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"Transformation for delivering sustainable growth" transcript

Good morning. And I am very pleased to have this opportunity today in our house to meet all of you and to share our view for the next three years. Already our Chairman shared with you our strategic guidelines, but jointly now, Guillermo, Matthew, Jose Maria and myself, we are going to elaborate a little more on that strategy for the next three years. They will cover the details on each region.

And I will make a general overview trying to cover how we see our markets. How we are going to capture our growth potential? And how are we going to change our operating model in order to support that growth that we see. We really believe that there is volume growth in our industry. And we believe so because users like to be permanently connected, they enjoy social networking. They are very open to generate content, and especially today, because there is something new in our industry.

For many years Internet evolved in one direction, completely separated from mobile services evolution. But now, there is a link, and there is a convergence. And mobile Internet has a huge impact on our industry. And it has a huge impact because powerful devices are available for consumers and they are able to access to hundred thousands of applications through those devices.

This is going to have -- this already has, a huge impact on our industry. And because of that, we are fully convinced that we are going to have a lot of volume growth in our industry. And this is going to happen, not only in the mature markets, but in the emerging markets much more. We see growth in all the services except voice services in mature markets.

Overall, in our markets, the first wave of growth is going to be mobile broadband. Then it will be fixed broadband. And we will still see a lot of growth on mobile services and in our markets, fixed voice, will be quite flat. As a result, traffic is going to continue exploding.

But the industry has a challenge, which is to convert this volume growth into revenue growth. And we see this as a unique opportunity, because we really believe that we are able to turn volume growth into revenue growth to some extent. How? Well, first of all, in a quite traditional way that is already experienced, and that is already providing very good results. On this way, is to provide more and more services on top of connectivity to provide more services for its customers.

And we see here, an opportunity because we see new services coming every day. And we are pretty sure, that in the future, we are going to see more and more services coming into our industry. This will help us to increase revenue per customer, to increase the loyalty of our customers and to reduce churn.

But we see a more innovative wave in order to try to turn volume growth into revenue growth. And this is what is based in going inside of customers' behavior. And when you look into customers' behavior, the first thing that you have to recognize is that there are a lot of differences between customers, of course.

It is very easy to recognize the differences between enterprises and consumers. But even in the consumer market today, we see that the market is more and more

polarized. We see customers that are asking for simple communications, are customers that are asking for more sophisticated communications.

For instance, in some of our countries, just 1% of mobile broadband customers are generating 50% of mobile data traffic. All of these is a good base in order to provide services on demand basis, in order to provide everything as a service. In order to provide bandwidth on demand, quality of service on demand, volume on demand, processing on demand; and this will help us to increase revenues for customers.

Then, taking into account the volume growth that we see, and taking into account the opportunities we see in the pricing environment, we really believe that in our industry, there is going to be revenue growth. And we see this 1% to 3% revenue growth, yearly in our footprint, thanks to the contribution of the emerging markets where we are currently present.

Then the next question is, how are we going to capture this growth? And already Cesar told you, that the way that we are going to capture this growth is by moving the whole company in two parallel directions. One in order to reach positive emotional relationships with our customers, and the other one in order to be a fully service provider company; and in order to evolve in those two directions, we have identified five major initiatives.

The first one is to have positive emotional engagement with our customers. You may think that all the companies talk around being customer-driven. And either you may think that you heard before us to talk about that. What is new here?

Well we believe that we are giving a step forward in this relationship with our customers. And we are giving a step forward because, in addition to drive the whole organization from the customers' point of view, and to motivate all the people around the customers, in addition to that, we need to have an integrated bill of our customers.

We need to have a single point of contact. And we need to have a first call resolution capability. And in addition to that, we need to focus the whole company on customers' value most. And for that, we need to simplify our offer and our complexity. And this a real revolution in the Company that will allow us to have that kind of positive emotional relationship that we want to build.

