

Telefónica



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Anticipating the future to transform the present

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Thank you, everybody. Thanks for coming to our Eighth Investor Conference here in London. We at Telefónica, we are very happy to have you here. We are very excited and we think we want to share with you how we see, what we think is a very good progress of our industry and especially the good progress for Telefónica.

It has been a year and a half since we last met and I can say that the worst of the crisis is over. And I can say the worst of the crisis is over and at least this is very clear from the footprint of Telefónica.

Our industry has shown that it is very resilient, and the growth prospects now are more encouraging than ever. And we are very, very confident about the future of the industry and especially about the future of Telefónica.

We see ahead a growth industry with lots of opportunities to use and to anticipate the clear trends of the industry. And I think we think that Telefónica has the right position, the right capabilities and the right strategies to make the most of it.

In my presentation I would like to cover three points:

- The first one will be the primer achievements we have made since our last Investor Day.
- The second one will be to summarize the main industry trends and the great opportunities for the telco industry ahead of us.
- And finally, the last part of the presentation will be to share with you the strategy Telefónica has to make the most of it and also share with you our guidance.

And now I would like to move to the first part of my presentation.

In the last Investor Day we said with you what we thought was a clear strategy that we have executed. And we have taken advantage of the crisis clearly.

Let me remind you that last year Telefónica Group has invested EUR20 billion and we have invested EUR20 billion because we are very confident about the future of Telefónica in the industry. And even at the same time let me remind you that we spent EUR20 billion and we paid our dividends clearly.

And I think we have been able to anticipate the growth trends of the industry. In the last 18 months we have delivered on our commitments, clearly, I assure you we do. We continued transforming our company as we always do. We have outperformed the market and we are reinforced clearly our scale.

Hence what is more and more important we have strengthened our capabilities to better position to capture the many opportunities ahead of us. We have made it an advantage to capture the revenue growth potential. Our revenues mix when you look at

it is moving in the right direction. Everytime more broadband and services represent more of our revenue mix.

We have become a streamlined company more focused on our customers. And we have a clear advantage on that and a positive gap with our competitors we have in the different markets. We have consolidated our brands and we are very happy to be recognized by Fortune Magazine as the most admired company in the Telco industry. And everywhere we are, our brands are number one or number two. In addition in the last two years the number of customers we have has grown by 7%.

And to reinforce our top line growth, we are advancing in a more efficient and growth enabling operating model which is key. With regards to the network side our multi-access strategy has allowed us more than double our capacity improving very much and significantly the coverage and capacity of our broadband network both fixed and online.

Regarding the IT which is a key transformator enabler we have improved a lot. We have improved our time to market in delivering the products and still the IT OpEx and CapEx over the total revenue remains at 4%. And we have advanced clearly to be a more online company. And you can see that in the last two years we have multiplied by five the number of transactions we do online.

2010 reinforced our track record of being a very highly predictable company and very profitable one. We have outperformed clearly the market and we have presented the best combination of organic growth and profitability. And at the same time maintaining a very sound financial position we have the best-in-class dividends.

And as you know we are a company fully oriented to maximize shareholder value. It is true however, that normally every year Telefónica's stock price had performed better than our peers. But it was not the case in the last year. When you look, any way you look, to our income, revenue increased in organic, our EBITDA increased on a reported and organic, well ahead of all our peers.

I only found one explanation for that, is that we have the headquarters of the Company in Spain and we are the most liquid stock in the Estoxx. But and not so much looking at the fundamentals that has always has been better than the previous year and every year will be better than the preceding one.

I always say to the managers of Telefónica and this is something I want to say to you that the headquarters of Telefónica is where they are and where the clients are. We are the most international diversified globally integrated telco Company in the world and our revenues and EBITDA come from this profile.

We will be working as always on the fundamentals of the Company. And I think what happened last year wouldn't you agree, is an anecdote. Also, we have reinforced clearly

our asset base in the industry where the scale and spectrum are extremely important and every time more and more.

When you see our organic growth in the last year and a half, the number of accesses has increased by 28 million. And with regards to the number of accesses we are the number five company in the world, with only three Chinese companies, one of them as you know we are an important shareholder and Vodafone ahead of us.

