

# Telefónica

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*Leading growth and profitability*

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Good afternoon, I am very pleased to have this opportunity to share with you our views on our business for the next three years.

As Cesar said already, my presentation is going to be focused on two key priorities. Growth and transformation, transformation in order to capture growth in a profitable way.

Regarding growth, we see many opportunities in our industry and we see many opportunities in our footprint. We see opportunities in the traditional business because we still see mobile penetration growth in our footprint.

We see the major opportunities on broadband communications, particularly in mobile broadband communications, and we will lead the market there. And we see opportunities on new services, cooperating in a very open way with third parties.

But, of all of those opportunities, the most important one, the major one, in our view is mobile broadband in our industry today. And we believe so, first of all, because the number of the smartphones and the number of tablets by the end of 2013 is going to double the number of PCs.

And, in addition to that, because, if you look how long it is being used a smartphone, it is between 1 hour and a half and 2 hours per day per user. As you look at the tablet, it is used around 3 hours per day per user. It is true that there are early adopters and because of that there will be a change in the future.

But, that usage is a huge amount of time in comparison with non-smart devices, non-smartphones, with an average of six minutes per day. Because of that, traffic is going to continue booming in the next years, particularly because of the video application impact. In fact, in 2010, already, in mobile data, 50% of the traffic was video and because of that we believe that traffic is going to continue growing in the next years.

And, then, for us, our biggest priority, the clear priority in Telefónica today, is to capture that growth and to monetize that growth in a profitable way.

And for that, we are going to innovate around our customers, around the customer experience. We are going to lead the market away from unlimited flat rates.

We are going to stimulate data services and application usage and, of course, we are going to do that in a profitable way with a clear focus on profitability in order to maximize customer lifetime value.

We can innovate our own customers because we are going to have a wider range of devices in our portfolio and more affordable devices in our portfolio. And we see a clear

trend to lower prices and we see a clear trend to higher level of functionality on the devices.

Because of that we are going to allow our customers to access to hundred thousands of applications through different eco-systems and, fortunately, in our footprints, eco-systems are very balanced.

There is no dominant eco-system today in our footprint. Though, we recognize that Android-based devices are growing quite rapidly right now. On top of those applications, we are going to deliver our own services embedded in our network, like the rich communication suite.

And we recognize that in this new world, there are more demanding requirements from our customers on customer care. And because of that we are changing our customer care in such a way that we have already specialized shops, we have specialized people on the shops to take care of these demanding requirements and we are using new technologies, like YouTube, in order to provide videos to help our customers to take care of the issues that they are struggling or we are using social networking in order to communicate and to support our customer demands.

In addition to this innovation, we have a tiered, a full tiered pricing strategy in place in all our single markets where we operate. And this is a very important change since we met one and a half year ago.

Do you remember? one and a half year ago, we didn't talk at all about tiered pricing. In just more than one year, we have fully changed the market. We lead the change on most of the markets.

Unfortunately, our competitors follow us and the whole industry completely changed mobile pricing, that was necessary and it is very important for the whole industry.

And we are changing this tiered pricing strategy in different ways in different markets. In some markets, we raised our pricing on services, like in Latin America we have different tariff plans for different services, we base our pricing on limited volume with additional bolt-ons, like here in the UK or we base on speeds in different countries or, even, we base on time of the day or, even, we have, like in Spain, the same tariff plans for different screens.

And this is very important to change how we monetise mobile broadband communications, data communications, for us and for the whole industry and this is a significant change in the last year.

In addition to that, we are going to stimulate, on top of connectivity, new services based on bundles on connectivity, and based on bundles on top of connectivity.

We are stimulating revenue sharing agreements with third-parties, like in financial services, with Master Card or in machine-to-machine applications with Jasper.

And we are doing that in a fully multi-stream, multi-platform approach. And this is allowing us to increase ARPU per customer. And we already have an uplift in smartphone customers of 1.5 times in comparison with average contract customers.

