

Telefónica



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“Focus to keep growing” transcript

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Well good afternoon to all of you and on behalf of the Latin American team of Telefónica welcome to our presentation. During the next 30 minutes or so I'm going to try to drive you through what has been our recent performance, and what's the kind of future that we see ahead of us.

Let's start with a brief review of our recent performance. Since last time we met in London a lot of things have happened but we have had a good performance. As of June this year, we have 161 million accesses in the region and we have been growing more than 50%, since last time we met.

We have also built up on our profitability, we have increased our OIBDA margin by five percentage points and we have also tried to build a much more sustainable model in terms of customer satisfaction, employee satisfaction and the number of our social programs and their impact in the region.

And as a result of all of that we have been able to grow our revenue by 11% year on year. We have been able to generate a cumulative cash flow of 15 billion euros and 63% of that cash flow has been generated in investment grade countries. So the summary of the last years since we last met I think is good for the shareholders of Telefónica.

And that has happened in spite of the fact that not many things happened accordingly to what we were projecting last time we met. We have the crisis and we have not been immune to the crisis in Latin America. We have been affected but to a much lesser extent than many other countries on earth. And in fact, probably as we speak we might be the last one to step into the crisis and probably one of the first regions to step out.

Brazil just in the month of August created more than 242,000 new jobs. And there are some things that occur during this period that are just historical. 70% of the gross domestic product in Latin America is today investment grade. And that has never happened in history. Brazil and Peru have become investment grade countries just in the middle of the crisis.

And that has happened thanks to the fact that the structural changes appear in Latin America. Most of them have already been covered by Santiago so I'm not going to repeat them. But let me just detail to you that a significant amount of people stepped out of poverty in the last years. A middle class has been created and employment rates are historically low and have stayed historically low during the recession.

And as a result today what we have in Latin America is growing demographics, growing economies, much more balanced wealth distribution, growing consumption patterns and a very young and dynamic population. So I think that the region has everything needed to attract a telecommunication investor.

And with this very brief review of the competitive environment and the regulatory environment well the region has more or less consolidated. There are two powerful regional players, ourselves and the Slim group. There are a new emerging force like the Brazilian champion, Oi and there are very few but strong local and semi-regional players.

So most of the game has already been done, but out of this competitive position if somebody was willing today to build up a position like the one that Telefónica has in Latin America, it just cannot be done. It's irrepeccable. Our position is the more diversified in terms of geographically speaking and technologically speaking.

So Telefónica has a sound platform in a very promising region. From a regulatory standpoint well the agenda is foreseeable and is on top of the table. Those are very important matters and very valuable matters like MTR cuts, most of them by the way have already occurred. We have portability issues. We have Spectrum auctions and we have in some countries now triple play. But you will see the agenda is foreseeable. We are working on this agenda and therefore is nothing that could be a disruptive movement according to what we see today.

And as a result of all of that we think that we have in Latin America a very good opportunity that Telefónica has a track record in executing and delivering even in tough times and therefore we are fully prepared to take advantage of these new opportunities. And being very straightforward and transmitting to you what is the size of the opportunity that we see ahead of us, let me tell you that just in the countries where we are present, not globally speaking the region, just where Telefónica is present we think that revenues are going to grow something between EUR23 billion and EUR31 billion in the next three years. This is more than half the size of the total Spanish telecommunication market. So we can just not afford not to be able to grab this opportunity.

And therefore we are going to be focused on our revenue market share, on value and we are going to be focused on still generating a significant cash flow. There is penetration and you will see that our traditional access and voice revenues are also going to grow. But also we think that there is new waves of growth emerging in the region and you will see some of those. And as a result our revenue function at the end of the period is going to be different.

The weight of the new services, broadband and applications, is going to be double what it is today and is going to be growing significantly but also the access and traditional services. And there is a lot of room to grow in efficiency and we will be much more efficient. But we will make sure at the same time that we maintain the adequate levels of quality to ensure this growth. Let's review how we intend to do that.

Well, our program is very similar to the rest of the group. We need to make sure that we capture the growth opportunity. We need to make sure that we are even more efficient in order to fuel up this revenue growth all around our P&L, and for us in Latin America we have two specific pillars of action. We need to make sure that we take the best out of the scale that we have – we have always being doing that. We need to make sure also that our business is sustainable and you will see how important this is for us.

Well, let's step into the growth opportunities. First source of growth, having the best customers and the most satisfied customers. We need to improve significantly here. We have on a country-by-country basis analyzed what are the causes of

customer satisfaction and customer loyalty. And those are not the same all around the region.

