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Focus on profitable leadership

Good morning. It's a pleasure to be here. I think it was a great first half of the morning. For me it was a privilege to hear directly from President Lula, the success case of Brazil which is the success case of South America, I can tell you, and the great prospect for the region. And also, I hope you had enjoyed Jose Maria's presentation showing how are we creating value in our fast-growing region.

I'm going to talk about how we are protecting value in a tough economic environment and how we will continue creating value in a tough situation. So, as you all know, Spain has been going through a very tough economic climate. Tough economic climate is the phrase that Investor Relations allowed me to use and not to use other more colourful descriptions. They told me not to use crisis situation in any case, so I will stick with tough economic climate.

GDP in Spain has declined since 2008, and unfortunately, and this very sad, unemployment is over 20% in Spain. The evolution has been worse than we expected and everybody expected when we had our previous Investor Day. And although the private consumption has shown some positive trends in 2010, GDP continued declining. So we are now facing and expecting a slower recovery in the Spanish economy.

In this period, the Telco market has been not only affected by the tough economic climate but also by intense price competition based on increased price sensitiveness of our customers obviously in a tough environment. This pressure could be illustrated by the drop in the market mobile average rate per minute, of more than 10% per year since 2008, and by the wide number of promotion that we are seeing in the market in fixed broadband in Spain also.

As a consequence we have faced a declining market in the telecom industry in Spain of more than 4% per year.

And although our revenue fell less in 2010 than in 2009 we are still to a little bit above the 4% drop. This decrease in our revenues was mainly explained by the strong impact that the overall situation of consumption and competition has on our traditional business our Access on Voice business, which decreased by more than 8%.

On the other side, this fall was mitigated by our growth in Services beyond Connectivity and mobile broadband, where we grew by more than 10% in 2010. We don't see a lot of double digit in growth Spain lately, so this is something remarkable.

And nevertheless with this scenario we have remained resilient in core value parameters. For example, in retail sales market share, retail revenue market share, we have been only hit by a 2% in drop in two years and we have to keep in mind that our revenue market share is even higher and more stable if you include our IT business and especially our wholesale business. So, we have defended very well our market leadership in terms of revenue.

Our 47% OIBDA margin, this is still a benchmark in the industry. And we have focused in the right stuff, we have focused on cash flow and if you look at cash flow after working capital the loss was a little bit over 5%. So, we have defended very well in this metrics, despite the fact that we continue investing. We continue in 2009 and 2010 investing in improving our mobile network in terms of coverage and speed and also improving the speed in our fixed network, so a very balanced performance in a very tough environment.

So, what do we think about the future? Well, let's start by the macroeconomics. As Santiago Fernández Valbuena said yesterday, we are confident about the long-term, medium-term potential of the Spanish economy.

The Spanish economy is expected to grow 0.5 percentage points of GDP above the Eurozone average in the medium to long-term. And many international reference institutions believe that the worst is over in terms of GDP and private consumption.

Nevertheless, as you know, there is uncertainty, volatility. So, we have to acknowledge that the shape and the speed of the recovery in private consumption may not be fixed or certain and we have to manage this uncertainty.

Moving to competition, competition is high and it's gotten higher in the last quarters but we do not expect further and higher pressure in the future. Why is that? We have roughly 53% of the revenues of the market. On our side we will continue to keep a reasonable approach to price and to service strategy, trying to ensure the long-term sustainability on the market, while protecting our revenues and our profitability.

Regarding competition, well, we believe that their focus on service will increase as soon as the macroeconomic conditions improve. And you take, for example, large international players like Vodafone or Orange, they will focus on our opinion on ensuring higher margins and maintaining the long-term value of the market.

Cable operators, they have a constrained investment capacity due to high leverage ratios. So they're likely to focus on financial discipline, and after more than four years of operation, Yoigo and the MVNOs have captured slightly above 2% of the revenue share in the whole market of 5% in the mobile revenue market. This is roughly half their access share. So, it's a success but not a great success, so far. And other wireline players form a diverse group and so far, they have behaved rationally.

Finally, it's worth mentioning that spectrum actions are going to take place in Spain and operators will have to decide to go or not go for spectrum and also to invest in mobile network. So, this will also bring some financial discipline for the future.

Regarding regulation, well, let me start with traditional regulation. We expect more predictability into the future, and regulation in Spain is strict. And many of the changes are heading towards more flexibility.

Regarding ULL prices, as you may know, the CMT has just approved an increase of our ULL price to, it's a 7% increase, to €8.32. This is still below the European average which is roughly €9. And a new regulatory path has been established for future increases in ULL.