This ARPU uplift is helping us in profitability. Mobile broadband is a profitable business today and it is a profitable business because of this ARPU uplift and because we are very focused on customer lifetime value.

And when you see our different countries, and when you compare profitability in smartphones in comparison with average contract customers, and when you measure customer lifetime value, taking into account churn, you see a significant improve that may change and may vary from country to country from 10% to 50%.

And we are comfortable with this profitability for the future because although, we recognize that the ARPU uplift will decelerate while we are increasing the mass market penetration, we see a lot of opportunities to increase profits based on a better customer knowledge that will allow us to avoid abuses that will allow us to provide better tariffs.

We really believe that there is an opportunity to increase our commercial efficiency based on lower device prices, based on optimization of subsidies, based on the multi-channel approach, and we really believe that our marginal network cost is going to improve in the future.

So, overall, we are very confident on the profitability of this business that is going to be the higher contribution of our revenue growth in the future. By the end of 2013, we expect 50% growth of our customer base with more than 80 million mobile broadband customers.

And this will mean revenue growth between 30% and 35%. We are going to manage this mobile broadband strategy in a very complementary way with our fixed broadband strategy.

We are not changing much, our fixed broadband strategy from the one that we shared with you one and a half years ago. We still believe that the future of the fixed line very clearly is full broadband, full IP to support all of the services and full bundle to support all the multi-media services, different devices, and, of course, to take care of a full integrated home networking.

And we are going to develop this strategy with a massive deployment of ADSL to support a triple play standard of quality, with full interactivity, and with entry level prices in addition to medium level prices for the medium level segment.

In parallel, we are going to continue a selective deployment of ultra-broadband based on demand and competition, with a very high quality offer, fully symmetric and with prices in accordance with this high level quality offer and with a multi-tasking approach that we are following here.

With this strategy, we expect to have 21 million fixed broadband accesses by the end of 2013 and its contributions to our revenues, to our revenue growth, is going to be between 4% and 7%.

But, beyond connectivity, we are going to develop new services, we are going to develop new applications, and we really believe that we can do that because we have a very important customer base.

Because we are approaching a multi-device strategy and because we have strong assets. Because we have key strengths in order to develop those new services.

The most important one is customer data, the second one is our customer care capabilities, the third one, that is very demanded by all of the third-parties that we cooperate, is billing, the fourth one is distribution that is very important in our business and the fifth one for the future would be advertising when we are able to set up a common platform for the players in the industry. And to reinforce these services beyond connectivity ecosystem, we have set up in the last year a new organization with seven verticals, very focused on various specific services, in addition to seven companies that are very complementary to these seven verticals.

With the clear criterium in our company, with a clear principle, to provide globally a single platform, one platform, to support one service with a unique rollout.

What does it mean? It means that, for each vertical, we are going to deploy, to develop, a global portfolio and, for each product of this global portfolio, we are going to identify a leading country.

For instance, in the case of the over the top TV, Argentina is the leading country. And, then, we'll extend this product to the rest of the countries.

In the case of advertising, mobile advertising, the UK is the leading country. And, then, we will extend progressively mobile advertising in the rest of the countries.

And, in the case of Cloud applications for the small and medium enterprises, Spain is the leading country. And, then, we will continue the expansion and we will follow up in a global way to accelerate and to reinforce execution.

This will give us the opportunity to grow our services beyond connectivity by more than 20% and, of course, because we recognize that some of those services initially are coming with low margins, we are going to focus on profitability.

And we really believe that we are able to improve the profitability of this kind of new services by 10 percentage points in the coming years thanks to our scale to leverage on our core business and because some of the services are evolving from a greenfield position to a run rate.

In addition to these new services and on top of broadband connectivity, still, we believe, we have opportunities in our traditional business. And we believe so because we have the opportunity to improve our position in the small and medium enterprises and multi-national customers in some of the countries on our footprint, we believe so because there's still mobile growth penetration in some of our countries because we are able to migrate more and more from prepaid to contract customer base and because we believe that we can provide more value on the fixed line.

