

Telefónica



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Q&A Session

Important Notice:

Although we try to accurately reflect speeches delivered, the actual speech as it was delivered may deviate from the script made available on our website.

Robin Bienenstock - *Sandford Bernstein Research*

Thanks very much. Two questions, if I may. The first is really about Telesp and about the growth opportunities in Brazil. You talked about line loss recovery at Telesp but Telesp reported EBITDA that was down 10%, free cash flow down 22%, and all getting worse in the fourth quarter. Broadband prices are falling and calling volumes are falling. So what I'd like to know is, how are you going to stop that decline going forward? And are you just going to stop reporting wireline numbers as you have done in Spain?

My second question is more of a general question, and it's about operating systems and about non-traditional revenues you are hoping to capture. You talked a lot about the collaboration amongst operators that you're going to need in order to capture those opportunities, non-traditional revenues, but I don't see any history or any evidence of collaboration amongst operators, if I think about mobile advertising platforms and now Android attempts to get people to sign up to non-fragmentation deals. I'm wondering why should investors believe that you are going to see that collaboration going forward and therefore you're going to capture those revenues? Thanks very much.

César Alierta - *Chairman and CEO, Telefónica*

I will answer the second question. Okay? This is a new world. I'm sure there's no history. And let me tell you very clear, the market becomes the history and not the future. But the opportunities are there and they are very clear. And the operators see that very clear. And we as the operator we have everything. We have the network. We have the customer. We have the billing. We have everything. And the opportunities are there and it's clear that we are going to cooperate because it'd be good for the industry and for the shareholders. And you will be seeing that in the coming months. In the coming months, in a very, very important way, you will see that and the way everything is working is clearly on that trend. And this is a fact and you can have two positions: believe it or not believe it. What I have to tell you from the point of Telefónica and we see it from the others, the trend is very, very clear in that way.

And is going to happen in every field, I mean. Let's talk about one thing: interconnection. I mean, there's going to be peering, I mean, the peering was made for one-to-one or one-to-two traffic but you know now there is an asymmetric traffic. Okay, asymmetric traffic, 1:68, 1:70. This is not sustainable. So all the peering agreements are going to change because it's needed, and it is necessary which means people will have to pay for the traffic.

Quality of service. We all agree on quality of service. It's very, very clear. We are reaching the customers. The examples Matthew was giving on advertising were very clear, but you can put that anywhere, in Beijing, in Mendoza, Argentina, in Arequipa, Peru, wherever you want, this is going to happen.

Who wants that? The companies, and us and we are clearly very much. We have the business intelligence. Nobody like us has the business intelligence. And we have done it. And we are going to do it and that it is going to be a personal approach to the millions and millions of customers. And this is going to be there very soon and you can do two things: believe it or not, but it's your problem; on our side it's not a problem, it's an opportunity and a reality.

Matthew Key - *Chairman and CEO, Telefónica Europe*

Robin we've got already two examples in my area which is Mpass in Germany, as Vodafone and T-Mobile are already delivering financial services through Mpass, and also in the Czech Republic where we've created relationships with the banks to create M-money. So, we've got two live examples already.

José María Álvarez-Pallete - *Chairman and CEO, Telefónica Latinoamérica*

And taking your question about Telesp, first you know that 18 months ago, 24 months ago, we went through a difficult period in terms of quality in Telesp. We've completed a full restructuring of all processes end-to-end.

And we are starting to collect little by little some results. It is true that at the end of last year all the figures that you mentioned about OIBDA performance and free cash flow performance are true. But it is also true that we have been gaining market share in broadband back from Net in the competition zone, which proved that our product is competitive. It is as well true that the customer satisfaction levels are highest in history.

And we are beating our competitors including the cable operators. It is true that churn is being reduced. And as a result of all of those measures you should expect revenue trends to improve and in fact they are improving, while OIBDA will slowly also be improving.

In the first quarter of this year, another heavy rain period happened in São Paulo. Therefore in the first quarter OIBDA is still going to be affected but it is true we made the effort to preserve quality. But all the underlying trends of Telesp are improving.

And once we are going to be able to complete the restructuring process of the exchange ratio between the two companies in Brazil in the last half of this month, you should expect a further boost in the both companies with bundle offers that will also boost the efforts. So we feel very confident because the commercial offer is proven to be successful, our customers are telling us that, we are gaining market share and our revenue trends are improving. So we keep trying to deliver. Things are improving little by little, so we hope that results will flow in the next quarters.