Moving to geographical segmentation, we believe it will take place in the near future and that will provide more flexibility in the broadband market.

The TV tax that was established to finance the public TV is under revision by the European Union.

And finally, on mobile termination rates, there's a guide path established until April 2012, and a new model has to be established for the future. Keep in mind that we will also have a fixed operation in Spain, so we can mitigate some of the effects of these cuts.

Regarding future regulation, well, key elements of the next generation network regulation are already established in Spain.

We have a bitstream wholesale offer up to 30 megabits already established.

Second, we have access, regulated access to our ducts and manholes, civil fibre infrastructure and also a framework for symmetric co-investment in verticals which is infrastructure that goes , fibre infrastructure that goes from the street to the different doors of the customers in a tall building. The rules have been established, and are going to be implemented in the near future.

And finally, as I mentioned before spectrum options will take place soon. We will participate in the 800, in the 900 and the 2600 megahertz spectrum auctions, and we will have refarming on existing 2G bands. So this is great news for developing and further pushing mobile broadband in Spain.

Let me also speak about growth opportunities in Spain, focused on three great opportunities.

One is fixed broadband, fixed broadband we believe there's still growth for fixed broadband in Spain. If you look at current penetration in terms of penetration over households in Spain is 65%, which is much lower than the 85% that we have in France, Denmark and Netherlands for example.

In IT, there is a very positive trend. There is a need in Spain, as you know, to improve productivity in all the businesses, so we are getting good traction with ICT solutions like cloud computing whenever we can prove to the customers that there is value to be captured in the short term.

And maybe the third and most important opportunity is Mobile broadband. Here we see a data traffic exploding and multiplying by 7 times in the period, in the three-year period, and smartphone sales doubling in the next three years, so it's another opportunity to be captured in this market.

So with this scenario in mind, which is our strategy for these three years? well, our goal is to focus on profitable leadership. By profitable leadership, we mean three principles:

First is an strict and a strong defend of our OIBDA and the value differential that we have versus our competitors; second, flexibility to adapt to changes in business environment; and third, a clear priority and mindset to capture value opportunities whenever the profitability is ensured.

These three principles translate into three strategic initiatives. One is what we call smart focus on value versus pure volume. We will focus on capturing, developing and retaining value customers, not just volume or access growth at the expense of profitability. And as we'll explain later, we have the assets and the customer base with to explode this strategy.

Second, we'll increase our cost flexibility by our reshape of our cost base. We are working towards having a more linear cost base and more flexible cost base, so we can optimize resources and allocate them whenever and wherever it's needed.

And third, we will invest to capture market growth opportunities, and we'll do it through an optimized use of capital. We'll selectively continue to invest in growth opportunities with a clear profitability mindset. And at the same time, we will sell assets when strategically appropriate.

So let me start with the first one, the smart focus on value. And let me start by reviewing the profile of our revenue segment by segment and the dynamics and the value they provide to the Company.

This is our revenue split in Spain. You can see almost 50% is Residential or Consumer, and more than 50% is Wholesale, Businesses & Corporate. We have a diverse base of customers that offsets competitive pressures in different segments. And that's the key for wholesale.

Wholesale, for example, pick up a business that really offsets pressure on the retail side and leverage our assets mainly maybe the contract that we have for Yoigo is a very good example of the way we offset flows with the wholesale market.

We have a very strong position in Corporate & Businesses, very strong. And this is a segment where we have professional and sophisticated decision-makers and where quality of service is a very important issue. Here, our core assets includes our in the field specialized sales force with more than 3,000 employees dedicated to sales and technical support to our customers.

More than 40,000 Corporate premises connected with fibre already and a fully integrated value offer, integrated, I mean, ICT, fixed, mobile. All these helped us to have, right now in the Corporate segment; more than 60% of our revenues coming from non-traditional access and voice, I mean 60% coming from broadband and Service beyond Connectivity in the Corporate segment.

The Consumer segment on the other hand, is a very diverse and very competitive segment. We have customers demanding very different things, customers demanding value, and customers demanding pure price. Here, we have positioned ourselves more on the high value part of the range, and we are trying, and we are offering a very complete and unique service, taking advantage of our best in class fixed and mobile network.

Now, our smart focus on value means three things for us: first, superior customer experience; second, value-based product portfolio; and third, growth opportunities.

A superior customer experience is critical in order to increase royalty, reduce churn and to defend price premium. A differentiated value proposition and a price mix strategy that is adapted to customer needs and customer value heads up to adapt to market conditions and to extract the best value from the market.