Since two years ago we have been moving by action in those levers and we have been improving the customer satisfaction levels in almost all of our countries. This is crucial. We have been changing our processes. We have been putting end-to-end processes, focus on customer satisfaction. We have applied first call resolution methodology in all our call centers.

And we want to improve all our channels of communication with our customer online, physical points of contact in order to reduce dramatically claims. We intend to do that and to have a reflection in our P&L through churn reduction and you will see that our churn reduction target on the mobile side is very aggressive, more than 30%. And on the broadband side is of 10%. Again, this is crucial. We are all aligned as a group in this target but for us in Latin America it gave us a lot of room to fill up growth.

We do see also growth in terms of penetration on the mobile side. And in fact, most of the growth is going to come from the mobile world. Latin America is today in the low 80s in average in penetration. There is no reason why according to what you have seen in wealth distribution it should not be growing to the neighborhood of 100% in the next 3 years.

That means between 130 and 140 million new customers stepping into the market and we need to make sure that we capture the proportionate or even a more than proportionate part of that. And for that again we have been improving all our points of contact with the customer, online, traditional distribution, call centers.

And because of our scale we have one of the most, if not, the most attractive portfolio of handset in the region. So we think that thanks to the effort that we have been doing very recently in improving our distribution channel, improving our online channel, and improving the portfolio of handsets that we have in a very segmented and comprehensive offer, we are in good shape to capture that opportunity.

And at the same time we do believe that there is room for ARPU improvement. I mean we want to turn around the ARPU trend and for that data is going to be crucial and new services are going to be crucial. We have already launched a distinctive set of portfolio of services and applications that is already contributing to turn around and to fuel up the growth of the data services.

On top of that we intend to move our customer value chain upwards from prepaid to hybrid products and from hybrid to contract. And as a result and you will see in the figures we intend to basically double the amount of post-paid customers overall total customer base.

If you believe that there is going to be something in the neighborhood of 600 million people in Latin America by the end of year 2012. And if you believe that there is going to be something in the neighborhood of 161 million PCs in Latin America by that time. And if you think that there is going to be more than 70 million smartphones and high-end devices then you should understand that we think that

mobile Internet is going to be exploding in the region in the next three years. And we need to be ready for that.

We intend to have 32 million accesses of broadband at the end of the projection period from the one million that we have at the end of year 2008. And for that we are reinforcing our networks as you will see later on. We are making sure that we have a comprehensive value proposition. We are getting away a flat, unlimited flat tariffs and we want to lead the deployment of these new waves of growth.

On the fixed line point of view we also see growth. You might imagine this growth is going to come from broadband and from TV. And we think that this growth needs to be more than enough to compensate the decline that we foresee in the traditional business.

And for that we need to really transform or to keep going on the transformation of the wireline company. We are going to keep pushing our bundles of voice, voice plus broadband, and voice plus broadband and TV. We are going to be changing our systems in order to make sure that we have a much more simple offer. We are reducing significantly the amount of product that we have in our catalog.

And we want also to improve the ARPU and to develop a specific offer for the SMEs in terms of desktop management. For that we need to improve our networks and we plan to improve our offer by multiplying by four the average speed of access in the projection period. So we do see growth on this part of the business thanks to the broadband effort and to the effort in TV that we are trying to do.

Let's now move into the transformation part of our business. Here as I was telling you we have significant room to go. On the mobile side we are all of us, all the competitors in Latin America in my view are evolving to a more rational use of our funds. From the commercial standpoint we are going to be moving to a level of close to zero on subsidizing prepaid handsets.

We are going to be acting on the sim-only space while centering our proposal in value. We are going to be reorienting our channel of sales from upselling and from just, pure captation or pure new adds to loyalty and retention of customers and contract. And we are going to be reducing sales commission in order to boost the quality standard and to reward for quality standard.

We are going to be progressively re-orientating our management again from just pure new adds to retention. And thanks to the agreement that we have with third parties we have been able to incorporate to our portfolio of products and services, new applications and we need to make sure that we even use our network more efficiently.

Thanks to all these efforts we intend to reduce our commercial expenses by roughly ten percentage points in the next years. On the fixed line point of view, again, we need to transform our business, radical simplification of our offer, reinforcing the alliance that we have with third party and with subcontractor.

Lean processes, leaner processing in back office. And all the sales process need to make sure that we reward the quality and that we deliver what we promise. In fact,

we are already radically changing our operation and that is giving result as you have seen before in customer satisfaction index.

In fixed we intend to reduce by 15% the failures that we have on broadband and to reduce the total cost, OpEx plus CapEx over accesses by 1% and to reinvest those funds into further quality and efficiency. And in terms of the network you cannot understand the transformation without deep changes to our network. Julio has covered how we intend to run our multi-access integrated network and the same plan applies to Latin America.