David Wright - *Deutsche Bank*

Two questions please, one to Matthew and one to the Chairman as well. Matthew, just on Germany, KPN are targeting 20% to 25% market share in the midterm, the Turk Telekom product looks like a direct competitors to them and you've also flagged this somewhat weaker, I think data story, so it does look like you're going after them and yet their market share ambition is way higher. So it looks like we've got quite a fight coming in Germany, if you could elaborate a little on that.

And then just a wider question to the Chairman and any of the members, we've just seen a fairly remarkable deal announcement in U.S. that could see the market consolidated to three players. Do you think Europe needs to consolidate in terms of the scale players? Thanks.

César Alierta - *Chairman and CEO, Telefónica*

We don't talk about other companies' transactions. If you remember the one in the footprint, we have 30% footprint in Latin America, we are happy with that. You know, 30% footprint from Rio Grande to the Patagonia is sufficient. And in Spain, we have 52% market share. And in Europe, we always said, we're already where we are. In the market share that we are, we have 24%, 24% market share revenues and with the industry alliance, we have Telecom Italia, its 20% market share and that is sufficient between the both of us.

So we are not worried about the consolidation in Europe. It will be good for Europe to have more consolidated, yes, but it's not our problem. And you know, at the end this is 2.5, and in Latin America we are 2.5 or 2.3, in Europe I think there is 186. But Telefónica took the advantage of having the right position in Europe, so the consolidation, the problem of the consolidation in Europe is the problem of the rest, is not our problem and it's going to be very important to have the right scale. What happened in the United States was very clear. Also, I'm going to say something, you know we never wanted to go to United States. We never thought we had any chance in United States. And there are many Spanish speaking in the United States, but for us it was very clear, it was not the best place to go. And we have the scale in Europe and we had the global reach. So, for us, the future is organic growth. And we aren't going to lose time with other M&A operations.

Matthew Key - *Chairman and CEO, Telefonica Europe*

David, just on your specific question on Germany. Our competitors will run their businesses and we'll run ours. We don't target competitors, what we do is deliver the right products to customers. So, the Turk Telekom tie up that you talk about specifically, is a specific segment in the German market that have really very close ties with their homeland and also from a German perspective, an awful lot of Germans go on holiday within Turkey. So that was the customer insight we had about creating that relationship with Turk Telekom. I'm not going to put out a target or we are going to try

and get through from a market share perspective, but don't think we're targeting E-plus. What we're trying to do is deliver the right products to the right customers.

Luis Prota - *Morgan Stanley*

I have two questions on Spain. The first is on the target to have 45% of the local loops, having 25 megabits by 2013, whether you think that that's enough, taking into account that cable is now taking 20% of net additions in the last three months? And if you could give us that percentage of 45% in the areas where cable is having exposure and cable is not having exposure?

And the second question is from the headcount cut, the 20% you have mentioned. I understand that you are going to start negotiations, so you don't have the details yet. But any help in understanding whether it's going to be kind of similar to the previous one, when you were letting go people of 52, 53 years old, 250,000 costs per head? Something like that would be useful. Thank you.

Guillermo Ansaldo- *Chairman and CEO, Telefónica España*

For the first question is, our target in 2013 is to have at least 45% of our loops ready for 25 megabits or more. The majority is fiber. Fiber-to-the-home, the rest is fiber to nodes. And basically on local exchange.

If we deploy this in a smart way, meaning that targeting the areas where we have to protect the majority of our customer base and taking into account the cable, we would think that's enough to defend ourselves through this cable. But we have to keep it, watching this frequently. So we feel comfortable that with this strategy, with this money and with this focus, we will be able to defense the value that we have in our customer base.

Regarding headcount, as I mentioned before, two things. First is, as you understood correctly, is the negotiation that we will start soon, very soon, immediately, with the unions, as we did in the past.

Second, the negotiation will take into account several aspects. One, as we mentioned before, is how we linked the pay and benefits variations to productivity and not to inflation. Second, outsourcing. And third, restructuring programs.

It could be a combination of outsourcing, the 20% I mentioned, with the restructuring programs, will be negotiated with the unions and as soon as we have an agreement, we will share all the numbers with you.

So that's our target for the three-year period and depending on the type of program that we put in place, the numbers are different. And that's why we have not included any of the upside in the guidance.

In the case it were part of that or the majority of that, were a redundancy program, I guess it will be similar to the ones that we had in the past, adjusting that with the inflation we have in the process, the yield curve and current labour legislation. But it's something that is going to be negotiated with the unions and as soon as we have news and facts, we will share with you, obviously.