And we are going to continue taking full advantage of growth opportunities in the future. Our target is to generate over 1.2 billion of additional revenues in mobile broadband and Services beyond Connectivity in the next three years. This strategy, we believe, will allow us to sustain almost half of the revenues of the market, so our revenue market share will be almost half in the next three years.

As I mentioned before, customer experience is key for creating value, defending the price premium we have.

Here, we have four priorities in the next three years.

First, to attack root causes of dissatisfaction and reduce the number of claims; this will cut down both operating cost and reduce churn.

Second, we will further differentiate service levels based on value. For example in the Residential segment, we are creating a premium call center for top customers in the Residential segment.

Third, we ensure an integrated customer experience that is the same each channel and each business that they face.

And we continue reinforcing, fourth priority, our emotional bond with our Movistar brand.

By improving customer experience, we'll reduce churn by 5 to 10%, 100% basis into 2010. That means 95 or 90 in an index base in 2013.

This can be easily translated into economic value. 1 percentage point of an annual churn means more than €100 million per year. So this is a value source and we'll clearly go for it.

We will continue adapting our product portfolio to customer needs. In the corporate market, in the Corporate segment, we are market leaders, as I mentioned before, thanks to our seamless Fixed & Mobile proposition, our global, multinational platform, and a really differentiated ICT proposal.

We expect this strategy to increase the contribution of broadband and Service beyond Connectivity by 8 percentage points, so moving from 60% of our revenues to 68% in the next three years.

Mass market, on the other hand, we're developing a much more flexible value proposition that's adapted to the needs and the value of each sub-segment.

This approach is based on three things: we will accelerate the penetration of fixed and mobile broadband and Service beyond Connectivity; we will favour online do-it-yourself bundles and service configuration in this segment; and by having a differentiated product strategy for different value clusters.

As a result of these initiatives, double and triple play penetration will reach almost 60%, moving from 43 to almost 60% in the next three years.

Now, turning now into growth opportunities, I would like to review two top priorities. One is mobile broadband and the other one is services beyond connectivity.

The mobile broadband is a core value opportunity for us, and we are leading this opportunity by pushing the smartphone penetration and by introducing price schemes that complement fixed broadband.

As a matter of fact, we will continue pushing smartphone penetration in order to foster mobile broadband adoption. Our pricing schemes are flexible and already, they are 100% of our pricing tariffs are tiered pricing. And going forward, we will evolve our pricing offering towards more speed, more flexibility and more value. This strategy will ensure both profitability and growth in this segment.

And finally, we continue fostering complementarity between fixed and mobile broadband. As of today, this is a recent study we finished, 70% of our mobile connectivity users has also a fixed broadband connection. And in terms of substitution, only 2% of our mobile broadband users has dropped their fixed broadband connection. So there is plenty of value to be captured in our opinion in complementarity.

By putting all these initiatives in place, we'll almost double our mobile broadband penetration by 2013, moving from 20% to 40%.

On Services beyond Connectivity, we will continue developing a bunch of new services and expanding our portfolio. For example, in TV, we are launching our over-the-top model. This will allow us to reach 90% of our broadband base, and we'll continue introducing improvement in quality and expanding our content portfolio.

Regarding ICT, we'll accelerate growth based on our new cloud computing platform, which allowed us to offer a state-of-the-art private cloud solutions and virtual data center services.

And our wide range of services, we will launch these shortly, like e-Health, e-Finance, Machine to Machine, Security, that will leverage from our effort in the Vertical organization that we created at the Group level.

But as a result of all these, our Service beyond Connectivity revenues would multiply by 1.5, accounting for €1.8 billion in 2013.

So, in summary, our smart focus on value will enhance and diversify our revenue profile, with non-traditional business accounting from more than 35% of our revenues in 2013. In this context and based on our strategy, and based on the scenario we are seeing in the macro side, we expect a revenue recovery to happen much more back loaded in the 2011-2013 period.

Let's move to efficiency, as mentioned before, we are moving towards a more flexible and linear cost base. We truly believe there is further room to improve efficiency in Spain and continue delivering a reference OIBDA margin.

In the commercial side, we will benefit from this focus on value versus pure volume. We will adapt gradually SAC to SRC and we will focus this SRC investment in a more granular way focusing on high-value customers.

We'll increase effectiveness of commercial costs by developing value-based commissions for our channels and improving commercial processes and implementing much more granular campaigns. And our goal here is to dedicate much more resources to the customer while maintaining the level of direct cost over revenues.

