Telefónica H1 2008
Results Conference Call Transcript

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Introduction

María García-Legaz

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss 2008 first half results. I am María García-Legaz, Head of Investor Relations. Before proceeding, let me mention that this document contains financial information that is reported under IFRS. The financial information contained in this document has been prepared under international financial reporting standards. 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 by dialing the following telephone number, +34-91-482-8700. Now let me turn the call over to our CFO, Mr. Santiago Fernández Valbuena, who will be leading this conference call.

Presentation

H1 08 Results Highlights
Santiago Fernández Valbuena

Good afternoon, ladies and gentlemen, and thank you for attending Telefónica´s H1 08 results conference call. During the Q&A session you will have the opportunity to ask questions directly to our Executive Committee, as I have today with me Julio Linares, Chief Operating Officer, Guillermo Ansaldo, head of Telefónica España, José María Alvarez-Pallete, head of Telefónica Latin America, and Matthew Key, head of Telefónica Europe.

In the first six months of the year we have posted a set of strong earnings and we are fully on track to fulfil our 2008 guidance.

Our differentiated profile in the industry, on the back of our unmatched diversification, our integrated business model and our proven track record of execution, has allowed us to deliver superior results.

Organic year-on-year growth rates across the P&L not only remain robust but have even picked up notably in the second quarter at OIBDA and OI level, showing our capacity to maximise efficiency.

In Europe we have recorded solid results, clearly outperforming competitors in our major markets. Latin America delivered a very strong performance, consolidating its position as the major growth engine of the Group.

Group margin continued to expand, with significant improvements in mobile in Latin America and an outstanding profitability in Spain.

The strong performance across regions is combined with a high financial flexibility, which along with limited M&A ambitions allows us to further accelerate the execution of 2008's share buyback program. As of mid July we have already executed 68% of the program, showing our commitment to prioritize shareholder returns when deciding about the use of our high free cash-flow.

Robust set of financials in H108, ahead of the pack
Santiago Fernández Valbuena

Reported year-on-year growth rates in nominal terms have been negatively impacted by changes in the perimeter of consolidation, forex and the capital gain on the sale of Airwave registered in Q2 07.

However, focusing on organic growth rates and excluding the impact from capital gains, in Q2 we recorded a strong acceleration from Q1 figures, ramping up from top line to OI, and further strengthening our distinctive profile.

Organic revenue growth remained solid at 6.7% in the first half of the year, while OIBDA year-on-year growth picked up in the second quarter, standing at 12.0% in the first half of the year vs. +8.2% up to March.

Operating income rose 24% in organic terms in the first six months of the year, up 7 percentage points compared to the first quarter.

As a proxy to cash flow generation, Operating Cash Flow in the first half of the year topped over 7.6 Billion.

With a strong underlying bottom line growth
Santiago Fernández Valbuena

January to June 2008 net income almost reached 3.6 Billion Euros, below 2007 reported figures, but up 29% on last year figures if we strip out the impacts from assets disposals (Airwave and Sogecable) in both periods.

Reported Earnings per Share reached 0.767 euros per share, posting a 32% underlying year-on-year growth.

Excluding the impact from PPA´s EPS would have reached 0.843 Euros.

Despite an unfavourable year-on-year comparison, reported Free Cash Flow per Share rose to 0.731 euros per share in the first half of 2008 vs. 0.725 euros in the same period of 2007.

As we leverage our distinctive portfolio
Santiago Fernández Valbuena

The strength and reliability of our operating and financial performance underlines the value of our high diversification.

Managing a well diversified portfolio of assets as an integrated Group is key to build a top quality profile, as it allows us to extract the full potential of businesses at different stages of development, to limit risks and volatility at the Group level, and to exploit synergies across operations and geographies.

Customer expansion remained strong in the first half across all growth levers, namely broadband, mobile and Pay TV, posting high double digits growth rates.

In Q2 08 we added close to 12 million customers (8 million excluding the acquisition of Telemig), to end June with more than 245 million accesses at the Group level, 15% above last year's figure, with an outstanding customer growth across regions. In addition, our initiatives to capture more value from our customers are prospering, with 38% of our total accesses having voice, broadband and TV bundles.

Latin America has consolidated its position as the main growth engine of the Group. Our operations in the region already account for 37% of consolidated revenues vs. 35% a year ago, while they represent 34% of the Group OIBDA.

Translating into a superior organic growth driven by Latin America
Santiago Fernández Valbuena

Latin America emerges once again as key differentiating factor of our performance, recording outstanding results. This region's revenues and OIBDA increased by 12% and 16% year-on-year in organic terms.

In addition, the healthy top line expansion and efficiencies achieved both in Spain and the rest of Europe allowed to deliver best in class organic growth rates at the Group level.

From a business perspective, mobile and fixed broadband are the main growth drivers, with a 26% year-on-year organic increase in mobile broadband revenues and a 14% year-on-year organic growth in fixed broadband sales.

With benchmark profitability and high OpCF generation
Santiago Fernández Valbuena

Turning to profitability and cash generation

Continuous focus on cost management, along with the benefits of our scale and our integrated business model are driving the expansion of OIBDA margin at the Group level.