Mathieu Robilliard - *Exane BNP Paribas*

Two questions. One, first on Latin America. My perception has been that the quality of the fixed line network of Telesp is probably not the same as in a number of European countries and so you need to do some quite substantive upgrades to the network to be competitive against cable. So can you tell us a little bit more about that? And interestingly so, how is the situation in Argentina, Chile and Peru where you also have important fixed line operations?

And I have a question for Matthew maybe with regards to your strategy in Germany in the context of the recent large investment you've made in Hansenet. Can you elaborate a little bit about your strategy in a world where fast broadband or super fast broadband is becoming more and more important, notably in Germany? Thank you.

José María Álvarez-Pallete - *Chairman and CEO, Telefónica Latinoamérica*

Thanks for the question. Starting by Telesp. During the last four years, we have been recurrently investing in shortening the length of the local loop, the average length of the local loop especially in the areas of highly intensive competition where the cable operators were, namely Net, was taking a significant market share. And as a result of that, we have been doing several investment in upgrading the network in investing in shortening the loops and in changing technology in some cases from ADSL to VDSL plus. And as you know, in one specific region in São Paulo, we are starting to deploy fiber in Campinas.

As a result of all that, we have been permanently, in the last three years at least, doubling the average speed per access in São Paulo because we also acknowledged that we needed to have a significant difference between the average speed of access of the mobile broadband offer with the fixed broadband offer in order to avoid cannibalization from the wireless operation.

And as a result of all that, we have been significantly upgrading the average speed of access of our networks not only in Telesp but that's also applicable to Argentina, to Chile, to Peru and to Columbia. So we can share with you specific data through the Investor Relations team on what has been the evolution of our loop length and also the average speed of access.

But let me share with you that we have not been losing market share. So it looks like we have a competitive product. It looks like it is competitive in the most intensive competition zone. In Chile, namely with VTR which is a cable operator. In Brazil, we

have been the first one to offer 30 megabytes and we are doing an extra effort in the regions where we know that GVT is going to be attacking us in the very short front. So it's a never ending effort. We'll keep going. But the major proof that we are having some significant results is that we are not losing market share and we have been able to preserve the market share in the different countries.

Matthew Key - *Chairman and CEO, Telefónica Europe*

Just on Germany, so I think there are two or three elements to the answer. The first is LTE. We see LTE as a real alternative in Germany to circa, I think circa, 30% of the population today do not have broadband access. So we think that wireless technology is a very suitable alternative from a commercial perspective for us but also from a customer experience perspective.

And as I said, we see that as pretty much a three player market. VDSL, we started to roll out VDSL off to the back of the HanseNet network. We've already got circa 10% population coverage and we use a wholesale product from Deutsche Telekom for another 15% so we get to serve the 25% there.

And then, the third element is the city carriers. Germany is quite unique in that virtually every city has a city carrier that's Germany's the next power company or water company that have ringed the cities with fiber which gives us great capability. As I said, we've only done two deals, one in Hamburg, and one in the west of Germany and we're looking to do further deals with city carriers

Jesús Romero - *Bank of America-Merrill Lynch*

I have two questions. The first one regarding to Europe. Can you tell us what we could expect from Europe in terms of broadband targets? The commissioner talks about 2020 targets that are pretty aggressive and could potentially imply higher CapEx, particularly in Spain in the future.

And then, the second question, very specific for Santiago. The amortization of commitments in 2010 was 834 million. In the last Investor Day, you said that number would be lower than 500 million by 2012. I don't know if you can give us an update what that number would look like for 2013? Thank you.

Julio Linares - *Chief Operating Officer, Telefónica*

Jesus, regarding your first question, as you said, I think that objectives included in the European agenda are a little aggressive. You know that they are including the universal broadband as universal services, the deployment of 30 megabytes per second to 100% of the population and the deployment of 100 megabytes per second to 50% of the households in Europe. And right now, there is discussion in Europe.

I think it is a good discussion between the European Commission and the industry. Three different task forces has been already set up in order to discuss the different issues regarding the impact of that objectives of the European Commission.

The three task forces are expected to deliver the results of the discussions by July 13th. And at that time I think, we will be able to see what is going to be the framework that will stimulate innovation and investment in Europe. Telefónica is participating very actively in the three task forces.

Santiago Fernández Valbuena - *Chief Strategy Officer, Telefónica*

In terms of the numbers, the total commitment amortization that we are going to have in 2011 is 769 million. And for 2013, it will be 575 million. That includes all geographies. If you were to include only Spain, Spain is about 65, 70% of that.