There is no way we can do that if we don't go further or the integration of our IT systems, of our data centers if we don't run our networks as a simple one. We have a huge network in Latin America globally speaking and we are struggling still not yet the best out of it. We have selective assets as you will see in terms of wholesale capacity. And we are going to be reducing complexity by switching off TDMA, CDMA and TDM switches on the wireline side.

We will keep leading the 3G deployment in the region in an accelerating manner to make sure that it matches the effort that we will be doing in broadband. And in terms of wireline broadband you see that we intend to multiply by four our speed of access in the next year.

Listen, one of the key factors of Telefónica in the region, in Latin America, is that we have become regional. And we are, in fact, the only player in the region that is really acting regionally. We have been doing that for the last seven years and we are generating more than 1 billion euros per year in synergies both in revenues, in OpEx and in CapEx. We intend to do that again and to again reinvest those efficiencies and those synergies into further quality. But on top of that we are going to be adding the global effort that Julio discussed and explained to you in his presentation.

On top of that we have unique assets in the region. We are the leader in the Internet in Latin America thanks to Terra. We have a unique platform with Medianetworks to capture exclusive content and to have also wholesale capacity on TV distribution. And we have TIWS, which is a company leading wholesale capacity and owns a submarine cable that surrounds Latin America.

So from a regional standpoint Telefónica has specific and unique strength that we intend to use for the future. I told you at the beginning you cannot be in Latin America if you don't get involved in sustainability. For us sustainability means gaining markets for us not only through performance but also through the way of obtaining our results.

For us, sustainability means customer satisfaction, employee satisfaction and the way the society perceives Telefónica. In customer satisfaction we have been improving significantly with some pending issues. In employee satisfaction all of our units in Latin America are already members of the Great Place to Work and some of them are leading not only the sector but globally speaking their countries.

We intend to keep building to that proposal because for us employee satisfaction is the first lever of action to get customer satisfaction. On top of that more than

40,000 of our employees have gone through some cultural programs in order to focus on customer satisfaction and in order to understand this virtual cycle of customer satisfaction and employee satisfaction.

We are very proud of our social programs in the region. Here you have some examples. As we speak today you need to know that Telefónica thanks to Proniño takes care of more than 120,000 kids that have been taken out of child labor and back to school. And we intend to finish this year with more 150,000.

This is probably the largest -- one of the largest, if not the largest, childcare program in Latin America. 24,000 of our people volunteer part of their time to that effort and I'm very proud of that. And we are also trying to lead the innovation part of the business thanks to the campus party effort that we doing all around Latin America and in just one single year we have had more than 280,000 visitors to our campuses.

Well that's for how we see the future ahead of us and what is the business plan that we intend to execute. Now let's try to land that on a country-by-country basis. Our position is very diverse so it is tough to understand that we are not managing one single region. We are managing different realities.

Here you have a little bit of what it looks like when you combine the potential market revenue growth in local currency of each of the countries and the units, the revenue market share that we have in each of the countries and the units and the size of the flag, equal the proportional revenue market size that we have in each of those.

So you will see that in some countries we are very big. In others we are growing very rapidly. In others we are both big and growing very rapidly. But you will understand that agenda though it has very common pillars needs to be applied differently in its local reality. And that's why we like to call ourselves a multi-local company.

We are going to be briefly reviewing some of them, not all of them. You have the information of all the countries in your papers but I'm going to be just reviewing some of them. Brazil, Telesp, we have gone through some problems this year but we are fixing them and Telesp is back on track.

The starting point is that we have fully redesign our processes in Telesp and we have focused our processes on quality. Good news is that the effort is paying off. After we have been able to be back on the market again in broadband the new customers that we are adding has higher customer satisfaction, high ARPU and less churn. So Telesp is back on track.

Our business plan for Telesp contemplates again quality as the center of everything we do, churn reduction, massive deployment of bundles all around, a significant improvement in the speed of access, selective deployment of optic fiber and a significant decrease in the level of claims that we have in the official institution. Telesp is back on track. And in fact during this period they put themselves a very aggressive target of more than doubling or basically doubling the amount of broadband over total accesses in Sao Paulo.

Now GVT; you know that we launched a tender offer for GVT two days ago. GVT makes a lot of sense for us at the level of Telesp. It's a perfect geographic fit, perfect. It allows Telesp to have a nation-wide footprint with very limited, if any overlap.

Remember that GVT covers all the rest of Brazil and therefore perfectly matches the strategic situation of Telesp. It allows us to adapt and to extend a very innovative offer on the way they use the technology. It's a successful challenger with leading broadband offering and they have very strong, very strong execution skills on the management side.