And we have completed all the strategic operations we told them we were going to do. Let me mention the acquisition of the 50% of Brasilcel, which completes our footprint in Brazil. And the second, also increasing the spectrum and the increase in shareholding in China Unicom, that I told you before we were going to get 10%. And we are capturing significant synergies of our global alliance which every time is over time more and more important.

I would think that with the industrial alliance that we have with our partners Telecom Italia and China Unicom we have the best rich global scale in the world. And this is going to be extremely important from now on. Also we have been working a lot in strengthening our internal capabilities to capture the fantastic new opportunities that the new digital world is offering to us.

As we know we have seven P&S global units that will help us to develop services and innovation. Also, we counted all over the top companies and as Maria was saying the CEOs of Terra, Tuenti, and Jahah will make a presentation at the end of the afternoon. Because we are at the beginning of a new way of living, a new way of living in which every transaction that is made by persons or by business will be done in the digital arena. And we are already taking advantage of it.

The combined global scale is extremely important. And it is going to be a key differentiating factor between Telefónica and all the other players because we are going to be and we are starting to be already the partner of choice for the leading innovative companies that want to serve with us the reach we have at a global level.

This is a win-win situation and one factor which is going to be very important now in this new digital arena is the economics of scope. And if anybody has economics of scope the world over that is Telefónica. At the same time we are still considered to be what we believe is very important: to be the most diversified, integrated, and I want to underline the word integrated telco company in the worldwide. Our geographical and business diversification creates value and every time will be a more important asset than it is already.

This premium diversified scale with the better focus we have on customers through what I believe also is one differential factor for Telefónica which is the multi-local and I want to stress the word multi-local but integrated global management. The best proof is the nearly 290 million clients we think at the end of last year and we are the number-one or number-two player in every market. With regards to revenue market share in

every region, we have 30% in Latin America, we have 52% in Spain and in Europe we have a 25% market share.

All together we reach more than 700 million with the industrial alliances as I tell you before with Telecom Italia and China Unicom, we reach more than 730 million customers which means more than 10% of the total population of the world. When everybody is talking about the necessity to be global we with our industrial alliance, we're already global.

But at the same time we have always been very much worried about having a business that will sustainable. And that's why we're so happy that is was for the second time in a row Telefónica has been awarded by the Dow Jones Sustainability Indexes for the second year in a row.

Because we think also it is very important factor to create long term shareholder value. It is very important that the corporate representative contributes to the creation of value because it boosts their trust in our business.

And let me finish the sector by highlighting how Telefónica is committed with the societies we operate. This year as you know we have made a contribution of EUR400 million to Telefónica Foundation to be able to make the short and medium term activities mainly related to this wonderful program which is called Proniño in which Javier Nadal, executive vice-president of Telefónica Foundation will talk more tonight at the dinner.

As you know we already have taken from work in Latin America and put it back in the schools, in the schools with a very good digital high quality education to 211,000 children and by 2013 we expect to have nearly 360 million children that we have taken from work and put them back to school.

And now, I would like to move to the second part of my presentation. And I would like to share with you the enormous opportunities that the ICT industry is offering to us. We in Telefónica, have no doubts we are in a growth industry no matter how you look at it I think.

Regarding the macroeconomic outlook it is clear that the worst is over and we foresee a steady global growth ahead. And as I was saying to you a couple of minutes ago even looking through the footprint of Telefónica this is very, very clear that the worst is already past and we have growth ahead.

There is a new economic order now and we in Telefónica we did anticipate this new economic order. The regions that are going to grow the most are Latin America and Asia and we are there. And Santiago will clearly elaborate after my presentation how there is direct correlation between income growth, penetrations and new products and services.

And the ICT industry is back to growth. It is expected that the total ICT industry will grow from 2010 to 2013 by 4.6%. And Latin America, once more, stands out as a region that will experience the highest growth. And this once again puts in value our different profile versus the rest of our peers.

On top of this, additional growth will come clearly from the desire of people to engage in a total digital life and to be always connected. On the slide you can see a few examples that show how customer demand is really driving this process.

