

RESULTS

January - September 2021

Conference Call Transcript

4th November 2021

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Introduction

Adrián Zunzunegui – *Global Director of Investor Relations*

Good morning, and welcome to Telefónica's conference call to discuss January-September 2021 results. I am Adrián Zunzunegui, from Investor Relations.

Before proceeding, let me mention that the financial information contained in this document has been prepared under international financial reporting standards, as adopted by the European Union. This financial information is unaudited.

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We encourage you to review our publicly available disclosure documents filed with the relevant securities market regulators. If you don't have a copy of the relevant press release and the slides, please contact Telefónica's Investor Relations team in Madrid or London. Now let me turn the call over to our Chief Operating Officer, Mr. Ángel Vilá.

Ángel Vilá – *Chief Operating Officer*

Presentation

Q3 21 Results

1. Higher growth, smart capital allocation, further de-leveraging

Thank you Adrián. Good morning and welcome to Telefónica's third quarter results conference call. With me today are Laura Abasolo, CFO & Head T. Hispam, Eduardo Navarro (Chief Corporate Affairs & Sustainability Officer) and Lutz Schüller, CEO of Virgin Media O2 JV. As usual, we will first walk you through the slides and then we will be happy to take any questions you may have.

Our third quarter results highlight consistent growth, smart capital allocation and further de-leveraging. It is the second straight quarter of simultaneous, year-on-year organic revenue and OIBDA growth. The revenue growth trend accelerated on the back of strong service revenues, and continued improvement in B2B revenues. FX was not a drag in Q3 and reported revenue growth, excluding changes in the perimeter, is aligned with organic growth.

EPS rose 6% on an underlying basis in the first nine months of the year. Organic OIBDA-CapEx stabilised in the quarter through efficient capital allocation, with CapEx to Sales at 13%. Net debt further declined in the quarter to €25.0bn, down 32% year-on-year.

Operationally, total group accesses grew 3%, and we further extended already one of the largest fibre footprints in Europe and Latam, with 157 million premises passed.

In parallel, we continued to make good progress in our strategic priorities. We continue reducing complexity; reprioritising capital allocation to core markets. In the UK JV integration is moving ahead at pace. In Hispam we continue reducing our capital employed, completed the Costa Rica sale and announced the sale of El Salvador. T. Infra continued with the development of fibre vehicles while maintaining the optionality across the Group's asset base. T. Tech again posted very strong top line growth of 25% year-on-year in Q3 while our digitisation programme increased to 79% of all processes, making our operating model efficient and sustainable.

Finally, we continued to be fully committed to our ESG goals, as demonstrated by our achievements in the three categories.

2. Financial performance

Moving to slide 2,

Reported figures were affected by capital gains and changes in the consolidation perimeter.

Q3 revenues amounted to €9.3bn and grew organically by 3.6% year-on-year, 0.2 percentage points higher than in Q2, while OIBDA maintained a steady growth of 1.6%.

Net income reached €706m in the quarter, and a record high of €9.3bn in the first nine months.

Free cash Flow in the quarter was affected by the €310m spectrum payment in Spain. In 9M 21, excluding spectrum payments, free cash flow reached almost €2.5bn, a very solid result.

Finally, net financial debt declined €1.2bn versus June to €25.0bn, post distribution to Telxius minorities.

3. Guidance and dividend confirmed

Moving to slide 3 let me confirm our full year guidance and dividend.

Nine months results are aligned with our full year targets for revenues and OIBDA of stable to slight growth, while CapEx to Sales at 13.2% stands well within the “up to 15%” target.

On shareholder remuneration, and as previously stated, we will be paying the first tranche of the 2021 dividend of 0.15€/share through a voluntary scrip dividend in December 2021 and the second tranche of 0.15€/share in June 2022.

In addition, we will propose to the AGM the adoption of the corresponding corporate resolutions for the cancelation of 1.65% of shares held as treasury stock as of 25th of October 2021, according to the CNMV filing.

4. Fully committed to ESG

Moving to slide 4, we reiterate our strong commitment to ESG, with key milestones reached in Q3,

In the “E” pillar, building a greener future, to move towards becoming a net-zero emissions company, we have reached new long-term renewable electricity agreements in Spain and Brazil, and continued our network transformation with copper shutdown in Spain and 3G switch-off in Germany, helping optimise energy usage. Over the last 5 years, Telefónica has implemented more than 1,200 projects, saving 2 millions tons of CO2 and 7 Terawatt-hours of energy. In addition, we have launched the free online platform ‘Net-Zero Hub’ to help small businesses become net-zero in the UK.

