarter.

HispAm: Solid revenue & OIBDA; OpCF +26.8%

Moving to slide 25, this growing adoption of data services is being translated into solid year-on-year evolution in revenues, up 16%, and in OIBDA, 9% above Q3 16 despite inflation driven costs, greater commercial efforts and tougher year-on-year comparisons in countries like Argentina and Colombia.

All in all, this has reflected in the strong OpCF generation in the first nine months of the year, reaching €1.3bn and growing by almost 27% year-on-year.

Telxius: Solid operational momentum

On slide 26, Telxius showed a strong set of results with revenues increasing by 7.5% year-on-year and OIBDA margin reaching 46.5%, fuelled by the positive performance in both the cable and the tower business.

Let me highlight that in the third quarter Telxius acquired 304 towers in Argentina and grew its tenancy ratio to 1.31x (+0.03x vs. December 2016).

At the same time, the Cable business is delivering a strong traffic demand while the two best-in-class cables, MAREA and BRUSA are advancing in their rollout plan as expected.

Deleverage on strong organic FCF and disposals

Let's move now to the financial metrics on slide 27.

We continue to steadily lower our Net Debt/OIBDA ratio down to 2.80x as of September 2017, which would be further reduced to 2.72x including the Telxius stake sale. This week we received the first payment of €0.8bn from KKR.

Strong organic FCF generation continued to be the main driver of our leverage improvement.

Stronger balance sheet and credit profile

Slide 28 shows how financing year to date of €8.2bn has increased our average debt life to 7.85 years and allowed us to build a strong liquidity position, to face comfortably for around the next two years of maturities.

The effective cost of debt in September 2017 stood at 3.23%, 71 basis points lower than the end of 2016. This positive evolution is mainly due to refinancing in Europe at very attractive rates.

I will now hand back to Ángel to recap.

Ángel Vilá - *Chief Operating Officer*

Closing remarks

Thank you, Laura.

To finish, please move to slide 29 for our final conclusions:

Today's results demonstrate the delivery of profitable organic growth and strong execution.

With our best technology platforms, IT systems integration and new digital P&S we are building for the future, with Cognitive Intelligence at the forefront.

In this context, continuing with our digitalisation program started some years ago, we see a big opportunity ahead of us in terms of better customer experience, higher efficiencies and new revenue streams.

On the leverage side, progressive improvement has been achieved.

Furthermore, we secured our market position and confirmed our outlook and dividend for the current year.

Finally, we have a clear and consistent strategy built on two pillars; sustainable growth and digitalisation.

Thank you very much and we are now ready to take your questions.

Q&A session

Nicolas Didio - *Berenberg*

A question about the network sharing in Latam. José María in the Q1 conference call indicated that you are being much more rational in terms of CapEx deployment in Latam, and that that's something we should score into our models. I'd like to know if this is something that we already see through the Q3 numbers or that's something incremental in the next quarters and years?

And the second question is about the arbitration in Colombia. There has been some CapEx, we hear on the other side, Millicom keeps investing at the expense of the margin, in terms of investing in growth. I'd like to know if the arbitration in Colombia, and the unfavourable ruling, is changing the" software" with which you are managing Colombia. Are you having a lower ambition than in the past? And do you want to catch up with MIC (Millicom) in terms of investments in broadband? And what about ETB? The sale has been put on hold; can you highlight your position in terms of the potential market consolidation in Colombia?

Ángel Vilá - *Chief Operating Officer*

Regarding network sharing in Latin America, we continue to believe that network sharing is an opportunity to reduce network costs without affecting coverage and quality. We already have several sharing agreements in place and we believe that, where infrastructure is not a competitive advantage, it makes absolute sense to share.

We are convinced that this is the way forward. Part of this is being reflected in our numbers, but we are in talks with the various players in various countries. Conversations in each country are different, with many formats of discussion, and we should be progressing along this line. We also think that, looking forward, when we move to other networks, like 5G, this will bring additional opportunities and needs for network sharing.

Regarding the second question in Colombia, we recapitalised the Company through two capitalisations: one to deal with the "PARAPAT" and the other one to deal with the arbitration award.

The financial result of these two capitalisations has been practically neutral in terms of leverage for the company, but has had the advantage of leaving a company free of contingencies and liabilities, with a very sound balance sheet and ready for a new phase of development and growth.