Organic OIBDA margin stood at 38.2% in the first half of the year, 180 bps above last year's figure.

In nominal terms, margins for our key divisions ranged from the 29% of Telefónica Europe to the solid 50% of Telefónica España.

We have a proven track record in managing both OpEx and CapEx, preserving cash flow generation.

In the first half of 2008 OpCF was up 13% year-on year in organic terms. The high cash-flow generation in the European region, that topped 5.3 Billion Euros to June, up 15% year-on-year organically, came from the growing contribution of our Latin American operations, which posted an OpCF of 2.3 Billion Euros, 7.7% higher in organic terms than a year ago.

We are fully on track to meet 2008 Group guidance
Santiago Fernández Valbuena

For an update on guidance.

The growth reported in the first half of the year for all metrics we have guided on are fully aligned with year-end targets despite the headwinds from more challenging operating conditions in Europe, as we leverage our diversified portfolio, our integrated business model and our strong execution skills.

Under guidance criteria, consolidated year-on-year growth rates in revenues, OIBDA and OI were 7.1%, 8.7% and 17.2%, respectively, within the guidance ranges.

CapEx up to June stood close to 3.5 Billion Euros. However, mainly due to seasonality, this figure should not be annualised as an estimate for the full year.

With all our regions delivering 2008 commitments
Santiago Fernández Valbuena

Delivering on guidance is an objective the whole Group is committed to, with all the three regions across the Group being on track to meet their guidance.

We reiterate our 2008 guidance both for the Group and for the 3 regions.

In Spain we are better positioned vs. our competitors to face the current environment, leveraging our strengths.

We are the market leader and this allows us to influence market performance. At the same time, we reap the benefits of being an integrated player, with a better quality customer base and a strong track record of successfully executing efficiency measures.

Let me now walk you through the operating and financial performance by region, starting with Spain.

Telefónica España: Solid results
Santiago Fernández Valbuena

Telefónica España posted solid results in H1 08, with revenues to June up 2.1% on a comparable basis.

Wireline revenues recorded a very robust performance, increasing by 2.5% in the second quarter and 2.2% in the first half on a comparable basis. Most of the businesses improved slightly quarter-on-quarter. Internet & Broadband revenue continued as the main growth driver, with a steady year-on-year growth rate, above 10% both in Q2 and for the first half.

Wireless revenue growth decelerated vs. Q1, strongly impacted by a significantly different year-on-year evolution of wholesale and handset sales revenue and the 0.7 percentage points slowdown in customer revenue growth, which still continued to grow at a healthy 2.7% in Q2 08.

Roaming and interconnection revenues were down mainly on tariff reductions and volume discounts.
Handset sales decreased y-o-y as we have now a more linear profile of handset upgrades, whereas over the last years handset activity was greater in the second and fourth quarters of the year. Let me remark that we have not noticed any significant change in the handset upgrades cycle.

The combined picture of wireline and wireless shows a solid performance, underscoring our more defensive profile and the fact that, although we are not immune to the current operating environment, being an integrated player has a significant value:

- Our top priority, maintaining our customer base to sustain future revenue growth, is reflected in the churn contention across mobile, broadband and TV services.
- We are capitalizing our leading position in high value segments, where our share is significantly above our total market share.
- We are capturing changes in usage patterns in both fixed to wireless and wireless to fixed substitution.
- Corporate clients and Public Administrations are positively valuing our integrated approach.
- and our integrated distribution channels are proving very successful, not just on cost efficiency terms but on upselling and retention opportunities as well.

These differentiating factors are showing at the top line, but are even more clear further down the P&L.

Leveraging our integrated management model
Santiago Fernández Valbuena

Telefónica Españas' OIBDA is growing ahead of revenues, even stripping out factors affecting year-on-year comparisons.

Our capabilities to manage the cost side are showing up in the margin evolution, with an almost 4 percentage points improvement vs. the first six months of 2007, to reach a 50.1% benchmark margin, or 49.2% excluding one offs.

This enhanced profitability shows the benefits of cost cutting measures taken in 2007, a continued focus to enhance efficiency across businesses and synergies derived from fixed & mobile integration.

Noteworthy is the sequential margin improvement in our wireless business from 43.7% in Q1 08 to 45.4% in Q2 08.

But not only margins are benefiting from further efficiencies achieved. Operating cash flow in first half 2008 grew at almost 12%, already exceeding the 4 billion euros by midyear.

Wireline Business: Sustained commercial activity fostering 2P & 3P adoption
Santiago Fernández Valbuena

The Spanish traditional access market keeps posting sound growth rates, close to 2%.

However, the continued activity in unbundling, with the change in unbundlers' approach towards the naked share model already seen in Q1 08, plus an increased pressure from direct access competitors, have resulted in a line loss of 172 thousand accesses in the quarter, with total lines decreasing 1.6% year-on-year. Though we expect this trend is to continue throughout the year, we are confident to remain within the long term target of losing up to 2% on a CAGR basis from 2006 to 2010, placing the company as a benchmark in terms of limited line losses.

In broadband, the market keeps growing at a lower pace than previous year, though trends have improved over the last 6 months and we continue strengthening our leadership with an estimated share over 57% by end of June. BB ARPU posted a solid performance, with a year-on-year decline of 3%.