With regards to the “S” pillar, helping society to thrive, Telefónica continues to connect people: 13m premises passed have been connected to Virgin Media O2’s gigabit broadband in the UK, where we have also created the first ever National Databank, providing free mobile data to tackle data poverty. And we highlight special advances in rural areas and inland areas, with agreements to connect 600 black-out zones in Spain, 250k premises passed in the south of Argentina, and 13k areas are already connected in Peru.

Lastly, on the “G” pillar, we are leading by example. Vivo has been listed for the 7th consecutive year in the Best Emerging Market Performers Ranking by Vigeo Eiris and introduced a new target to achieve 30% ethnic minority executives in leadership positions by 2024. In addition, Telefónica has been awarded prestigious awards for its commitment to and achievements in diversity: in Chile, the Ministerial “Equal Conciliation Seal” and in Peru, the Scotiabank “Equality Grand Prize 2021”.

5. Spain | Ongoing recovery, strong cash generation preserved

On slide 5, we review the performance of our Spanish operation.

In Q3 21, T. España's recorded year-on-year revenue growth for the second consecutive quarter, supported by sequential improvement in net adds with customer satisfaction remaining at record levels with an NPS of 33% in September.

The already low churn rate further improved year-on-year proving that market rationalisation is already a reality in the high value segment. As expected, the start of the football season had a positive impact on convergent ARPU which improved +2.5% vs Q2 up to €89.6.

Year-on-year revenue growth was again recorded thanks to handset sales and record growth in IT. This was achieved in spite of more unfavourable comparison, intense low end competition and the extension of travel restrictions still impacting roaming levels.

Meanwhile, year-on-year OIBDA was negatively impacted by the rise in energy costs and the extraordinary one off effect of lower content costs in Q3 20. Excluding these factors, OIBDA trend would have improved sequentially in Q3 with an OIBDA margin higher than 39%.

The development of NGN also advanced and we delivered on our first priority: strong cash flow generation of €2.5bn in 9M with a margin of 27.2%, in organic terms, benchmark among incumbents in Europe.

Finally, as first visible allocation of European Funds, on 28th October, T. España was awarded in the 2021 call with c.80% of the total funds devoted to extend ultra-fixed broadband in rural areas.

6. Germany | Strong commercial and financial performance

Moving to Germany, where we have had another quarter of strong commercial traction, underpinned by a successful network marketing campaign driving quarter on quarter acceleration in contract net additions and ARPU growth.

The 5G network is now live across more than 100 towns and cities, and is on track to reach 30% of the population by the end of this year.

Looking at the financials, this commercial momentum has driven sustained improvement in revenue trends of 5.1% growth year-on-year, which, together with operational efficiencies has resulted in an OIBDA increase of 3.5% year-on-year in Q3.

This has led to continued strong cash generation, with the OIBDA-CapEx margin remaining broadly stable in the first nine months of the year, leading to 2.6% year-on-year growth, despite accelerated CapEx spending during the same period.

7. UK | Strong commercial momentum, integrating at pace

Moving to slide 7 and our Joint Venture in the UK, Virgin Media O2, which continues to move at pace with integration, launching its first joint convergent product called Volt in October, leveraging the combined capabilities of the new company.

Commercial focus has remained a top priority, with the total base growing 5% year-on-year to reach 55.3m accesses as of the end of September, together with 5G now available in over 210 towns and cities, and the fixed gigabit upgrade is on track to cover 100% of footprint by the year end.

Looking at the financials, revenue has returned to growth in the quarter, whilst OIBDA growth has slowed due to the return of some sales and marketing costs as restrictions were eased and commercial traction picked up.

CapEx grew by 9.2% year-on-year in the first nine months, driven by increased investment in future technology such as 5G and fibre.

Given trends in the first nine months of this year VMO2 expects proforma transaction-adjusted EBITDA growth to be flat to positive and a second half 2021 dividend of at least £300m.

8. Brazil | Strongest service revenue growth in 6 years

Moving to Brazil on slide 8,

Vivo continued showing a strong momentum in both mobile and in fixed.

In mobile, we maintained clear market leadership with a very low contract churn, leading to robust year-on-year growth in our customer base.