And by doing that, we'll be the leader of customers satisfaction, in all our countries. We will outperform the industry in market share, both in countries where we are incumbents and in the rest of the countries. And by doing that, we are going to reduce churn that we will have a solid positive impact on our results. But in addition to that, to have emotional relationship with our customers, will provide us the right to provide them more and more services, on top of connectivity.

What kind of services are we talking about? Well first of all, mobile applications. I think today, there is an explosion on mobile applications in our industry. And we want to be, and we are already, very active in this mobile applications world.

This is extremely important for the whole industry. And this is extremely important for the evolution of our portfolio, and for the relationship with our customers. In our

case, we are going to focus on four kind of mobile applications. Applications related with communications, of course, that's our core business, with communities, extremely important today, with transactional services and with entertainment.

In addition to that, we are going to be very active in the digital home. We see that customer premises equipment are getting bigger and higher in every single home. And because of that, we believe there's an opportunity for integration and an opportunity for management of the whole package of equipments in the house. And an opportunity to provide services on top of that.

Of course, one of the most significant services for the digital home is TV. And in TV, that we already have, a very good customer base, we are going to continue being very active enhancing the services that we are providing with better content, with better user experience. And I think this is a necessary base for the future. Because if today we see mobile broadband as the first wave of growth, in some years time, we will see video as one of the drivers on the following waves of growth.

In ICT services, we have been very active. In fact, we had very good results. And this is a good base to continue working on those kind of solutions by taking advantage of the new technologies like Cloud computing. And we are going to enter in new business. And we are going to focus on two, Financial Services and e-Health. The growth we see on revenues in these applications, and new services, is between 12% and 15%, very nice growth, though it is not the first wave of growth.

But in addition to that growth, I think it is extremely important, because those services, those applications, are going to help us to develop the most important part of our business, which is broadband. And mobile broadband is going to be, in the next year, well in fact, it is already today, and it is going to continue being in the next three years, the first wave of growth of revenues.

By the end of the period, we are going to have 67 million mobile broadband accesses. And this revenue, based on mobile broadband, is going to grow between 40% and 45% per year. How are we going to capture this growth? Well, exploiting the distinct attributes of mobile broadband. And there are basically three, mobility, convenience and simplicity, and helping our customers to access to Internet through mobile communications.

We are going to do it in such a way that we are going to position this offer in most of our countries in a complementary way, to the fixed broadband offer. We are going to be very active in the smartphones' world.

And in fact you will see later than in some of the countries, our objective is to become the home of the smartphones. We are going to be very active in deploying datacards in a massive way through new channels, with collaboration with third-parties and of course, focusing on new devices like notebooks and e-Readers.

How are we going to position our product, from the point of view of speed with rationality, 1 to 2 megabytes. From the point of view of pricing, we are going to avoid unlimited flat rates. We are going to base our pricing on the speed, on volumes and on services. We will avoid unlimited flat rates.

This offer is going to be complementary of our fixed broadband offer. And here we are going to continue a massive deployment of DSL, in a more segmented way. We are going to launch entry products in order to cover our areas that they are not yet covered with DSL or we do not have any DSL customer.

We are going to continue in a standard offer with the right price, and with the right speed to be competitive in the massive market. And we are going to have premium offer for higher speed in order to support more services for a segment of the market that is asking for sophisticated services.

And this premium offer is going to be complemented by a selective deployment of optical fiber. And in this selected deployment of optical fiber, in our view what is important, is not the number of homes passed. But, what is really important is to have a portfolio of services that will help us to connect our customers with optical fibers, because they are going to enjoy those services on top of optical fiber.

Just Internet access is not enough in order to develop and to deploy the optical fiber market. We are going to be very active in developing new services to support the optical fiber deployment.

Fixed broadband is the core of our bundles. It is absolutely key for our bundles, for the residential market and for the consumer market. And because of that, fixed broadband and bundles are the best solution to protect the traditional lines. That's the best way to defend our traditional lines. Because of that, at the end of the period, at the end of 2012, 60% of our traditional lines are going to be bundled with voice, with broadband or with TV. And this is the best way to protect this significant asset.