In Pay TV there are no major changes in terms of client growth, while our efforts to drive 2P&3P adoption, are progressing steadily, pushing up total ARPU 3.5% year-on-year.

Wireless Business: Further customer growth while fostering usage
Santiago Fernández Valbuena

In a highly competitive market with a 113% penetration rate, our focus remains on high value customers, with over 61% of our customer base being contract. Contract net adds reached 311 thousand in the quarter leveraging our benchmark churn rates, which remains stable at 1.1%.

Despite a flat MoU vs. Q2 07, with a better performance vs. Q1 08 due to consumption fostering initiatives, ARPU declined 6% in the quarter and 5% in the first half.

Incoming voice ARPU was down 14% in both, second quarter and first half of 2008, due to the 16% cut in MTRs over the last twelve months.

Total Outgoing ARPU decreased 4.8% in Q2 08 and 3.6% in the first half, impacted by several factors:

(i) the different profile of promotions: whereas in Q2 07 there were no promotions, in Q2 08 we are having the effect of the Christmas promotion and of specific commercial actions to stimulate usage.
(ii) the higher penetration of lower priced tariff schemes launched last year for the residential segment, which are impacting ARPU but having a positive impact on churn levels.
(iii) changes in usage patterns in some segments of the consumer market, optimising their usage by shifting to cheaper voice and data options, such as SMS.

On the contrary, Data ARPU continues to record a very strong performance, with outgoing data ARPU rising over 10% vs. last year, both in Q2 and H1 08. The healthy boost in connectivity revenue, up over 55% in Q2 year-on-year along with the strong push on content SMS, due to the Superconcursos taking place over H2 08, drove the 16% year-on-year growth of data revenues, while person to person SMS volume continues strong.

For the fourth consecutive quarter we have led the growth in the 3G market, and now more than one out of five customers have a 3G handset.

Telefónica Latinoamérica: Very robust results in a fast growth region
Santiago Fernández Valbuena

We continue our focus to capture growth in the main fields: the mobile business and the 2 higher growth areas in the fixed business, broadband and Pay TV.

Accesses expanded across markets and business, reaching 148 million accesses, up 21% on June 2007.

Telefónica Latinoamérica posted solid revenue growth, exceeding the 10.5 Billion Euros mark in the first half of the year, up over 12% in organic terms, driven by the robust growth rates recorded in mobile, internet and TV revenues. By countries, Brazil, México, Venezuela and Argentina contributed with more than 2 percentage points each to revenue growth.

I'd like to highlight the performance of our businesses in Argentina, underpinned by a strong acceleration in revenues in the mobile division as well as in the wireline operation.

OIBDA year-on-year growth rate in Q2 picked up significantly vs. Q1 08, leading to a close to 16% growth in organic terms in the first half, 4 percentage points more than in Q1. This performance was driven by the strong acceleration in mobile OIBDA and the better performance of the wireline operations. By country, Venezuela and Mexico contributed over 4 percentage points to OIBDA growth.

The OIBDA margin expanded 120 basis points year-on-year to 36.4%, despite the higher commercial activity across all businesses.

Wireless business: Strong commercial push & increased usage
Santiago Fernández Valbuena

Please notice that from last April Telemig is included in our figures. The company had close to 4 million customers at that date.

In organic terms, wireless net adds in Q2 reached 5.8 million, up 17% year-on-year driven by robust gross adds in most markets, which stood at over 14 million on the back of the successful commercial campaigns, and churn containment in the region.

Growth in gross adds was especially remarkable in Brazil and Colombia. It is worth highlighting the strong growth recorded in the region, despite the increased penetration vs. a year ago.

Total wireless customer base surpassed 113 million, a 22% increase in organic terms, with double digit growth rates in most single market and very strong performance in Brazil, Mexico and Peru. Customer growth in Argentina and Chile was outstanding despite the high penetration levels reached in these markets.

The weight of GSM continued to increase to 72% of our customer base, a 21 percentage points rise vs. June 2007.

ARPU performance in constant terms was impacted by the strong customer expansion, commercial promotions and lower MTRs. Outgoing ARPU performance continued to be strong, posting a 2.7% year-on-year organic increase in constant currency, boosted by the 23% advance in outgoing MoU and higher data usage.

Data revenue recorded strong growth rates (+41.5% year-on-year), increasing their contribution to total revenues to 14% in the first half of 2008, up over 2 p.p. vs. June 2007. Data revenue continues to show strong growth potential, leveraging the introduction of 3G services and the development of wireless broadband.

Wireline business: Transformation to capture the BB opportunity
Santiago Fernández Valbuena

Our efforts to transform our wireline businesses are showing up, as noticed in Brazil and Argentina, where better traditional service performance and solid Internet & TV growth led to a notable top line acceleration vs. Q1 08.

Total accesses in the region recorded a fast expansion, ranging from the 2% advance in fixed line accesses to the 69% growth in Pay TV, with an outstanding 26% year-on-year growth in broadband accesses.

Let me highlight the strong BB net adds posted in the second quarter in Argentina and Colombia, which were up 23% and 46% quarter-on-quarter respectively.