Of course, we will continue with our legal actions, be that at the domestic level or internationally, that we deem appropriate with respect to the situation. But, the Company now is enjoying, which was not the case before, a quite light and unlevered balance sheet, and it has all the opportunities to capture growth as they present themselves.

Joshua Mills - *Goldman Sachs*

On Spain, just in terms of revenue trend, it's encouraging to see that it´s back to growth. And one of the key swing factors this quarter was in Wholesale. I know that there's potentially some losses to come on the MVNO front, given you've renegotiated contracts with MásMóvil, so is that going to weigh in Q4, or is that more of a 2018 story?

I'm just trying to understand whether or not we can see a further acceleration in the overall Spanish service revenue growth, given you've already kind of met your guidance initially to stabilise by year-end.

On digitalisation, I think on slide 16 you lay out some very clear data points in terms of how this is a cost-cutting opportunity. But the reference that you make to monetisation and how this can help improve the customer experience, on slide 14, are a bit vaguer. In a nutshell, do you see digitalisation as an opportunity to really increase ARPUs and ask for more money from the customer, or is it mainly going to come through on the cost side?

Ángel Vilá - *Chief Operating Officer*

In Spain, we have had a very good third quarter performance. In previous results' calls and investor meetings this year, we had been saying that we expected revenue trends in Spain to improve along the quarters. And in Q3, Spain is back to service revenue growth. We have recovered positive commercial momentum following the launch of the new convergent bundles, as you have seen in the presentation.

Improvement in service revenue is in all segments, in B2C, in B2B and in Wholesale.

B2C, which, as you can see on slide 19, accounts for 54% of service revenues, is growing 2.1%, and this growth in B2C service revenue accelerated from Q2 to Q3.

B2B, which account for 27% of service revenue, is declining 1.1%, but it's improving sequentially 0.2 percentage points quarter-on-quarter and is declining a bit less than in the second quarter.

And the third component that you were asking about: Wholesale and Others, accounts for 19% of the revenues, and it's improving sequentially, +3.2 percentage points quarter-on-quarter. Wholesale revenue has several components: One is Wholesale revenues from selling football content. We had already been saying that the unfavourable year-on-year comparison would fade away from August because now we have the same content that we were wholesaling in the same quarter of one year ago; so, the football rights' component is fading away starting in August. We have seen also a good performance in NEBA and roaming revenues. The impact from the loss of Yoigo revenues will be more in 2018.

So all in all, service revenue trends are improving in all three segments. And, I should say, we expect them to continue growing in Q4.

Regarding digitalisation, this is a topic in which we started early and we are already seeing results. We have tried to make an effort in this presentation and we have included five slides on this, giving you an overview on our approach to digitalisation, which you saw on slide 14; a description of the areas where we can see potential benefits on slide 15; the progress made so far in E2E digitalisation and enabling digital capabilities that you can see on slide 13; and then the proof points that we are achieving already with respect to two examples, which are Spain and Brazil, but we have more. The ones in Spain are on Page 16, and probably you can go through them.

We see beyond cost benefits from digitalisation, we see benefits that can affect the cross-selling and upselling through our customers. We can foresee benefits regarding loyalty, and therefore, reducing the churn of our customers. We can see benefits obviously at cost and efficiency level, and we also see benefits at CapEx deployment level with the use of big data to be more efficient. So, it is more than cost-cutting, it goes beyond efficiency. We tried to present how it permeates all the platforms of our business. And again, I would like to highlight that we have achieved significant benefits, but there is much more to come.

Joshua Mills - *Goldman Sachs*

Have you got any data points that show, for example, that people that have a digital relationship with Telefónica pay more or have a higher NPS, for example? Or is it still too early to get those kind of numbers?

Ángel Vilá - *Chief Operating Officer*

Our customers that are in Spain and, for instance, have fibre, they pay more than they used to pay when they had copper. The ones that not only have fibre, but have the advanced Home Gateway Unit in Spain have access to higher audio visual quality content than customers that do not have it. The ones that have the Smart Wi-Fi capabilities at home can adjust also their coverage at home. And all of this is resulting in customers being willing to use our pay TV compared to one of other players, and that would be one example, for instance.

Sam McHugh - *Exane BNP Paribas*

On Spain, I think you said before you are spending something like EUR 100 million to EUR 200 million over the next year or so on original content, and that number is in your guidance. But should we expect that to grow in the coming years?

And then secondly also in Spain, we've seen a bit of a slowdown in customers taking the 100 and 300 Mb fibre. Can you talk about consumer experience and demands for higher speeds? Is this a structural problem, or do you think growth areas are going to reaccelerate going into 2018?