In addition to that, to improve that protection, we are going to develop and to launch prepaid fixed broadband for segments of market that are not able to afford current offers. In addition to the traditional line and the Fixed Voice business, we see still very good opportunities to grow in Latin America, in the traditional mobile services. Because we see that it is possible to grow in penetration because we see that it's possible to grow, migrating prepaid customers to postpaid customers and because we really believe it is possible to grow in ARPU.

With these actions, we are going to have our traditional revenues -- our revenues based on traditional services, quite flat. And this is extremely important, because this is the base on top of it, we are going to build the three waves of growth that I mentioned before, mobile broadband, fixed broadband and applications and new services.

And with this effort, we are going to grow our customer base and our access base by 6% yearly. And we are going to grow our revenues, as already was mentioned from 1% to 4%. But I think it is very important, not only this growth, but to look a little bit about the change in the mix of accesses and revenues.

And you see there is going to be a significant growth on broadband accesses that will be 28% at the end of the period. There will be a significant growth on mobile

accesses and Telefonica at the end of the period will be a very mobile company, 80% of our customers will be mobile.

And you see that 27% at the end of period of our revenues, ten percentage more than at the beginning, are going to come from broadband, connectivity plus applications, plus new services, new businesses. So this is a very strong evolution with a very nice growth. And we are absolutely convinced that to support that growth, we need to change our operating model. And we need to go to a fully new operating model in our company.

First of all, because we need it in order to support our customers' demand that I mentioned before. But in addition to that, because we really believe that it is not possible to manage the access part of the network as we had been doing till today. And now, for us, we were managing voice fixed and voice mobile in the access part of the network completely separated. And we managed both kind of accesses completely separated.

Now we see a lot of reasons to manage absolutely in an integrated way. And our strategy is a multi-access strategy with an integrated view on the kind of solutions that we are going to offer to our customers independently of the technology that we are going to use.

We need to continue doing an effort in order to evolve our network towards a fully IP network with more intelligence embedded on the network. We need to incorporate new technology to our network, like a Cloud computing. And we need to change our relationship with the external world. And we need to become a fully open company, very cooperative with external world.

And we have to be very open to cooperate with third-parties, regardless they are big companies, small companies or individual, to help them -- to facilitate them to develop together with us, new applications for our customers. And thus, the open Telefonica platform that we are building to support these facilities to facilitate this kind of cooperation.

In addition to this network view, we need an evolution, a radical evolution, in our IT systems from the point of view of the production, and for the point of view of our applications. And this will help us to review end-to-end all the processes, and to evolve the whole Company towards a fully online company.

In addition to these three initiatives, of course we are going to focus on our operational activities, because they have a significant impact on our costs. And we are going to focus on our commercial activities in order to optimize the way we do it. The five initiatives will be reinforced by our scale and by our strategic alliances.

In the network part, in the first initiative, the access was, and will be, always the most important part of the network from any point of view. From the customer connection point of view, from the opex point of view, from the customer point of view, from any point of view. So, our focus is going to be in the access part of the network.

And in the access part of the network, we are going to do two basic things. One, to optimize as much as possible the CapEx we spend in the traditional part of the access. And we really believe that here we have a huge opportunity in relationship with a copper plant and in relationship with 2G, because we already cover most of our countries with these two technologies.

Because of that, we really believe that we may contain CapEx in this area. And by doing so, we are able to spend more CapEx than before on new growth opportunities. And we are not going to lose any new growth opportunities. We are going to take care with our CapEx, all the growth opportunities we see in front of us.

And we have three priorities here. The first one 3G coverage, and we are going to multiply by two the coverage of the population with 3G. Of course, for this 3G coverage, we are going to need new spectrum. And we will have to bid for new spectrum. The CapEx needed for the spectrum is not included in the numbers that we have provided to you. It is not in our guidance. We do not have yet enough visibility in order to be able to include it in our guidance. It is not included.