Contribution from Internet & TV revenues continued to rise on the back of the robust bundling offering uptake, shifting the revenue mix of our wireline operations and reducing the exposure to regulated services. Across the region these revenues weight 18% of total wireline revenue, an advance of over 3 percentage points vs. the first half of 2007.

The higher penetration of bundles continues to drive the increase in average revenue per wireline access, which was up 3.5% in constant currency vs. the first half of 2007, while at the same time proving to be a good retention tool.

Total bundles already surpass 55% of our fixed accesses, 7 percentage points higher than in June 2007, while 2P and 3P reached 42% of the DSL base in June 2008, 16 percentage points more than a year ago.

Main operations review
Santiago Fernández Valbuena

Let me quickly review our main operations in the Latin American region.

As I just mentioned, revenue growth in Telesp and TASA posted an acceleration quarter on quarter, with an increase of 140 and 190 basis points respectively from the first quarter of the year, reflecting the benefits of the business transformation. In terms of profitability, OIBDA margins also improved vs. the first quarter by over 300 basis points in the case of Telesp to reach 42.4% and by over 200 basis points in TASA to 35.7%. This performance shows our ability to contain costs and to leverage workforce restructuring measures.

In Brazil, Vivo posted solid results. Gross adds in H1 08 increased by 47% in organic terms on the back of the strong campaigns on Mother’s and Valentine’s day, with gross adds in Q2 up 41% year-on-year.

The strong customer expansion along with greater traffic promotions in a very competitive environment and a higher proportion of SIM only adds vs. last year impacted ARPU performance. MoU showed a robust growth in the second quarter, +24% up on organic terms, boosted by the commercial campaigns and an over 30% increase in top-ups. OIBDA grew a 13% on organic terms in the first half of the year. Excluding Telemig, OIBDA margin in Q2 showed a healthy year-on-year expansion of around 150 basis points despite the strong commercial activity.

In Mexico, we continued to record robust results. The customer base grew 38% year-on-year in H1 08 to 14.1 million, leading to a market share over 19%. Churn continues to go down due to the better quality of the customers we are adding. As a result, outgoing service revenue grew 53% year-on-year, while economies of scale led to an over 22% margin in the first half of 2008, 13 percentage points more than a year ago, with a remarkable 25.7% in the second quarter. OpCF improved significantly to reach 38 million euros in the first six months of 2008.

Sum-up: Strong growth profile in the region capitalizing our unique integrated approach
Santiago Fernández Valbuena

To sum-up…

We are capturing the strong growth potential of Latin America, capitalising on our unique integrated management model.

The mobile business along with Broadband and TV back the solid top line performance across markets.

Broadband & TV revenues recorded outstanding year-on-year growth rates, from 16% in Peru to over 100% in Colombia.

Mobile service revenue posted double digit growth rates in most of our markets, driven by the good performance in outgoing service revenues. Colombia's revenue performance was strongly impacted by sharp cut in MTRs.

OIBDA growth was robust across the region, driven by higher margins across mobile businesses, leading to an enhanced profitability at the regional level vs. June 2007.

Finally, let me remark the strong margin expansion in Colombia mobile, +8 percentage points vs. January-June 2007.

Telefónica Europe: Sound results, strong commercial activity
Santiago Fernández Valbuena

Telefónica Europe delivered another quarter of sound results. The exit of Airwave from the Group in April 2007 and the weakening of sterling vs. the Euro impacted reported growth rates in the first half, but like for like revenue and OIBDA grew by 6% and 4% respectively. Customer base growth was driven by strong contract net adds, along with a good performance on churn. Telefónica O2 UK now has the leading contract churn rate in the market.

OIBDA growth slowed in the second quarter compared to the first, mainly due to customer growth at Telefonica O2 Germany, which added 1.1 million customers in the first half, over double the figure of last year.

O2 UK continues to outperform the market with strong revenue growth and a flat margin on a like for like basis year-over-year. ARPU growth of 3.7% year-on-year in local currency in the first half demonstrates the focus on quality customer growth.

In Germany we continue on track with the turnaround of the business, with revenue growth accelerating to 3.8% in the quarter, giving 2.7% for the first half. The business again posted strong net adds, especially on contract.

In the Czech Republic, line loss was reduced year-on-year and revenue growth of 1.1% in local currency in the first half was impacted by timings of revenues of ICT contracts, which will come later in the year. Slovakia diluted margin by under 3 points in the first half, and during the second half the OIBDA loss in the Slovak business will begin to decline year on year.

Ireland contract net adds in the second quarter were again one third higher than last year, and we have regained momentum in the prepay market with positive net adds vs. net losses last year. Revenue and OIBDA declined year-on-year due to the lower prepay base and investment in the customer. We expect to see a better performance in the second half, reaping the benefits of the good customer growth in the first half.

O2 UK: Continued healthy customer growth
Santiago Fernández Valbuena

O2 UK recorded another strong quarter of contract net adds, on the back of iPhone but also traditional handsets connections and the increasing popularity of SIM only tariffs.

Total ARPU continued to grow, reflecting the focus on quality customer growth, although contract ARPU did fall year-on-year in the second quarter driven by optimizing behaviour of customers and the growing base of SIM only customers.