On the non-commercial front, there's further room for improvement. For example we will continue leveraging our global scale to generate synergies, for example in the global purchasing platform we have for the global product development, the Verticals that we mentioned before.

We will continue increasing in the levels of automation and remote management.

We are working to create a much more simple math in terms of applications, legacy networks and product portfolio.

And commercial processes, this is very important for us. We'll be fully online by 2013 that means that we'll have a radical process simplification, full information traceability and a seamless 24/7 multi-channel and multi-segment, multi-product online client experience.

Now, we need to work and we are working on additional measures to gain more flexibility and to establish a leaner cost base. Some of the measures are already in place and we shared this with you in the presentation of our 2010 results, for example, the reduction of the 6% of our manager workforce. That was accounted in our books in 2010.

The new collective bargaining agreement that we have in Telefónica Móviles, in the mobile business, we have linked the increase not to CPI but to productivity, and we have other initiatives under design.

We will continue working to laying pay and benefits revisions to productivity in all our companies, not only in mobile, in all of our companies. Currently, we have 85% of our workforce under collective bargaining agreements. So, each percentage point of CPI means €15 million of additional cost. So this is a lever that we need to move and attack.

And we're also working on additional measures from the labour force. We are ready to start negotiating a series of initiatives that moves from outsourcing to workforce restructuring programs that will affect approximately 20% of our workforce, mostly in the wireline business. These programs, as I mentioned before, we will start negotiating soon with the unions. And the impact of this upside is not included in the guidance. So this will go on top of the guidance provided for the Group level.

So, in summary, we're working towards efficiency and flexibility, focusing on delivering a reference OIBDA and continuing to be a benchmark in the European Telco sector.

Well, moving to optimize use of capital. Here, on the sales side, we are continuing the process of selling IT application rights and real estate assets and we have other projects under analysis. And all this will generate over 600 million of cash proceeds in the next years.

On the investment front, we will continue exploring and expanding opportunities in mobile network sharing opportunities, and we will co-invest with other players to build fibre verticals. As I mentioned before, this is the part of the network that goes from the street to each of the floors in order to accelerate this market in a very cash-efficient way.

So, we manage actively our asset base and we relieved cash whenever it's strategically appropriate and we focus resources in deep prior initiative.

And speaking about CapEx, one of our top priority is to build the best fixed and mobile network in the market in terms of quality and coverage.

In the fixed side, we are smartly investing in improving the speed experience for our high-value customer. By 2013, 80% of our loops will be able to deliver at least 10 megabits per second, and around 45% of our loops will be able to deliver 25 or more megabits per second. To do this, we will rely on copper evolution and also in fibre deployment.

In the mobile segment, we are also increasing the quality and speed and coverage of our network. By 2013, 100% of our nodes will be ready for 14 megabits or more speed and 25% of our nodes will be ready for more than 42 megabits per second.

In summary, annual CapEx will remain stable along the period, the three-year period. And we'll dedicate a third of our CapEx, over total CapEx to new access networks in the next three years. And at the same time, we will remain flexible and adapted to market conditions.

So to recap, our focus on profitable leadership will be executed and based on three strategic principles.

First, the smart focus on value versus pure volume. We are ready to defend our OIBDA and profitability and value leadership with a very flexible stance and taking advantage of new market opportunities.

By doing so, we'll retain about half of the market share, revenue market share of the Spanish market, and also we will generate, at the same time, €1.2 billion of additional revenues in new business areas.

Second, reshaping of our cost base. We dedicate more resources to customer while maintaining the rest cost of revenues. And as I mentioned, we'll start new negotiating immediately initiatives that will provide further efficiency and flexibility to our labour costs. All these will help us to deliver a reference OIBDA in the market.

And finally, the optimized use of capital. We'll generate around 600 million of cash proceeds from asset sales in the next three years, and we will apply co-investment approach for whenever it's feasibly appropriate for mobile and for fibre.

And we'll also invest smartly in new fixed and mobile network dedicating a third of our CapEx base to these two initiatives. And again, we will be very pragmatic and very flexible, adapting our CapEx to market conditions.

So in summary, in one of the worst macroeconomic crisis in modern Spanish history we have proven to be resilient in core value parameters such as revenue, market share, OIBDA margin, cash flow generation. And we believe, we want to believe that the worst is over but we acknowledge there's a lot of uncertainty and we have to manage that. In this scenario, OIBDA is a must, its defense is a must but also selective investment in the future is a must for a market leader.

Both concepts will be managed with a strict profitability mindset and flexibility to adapt to market conditions.

Well, thank you very much for your attention.