Overall, through these actions, we think, that mobile voice revenues are going to be flattish in this period even taking into account the 2.5 percentage points impact because of the MTR cuts.

And because of that the total voice revenues will decrease between 3% and 1%. This strategy to capture growth is going to give us by the end of 2013 a customer base, a number of accesses, of more than 340 million.

And I think it is very important to take into account that, in this customer base, we have a good opportunity because we still have a lot of room in order to move our customers from pre-paid to contract and from contract to smartphones.

And any time that we give this step, there is a clear ARPU uplift. And, by the end of the period, only 25% of our customers will be smartphone customers and that we have plenty of room to migrate and to increase our ARPU uplift.

In the case of the fixed business, any time that we move a customer from a single play to a double play to a triple play offer, we are increasing our ARPU quite significantly, multiplying by two and by 1.5.

And, by the end of the period, 50% of our customers will have double and triple play bundles and because of that still we have a good opportunity for the future and, of course, for the next three coming years.

And through these actions is how we are getting this change on the mix of our revenues that already César shared with you. But, I think it is very important, not only to capture those opportunities, but, in addition to that, to transform, to change our company to accelerate the transformation in our company in order to really be able to support this growth strategy.

And, in order to accelerate the transformation of our company, first of all, I think it is very, very important and very relevant to understand today's customers behavior.

Based on the preliminary information we have, based on the preliminary data we measure on some of the countries where we have fixed and mobile operations, and recognizing that this may change in the future, what we are getting is something very interesting.

It is very interesting because what we are seeing is that traffic generated by smartphones is growing more through WiFi and through the fixed network than through the mobile network.

That's a big change and that means that before, our customers were using a device that was tied to the network. But, the customer was not able to select the network.

Today, and from now on, the customers not only select the device, not only select the screen, but he also chooses the network he wants to use per application and per service.

And this is a big change in our industry and we really believe that we are in a really good shape to be able to take care of this change in our industry and to support these changes on customer behavior and to have the best offer in the market to support that new demand.

And we believe so because we are already using fixed technologies to improve mobile services and, by using this technology, today, we are able to provide more and better bandwidth.

We are really able to provide better coverage and we are able to provide a better customer experience. Today, we are using mobile technology, wireless technology, to provide fixed communications and that's an important strength of an integrated company like Telefonica.

This is today, but, maybe, you are interested also to know what is our vision of the future. How do we see the future today and, when we look to the future, to the next years, what we see is what I have in my hands.

What we see are, in a simplified way, these two elements. Optical fiber and base stations, and when we see that some customers will ask for this, some customers will ask for this, and some customers would like to have this linked together.

But, the magic of this small cube that is a base station with the antenna included, is that we are able to build, not only a femtocell, but we are able to cover a macro cell by building together one cube on top of other cubes and build up an array that is able to provide a huge area coverage with these kinds of cubes.

And, in addition to that, this cube is so simple because we are able to connect it to optical fiber and because it's connected to optical fiber, it is possible to simplify the electronics associated to the base station.

And it is possible to change that electronic into software and it is possible to have that software on the Cloud and this is the future we see. This is the trend we see and this is what we want to build step-by-step.

It doesn't mean that we need this in the whole network tomorrow. What it means is that we have a clear view of the future and we are going to build it step-by-step.

Because of that, we are going to connect our base stations to optical fiber and, by the end of 2013, 63% of them will be connected to optical fiber. We are going to include more intelligence in our network and we are going to build a content delivery network.

Because we have that view, we are going to extend the coverage of our networks in a very comprehensive way using the right technology at the right time for the right geography.

And we are going to deploy ultra-broadband for selected urban areas so that, by the end of 2013, 26% of our lines will be covered by this ultrabroadband technology.

We are going to use new mobile technologies like LTE initially in high potential areas and we are going to continue extending 3 and 3.5 generation in order to provide good bandwidth in large areas at the same time that we continue our massive deployment of 2G.