As previously mentioned, contract churn in the quarter fell to 1.4%, a market leading figure, helping the net adds performance.

Mobile service revenue growth did slow during the quarter, but there was not a “step change” in the growth rate from Q1 to Q2 08; MoU is performing well, there is strong demand for iPhone 3G on a good mix of high end tariffs and bad debt levels remain stable.

In broadband, we launched our mobile proposition in April, while our DSL service is delivering high quality and satisfaction, adding 124 thousand customers in the first half.

O2 Germany: on track with execution of our turnaround strategy
Santiago Fernández Valbuena

In Germany, we are on track with our turnaround strategy.

The first quarter saw strong net adds, with both O2 and partners such as Tchibo, Fonic and HanseNet delivering a good performance, especially on contract.

Revenue growth accelerated from Q1 levels to 3.8% year-on-year in the second quarter, with mobile service revenue still impacted from the migration of customers onto new, better value tariffs.

61% of the total contract base are now on the new tariffs, and as 1.1 million contract customers are expected to remain on their existing tariffs, this means around 75% of expected migrations have already taken place. Therefore the impact of migrations in the second half of 2008 should be reduced, allowing for an improved service revenue trend during H2 08.

Although OIBDA grew quarter on quarter, it declined by 8.2% year-on-year like for like, due to investment in growth, evidenced by the increase of almost 200 thousand in net adds in the second quarter 08 vs. the second quarter 2007. Margin expanded over the first quarter as we saw the benefits of restructuring, scale and a positive contribution from the ULL business.

Improving leverage, financial cost and maturity profile
Santiago Fernández Valbuena

Turning now to our financial profile, I want to highlight how we continue improving.

First, we have dedicated 3 Billion Euros to shareholder remuneration in the first half.

Second, we have been able to make compatible this enhanced remuneration with another reduction of our leverage ratio, by moving net financial debt to 2 times OIBDA in June. This has been the result of close to 1.3 Billion Euros debt reduction in 2008 coupled with OIBDA ongoing increase. When adding our commitments to the financial debt, the ratio stands at 2.15 in the lower part of the range set in the last Investor Conference.

Third, we have been able to reduce 25 basis points the effective interest cost of our debt reaching our 6% target.

Fourth, our liability mix keeps on benefiting from the depreciation of sterling in the semester, more than offsetting the czech koruna strength, leading to nearly 285 million euros savings in the euro value of our debt.

And finally, we have smoothed our maturity profile for the coming years with cash exceeding debt maturing in 2008. On top of that, we have close to 9.5 Billion Euros undrawn credit lines, more than 2/3 long term. Despite current market conditions, we were able to price a prudent and opportunistic 1.25 billion euros 7 years deal in May which allows us to keep an average debt life around 6 years, term we estimate to be long enough to fully repaid out of CF if we wished.

Conclusions
Santiago Fernández Valbuena

To sum-up:

In the first half of the year we have posted strong earnings, clearly ahead of the pack.

We are fully exploiting our differentiated profile, leveraging our highly diversified asset portfolio, our integrated business model and our strong execution capabilities. We have delivered solid organic growth rates across regions and businesses.

The ramp in OIBDA and OI year-on-year growth rates in Q2 show our focus to preserve our high cash-flow generation profile, leveraging cost initiatives and disciplined CapEx management.

Our unique footprint in Latin America is boosting our growth, while in Europe our solid results, well above competitors, outline our business strengths.

On the other hand, under current credit market conditions we maintain a robust financial position, with leverage ratios down year-on-year and in line with our targets.

We continue to prioritize shareholder's remuneration, as showed by the accelerated execution of our share buyback program. Close to 90% of the total FCF generated in H1 08 has been used to pay dividends and buy our own shares.

Finally, I'd like to reiterate our confidence to deliver once more our commitments. We are well on track to meet 2008 guidance.

Thank you very much, and now we are ready to take your questions.

Q&A session

David Wright - Deutsche Bank

It's David Wright here from Deutsche Bank in London. Three parts to my question, please. Firstly in Spain, I'm looking for the revenue boosters I guess in the second half revenues in Spain are trending towards the low end of guidance and I guess we would expect some ongoing pressure from the GDP slowdown. So in terms of the boosters to offset that, could you give us some idea of the Yoigo materiality, the roaming contract to come on in H2? And also maybe some indication of roaming elasticity so we can clean out our Q4 number as the year-on-year roaming reduction cleans out?

Secondly, on Latin America, is the Telesp margin trend something we should be comfortable with now? Can that be sustained, that reduced margin pressure?
And maybe also a question for Matthew on O2. If you could give us some indication of how you plan to address a very tough operating performance I guess we could call it in Ireland? Thank you.

Guillermo Ansaldo - Telefónica

Ok David, this is Guillermo Ansaldo and the question regarding Spain revenues in the second half - we see several factors, at least seven factors that we should consider as positives for the revenue in the rest of the year. First of all, as you remember, the deceleration started after the summer and we started feeling after the summer. So the performance especially in the fourth quarter of this year will be compared to performance of an already slowed down fourth quarter of last year. So year-over-year we expect the daily growth rate would improve assuming the same slowdown situation in the economy.