Ángel Vilá - *Chief Operating Officer*

Regarding content, I think that you were talking about our own production. The figures that we have given to the market are the ones that will stay.

Here, if anything to be highlighted, is that we are having quite a successful reception to the series that we are producing. We have been previewing them in film festivals. They have been deemed to have the best quality and the start audience that we are having in our series is quite successful. This is one part of three legs that make a TV strategy successful: one would be the high-speed connection and the home equipment that I was touching before, then the content, own content and acquired content, and then TV platforms with the best functionalities.

We have, on content, the most complete and widest offer in the market, including movies, series and sport. None of our competitors has a similar level of contents than the one that we have. And we are producing, in the limited figures that you know, our own production. We have noticed, on the other hand, recent inflation on certain soccer rights, and as always, we will analyse the cost/benefit equation of content in a rational way, and we'll decide accordingly.

Regarding Spain fibre, we have been recovering momentum commercially in Spain. We have launched in July some new convergent bundles that have led to traction commercially in several metrics. We have had very good commercial traction on TV, we have had very good commercial traction on mobile, we have had traction going back to positive net adds in “Fusión” and fixed broadband gained traction as well, and it is in positive territory in the last two months of the quarter. So, since we launched the new offer, we have a good recovery in commercial momentum in Q3.

Samuel McHugh - *Exane BNP Paribas*

Can I just follow-up very quickly on the content if that's possible? Is there particular series, or is there a kind of a point in time when you will launch some of your new series, and we will see a little bit more of a commercial splash? You know, do you have your own version of "Narcos" sneaking around the corner somewhere, or something like that?

Ángel Vilá - *Chief Operating Officer*

Well, we have a series called "Velvet", which is quite successful. We are also launching one called "The Zone", which is also being very well received. We plan to add more Hispam flavour to the production of some of our series, so that they fly over to Latin America also successfully. And we can leverage that in our over-the-top TV proposition "Movistar Play" in Latin America, which is already active in Peru and will be deployed across the footprint in Latin America. So this is really getting traction within limited or not exaggerated budget.

David Wright - *BofAML*

Just a couple of questions on Roam Like at Home, because it's obviously impacting the UK really quite materially, and there's also, I think, in the domestic business, there's some increased roam like at home expenses. In Q3 we might expect a seasonally higher impact. So, given that you have, I believe in the presentation, quantified the UK impact in Q3, could you give us an indication as to how that could progress in Q4? And similarly, in Spain, the drag in Q3, if you could quantify that, and how you could expect that to progress in Q4? I think that will be very useful.

And then my only other question is on the CapEx side. Again, just visibility in full year 2018 domestically, if you could give us some indication of whether absolute CapEx levels could be falling.

Ángel Vilá - *Chief Operating Officer*

Regarding Roam Like at Home, we have seen a high traffic elasticity since these new regulation is in place; data traffic growing by 3x to 4x, voice traffic also growing, although at a slower pace. We have seen a significant impact on group revenue and OIBDA from Roam Like at Home in Q3 due to the seasonal behaviour of roaming revenues; in the holiday season is clearly high. Those impacts should be lower in Q4, both the positive ones in Spain and the negative ones in Germany and UK, compared to Q3.

In the UK, it has a significant impact. We have put the figure, EUR 48 million impact on OIBDA in Q3 from Roam Like at Home. It's a slight lower impact in revenues, but revenues that grew 1.1% in the UK in Q3 would have grown 3.6% excluding roaming and MTR impact. So, this has been significant in the quarter. The third quarter is the highest; it was positive in Spain, it has had a negative impact in the UK, a little bit more phased impact in Germany, because not all the customers had moved to the new roaming tariffs. But Q4 will have lesser of an impact, less positive in Spain, less negative in UK and less negative in Germany.

David Wright - *BofAML*

Are you able to quantify the kind of net headwind you've had? You've got positive impact in Spain, you've got negative the others so is the net roaming impact lower in Q4? Obviously, the benefits in Spain, the reduced roaming benefit there, is that more than offset by the reduced headwinds from other markets?

Ángel Vilá - *Chief Operating Officer*

It will continue to be a negative impact the net impact group wide, though it will be lower.

David Wright - *BofAML*

Okay, that's clear. And the CapEx, please, Ángel?