In fixed, our second-to-none FTTH assets continued to deliver. In just the first nine months of the year Vivo connected more customers to its FTTH than in the whole of full-year 2020.

On the financial side, we posted very solid results, generating fixed revenue growth for the first time in four years and the strongest mobile service revenue growth in six years.

Thanks to this positive revenue momentum, together with progressive digitalisation and efficiency enhancements, the company was able to reach a 42% organic OIBDA margin in the first nine months of the year.

And finally, we continued prioritising our ESG commitments. We are planning to have 83 renewable energy plants functioning by the end of 2022, while on the diversity front, we launched a new internship program that 50% will be filled by Black students.

9. Tech | High growth and increasing scale

Moving to slide 9 and the main highlights of our fastest growing unit, Telefónica Tech.

Revenue growth continued to be strong, up +25% year-on-year in Q3 and once again well above market growth.

Over the quarter, T. Tech's scale was reinforced, with an annualised revenue base of around €1bn following the integration of Cancom UK&I (now Telefónica Tech UK&I) in August. This further reinforced our position in advanced Cloud and Digital Services in Europe and improved our revenue mix owing to the increased weight of value-added services.

From a commercial perspective, sales continued to grow. In Cyber & Cloud sales growth is largely driven by public administration, banking and retail while in IoT & Big Data, the growth is attributable to connectivity and connected cars, industry 4.0 and utilities.

Tech services continue to support the sustained growth of Group B2B revenues, which were up +4.8% year-on-year in Q3, delivering a differential performance in Europe.

10. Infra | Growth and optionality ahead

Moving to slide 10, to review our infra projects.

In Q3, we continued to focus on executing the initial phases of work across our portfolio of neutral FTTH wholesale vehicles:

In Germany, UGG continued its rollout and commercialisation programme, with the first customers already connected and new wholesale agreements signed with two regional ISPs. Additionally, MOUs signed with municipalities represent more than 100k premises.

In Brazil, FiBrasil announced the acquisition of Fiberty 1 in August, improving and expanding its footprint. As a result, the company updated its target to reach over 6m premises passed in 4 years, up from 5.5m previously.

In Chile, ON*NET Fibra continued with an accelerated rate of deployment, with around 90k premises passed per month, reaching 713k premises passed in the first nine months of the year. In Colombia, we expect to receive all approvals for the InfraCo by Q1 22.

In parallel, we continue to analyse our portfolio to capture further growth ahead, while assessing our optionality across all asset classes, including fibre, towers, subsea cable, and data centres.

I will now hand over to Laura for a review of our Hispam operations and the financial position.

Laura Abasolo - *Chief Financial and Control Officer & Head of T. Hispam*

Hispam | Renewed strategy bears fruit

Thank you Ángel.

Moving to Hispam on slide 11,

We can see how our renewed strategy is gaining traction.

We continued transforming our operations to FTTH after connecting 669k new accesses in the first nine months of the year. Additionally, new fibre vehicles in Chile and Colombia will further accelerate FTTH deployment.

In mobile, accesses rose 9% with all five main countries posting growth for the fourth straight quarter.

This focus on high-value accesses, together with the maximisation of operational efficiencies from the new operating model and digitalisation drove an improved year-on-year trend in both service revenues and OIBDA for the fourth consecutive quarter. It is also worth highlighting that revenues and OIBDA posted positive growth on both reported and organic basis.

Finally, we continue to lower capital employed in the region and CapEx to Sales was reduced to 9% in the first nine months of the year.

Significant debt reduction on inorganic deals completion

Turning to slide 12, net financial debt stood at €22bn as of September or at €25bn post estimated distribution of proceeds to Telxius' minorities. Including post-closing events, net debt would be reduced to €25.6bn, a reduction of €9.6bn since December 2020, mainly due to inorganic deals such as the sale of Telxius towers and the VMO2 UK JV, coupled with a resilient free cash flow generation of €1.5bn.

The Net debt/OIBDA ratio went down to 2.49 times, 0.3x below the FY 20 ratio.

We maintained a healthy liquidity cushion of €22.6bn, thanks to some liability management exercises and repayment of short and medium term bank debt. As a result, our average debt life has increased to 13.85 years and debt maturities are covered beyond 2024.