Second, as you mentioned, there was a sharp roaming tariff cuts in September last year. So the revenues in the rest of this period from September to December will be in this revenue stream will be favorable comparing to tariffs that were already cut last year, so this is the second effect.

The third one, you mentioned it also in your question. Yoigo, we switched, we finished switching the traffic in the Yoigo contract last June. So in the rest of the year we'll see an additional revenue stream coming from this contract. Unfortunately we cannot disclose the numbers of this contract, but, as you can assume, the better Yoigo does the better our traffic in this contract will behave, it is a significant additional revenue stream.

A fourth factor is related to wireless data. Wireless data, we are, as you've seen in the numbers, showing a very good growth in data ARPU and in data revenues. And we will continue pushing this initiative in the rest of the year. And also obviously in this arena the iPhone will be instrumental. Remember we launched the iPhone in Spain last July 11th, - and we have the summer in the middle - so the effect of the iPhone will be very positive from September to December.

A fifth factor that we mentioned in the last call is that in the first part of the year, the first quarter we saw a small slowdown in IT revenues which is already recovering in the second quarter. Especially all the IT contracts related to the public sector, once the general elections are over we are starting to see a lot of decision-making and a lot of projects coming in. So we expect that in the rest of the year we will have a positive effect coming from this area.

A sixth factor is regarding to the Universal Service fund. We expect -we hope- that 2003, 2004 and 2005 Universal Service fund will be issued in the rest of the year. And as you know, we will be net receivers, the mobile business will be a net payer and the wireline business will be a receiver as any other universal service fund. This will be an additional revenue stream.

And a seventh one is the fiber. We expect to have -we hope- to have a positive green light from the regulator and so we expect to start selling fiber, high definition and other value added services over the fiber in the rest of the year. Obviously this will start in September and will go higher and hurry in 2009. So we see several factors that are differential vis-a-vis the first half and they will be obviously much more concentrated in the last quarter of the year, but that will help us to meet the guidance that we are already projecting.

David Wright - Deutsche Bank

Can I just follow up on that? That's a very comprehensive answer. Obviously the EBITDA is running way ahead of guidance if we clean out all the property and retiree affects. Would we be looking to invest some incremental margin in the second half to drive commercial activity to see that EBITDA trend more towards the guidance range rather than ahead of it?

Guillermo Ansaldo - Telefónica

Well, As you mentioned, we have in the last part of the year, it is arithmetic, we will have a push on our OIBDA because last year we had a very strong provision of the redundancy program, this year we don't have any expected. As you see in the numbers in the first half, profitability and, even netting out all the one-offs, the margin is improving. And we will keep on focusing on capturing synergies from the integration of the mobile and the wireline business.

We are also profiting from the industrial alliance with Telecom Italia. We are doing a lot of efficiency programs started a few years ago. So efficiency will continue to be a priority and that will help significantly on the OIBDA front. We will maintain our commercial activity as long as we see opportunities to grow. So we will not step down on that front.

José María Álvarez-Pallete - Telefónica

On the Telesp margin evolution question, the evolution of this quarter is the result of several actions. First, we have been able to contain the line loss, in the neighborhood of 60,000 negative net adds figure, and that has helped to stabilize the average number of accesses.

Second, on that front also, we have been able to slightly increase ARPU the traditional line, a little bit below 1% increasing ARPU year-on-year.

Third, broadband expansion, massive broadband expansion, and I would say widely appreciated by the market, in terms of increasing speed of access and bundling with traditional lines and with Pay TV. And on that front we have also been able to improve the ARPU on the broadband side by roughly 5% year on year.

Fourth, I would say that the bundling strategy is paying off and the fact that we do have now a competitive product bundled with our broadband in the most intensive competition zone in Sao Paulo helped us recuperate market share gain in terms of net adds in those regions. I would say on top of that, that we have been able to run and accelerate the efficiency program in terms of reducing the workforce level of Telesp in the second quarter and that's going to be starting to pay off in terms of a more efficient cost structure.

Also the fact that we are setting up a significant effort in the region - all around the region- in terms of boosting further efficiency regionally from the wireline businesses. And finally, I would say that there are other two effects that are going to be helping us in the second part of this year to sustain or even increase this level of margins in terms of the tariff increase that had been approved in July in the neighborhood of 3% and also the comparison year-on-year because of the ongoing comparative effect of bad debt cleanup that we have all around last year.

So the answer is, yes, we feel comfortable with this evolution and we keep fighting to even improve this position.

Matthew Key - Telefónica

Hi, David, it's Matthew. I guess a two-pronged approach in Ireland. First, we have to regain customer relevancy and I think if you look at some of the propositions that we've launched in the first half, they're certainly cutting through in the marketplace in new prepay proposition in O2 Clear which is a little bit like Simplicity in the UK. What that's shown actually in our first-half numbers is that we've grown by 42,000 customers in the first half, 25,000 in the second quarter. And if you compare that to last year we actually didn't grow at all for the first three quarters.

So first is customer relevancy, get some customer momentum and then get the top line going, and the second is clearly the cost base. We've got a lot of operations going on there. You may have seen that we outsourced our IT function to IBM during the first half and we're now really starting to leverage the scale from the Group but particularly from the UK. So as an example, we're now running our MMS platform and our visual voicemail platform for the iPhone from the UK for Ireland. So customer relevancy to get the top line going and driving down the cost base.