Tim Boddy - *Goldman Sachs*

Just a question on Spain to start with. Often people talked about the relative pricing of the retail lines in Spain, particularly, broadband pricing and look at the GAP versus other markets. Can you just explore with us, some reasons why you think that GAP is sustainable in those high prices?

And then secondly, a broader question around your 2013 comments around dividend versus buybacks in the total shareholder remuneration policy. Is clear from your comments, you think the stock is undervalued. In that case, wouldn't a greater mix of buybacks sooner make more sense?

César Alierta - *Chairman and CEO, Telefónica*

You know, the Board of Telefónica decided that we were to be very clearly and that we want our shareholder to sleep very well. Ok? So the Board decided that we will announced the increase of dividends for 2011, 2012, and that is clearly and that is the reason why we have the highest dividend yield. And the board has also very clear, the remuneration for shareholder can only go up and never down. So was a big commitment, sure that we made that commitment and we made that numbers and we really know the company very well and we know we could pay that. And then also, one of the priorities of the Board is the shareholder remuneration and the stock price appreciation. And when the Board convenes in the second part of 2012, we will say how the remuneration to the shareholders will be appropriated.

We thought, and the Board thought, that in times of such big turbulence, tactical movements have a very short life, Ok? And as so you go with the share buyback and that's very good for one month and then what? So we thought the floor of the dividend is there, and it's very, very important. And this floor and they knew, you know this is going to be 2009, 2010, are going to be tough. And we knew it. That's the reason.

We knew our results will be good, and we'll be able to pay that with no problems and we've known and I sleep very well about the ability of the Company to sustain its commitments. I don't lose one single minute of sleep because we can do it very well. But at the end, in 2012, we will convene and decide, what is the best combination or remuneration for the shareholders. Having to say one thing, remuneration for shareholders can only go up, it never goes down in Telefónica.

Guillermo Ansaldo - *Chairman and CEO, Telefónica España*

Okay. Taking the question about fixed broadband prices in Spain. Well, our strategy has been and will be to offer more services and more value for the same price. We have to keep in mind that in Spain, we offer not only speed, but we also bundle with traffic. Recently this year, we started to include not only fixed traffic but also fixed to fixed but also fixed to mobile traffic in our offering so as to give more value for the same price.

We will continue along that path. We are adding more services, anti-virus, virtual disk, hard disk on our cloud solution. And also the fibre deployment would help us to sustain ARPU because we're able to offer not only more speed but also more services from top of connectivity. So, here again the strategy is to offer more for the same and keep in mind our target of 48% to 50% revenue market share overall in the market.

Torsten Aichtmann - *JP Morgan*

Two questions, firstly on Brazil Vivo and Telesp. Can you update on financial and tax synergies what you expect and when do you think they could come through in Brazil and in Spain.

And secondly, on Mexico when do you think you will see the improvement coming through, given some of the pricings you've changed I think we can see some improvement already in the first quarter. Thank you.

José María Álvarez-Pallete - *Chairman and CEO, Telefónica Latinoamérica*

On the financial synergies and operational synergies as well in Brazil, we need to wait for the final approval of both shareholders meeting at the end of this month. The independent committees for the different Board of Directors have already been issued a recommendation about an agreed exchange ratio. And therefore, in the next two weeks we should have the process concluded. And starting from this moment the synergies will start flowing all of them, I mean operational, financial and tax wise.

Let me share with you because for the time being we are restricted on comments because of this legal process that everything is going according to what was estimated. And as I was sharing with you within the presentation, after a few months of full control of Vivo and working together with both teams, we see the €2.3 billion, €2.7 billion that we shared with you as the low-end range that we are aiming internally. But we need to be careful and wait for the final outcome of the process to be more specific.

And on Mexico, last year, three things happened in the second half at the same time. First, somehow, a weaker market sentiment in terms of consumption in Mexico that was aggravated by a tax, a direct tax, that got put on the telecommunications sector that we all operators passed to consumers. And finally, we make our own mistakes in terms of the commercial strategy by eliminating some micro recharges and by eliminating some promotions.

We immediately felt that on the market and we are restructuring the offer the first quarter of this year is still going to be tough on that front but we are already seeing the first symptoms of recovery in terms of the average customer recharges, and the total number of customers that are recharging out of the total customer base. So, we are still starting to have some signs, the first quarter is going to be tough, but we are aiming for a noticeable improvement in the second half of this year.

Santiago Fernández Valbuena - *Chief Strategy Officer, Telefonica*

Just caught on. I think we're expecting zero tax synergies to come from Spain on this particular deal.