Telefónica financing activity amounts to €5.4bn year-to-date, including the financing of JVs, such as VMO2 and the fibre vehicles UGG and FiBrasil. We maintain an increased focus on ESG financing and continue to increase debt in Latam currencies, most recently in Uruguay.

The effective cost of interest payments over the last twelve months stood at 3.27% as of September 2021. Telefónica Group, with the vast majority of its debt at fixed interest rates and denominated in euros, is in a solid position to face any future rise in interest rates in the G7 countries.

I will now hand back to Ángel to recap.

Ángel Vilá – *Chief Operating Officer*

Wrap up | Sustainable long-term strategy

Thank you, Laura.

To wrap up, on slide 13,

Our strategic focus remained on sustainable and profitable growth, through ongoing portfolio simplification, further deleverage, execution of transactions to crystallise value, development of fibre vehicles and Tech units, and continued digitisation with high quality, secure and greener networks.

Top-line growth accelerates within a quarter in which FX has not been a drag, with both revenues and OIBDA showing organic growth for the second consecutive quarter.

Smart capital allocation is reflected in c. 45% of CapEx being devoted to next generation networks, whilst acquiring spectrum so far this year at significantly lower-than-benchmark prices both in Spain and the UK.

The integration of our JV with Virgin Media is progressing at pace, returning to top line growth in Q3 while continuing to invest for the future.

It is also worth highlighting the strengthening of our balance sheet and capital structure.

And finally, we are confirming our 2021 outlook and dividend.

Thank you very much for listening. We are now ready to take your questions.

Q&A Session

David Wright – BofA

A very poignant message given by your CEO writing about Jesus Romero, which I think is very much appreciated by all of the analyst community who knew him well. So thank you very much for that, and of course, our deepest sympathies.

Just going back to the print itself. You have mentioned both in the presentation and in the report that Q3 domestic OIBDA was impacted by higher energy costs, but that you don't expect these to continue. So I wondered if you could just expand on that. That would seem counterintuitive to perhaps what is happening right now. So just some detail on that, please, and how we could expect that domestic margin to evolve.

Ángel Vilá – Chief Operating Officer

Thank you, David. And first of all, thank you for your comment on Jesus Romero. He was a very much appreciated colleague, a very smart person, and a great colleague and friend. All of us are going to miss him very deeply.

So, going to your question on Spain. The third quarter OIBDA had a decline of 8.9% year-on-year, dragged mainly by two factors. The first one is the energy price doubling, which explains close to 3 p.p. of this decline. And the other factor is a tougher comparison base, as we had already anticipated in previous calls, on content costs year-on-year due to the onetime impact we had in the third quarter of 2020 on sports and other content rebates.

Revenue improvement, on the other hand, is not totally reflected in OIBDA margin as the growth drivers of revenues relating to IT and handsets yield a lower margin. In addition, roaming did not fully recover for this quarter, which is, as you know, a high-margin contributor.

So, we can say that OIBDA is impacted by some short-term impacts and a tough content cost comparison base, that will not be there in the coming quarters. We expect the energy impact to potentially affect a few quarters ahead, but to fade away at some point in the next year. And the return of roaming will depend on the COVID situation but is still not fully recovered yet.

In any case, if one were to exclude the effect of the higher energy costs and the content base effects, the year-on-year organic OIBDA trend in Q3 would have clearly improved versus the second quarter.

So, margin in Q3 stays at 38%, stable versus Q2. If we were to exclude the energy price inflation, margin would have exceeded 39%, as we had been communicating and as it was expected.

Given this situation, especially on the energy inflation front, you should expect us to activate even further efficiencies in our Spanish operation to try to mitigate this impact as much as possible. And then, of course, if one looks at the capital intensity of our Spanish business, I would like to highlight the operating cash flow margin, which stands in the 9 months at 27.2%, and continues to be a benchmark figure. If it were adjusted by energy costs, which at some point will fade away, it would be even higher than that.

Fernando Cordero Barreira - Santander

A follow-up on the Spanish operation, and particularly considering the recent developments on the fibre-to-the-home assets. In that sense, I would like to discuss a little bit the impact of the recent regulatory update on your wholesale fibre offer. And in that sense, what could be the impact of this new framework in your portion of revenues and potentially considering the recent press reports on your ownership of the fibre network and the value of that network?

And secondly, also as part of this regulatory update, there has been an acceleration of the process of the corporate network switch off. And I would like to understand the current progress on savings materialisation of the switch off of the copper network.