And we can do that because we really see a positive evolution on CapEx on the fixed business, as well as in the mobile business, and, particularly, in the mobile business.

And with this reference we are going to increase the capacity of our network because we know that mobile traffic is going to multiply by six. Fixed traffic is going to multiply by two and the transport traffic is going to multiply by three in the next three years.

And we need to cover this capacity and we are going to do it by using the right technology in the access. We are going to do it by offloading mobile traffic to the fixed network, by improving the interworking of the smartphones by using new technology, by using the right approach in big cells and medium cells by optimizing management of spectrum, by using the right mix of technologies in the access part of the fixed network, by including more intelligence in the network and particularly to improve our data information in the network to manage traffic in the right way at the same time that we collect all the information that need for the new billing of the new services.

And of course, we are going to make an effort in optimizing our operational model in two key priorities. The first one, in extending our negotiating agreements with other operators and in addition to that internally optimizing the cost of building of new sites. And through these actions we will be able to reduce between 45% and 50% network OpEx per gigabyte in the next three years.

In IT there is no big change in our strategy, it's very consistent with the one that we shared with you three years ago. Our focus is in execution. We launched the consolidation of data centers already in Brazil, we are going to launch right away the consolidation of data centers in Spain and we will launch during this year the consolidation in Czech Republic and in Mexico. And by the end of the period we will only have the six data centers that we share with you one and a half year ago.

On applications, we are in a pragmatic approach, trying to improve and to use global applications when we see a clear financial and economic benefit or, when we have new opportunities or new need.

And we are progressing systematically and we believe that by the end of 2013 more of the most important applications will be already global, taking into account the one objective is that OpEx+CapEx to revenues in IT will be around 4%.

We live in a digital world, we are providing digital services, we need to be a digital company and to really be a full digital company we are going to use online communications to connect with our customers, with our people internally and with our suppliers at the same time that we are going to use online communications to simplify our processes and to have an end-to-end vision of simpler processes and more integrated processes at the same time that we are going to enlarge the use and to extend the use of online communications for the new services that I mentioned before, for new customers and of course for cooperation with third parties.

And all this strategy, as our chairman said, is based on a clear multilocal, integrated, global organization that has progressed quite a bit in the last year, in integration on the local units particularly in Spain, Czech Republic, in Germany and Chile. And you will see more integration at the local level in the coming months, particularly in Latin America based on the new organization.

You have seen that we have more global units providing services to the rest of the local units for products and services like the seven verticals that I mentioned before.

We setup a global, multinational unit that is reporting to Matthew Key, and you will see some information tomorrow. And we created three new companies in order to better support in a more efficient way this global organization; one for IT, another one for procurement and another one for roaming.

Based on this, the savings that we are seeing in this, the cumulative savings that we are seeing in these three years it is around 1.5 million euros of OIBDA. So with this effort in transformation we really believe that we are able to increase the cost that we are going to allocate for commercial activities and for network activities, taking into account the growth that we want to capture.

And this is going to be compensated by the decrease in interconnection cost because of the MTR cuts. Regarding CapEx, one-third of our CapEx of our cumulative CapEx in

the next three years, it is going to be allocated to ultra-broadband and mobile broadband. And we foresee a significant decrease of our CapEx on the legacy systems in the fixed business and in 2G. Our CapEx to revenues ratio will have a peak in 2011.

In summary, three clear objectives on growth. Profitable mobile broadband monetization is our key priority. Services beyond connectivity are the new growth engines and we still believe we have clear growth opportunities on fixed broadband and in mobile communications.

And, three clear priorities in transformation, to provide the best class network, integrated and with an efficient management of traffic growth and coverage. We see online and IT as clear accelerators of our transformation and we are going to continue dipping, going deeper in our multilocal integrated global organization to leverage our scale and our diversity. That's the way that will allow us to capture, to meet the guidance that we already share with you.

Thank you very much.