People and households are becoming more and more digital and the new generations we know are totally full digital natives. I'm sure that this additional potential growth is not fully reflected in the market figures that we just have seen. The digital convergence will allow us to expand the scope of the real economy into the online world.

New digital based services like financial, health, government, education, entertainment and services can now be reached anywhere anytime and through any device. In fact the digitalization of the real economy is clearly enlarging the scope of our market.

Therefore I'm sure the ICT will increase its share in the consumers' wallet. You can see in the graph how, even in a crisis period, people have been willing to maintain or even increase their expenditure in Communications.

And now I would like to go a little more in depth into many new industry trends that we find and how are they clearly anticipating further growth for our industry. There are still very important penetration growth opportunities, as customers are expected to grow at still a very solid rate.

Worldwide accesses will grow at an annual rate of 6% from 2010 to 2013. Mobile and fixed broadband accesses will grow at 8% to 9%. And mobile broadband is going to grow at the expected increase, impressive rate of 46% per annum until 2013. There is a clear trend towards full penetration of broadband at households and enterprises and mobile broadband for internet users. And also internet users and social networking users are expected to grow at two digital rates.

The proliferation of improved internet devices, more powerful, more affordable and I want to underline more affordable, and more easy to use is a clear trend in the industry. The annual global sales of personal devices are forecasted to grow at almost 20%. And this explosive demand is driven mainly by smartphones and tablets.

These trends offer a clear opportunity for the telco players as the smartphones increase the average ARPU, clearly, and the lifetime value of our customers. And these two factors are of tremendous importance for the revenues of the industry and moreover for the Telefónica industry.

With smartphones, mobile devices have moved beyond the realm of communication to become tools that manage consumer's daily digital lives. And on top of that machine to machine are expected to grow exponentially.

There is no doubt that by 2020 every device will be connected. So you can calculate how many of them there're going to be. We are talking about everything: connected cars, free smart meters for everything, smart cities, e-health, education, recreation, security. Even the consumer electronic products will be. All digital cameras will be connected.

And this is an opportunity for the telcos who will provide clearly the connections and the services over connectivity. An opportunity that is there but still is difficult to quantify, but to quantify on the plus side and not in the minus side, clearly.

Beside devices' possible growth there is a clear growth trend when we look at the proliferation of new services applications that we are already providing and we are already monetizing. Services beyond connectivity involve an additional market opportunity of more than EUR700 million are expected to be the market by 2013.

And the first thing which is very important to highlight is that the booming traffic driven mainly by new applications and services and especially by video. The challenge here we have is to be the most value possible over traffic volume.

It is very clear that a technological evolution will allow this data traffic to explode and moreover much more with the new spectrum which is much more efficient. We both own spectrum and networks and there are two key assets in the new digital life that you need to be successful. The companies that don't have the spectrum and the networks they have a problem.

And we have it and still having the clients. This is a tremendous differential competitive advantage we have in this ICT industry and the adjacent business and everybody will be looking and is looking to make agreements with us. To reach what is the most important: the premium customer base we have been building this year.

In summary, all the industry trends show that ours is a clear growth industry. Our customers grow. Every time there is more powerful for connected devices and cheaper. There is a proliferation of applications and new services and all this drives growth and so revenues.

So, our industry has one of the best growth prospects of the economy since I've been in the industry by far and we are already monetizing this great opportunity. In the third part of my presentation I will explain how Telefónica is going to profit clearly from these things.

These trends show clearly that the telco market is enlarging and is a growing market. Growth will come primarily in the coming years from mobile data that will increase at a rhythm of 11% as you can see in the slide.

Fixed data and mobile voice will grow at an annual rate of 5% and 2% respectively. And the telecom industry is expected to grow at 2.6% but the footprint of Telefónica will grow faster as you can see at least by 3%.

But we are not only targeting the traditional telecom services anymore. We are also targeting clearly the services beyond connectivity that are expected to grow at a 5% premium. A growth industry together with the operational leverage that you have, if you have the right skills and the right efficiency as you know always has the multiplier effect in EBITDA and cash flow.

Up till now I have focused about the opportunities and I want to spend a few moments talking about the challenges. But these challenges are the type of challenges that if we solve them properly will further accelerate the growth of our industry.