Ángel Vilá – Chief Operating Officer

There have been some developments recently in the broadband fibre market revision. The main one has been setting the new competitive zones, which means non-regulated zones, now to cover 696 towns and cities in Spain. Before, it was just 66. This now represents 75% of the Spanish population. And previously, it was half of that, 35% of the Spanish population. This deregulation will be applied after a transitional period of six months. We don't just have the regulated part of the wholesale business, we also have reached commercial agreements with several of the players in the Spanish market. This results in a substantial revenue number and strength in our "Wholesale and Others revenue" line in the Spanish P&L, which is growing at 8.9% in the third quarter. Despite still not having a full roaming recovery, we're having a strong impact, both from the fibre wholesale through NEBA and other modalities, but also from MVNOs.

As you know we have a very well-developed fibre network in Spain which is now close to covering 85% of all the households in the country. We have developed one of the largest fibre networks in the European market. For us, this network is a strategic asset. It's probably not reflected in our valuation but gives us optionality in the future. It's such a well-developed network that the greenfield opportunity in Spain is probably less relevant than what you can see in other markets where we are developing FibreCos, such as Germany. And the commercial wholesale agreements are already in place, which enable very good wholesale monetisation of this fibre network.

There is a strong interest in the market for this type of assets. We have a very valuable asset which gives us full optionality and flexibility to assess future options. I would like to stress that any option we may pursue in the future will always consider the strategic relevance of this asset for the Telefonica Group.

Then regarding the copper switch-off, we continue to progress consistently across the Spanish footprint. We plan to decommission the copper network by 2025. Since 2015 we have closed 1,015 central offices, and we have increased in the past every year to close as many central offices to reach this target in 2025. This would also imply real estate capital gains. It will be possible on the back of the new broadband market regulations to reduce the time to shut down with unbundled local loop players in those central offices, from 5 years to 2 years' notice. So, this will help us accelerate. And we will, of course, be achieving the one-off benefits of selling the real estate, selling the copper, the OpEx efficiencies, because of the fibre network is much more efficient than copper, and also CapEx efficiencies in this process.

Carl Murdock Smith - Bernenberg

On La Liga and just ask you to expand on your approach towards that auction, your expectations with regards to inflation or deflation, and more broadly, your thoughts on the potential for content ownership fragmentation going forwards.

Ángel Vilá – Chief Operating Officer

Thank you for your question. The conditions for the tender of La Liga were published yesterday evening. And at the moment, we are evaluating the procedure and the different possibilities. There is some time ahead because the tender is open for applications until the 13th December. So, the envelopes will be submitted on the 13th of December.

What we see is that it's in line with La Liga's intentions that had been speculated or published in the press. So there are several options to package the matches and even the length of those rights. The packages can be the whole 10 matches for every weekend, can also be split by packages of 5 and 5 matches, or 7 and 3 matches of every weekend, and it opens also the possibility of some bidders potentially acquiring all matches for specific weekends. And the period for the rights is between 3, 4 and 5 years.

We are interested in this differential content. It's a content which is relevant for us to maintain and improve our commercial ratios, such as ARPU and churn, which are quite differential to any of our competitors. But of course, these rights have to be acquired in a cost-effective way. So, we apply very strict cost analysis based on profitability as we have done every time in the past.

We will aim for cost deflation in this content. We achieved slight deflation in the previous cycle of La Liga. We achieved double-digit cost inflation in the current rights of the Champions League. But of course, it's early to say how the whole setting will apply.

This is not the first time that the La Liga auction comes with several lots. We have lived in the past with situations in which we own part of the rights, and we acquired from other players other part of the rights. In the last 3 years, we have been integrating some over-the-top players in our platform, among them, some sports-oriented over-the-top players. So, we are analysing this in detail and developing strategic approaches for the various outcomes that could come from the different lots of this auction. It's something which will develop later in the fourth quarter, bids have to be submitted by 13th December, and then the process will go on. We'll keep the market updated as we have more news on this.

Nawar Cristini – *Morgan Stanley*

I have two questions, please, one on Hispam, the other on Spain. Starting with Hispam, looking at the good portfolio this morning, I was curious to know how this is tracking versus your initial expectations. And ordinarily, you have announced a strategic review of Hispam two years ago. It would be good if you can elaborate a little bit on the main priorities going from here given that the number of actions were already taken in the region.