Ángel Vilá - *Chief Operating Officer*

Yes. CapEx is on a declining trend in Spain. We have already 97% LTE coverage. We have close to 70% FTTH coverage. We will continue deploying fibre, but at a more reduced speed and focusing on connecting. You know that we don't guide CapEx by markets, but the CapEx trend in Spain is already declining in terms of CapEx to Revenues.

Keval Khiroya - *Deutsche Bank*

On the assets in Chile and Peru, within the mix these two assets are relatively weak from an OIBDA perspective, are you happy with your strategy for turning these assets around? And if so, do you have visibility as to when the double-digit EBITDA declines are seeing within to improve could also start to improve as well?

Ángel Vilá - *Chief Operating Officer*

Both in Chile and Peru, we are seeing improvements from Q3 compared to what was Q2 but we see challenges in both markets.

In Chile, we are seeing some increasing commercial intensity on the mobile side, with the launch of some unlimited tariffs, and in spite of this, we have seen a progression; a lesser decline in mobile, in total revenues, but still a slight decline. OIBDA is decreasing due to an increase in operational expenses that are driven by this competitive situation, but we are managing to control the OIBDA margin. And through some adjustments on CapEx, we have managed to have an operating cash flow growth year-to-date +5.5% year-on-year.

Regarding Peru, again, Q3 is better than Q2, but challenges remain. We have seen some improvements in some trends: our prepaid base with frequent top-ups is returning to growth, postpaid loss is slowing down, and in fixed, we continued to have a robust commercial trading with pay TV accesses growing 5%, with fixed broadband accesses growing 4%. So here, we are having a better performance.

All in all, these are markets where we are focusing a lot our management efforts, and there are still challenges looking forward.

Georgios Ierodiaconou – *Citi*

My first question is around DTH in Latin America. Yesterday, VIVO suggested that the focus is more on IPTV and that DTH options are not that appealing in Brazil. Obviously, you do have some M&A options there. And I'd be interested to hear your thoughts more broadly, not just in Brazil but across Latin America, where there are countries where, maybe, adding a DTH base could help with cross-selling and whether there is any scope of that.

And my second question is around the moving parts on OIBDA for Spain in 2018. Obviously, we've got the content side, we've got the loss of MVNOs revenues. I was just trying to understand whether digitalisation will get some savings through. If you could more or less give us an idea what are the headwinds and tailwinds we should anticipate going into next year. And whether you think you can offset this in order to be on flat positive EBITDA performance?

Ángel Vilá - *Chief Operating Officer*

On DTH in Latin America or our video strategy in Latin America, we have different situations in different markets.

In Peru, we are, by far, the leader in pay TV through our historical position in cable. In Brazil, as was highlighted in the call yesterday, we are focusing on IPTV; we are growing our fibre base covering more and more cities and following that with IPTV. And in markets like Argentina, we will be able to offer pay TV starting next year in some regions and progressively nationwide.

Our strategy is more focused on IPTV, and second, in those markets where we have a lesser position in IPTV, we are focusing on an over-the-top aggregator strategy, with “Movistar Play”, that is already in some of our markets. This will be our priority rather than progressing on DTH.

We know that, at some point, there could be some potential available assets on DTH. We tend to look at opportunities for in-market consolidation always, but it would have to make sense in terms of valuation conditions. We are, at this moment, focused on our organic development.

Regarding what you call the moving parts in OIBDA in Spain. You were asking about 2018 and obviously I cannot give an answer.

But if I had to give you some colour, first, let me touch on the Q3 OIBDA evolution. The OIBDA in Spain in the third quarter had a margin of 41%. It's an outstanding OIBDA margin figure for Q3, and we believe and we have been telling that we continue to see margin sustainable around the 40% level.

OpEx in Q3 grew just 0.2% year-on-year organic, on lower personnel and higher supply costs. Personnel cost was 4.5% down year-on-year, other operational expenses were down 1.1% year-on-year and supply cost was up 4.2%, mainly on higher content cost, a lower decline in handset costs and a little bit higher roaming out, but we are managing to maintain margins sustainable around 40% in spite of the content inflation.

Do we have room for additional efficiencies, and part of them from digitalisation? Yes, for sure.

We can have additional efficiencies in distribution channels, from end-to-end digitalisation, leading to increasing online sales, the usage of the improved “My Movistar” app will drive lower CRM expense. We continue, and you saw it again (and I encourage you to look at slide 16), points of sale and store optimisation, lower commissions and so on.