There is the need to be very cooperative with the ICT players and I think this is key. Regardless of the telco players we will see more stable and presentable regulatory outlook in the traditional business and no-regulation for the new business.

From the device supplier side, it is clearly that an open operating system is needed. When you look at the number of mobiles that are going to be in the world it's impossible to be competitive with a closed system, just impossible. 1% of the total market share is nothing.

And regarding internet players it is clear that a new sustainable internet economic model is needed which requires retail pricing, rethinking clearly retail pricing and we will talk in our presentations a lot about it and how it's evolving in a very positive way.

Interconnection and peering charging models have to change. The peering model was done when there was the same, symmetric traffic and now we find the ratio was one to two and we found our situation is one to 60 and this just impossible and it has to change and is changing already.

New managed services based on quality of services that is what the consumers want we are already as I told you working on these points and the only thing that is that we're going to be in the coming months is positive news for the telco industry. And this is very, very clear otherwise the internet system is not viable.

So now let me go to the strategic blocks of Telefónica for the next three years. In Telefónica we, as always, have a clear strategy to capture the opportunities of this new digital world. Our strategy is based on two pillars. First one is growth. Our ambition is as always to keep leading the growth in the industry through the monetization of the growth opportunities that we have ahead of us.

And transformation we are as we have always done to make a profitable global reaching a very efficiency optimization in our asset side and cost side. In both things at the same time the maintaining as always the customer in the center of everything that we do and leveraging at the same time the scale and the diversification to become the really truly global company that will ensure our growth prospects.

As I told you in the last investor conference we have been working to put the customer at the center of everything that we do and provide the best customer experience. The customer focus is driving our strategic actions and we have developed seven initiatives to improve the quality perceived by our customers.

A value proposition which is already being the key. All the business has to be based on very clear business intelligence and there is nobody else like us to have the business intelligence of the customer, offer simplification, multichannel company, brand unification and emotional engagement.

These initiatives will clearly improve our customer satisfaction and the reduction of the churn ratio. And you know very well how very important these two factors are because in the P&L if you move in the right direction.

And we are taking what we think is a very, very important step. Our next step is not customer experience which is very important and we are there, is customer value and this is the key priority for the next three years for the whole management team of Telefónica and we are on it. And we are increasingly capturing growth opportunities that we translated into our revenues. We increased prospective revenues in the next three years between 1% and 4% until 2013.

We will reach more than 340 million customers which mean a growth rate of 6%. And these four priorities are based on profitable mobile data growth monetization clearly, continuing to enhance the portfolio of fixed broadband, the clear development of new applications and services and why not capturing the remaining mobile and fixed voice opportunities.

Julio Linares is going to explain later much more in detail the four priorities for growth. First the profitable data growth monetization based on tiered pricing, ARPU management, customer innovation and yield management. And thus the mobile broadband revenues are expected increase in the Telefónica group by 30% to 35%.

Second; to continue enhancing the fixed broadband portfolio with full, fixed broadband proposals; full IP services and full bundles. Fixed broadband services, revenues are expected to grow between 4% and 7% in the coming years.

And the development of applications and new services beyond connectivity significantly broadening our portfolio and increasing at an annual rate of 20%. And capturing, as I was telling you before, the remaining mobile and fixed voice

opportunities, increasing penetration and usage of mobile and defending the ARPU of the fixed lines through additional services.

Reaching this revenue growth we will further evolve our revenue mix. Broadband connectivity will rise from 18% to 25% of revenues. Services beyond connectivity will increase its weight to 9% by 2013. By 2013 36% of our revenues will be growing at an annual rate between 14% and 17%.

If you make the multiplication, which is very clear, it means it will be growth between 5% and 6%. But profitable growth requires social and accelerating transformation and we have identified as always three key priorities that will enable growth while maximizing efficiency.

First, have the best-in-class network. We know that networks are every time more and more important and we are clearly taking advantage of being an integrated company leveraging on the fixed and mobile technologies to provide which is very important a differential offer to our clients.

So again, IT transformation which is clearly a key accelerator instead of moving to a full evolution or digital company and including the online processes that will improve the engagement with our customers, with our employees, with the vendors we allow clearly process simplification and end to end integration.

