Telefónica’s 7th Investor Conference

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“Delivering sustainable growth” transcript

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Good morning to everybody, and we are very happy in Telefónica to welcome you to our seventh investor conference. Investor conferences are going to take place in Distrito C. We are very proud of Distrito C, basically because we think Distrito C shows what Telefónica is, an open and integrated and looking forward company. It has been two years since we last met in London. At that moment, nobody could foresee the following years will bring about one of the most profound economic downturns in many decades.

And however, taking into account our 2008 results, the guidance we have given you for 2009 and the guidance we have given you, 2009, and 2012, I think the shareholders of Telefónica can continue to feel very, very confident. We maintain our ambition to lead the industry in the coming years and to become the best company in the digital world.

Today, we want to share with your our industry visions because we believe Telefónica has a leading role in the ICT industry. I want first of all before, to explain why telecoms will continue to be a source of growth, no matter the economic cycle. And second, I will explain the basis why I think Telefónica, is the right choice, we see in our industry to combine high returns and limited risk exposure. At the end of the day, we are a company fully oriented to maximize shareholders' returns.

There is no doubt that these times are extremely challenging for all the businesses. But I can tell you that in Telefónica, we feel more confident about the future than before the economic downturn. Telecoms are proving to be somewhat sheltered from the weak macroeconomic conditions, and this is not surprising to us. Ours is a very resilient sector. And leading players that focus on customers and have advanced in their transformation have the opportunity to benefit from the greater demand from customers and a more rational behavior from competitors and regulators. We know that customers ask for more control, value and trust and we are in a better position than other players to offer to them this.

Certainly, from a Telefónica perspective, we are really excited about the opportunity that innovations can bring. We see no limits in the capacity for all kind of customers to absorb innovations. Acceleration of the business cycle shows as you can see clearly in this slide, that there’s a huge latent demand for new services that improve the way people live and work.

Telecommunications are expanding, and its customer base is growing. This industry has created a very connected world, meeting the increasing demands from our customers and, you know, that figures became outdated every quarter. And how many sectors can say the same thing? People from all regions and ages are actively using these new means of communications. There is a growing demand for personalized services, and everybody wants to be always connected. People and households are becoming more and more digital and customers’ greater involvement will boost the demand of new services and applications.
Today`s economic conditions will separate clearly the incidental from the essential. And rationality, will drive the change in business projects. And our industry will be strengthened because we offer real value. Broadband increases productivity in all sectors, and particularly in knowledge intensive activities. It also boosts services and process innovations and increases specialization. Telecos are really becoming an essential part of the companies operations. They're challenging the common view about IT services in working or even travelling, conforming a new way of making business.

I have mentioned on several occasions that this sector is part of the solution, not part of the problem in the current world situation. The multiplier effect of the telecom sector turns it to be the perfect ally of the governments to reactivate the pace of development in all the countries. This is being fostered by public administrations and policy makers through digital agendas and technology programs although not with the needed determination. There is also an awareness of the need for more collaboration between industry and regulators, and a more predictable regulatory environment that encourages the investment in innovations.

Telecom accesses have a track record of outstanding growth; that story has not ended. Our industry will continue growing. More mobility and broadband have enabled new ways of doing business and new life experiences. There is a clear trend toward full penetration of broadband in households and business in all the developed markets. And we observe that this combination of broadband and mobility is allowing a truly mobile Internet experience for our customers and a great commercial success for us. Moreover, traffic volumes are expected to explode, driven by video, new applications and users involvement. We are truly moving from a verbal or voice world to also a digital world.

Additional growth will come from new applications, services and business models in adjacent sectors, such as virtualization, advertising, financing, health, digital home or e-Commerce; a real total digital life. The digital revolution is here and the players that deliver superior customer experience and innovation will emerge stronger. This new environment is fast and complex, but at the same time, it's opening high potential opportunities for us. We have the real power of transformation and transformation clearly means growth.

So far, we have reviewed how our telecom industry will continue to be a steady growth story. And what was previously perceived as threats in an extended value chain, are clearly transforming into very exciting opportunities. And now, I would like to tell you that Telefónica is one of the best positioned players to take advantage of this promising industry.

Our equity story for the next three years, is based on three interrelated building blocks. First, our current strengths clearly show that we have the right levers to take advantage of this growth industry. Second, we have a focused growth strategy that will allow us, clearly, to prioritize and capture the growth opportunities that are arising.
And third, our guidance for the next three years, will lead us to a sustainable growth and even a lower risk profile that enable us to enhance our shareholders’ return policy.

I would like to start this part of the presentation by saying that since when we met in London two years ago, we have continued to strengthen our growth profile. First, a differential scale, with value creating diversification and optimum risk profile. Second, a consistent growth company. Third, trusted and strong brands. Fourth, an excellent execution track record. Fifth, an experienced and committed team. Sixth, best-in-class efficiency with room for further improvement. Seven, very strong financials. Eight, the right partnerships and alliances, and nine outperforming on corporate sustainability.

Thus, I hope that after reviewing Telefónica current strengths, you’ll be convinced, as we are, that Telefónica has the best fundamentals to build on the future.