We will continue to have incremental savings from personnel redundancy programs because the run-rate will not be achieved until 2019, so it still has room to grow.

We will continue to have efficiencies from running a full fibre LTE network. The maintenance cost of fibre customer equipment vs. copper is 40% lower. And as we continue deploying, that will continue flowing through. And we continue to switch off legacy. By year-end, we will have closed approximately 70 copper central switches and we will have tendered 300 closure announcements, and this will continue. For the next 10 years we expect to close 2,000 copper switches, so this is something to continue.

Of course, we are seeing inflation of content cost, and as I said before, we will continue working optimising the content cost according to our rational cost/benefit analysis that we perform.

And then, migration to full stack business support systems will drive additional simplification and reduction in our IT costs.

So, we think that we continue to have levers to be able to maintain the Spanish operation in the levels of OIBDA that you are seeing.

Fernando Cordero - *Santander*

My first question is related with your guidance. Considering that you have reiterated the OIBDA margin expansion up to 1 percentage point year-on-year, and given the performance in the first nine months, should we consider that the fourth quarter should reflect more than the nine months' margin expansion?

And the second question is related to your previous comment on the efficiencies to be pending to be obtaining in the Spanish operations and particularly on the copper network switch-off. You have said that you are expecting to close 2,000 switches in ten years. Given the diversity of the switches, I would like to know how many of the current lines, or the size of the network, would be switched off in these 2,000 switches closed?

Ángel Vilá - *Chief Operating Officer*

On the guidance, first of all I would like to reiterate that with our Q3 results, we are well on track to deliver on the guidance across all metrics. We have upgraded revenue guidance in Q2. And, well, you know, we tend to be conservative, so if we extrapolate the nine-month's performance, we should exceed the revised revenue growth guidance. At the same time, we expect to be in the range regarding the OIBDA margin and we expect to comfortably meet the CapEx guidance. So, we expect to be in the range regarding the margin.

With respect to the copper switch off, I think Telefonica Spain is the company that has done the most globally across all operators with respect to switching off copper networks. Here we need to give advance notice in those switches where we have other operators co-located. We need to give notice in advance of five years. If we didn't, which is quite unusual, have anybody co-located, we could do it with one year. But, since we started our fibre deployment back in 2012, we started turning in those notices and we are steadily closing some of those switches. There's going to be a much optimised network and the metrics I gave you before central copper, central switches closed down by year-end and 300 closure notices already tendered.

Mathieu Robilliard - *Barclays*

First question is in terms of the regulatory environment in Europe. Obviously a lot of discussion recently about what the final text is going to be around regulation around fibre. And, I wanted to know if any of the recent changes are discussions that could introduce tight oligopoly or not allow deregulation on fibre, if that could affect your expected return on investment, and generally your operations in Spain?

And the second question is about the competitive environment, how would you characterise it today compared to a few months ago? I mean, are you seeing the kind of discipline you were expecting and hoping at the mid to high-end of the market?

Ángel Vilá - *Chief Operating Officer*

With respect to fibre regulation, you know that in Spain we have the biggest fibre deployment in Europe and this was the result of a regulation that favoured infrastructure investment as opposed to favouring other metrics. What we have in Spain separates between competitive areas in which it's not regulated, which are those areas where you have three networks with commercial competition, from those areas in which there are less than three networks, in which there are different degrees of regulation. So, it's a geographically segmented regulation.

We think that at European level, with a Euro Gigabit vision, there is an underlying desire to promote more pro-investment and more pro-innovation environment. And, you know, it's still in process. But, the proposal represents a good starting point, because we think that there are areas, including the promotion of infrastructure investments are in the correct direction. Also, generating or proposing some measures that address the level playing field with respect to over the top. So for us, if regulation continues to be one that promotes investment for us, it's the way to go forward and we think that Europe is taking some inspiration from the Spanish case.

Regarding competitive landscape, and I assume you were asking about the landscape in Spain, we think that the market remains competitive but rational, which is quite important. The market is driven by convergence in all services with quality fibre, TV and mobile data as the main levers.

But this competitive environment is clearly segmented. The mid/high-end segment has three infrastructure-based players, all oriented to upselling and cross-selling. Here you can see, and you will see tactical promotions, but not structural ones. And we believe that different players have adopted policies or strategies that in the end aim to be ARPU accretive. The low-end is seeing some more intense competition, but we feel well-equipped to compete here, because we have differential strengths. We have the best fibre network, we have an LTE coverage which is second-to-none, we have the best platform, the best content, we think we have the best distribution channels, and we are working, as we have been highlighting throughout the presentation, to have the best digital customer experience.