In case we will be the winner of the tender offer process it would create a very solid player on the wireline space in Brazil and it would reposition Telefónica and Telesp again in the market all along the wireline sector in Brazil.

There is a significant amount of synergies that we can put on top of the table, not only tax and financial which by the way are huge, but also operationally speaking it give us a lot of synergies in terms of transmission worldwide, in terms of the integrated offer that we can provide to corporate customers and also in terms of cross-selling of products. So it makes a lot of sense and we are convinced that it creates a lot of value.

VIVO, well VIVO is a key asset. VIVO is the market leader in a huge market like the Brazilian one. We will has the strongest brand, the best network and the best distribution network. VIVO has been awarded by the regulator the award of the best quality of signal and VIVO is leader in customer satisfaction and in profitability in Brazil.

As you have seen the Brazilian market is going to be increasing its penetration from the low 80s to 100% in the next three years, and VIVO is more than well positioned to capture that growth. We need to make sure that we capture that growth. We are going to be trying to increase the ARPU also by extending this new services and applications and massifying the deployment of wireless broadband in Brazil.

And we intend to keep the leadership of 3G deployment all around Brazil with an accelerated deployment of our network. And we intend to do that and at the same time keeping being the leader in profitability.

Our action plan involves the we need to reinforce our network, we need to keep building on our network. We need to keep building on our distribution channel. We need to keep building and investing in our brand. It's a wonderful brand in Brazil. And we need to focus more the distribution channels from just new adds to retention, customer programs. And that's why in the recent months you will see that handset subsidy globally speaking in the Brazilian market have been reduced.

I will only deepen our network infrastructure sharing with Telesp and with other competitors in an effort to try to boost efficiency and in order to be more rapid in time to market.

Let's move to Mexico. Well I'm very glad to say that in Mexico we are in a very different position than last time we met. As we speak we have already more than a 20% market share which was probably unthinkable just four years ago. As we speak,

Movistar in Mexico, Telefónica in Mexico is leader in customer satisfaction in prepaid. We have a very good network and our customers are highly satisfied.

And again we have become profitable at all levels, which was also probably unthinkable like four years ago. So we are very proud of what we are doing in the Mexico market and the Mexican market is also huge and is going to grow significantly.

It's going to pass probably from the 70s and in terms of penetration to 95 or even close to 100%. And we need to make sure that we capture more than a proportional part of that market share because we are ready to do that. And if we want to do that we need to improve in some aspects. We need to improve in our contract proposal and we need to make sure that we do at the same time that we keep a sound distribution channel and that we keep a sound quality of our network.

If we want to take advantage of the 3G opportunity in mobile deployment in Mexico we need to get more spectrum and that's why we are so eager for the option of new spectrum in Mexico.

And finally, Venezuela. Well in Venezuela we have an outstanding operation. An outstanding operation is one of the very few for Latin America, the only operation that has a quadruple play offer with wireless technology. Venezuela has very strong customer satisfaction, one of the best coverage, if not the best coverage in terms of network of the country and I'm sure of that, the best distribution network. It is best-in-class in brand recognition and customer value.

In Venezuela penetration is already 100% so our effort in Venezuela is going to be focused on growing ARPU through new services and products and moving from prepaid to contract. Remember that we also launched our TV offer in Venezuela, satellite TV offer, and we intend to grow there. And we intend to lead and we are already leading the deployment of the mobile Internet.

Venezuela, there is still growth to capture even though penetration is already 100%. But remember that we have from an operational standpoint one of the best units of Latin America is placed in Venezuela. Again, in the interest of time you have all other countries in your document that I am going to move to the conclusion.

On behalf of the team Telefónica Latinamerica we need to tell you that we see a significant opportunity ahead of us and that we think that we are prepared to take advantage of it. If in the middle of the worst economic crisis that the humankind remembers, Latin America has been able to perform the way it has done imagine what the region can do in a much better economic environment.

We are sure that there's going to be growth in consumption in the near future, in the immediate future. And that means that we are going to have a significant growth in the telecommunication landscape.

Remember that Telefónica has a very credible platform in Latin America. We have been there for the last 23 years. We have a very, very good team in Latin America and very motivated. And therefore you need to have trust that we will be able to capture that growth. We have a very clear action plan to grab penetration and to

drive ARPU expansion and to improve our networks and to improve in quality and to reduce down churn.

We know how to transform our wireline business. It's paying results already in most of the units that we have on the wireline side in Latin America. And thanks to the side of Telefónica and thanks because this is Telefónica and the strength of Telefónica and the scale, we are going to be boosting revenue growth through our P&L. Thank you very much.