Our first strength is having a different differential scale. Our scale is global. We are now the number five operator in the world by number of total accesses. Also our scale is regional, as we have relevant assets markets served both in Europe and Latin America. But most, and most important of all is that our scale is local; being number one or number two in most of our markets.

In addition, we add value to our scale through an ambitious and great diversification. A geographical and business diversification that creates value and provides us with an optimum risk profile. This premium diversified scale, allows us to better focus on our customers through the multi local and integrated management.

Our second strength is that we are growth company. We have been growing consistently for the last 20 years, but if we look at the last years, since the year 2000, we have multiplied the number of clients by four, our revenues by two and our operating cash flow by five times.

The third strength that I want to share with you is that Telefónica has a strong and trusted brand. Our brands stand at number one or number two in top-of-mind in 90% of our markets. This year we have developed a new brand model, with role separation, institutional and commercial, that best leverages the value of our three great brands. A strong institutional brand, Telefónica, as the only brand to take the role worldwide; and two strong commercial brands, Movistar in Latin America and in Spain, and O2 in the rest of Europe. A very pragmatic and efficient model, driven by business and customer vision that will help us greatly to face the future challenges and opportunities.

Telefónica fourth strength, is our excellent execution track record, translated first in delivering on what we promise, no matter the business cycle. And second, setting the idea that Telefónica is a highly predictable company, thus a lower risk investment choice. We constantly deliver on our commitments and this is the reason for our credibility. While others are laggards, we keep on being leaders.

As you know, in a more difficult economic environment, we have posted very solid earnings. Major growth opportunities in our markets, combined with the benefit of
the scale, diversification and execution capabilities have allowed us to combine industry-leading organic top-line growth with the best-in-class EBITDA margins.

From my point of view, one of Telefónica main strengths is having a highly committed management with broad experiences in our business. Here, you can see, the executive committee members. But Telefónica biggest strength, is its full management and professional strong team. I believe in teamwork, but also in people that take decisions and our organization is always framed in such a way that makes both objectives, teamwork and decision taking, achievable.

In the efficiency side, Telefónica is a benchmark in the industry, as you already know. But today, we want to tell you that we still see further room for improvement. Through today’s presentation, you will have a clear view on how Telefónica will move further to the left on this chart.

We benefit today from a steady financial profile, recognized by all the rating agencies and provide the best-in-class cash flow generation. As you can see, in the right-hand chart of the slide, our conversion rate of revenue into free cash flow is ahead of those of our main competitors and reached an outstanding level of 15.8% in 2008. Stability in finance, and high conversion of sales into cash flow takes on a special meaning within the current recession scenario. This is clearly in sharp contrast, not only relative to our peers, but also relative to other sectors, which now are struggling to show any profit at all. I have no doubt that Telefónica will excel even more clearly when the economies turn around. And this is clearly the true path towards shareholders’ remuneration.

This is why today, either when you look at the last 20 years or the last 24 months, we deliver the best-in-class shareholders' return in our industry even outperforming the key stock indexes as the Dow Jones Telecom or the EURO STOXX 50.

No doubt that our alliances are fostering our leadership position, with a combined global customer base of more than 650 million customers, that represent close to 10% of the total world population. We are fully committed to our industrial alliance with Telecom Italia and with our strategic alliance with China Unicom, which has been broadened lately and we are already, capturing the targeted synergies. And I can tell you we will continue working to make these synergies for the benefit of our shareholders and our customers.

I also want to highlight our business alliances as a strength for Telefónica since they allow us to reach win/win cooperation agreements and to improve our commercial and innovations capabilities.

The last strength I would like you to realize is our leadership in corporate sustainability within our industry, as recognized by the Dow Jones Sustainability Index. A leadership that we have achieved two years ahead of what we had committed. To be leaders in sustainability, for us, is the proof that we are doing the things right. For Telefónica, the sustainable management is not only a necessity, but mainly an opportunity to differentiate and enhance our long term values.
And all these strengths allow us to fulfill, which is for us the primary focus of everything we do; to fulfill our stakeholders' expectations; the only way, clearly, to achieve a sustainable leadership in the long run.

Now, let me go through the second building block; our growth strategy for the next three years.

Our strategy is based on two main pillars. The first pillar is to fully capture revenue growth potentials as it often will focus on our traditional business and broadband connectivity, while developing applications and new businesses. And the second pillar, we will work on further transformation to keep growing profitably.

You will see that our efficiency target is very ambitious, but you know better than anybody that we know how to achieve it. And we will continue to be the reference on excellence and the most competitive company in our industry.

We have a growth industry ahead. The telecom sector revenues in Telefónica's footprint is expected to increase between 1% and 3% per annum between 2008 and 2012. Growth rate that will be much higher if we consider 2009 to 2012, because of the inflection point of 2009 in terms of macroeconomic impact. Most of the growth will come from broadband and mobile, where we see almost full penetration in developed markets. A traffic explosion is expected in the next 3 years, basically driven by video, user-generated content and new applications growth.