And moving to Spain, I wanted to ask about the wholesale competition. We see an increased interest from pure infra players like, for instance, Onivia. They are targeting 9 million homes by 2025. We see also a newcomer, Ardian, put the acquisition of Adamo, going for 3 million homes. It will be great to have your thoughts on this. What risk this increase of these players are posing to your wholesale business? And how you defend yourself in this context?

Laura Abasolo – *Chief Financial and Control Officer & Head of T. Hispam*

Starting from Hispam and the good performance against initial expectations. I would tell you that since we took the decision to run Hispam in a different way, we've been approaching the region with a very disruptive model. And therefore, we have achieved great results from the new management model. It has not surprised us because it's been based on a very thorough execution, pulling many levers.

First of all, the management approach is completely different. We have gone through a regional model in which we not only share best practices, but we run many important projects for the whole region, with a team composed by some people in Madrid, and also with people in every country in Hispam. That not only allows us to be more efficient, it has also resulted in a lot of agility. And we are already reaping good savings from the new regional model that will be at the run-rate by 2022.

Also, we modulated exposure through CapEx reduction, but that doesn't mean we will jeopardise growth. And in fact, you are seeing we are having record net adds as we are going through a lean and more variable CapEx and investment model.

Another focus was high-value customers. So, we have put all the focus on FTTH, on contract and on providing the Best service possible to our clients, and NPS has improved. In the places where we were not running so well versus competitors, we have improved substantially. So, not only NPS in absolute terms, but also relative NPS has improved significantly.

Another thing, is that Hispam is not dragging management focus, not dragging financial resources, being self-sustained. And for that, we have allocated much more debt. The Debt to OIBDA ratios in Hispam are similar to the group levels or even higher. You have seen a lot of financing activity in Chile, Colombia, Uruguay, being the most recent. Peru already had leverage that was raised prior to this year. That has also made Hispam much less volatile to FX movements, and at the same time, very autonomous from a financial point of view.

Finally, I would say that we still have a lot of optionality, but not only in the inorganic front, as we have proven with the sale of Costa Rica, already approved, and the fibre companies. Both FibreCo Chile and the sale of Costa Rica were approved this quarter. And they have posted nice capital gains and also net debt reduction. We also signed the El Salvador disposal. And, with that, all Central American assets have been divested. And we will also

get regulatory approval for the FibreCo in Colombia. Both transactions will continue helping the net debt reduction. But there's a lot of optionality in the organic front, we definitely have improved business plans from 2019. And we will continue executing thoroughly versus those stronger now business plans.

And also, a final comment, on the beat that you commented. That beat was evenly distributed and part had to do with Argentina.

I think that Argentina shows how we manage in inflationary environments. Our capacity to raise prices, but also to manage every OpEx and CapEx line is really remarkable.

And in the case of Argentina, it's not only the OpEx and CapEx management. It's also how advanced we are in digitisation, and this applies for the whole of Hispam and also for the remainder of Telefonica. So we have reduced the weight of the most inflation impacted OpEx. and as we have a much more digitised business model to serve our customers and in our operations. We are more resilient, and I think Argentina is a good proof of that when you look at the performance despite inflation being around 50%.

Ángel Vilá – Chief Operating Officer

Regarding your second question, we have recently seen infrastructure fund investments in the fibre space in Spain. First, this proves the very high valuation of the infrastructure assets in our country. Again, not necessarily our asset is being valued. But it also leads to potential new competitors in this segment. We believe that the risk is under control as much of our wholesale business is protected by long-term agreements. We also have a fully developed network, which is available today for any wholesale counterparty compared to the potential growth plans of these FibreCo challenges, which have a very limited footprint.

We compete with differential assets. We have a long-time expertise in the wholesale market, and if anything, one could see that part of the expansion plans of some of these Fibreco challengers are not only organic, but also inorganic, thinking of consolidation of small Fibreco players, which brings the topic of potential consolidation in the Spanish market in this small infrastructure space.

But also, one has to reflect about the Spanish market and the sustainability of its current structure. We believe that players are showing low or insufficient return on capital employed ratios except for Telefónica, this is not sustainable in the long term. This could lead to further consolidation in the market. Of course, we would be supportive. We would welcome market consolidation and market repair that would foster further next-generation investments and benefits for customers.

Jakob Bluestone – Credit Suisse

You've obviously referenced the increase in energy prices. But I'd be interested in just any comments on sort of broader pricing inflation you're seeing. Specifically, do you see risks that your labour costs might have to rise as a result of rising inflation?