Christian Kern - Lehman Brothers

I was wondering if you could quantify the positive impact Easter had this year by having two more trading days this quarter versus last quarter? Second question is I'm trying to find or to close the gap between your 6% ARPU decline in domestic Spain and the service revenue which is up half a percent with about 217,000 net adds; I think there's a little bit of a gap.

And if I understand you, your Yoigo initial roaming contract only kicks in July.

And the final one, if you could help here with regard to the roaming; there's been a steep decline in the roaming in revenue growth in domestic. It was I think 12% up in Q1, 17% down in Q2. What are your thoughts there on the Q2? Thank you.

Guillermo Ansaldo - Telefónica

Christian, let me start by the second question. If I understand correctly you're trying to reconcile the ARPU decline in Spain with the revenue growth. Is that right?

Christian Kern - Lehman Brothers

That's correct, yes.

Guillermo Ansaldo - Telefónica

Okay. We have the increasing customer base as one clear effect on the side and also we have, as you mentioned, some of the wholesale income coming in. The Yoigo contract started in the beginning of June so we have only one month of revenue coming in the semester.Data ARPU is already in there, but it's basically planned and some of the wholesale income like the Yoigo one. I think that was your question not, why the 6%, but to reconcile the gap, no?

Christian Kern - Lehman Brothers - Analyst

That's correct.

Guillermo Ansaldo - Telefónica

The other question I think you were asking about the domestic roaming, what happened with the roaming in that had a change quarter to quarter?

Christian Kern - Lehman Brothers

From your presentation I see there's been a big swing in the revenue growth from plus 12 to negative 17.

Guillermo Ansaldo - Telefónica

Two things first, these roaming contracts with the international operators are very volatile in the sense that are annual contracts and the discounts are applied depending on the traffic that is coming in and coming out with this operator. So the relevant measure for us and the relevant metric for us are to see the margin between the roaming in income and expenses of roaming out with the same operators.

In that sense we also have a decrease on the roaming out expenses so the margin is basically the same. Unfortunately it plays funny numbers in the income and in the expenses. But the margin of these operations is quite sound and it's going in line with expected. And regarding the first week, the first question, I didn't get it. Can you repeat it?

Christian Kern - Lehman Brothers

On the Easter effect, this Q2 will have for any operator positive Easter effect because last year Easter was in Q2 whereas this year Easter was in Q1. I was wondering if that's something you can quantify and have looked at?

Guillermo Ansaldo - Telefónica

I don't have that number right here. You're right there is a positive affect on Easter because it was in different quarters. And we can provide you with information after with the investor relations team. But unfortunately I don't have the number here, but if you're right it's a positive effect in the second quarter.

Jesus Romero - Merrill Lynch

Jesus Romero from Merrill Lynch in London. Guillermo, I had a question on the line loss in the second quarter. You mentioned in the release that the market was growing 2%, but in spite of that we saw a decline in your line of 1.6%. When you talk about that 2% decline over the next three years through 2010 what assumptions are you making for market share loss and what do you think the market will be doing?

Guillermo Ansaldo - Telefonica

Yes, well, according to our estimations the market has grown close to 2%, the actual number is 1.9%. Basically what have happened in our access space are two things. First, an effect that we saw in the first quarter which is this change of nature of this new feature of naked share unbundling which, to give you a flavor, the net gain of this type of unbundling was close to 160 thousands in the first half of the year. That was something that did not exist in the previous year. And that explains a good part of the loss.

There is a second factor and especially in this quarter which we saw more commercial activity on direct access, meaning some cable operators and some other competitors that have direct access to customers. So we lost some lines to some direct access also in the year. It's a smaller effect, but it does have an effect. We don't see yet an effect on the market so far. So basically the first quarter was basically 100% due to this new shared unbundling and the second quarter is maybe two thirds due to the shared naked unbundling and one third to more activity on the hands of some competitors' indirect access.

Jesus Romero - Merrill Lynch

What is the possibility in the second half you see the market slowing down or declining and on top of that you continue to lose market share?

Guillermo Ansaldo - Telefónica

We will see some; this trend of the naked share will continue. I'm not sure about the pace it will continue because we've seen both migrations from plant shared to naked shared. And obviously some players are directly going into this feature instead of going into wholesale ADSL or to share unbundling, so that trend will continue. The pace will depend on seasonality and on the strategy of these customers.

Regarding the market we'll see, so far we haven't seen a change in the market but it's something that we have to be; honestly we have to be very cautious and see what will happen in the future. So far we haven't seen any change.

And you also asked before about the long term. We still believe that 2% is doable. Obviously we see; we have last year a very good number in terms of line loss, so that helps in the arithmetic. This year, well, I don't have a number, but obviously we'll be above 2. And once this naked share effect starts to ease up because the migration will finish and we'll have only the new adds we see that will help to get into the 2% number that we shared with all of you in London.