Our second priority, it is going to increase bandwidth on fixed accesses. And we are going to multiple by nine, the number of lines that are going to be ready to provide more than 25 megabytes per second. And we recognize that we are going to need more capacity to support this new world. And we are going to need more capacity in the backhaul, and we are going to need more capacity in the backbone. And we are going to multiple by four. Those are our efforts. Those are the efforts that we are going to do in optimizing our CapEx in order to have CapEx to cover all the growth we see for the future.

Regarding IT we need to change a lot, our systems. Now first of all, we are going to concentrate our datacenters from 70 to six. And this is going to be a very big opportunity to have a common architecture and a single foundation for the whole company. And this will give us the opportunity to provide common applications, whenever it's applicable, to all the countries in Telefonica.

And in addition to that, we are going to extend to all our geographies, our -- the so-called application management model that proves to be very efficient in our experience. These changes in IT will help us to move the whole company towards an online company, in such a way that by the end of the period, 25% of our relationships with our customers, will be online, 95% our relationships with our suppliers, with be online, 40% of them will be digital auctions.

All our relationships with third-parties through Open Telefonica will be online. And most of the internal activities for our people will be online. These three initiatives will help us to improve our efficiency. But in addition to that, we are going to make a special focus on operational activities, increasing the level of automation, mainly in everything related with a copper plant and with everything related with installation, maintenance and subscriber premises.

We are going to extend outsourcing activities in more geographies, and in more parts of our networks. We are going to increase the kind of activities around operation, maintenance, and agreement with third-parties that are going to need

regional or global. And of course, we are going to continue doing with other operators' network sharing agreements.

That's something that happened in the last year. We are very happy with the results. And we are going to continue doing and extending in the future. At the same time, we will try to become a more green company, being more efficient from an energy point of view.

In the commercial side, and in the cost of goods, unfortunately our regulators are helping us here. And because of the new pricing of MTR, there is a positive impact on the cost side with very significant impact, because of the reduction of prices in interconnections. But in addition to that, we see in our industry and we are going to try to limit, as much as possible, a new dynamic around subsidies for subscriber acquisitions and for subscriber retentions. And we really believe that it's possible to do it in a smart way -- in a better way, than before the subsidies used to close them more and more to value customers.

In addition to that, because we launched several years ago to be an integrated company, and because we have managed Telefonica as an integrated company in every country, we are progressing and we have opportunities in China's integration and in order to improve the mix of channels.

All those five initiatives are going to be reinforced by our scale and by the agreements that we have with strategic partners like Telecom Italia and China Unicom. Today, Telefónica is managed as a multi-local integrated company. It's managed as a multi-local, because we recognize the value of each local unit, and the importance of each local unit within our organization. They are the owners of the customers.

They are the owners of the factories. And they are the owners of the relationship with the local regulator. And we are going to preserve this important piece in our organization. At the same time that we are progressing, and we are creating, global capabilities to benefit from our scale.

We are improving our capabilities in procurement. We are improving our capabilities in roaming. We are improving our organization in multinationals. We are improving our capabilities in global product and service development leveraged on our R&D organization. We are improving, and it is very important, global negotiations with third-parties, that give us a lot of power in these negotiations and they are extremely important from many points of view.

By doing this, we really believe that we are able to reduce opex per access from six to three in the period of time yearly, then our OIBDA will grow as you saw before from 2% to 4%. We are going to spend, in this period of time, a cumulative CapEx of 30 billion euros. And what is very important here, 78% of that amount of money is going to be for growth and transformation. Because of that, we are not going to miss any opportunity. And we are going to improve our efficiency that already is a benchmark in four percentage points in the next four years.

So, this is our view. And I can tell you, on behalf of the whole organization, that we're all absolutely focused on growth and transformation. And we all are

absolutely convinced that those ten initiatives are going to take us to the targets that we ambition. And I personally can tell you, that those ten initiatives are my own priority in order to deliver to you the guidance that we are committing today. Thank you very much.