In this context, we are working to put the customer at the center of everything that we do. Evolving, from a transactional company to the company with an emotional relationship with its customers. At the same time, we will offer them services, platforms and applications that respond to our customers' evolving needs. In such a move, we are going to become emotionally relevant to our customers as we add value to their lives. If we manage to build a meaningful relationship with our customers, as we do, and we will continue to do, it will further differentiate Telefónica from others and it will enable us to play a leading role in new areas.

In this journey, we have identified five growth priorities. First, customers focus and consistency that will drive our strategic actions. Second, the development of applications and new business where revenues will progressively increase its weight in the coming years. Third, the massive mobile broadband development, leveraging its differential attributes and facilitating access to Internet. Fourth, DSL upgrade and selective fiber optic deployment, maintaining our leadership in broadband by an increasingly segmented offer. And, fifth, defending and growing our traditional business. As a result of these priorities, Telefónica will obtain a differential revenue mix where broadband connectivity, applications and new business will increase its weight to a minimum of 27% in year 2012.

Profitable growth requires a new operational model, thus we have also identified five key priorities in the transformation strategic plan. First, one multi-access network to enable growth while manage CapEx efficiently. Our second priority is IT and we consider it a key transformation enabler. Our third priority is to evolve
towards a complete online company to increase agility and efficiency in our relationship with all our stakeholders.

Fourth, operational excellence to release resources for growth. And, fifth, commercial efficiency, tailored to local market conditions, and all of these further leveraging our scale and strategic alliances. Later on, Julio will explain in detail how we tackle these programs.

The execution of this strategy will allow us to accomplish ambitious operational targets for 2012. Telefónica will lead customer satisfaction in any of the countries where we operate. And we will outperform the industry and our revenues and access market share. You will know the huge impact on value of reducing every decimal point in the churn ratio.

In this instance, Telefónica is committed to reduce this churn ratio by 30 decimal points between 2008 and 2012. As I have already told you, our efficiency target is very ambitious and we are expecting an improvement in our efficiency of four percentage points along the guidance period.

Let me now move to the guidance for 2012. Our level of ambitions is reflected both in the operating and financial guidance, where it is very remarkable how our operating returns will outpace revenue growth. We are accelerating access growth. We expect to reach more than 320 million accesses by 2012, with an annual growth rate of 6%.

We expect to increase revenue between 1% and 4% per annum, our EBITDA between 2% and 4% per annum, and our operating income between 4% and 7% per annum. And please note that this growth is pure organic growth.

At this time, we are going to improve our capacity to turn growth into cash. While we would renew our CapEx commitment with cumulative CapEx guidance for the period 2009 to 2012 of approximately 30 billion euros. We would generate a total of more than 64 billion euros operating cash flow in 2009, 2012, which means an annual growth rate between 5% and 7.5%.

In 2012, Telefónica will become a company more diversified, as more than two-thirds of our accesses will be in Latin America, more innovative as applications and new business will have a higher weight, more mobile, as almost 80% of our accesses will be mobile and more broadband, as the increase in broadband accesses will be significant, representing 28% of our total accesses, 18p.p. more than in 2008.

And we will continue with a great track record of turning organic growth into earnings, as you can see in this slide. I would like to confirm our 2010 earnings per share target of an amount of 2.1 euros per share, which implies a 29% increase over the 2008 figure.

The 2010 original London guidance has been depressed by a weaker economy, less favorable exchange rate and a higher sensitivity of revenues to the business cycle, especially in mobile. But we confirm our 2.1 euros stress scenario for 2010 on the back of the embedded operating guidance and continuing with gaining efficiency across all the items of the P&L and some non core asset disposals.
And we will continue with the same great track record, turning earnings into cash. In this sense, we have proposed to the Board of Directors a dividend increase for fiscal year 2010 to 1.4 euros, which will be in line with the 2010 earnings per share target. This represents a 22% increase over 2009 dividends per share.

Furthermore, we have targeted an additional dividend increase for fiscal year 2012 to a minimum of 1.75 euros that at today's price would imply a 9% yield. These commitments show our high confidence in the future of our company and how our shareholders are the first priority for Telefónica.

From 2009 to 2012, Telefónica will generate the free cash flow of more than 40 billion euros that will be allocated following these priorities. As I have already told you, our first priority is shareholders remuneration. Our second priority is to maintain our leverage stable and we expect a ratio of net debt plus cash commitments over EBITDA between two and two and a half times range.

Our third priority is a very selective M&A. M&A operations will be focused on current markets to foster organic growth, as well as the shareholding increase in China Unicom, up to 10%. We could consider very selective growth opportunities if appropriate. And finally, we will continue tactical share buybacks for free cash flow excess.

In summary, I think we have a great opportunity to move Telefónica to the next level of organic growth and returns and I'm sure we will succeed. We are one of the best positioned players to take advantage of this growth industry. We have the right growth strategy, we consistently deliver on our commitments and we are a lower risk investment case. We have a very committed management team for value creation, and we will continue to be a company focused on enhancing shareholders' returns.

And now, I will pass the word to Santiago. Thank you.