All this to still be Telefónica the reference in the industry and be where we want to be and have always been the most competitive company in the industry. And we will continue maximizing the benefit of our skill and diversity adapting always clearly to the local needs. And for that we have the best in class management model which includes the multi-local approach with an integrated and global reference.

The management model that is already providing us with global services and global functions like we have in R&D, in products and services development, in finance, in procurement, in IT and technology and we will give on those lines.

And we still further leverage on our industrial alliances. With Telecom Italia, as you know, we have delivered EUR1.3 billion synergies in the last two years and the actual program state we will expect to generate at least EUR500 million per year in the next coming three years.

Our alliance with China Unicom is a growth value story. The impressive growth of China Unicom has been impressive and I was not surprised when the stock price of China Unicom moved so fast in the last two weeks because we still have not reached the potential of this company in China.

But up to now all the synergies have been cost and revenues but now to become the partner of choice for the leading innovative companies in the world the scope and the

size are key and we are best positioned than anybody else to have these alliances and generate this additional revenue.

That is the reason I want to be very frank and honest that Telefónica is the right company to invest in. In the global reach of our industrial alliance we are by far the best and the only one best placed. We have three specific regional strategic priorities that tomorrow Guillermo, Matthew and José María will explain more in detail.

In Latin America to capture the growth through a full offer, leveraging on a unique platform reinforcing our global strategy and our regional skills maximizing the value of our diversified portfolio there and especially at this moment our leadership in Brazil.

In Telefónica de España to defend the OIBDA and the value leadership, capturing the growth opportunities and services beyond connectivity increasing the flexibility and improving the use of capital efficiency to a growth oriented CapEx and asset optimization model.

In Telefónica Europe to outperform the market by focusing on revenue market share growth, data penetration and return per customer accelerating the growth in Germany and outperforming as always in the UK and increasing the total aggregate cash flow from Czech and Slovakia and Ireland in the coming years.

And Telefónica, I will tell you, that I think that the best thing that Telefónica has is the committed and motivated team that we have. We have a very committed management team and we have very committed and engaged employees, and that's the reason we are creating a great place to work and in many, many countries Telefónica is becoming the best place to work in the whole country. In our Company we are all, everybody is aligned with the strategic priorities and the incentives are linked to the operating and financial KPI's.

That's the reason we believe that the best asset of our company is our management and we will keep working on that. Our level of ambition is reflected in the increase of the revenues which is going to be between 1% and 4% for the coming years.

And despite the increasing commercial activity we're going to have in the next years, we will be able to fully deliver an industry leading profitability and we expect OIBDA margin to be in the high 30s. And the cumulative CapEx for the 2011 to 2013 excluding the spectrum will no surpass EUR27 billions.

In our financial policy we will be centered on cash flow allocation because in terms of shareholder remuneration Telefónica will return EUR1.60 dividend per share in 2011 which means an increase of 14% year-on-year and EUR1.75 in 2012.

If you look at today's prices you find a dividend yield between 9% and 9.7%. Our cost of equity according to the financial department is 9.45% which means that our dividend yield is higher than the cost of equity. You know if you go back to school they

told us the cost of equity was composed of two things: dividend and g . If growth (g) is not affecting the stock price, and you know all the pages I have been talking to you before is about the best future growth prospects we will have ahead of us, so something is missing there.

And then with regards to the solvency protection you know how clearly we have been always committing to have the ratio between 2x and 2.5x times OIBDA and we done always that and Santiago will lever more on that.

In M&A operations I told you we have completed our strategy. Our strategy is completed and the only thing we have ahead of us is the spectrum and some product innovation companies. We have the footprint we wanted to be. We have the most reach in the globe anybody can have so we don't need any more M&A. Everything is going to be organic.

In summary, we are better positioned than anybody to lead the growth industry because we have the right scale, the right capabilities and the right strategy. We are focusing on value growth and on capturing the new services and applications and opportunities.

We have been always transforming our company to enable growth and maximize efficiency and we will maintain a very solid financial position while investing in our business and committing the best as always shareholders remuneration.

Thank you very much for your attention.