James McKenzie - *Fidentiis*

Thank you. Just a quick question on smartphone ARPU. You gave a very interesting statistic saying that ARPU increases 50% as a contract subscriber turns to a smartphone. Could you discuss how that varies across your three geographies? And for each of the three geographies, how you think it might vary going forward as penetration increases?

Julio Linares - *Chief Operating Officer, Telefonica*

Well, in general terms, I think that the geography that is more advanced in that process, in that progress, I think it is Europe, particularly Germany and UK. UK is a very active country. Then, Spain is also a country where we see good evolution and the market is very active. And, of course, in Latin American countries, penetration was lower until now. But we really believe that the prices decrease in mobile handsets, in the smartphones that we are already seeing, and we see for the future will have a significant impact on this penetration, and this evolution in Latin America in the coming years.

James Ratzner - *New Street Research*

Hello. Yes. I've got two questions, please. The first one is just trying to think about how Group margins would developed over the forecast period. On one hand, you're trying to push into Services beyond Connectivity, which are lower margin than your existing businesses, but on the other hand, you're trying to implement some cost-cutting initiatives. So should we think about margins 2011, '12, '13 being flat, gradually going up, gradually going down? Hope to get some guidance on that, please.

And the second question for Santiago is just regarding repatriation of cash from Latin America. You said you repatriated 80% of free cash flow last year. To repatriate 100%, you would have had to pay some additional taxes. Could you quantify what the size of that tax there would be, if you wanted to repatriate 100% of your cash flow? And is that an issue protruded to 2010, or is that an ongoing issue for the future as well? Thank you.

Julio Linares - *Chief Operating Officer, Telefónica*

Regarding your first question, you know that our guidance it is that our OIBDA margin will be upper 30s with a limited erosion. We believe so, because of the evolution of the mix of services or revenues that we are going to have, and taking into account the impact of the effort that we are going to do on broadband on Services beyond Connectivity. Of course, Services beyond Connectivity, initially come with lower margin, but we believe that based on our core assets that will help a lot in the development of these new services, and based on the evolution of those Services beyond Connectivity from greenfield positions they have some of them today to a run rate evolution, that will have a positive impact.

In addition to that, we believe that marginal cost will decrease based on the scale and the significant growth of broadband services and Services beyond Connectivity. So overall, we are pretty confident on this guidance.

Santiago Fernández Valbuena - *Chief Strategy Officer, Telefónica*

In repatriation, the point I was going to make yesterday is that most if not all the free cash flow is available for repatriation. If we don't do it, it is sometimes, as in the case of Chile, because there are short-term capital movements that are taxed. In the case of Chile, it's about 16% tax rate which would be silly to incur in, if you don't absolutely need it, but just used that as an example. We do have cash sitting in some of those bank accounts in the region because interest is in the wright currency and not a high rate.

So the point I'm trying to make is not that we cannot repatriate 20% of the free cash flow for tax reasons, the point is, there are some frictions to be incurred and 100% of it except Venezuela, of course, could be repatriated but we just don't find it sensible to do so.

Justin Funnell - *Credit Suisse Research*

Thank you. I probably missed this point, but just on smartphones in Latin America, is this the year where they take off or is it next year? Are you at the tipping point on the purchase price of the smartphones or do you need them to come down a bit more, please?

And secondly in Germany, O2 Blue, that's a new tariff, €20, semi flat rate, is this a game changer in the market?

José María Álvarez-Pallete - *Chairman and CEO, Telefónica Latinoamérica*

On the smartphone price trend, we think that already in this year, 2011, you will see some of the evolution. In fact, we already have some terminals below the \$100 benchmark. It's the first time that that happens. We think we can go even lower. We have some agreements with some suppliers and we have even our own label a Telefonica smartphone offer, branded offer in the region, so it is already starting to happen.

But our target is to go even lower than that so we needed to come even lower. We really want to have our real massification on the market. I think my personal view is that because of this operating system issue, the battle that we have between the different operating systems, this is going to be accelerated because the first one that targets a massive market in this range within \$50 and \$100 is going to have millions of customers namely in Brazil or in the whole of Latin America. So my view is that this trend will be accelerated.

Matthew Key - *Chairman and CEO, Telefónica Europe*

From a German perspective, one of the reasons that we launched O2 Blue which with, by the way, are very pleased with the traction that we're getting, is to make sure we get the right balance in our tariff mix in the market, because clearly in the German market is sitting on a sort of mid-teens percentage, we're looking at going upwards but what we need to do is to make sure we go at the right pace, so there's a volume/value equation that actually accelerate our growth, but we don't take value out of the overall market. So for us it's about a balance of having the right tariffs in the right places and not taking too much value out of the market as we accelerate our volume.