The second question, you mentioned earlier the optionality around your fibre in Spain. I was wondering if you could maybe be a little bit more specific, given there's been some recent press coverage about a potential minority stake sale in your Spanish fibre network. Could you maybe just sort of share with us what do you think are the pros and cons of such a move? And what would be your red lines?

Ángel Vilá – Chief Operating Officer

Thank you, Jakob. As for inflation, our base scenario is for inflation to peak in the near term. But of course, we are taking steps to fight the risk of a scenario of a longer-term inflationary environment. We are paying very close attention to energy costs, wages, and other issues such as chip shortages.

For the time being, the main impact that we're seeing is higher energy prices. And we are trying to manage these inflationary pressures in different ways.

- On the revenue side, we are working to improve our growth profile through capital allocation into growing businesses. And this is partially reflected in our digital B2C and B2B new businesses.

- Inflation adjustment, which is possible in U.K., Brazil and Hispam where there are inflation-linked tariffs, is not the case in Spain, although we have been still been able to promote more for more moves in the market.
- We also have pass-through mechanisms in most of our wholesale contracts. So, we have on the revenue side some mechanisms.

On the OpEx level, we will continue to implement and accelerate efficiency measures, fostering digitalisation, as Laura was saying. And I should say that we have an OpEx structure that somehow hedges us from this. On one hand, the content costs, we are working in deflation in sports content. We achieved this in previous auctions of the Champions League, Formula 1 and other content, and, in this La Liga auction, we're going to aim for a certain degree of deflation. In network costs, we have the energy costs that amount to around 3% of our OpEx base. And here, we are taking steps to be more efficient in both energy consumption and also in the contracts for supplying that energy.

Looking at employee costs, given all the efforts that we have done in the past for being more efficient in personnel and more productive in our operation, the weight of employee cost is a significantly lower weight over total revenues than the sector average, which is protecting us.

And finally, on CapEx, our first natural hedge is the significantly lower than average capital intensity because of the investments we have already done in in Spain.

So, we are not immune, but we have been taking and we'll continue to take measures to offset inflation-related impacts. And we believe that, as we have shown in the past, we have lived in our perimeter inflationary situations in many instances. We have proven in the past our ability to adjust our cost base.

Then regarding fibre, I'm afraid I cannot be more specific. We have, again, a very well-developed fibre company. It's very well invested, still has some growth opportunity. But the greenfield opportunity is not that large.

We are also taking benefit of the European recovery funds through the program UNICO, in order to continue expanding the network into different areas. It's a very effective capital deployment model while helping to improve the connectivity in the country.

And it's a very attractive asset and we know that there is interest. We are seeing valuations given by the market to this type of infrastructure. And this gives us flexibility to assess future options, that, in any case, we will continue to take into account the strategic nature of the asset for us.

Keval Khuroya – Deutsche Bank

I got a question on Spain, please. You've highlighted the strong domestic free cash flow margin, partly reflecting the lower CapEx of some of the growing revenue streams. So is there anything you can say on how we should think about how the domestic free cash flow margin should evolve over the next year or 2? Would your goal be to maintain it close to the current 27%?

Ángel Vilá – Chief Operating Officer

As you know, we don't guide on specific operations. And we will be issuing the group guidance for 2022 and forward with our full year results.

But what we see is that the momentum on our revenue line is sustained. So, we believe that, as we said before, the ARPU in the second half of the year will be higher than in the first half and we continue to develop new digital products in B2C. The traction in B2B is quite strong in the recovery from COVID. Also, the wholesale line is strong. So, momentum on the revenue line is strong.

We will continue to work on efficiencies to maintain the OIBDA margin in the levels of very high 30's where we are trading right now. And CapEx would remain focused on deployment of next-generation networks, not so much fibre anymore. Yes, we will continue to deploy 5G. We already have coverage with non-stand-alone 5G, higher than 80% in Spain now, but moving into 2022 and into 2023, that will develop further.

In any case, we continue to prioritise the operational cash flow in Spain to be the benchmark in the industry in Europe. That is an absolute priority for us.

Ángel Vilá – *Chief Operating Officer*

Thank you very much. We hope we have been able to respond to the questions that you may had today. Please feel free to reach our Investor Relations department for any further questions that you may have. Thank you.