So, we feel very well-equipped to compete. And, you can see this, in addition to all this talk, you can see this in metrics. Since we launched the ""Fusión #0" and the ""Fusión Series" to address at the low-end segment, we are back to positive commercial momentum. We have added "Fusión" customers. The mix of "Fusión" customers is better than the one we had in the previous quarters. We have more "Fusión" customers in the mid and high segments. "Fusión" ARPU is up, +7.1% year-on-year, or €5.8, and churn is broadly stable in a controlled range.

So, it continues to be a competitive market, but we think it's a rational one and we are competing comfortably in it.

Luis Prota - *Morgan Stanley*

I have two questions. The first one is on Mexico. I don't know whether you could give us some rough estimate on the impact on OIBDA in Telefónica Mexico from the new regulation on termination rates and whether you see this is a major change to the competitive landscape.

And the second question is on Spain and the wholesale market. I don't know whether you could give us some data points on the take up of wholesale fibre accesses by Vodafone. I don't know whether you could give us a run-rate or what could we expect midterm in this regard and potentially helping to stabilise or even grow wholesale revenues once the Yoigo impact is over.

Ángel Vilá - *Chief Operating Officer*

Regarding Mexico interconnection, in the month of August the Supreme Court ruled in favor of América Móvil's injunction regarding the legality or constitutionality of having a "zero fee" interconnection. Two points here:

The regulator now has to set the new rates, but those rates have to be based on the principle of asymmetry. There will be lower asymmetry, but maintaining asymmetry. And the second important point is that this ruling was not retroactive, so this would be applied from January 1, 2018, onwards and is not retroactive.

This is going to be decided quite soon because it has to be applied by the beginning of next year. And there are different speculations about where could be the levels of these termination rates in their respective networks, but there will be a level of asymmetry. It's likely that there will be less asymmetry than the one that we had before, so this will have an impact in our OIBDA and an impact in other players' OIBDA in Mexico, but it's still soon to quantify the potential impact.

Regarding the fibre wholesale in Spain, the fibre NEBA growth keeps ramping up, based on recent agreements and regulation, but penetration is still low. And this is going forward something that will grow.

Another important thing to note is that the migration from unbundled local loop to NEBA, given the price, is revenue accretive. And this will be another important factor into this growth. And I must say that we're happy with our Vodafone agreement and are open to further agreements with other players, which could be or will be analysed according to profitability criteria.

So, if one were to look at the moving pieces of the service revenue evolution for looking forward, I can give you not a guidance, but same trends for Q4. In B2C and B2B, we expect similar trends, but in wholesale, and this part include fibre wholesale, we expect to continue to improve trend in 2017. I hope these can help you with your model.

James McKenzie – *Fidentiis*

A question on Spain and the "Fusión" KPIs. You have seen a big tick-up, well, a reasonable tick-up in churn during the quarter. In previous quarters, I think we've talked about churn being higher in the low-end bundles. Is that still the case? Or has there been a tick-up in churn in the high-end bundles because of the price increases you've put through?

And then I mean, just finally on "Fusión", how do you see the commercial success of the new low-end offers that you launched at the beginning of July? How have the gross adds been doing on the low-end bundles?

Ángel Vilá - Chief Opera*ting Officer*

I would challenge your statement that "Fusión" churn is worsening. We have been seeing in the different quarters a 0.1 percentage point up or down movement. This is a metric that, as you can imagine, we monitor very closely. We're seeing that this is broadly stable and is within a controlled range. And what we said in the previous call continues to be true. The churn in the mid/high-end subscribers is around 70% of the churn in the low-end segment because the higher-end subscribers show more loyalty. And actually when you look at the mix of mid and high-end, it's moving up rather than moving down.

And to your second question, we are seeing traction in the lower-end offers that we launched including TV "Fusión #0" and "Fusión Series". "Fusión Series" is, under a promo, at the same prices as ""Fusión #0", and what we're seeing is traction in ""Fusión Series". And bear in mind that this is under promotion. And when the promotion finishes, we continue to see a substantial percentage of the customers staying with the products, and therefore it tends to be ARPU accretive when the promotion finishes. We'll get commercial traction partially through a promotion, that when it ends up it will become ARPU accretive. So I hope this answers your question.