Jonathan Dann - JPMorgan

It's Jonathan Dann from JPMorgan. Two questions. The first one is to better understand naked share access; so which of your competitors are using it and what should we expect? Is it the 0.5 million wholesale DSL that you would expect to migrate? So perhaps line losses above worse than the trend for a year but then returns below 2%?

Secondly, could you provide a number for mobile data cards that you've sold over the last year? I think in the release you said you sold 2.1 million 3G handsets, if you have any figure? And then finally, I think in the press yesterday one of the other shareholders in Telco in Italy was talking about a capital increase. What are Telefonica latest thoughts there?

Guillermo Ansaldo - Telefonica

Naked share is basically used by Orange and Ya.com, so basically several players but basically it's Orange and the Orange Group. And also we have to see that we depend on the strategy that we'll follow in the future and the aggressiveness that they put in the market to see what's happening.

You know, to switch a customer from shared to naked share, you have to call the customer and basically tell the customer that he will not have any more commuted voice and that he or she will have voice over IP. And of course they will save money because they will save part of the monthly fee depending on the offer that, in this case Orange for example, will make. So it depends on contacting the customer, convincing the customer to drop the traditional voice lines which is very normal, maybe very affected by some segments and not very affected by other segments. And third of course that they will agree to the new offer.

So the trend will continue, but it's not also possible to get 100% of the customer base; to convince 100% of the customer base. So we have made some hypothesis but to be honest it will depend on the strategy that, for example, Orange will follow.

Jazztel, for example, is much more on the full unbundled. So they have a different strategy, they are improving in market share, they're doing very well but they are full unbundling and that also hurts us or threaten in terms of market share of broadband which has not been an issue so far.

Regarding your second question let me give you a couple of numbers. First, the total number of dongles or cards and so on that we have so far is 300,000, a little over 300,000. Additionally if you add all other type of Blackberry's and other type of advanced type of smart phones, we have almost three quarters of a million, 750,000 roughly.

I don't know if that was your question, but basically that's a gross figure. Then you mentioned also before the 3G, that's in general, that doesn't mean that a 3G terminal has a data contract and so on. But basically to give you a number, you have like 300,000, 300,000 people with either cards or dongles.

Julio Linares - Telefónica

Regarding your third question on Telecom Italia capital increase. As Telefónica, we have nothing to say here and I think Telecom Italia is much better positioned to answer any questions regarding its own capital structure.

James McKenzie - Fidentiis - Analyst

I'm calling from Fidentiis. I've got two questions, one on Spain. I wonder if you'd give us an idea of where bad debt stands currently as a percentage of sales and whether you've seen any significant increase in the second quarter or recent months. And then on Latin America, I was very pleasantly surprised by the EBITDA margins. That's been done in an environment, as you said, of very strong growth. And I think your main competitor actually saw a small fall in EBITDA margins. What's behind this? Is this operating leverage, i.e. is your EBITDA excluding SACs, has that increased 400 basis points?

Guillermo Ansaldo - Telefónica

Regarding the bad debt question, our numbers are still below the 1% over sales in the provision over sales. To give you an idea, the first quarter, if you correct the effect of the sale of the loan portfolio we sold, we show a positive affect on the provision. If we correct that it will be 0.8 and second quarter is 0.9. So it is increasing a little bit, but not significantly and obviously it's below the 1%, so they are still good numbers.

James McKenzie - Fidentiis

Is that a big increase on last year for example?

Guillermo Ansaldo - Telefónica

Last year, to give you a flavor I have the figures here for the third quarter it was 0.7. So it looks like it's increasing a little bit, but it's not very relevant. Obviously when you put in the first quarter the sale of the bad debt portfolio the number is 0.3, but when you correct that it's a little bit more. But claim numbers we've seen maybe a

0.1 percentage point decrease. If you look back in the whole of our operation, our margin shows deterioration, but it's minor.

Jose María Alvarez-Pallete - Telefónica

Taking your second question on the evolution of margins, I understand that you are addressing the question on the wireless side. Am I correct?

James McKenzie - Fidentiis

Exactly, sorry.

Jose María Alvarez-Pallete - Telefónica

On that front I think that for us what is playing in our favor is scale as the first part of the answer. The increasing size, the increasing volume of our customer base is helping us to boost operating leverage in a highly controlled base of fixed costs. Also the fact that we run the region as a unit in terms of not only a unified brand, but also unified systems, unified asset purchasing and a significant amount of initiatives help us to have better margins than all of our competitors.

But probably the most significant effect when compared to previous years is the fact that we are having more and more clients on our GSM networks and we will be progressively switching off the other networks, and that's also helping to boost efficiency. Also the fact that we have controlled bad debt and the fact that we have been able to have a highly segmented subscriber acquisition cost approach is helping us to highly control I would say the net adds of our customer base.

So we are fairly positive about the future evolution of our wireless margin. We have been also working significantly on the wireline side, but I'm talking specifically on the wireless side. I think that the 20s is solid.

James McKenzie - Fidentiis

If I was to look at SACs and SRCs as a percentage of sales, would she be able to give me a figure as to how that's evolved over the last year?

Jose María Alvarez-Pallete - Telefónica

I'm afraid that we do not disclose that figure, but those figures have trended down and we would think that will continue to be the fact. Remember also that we are running best practice approach and we are very effective transferring successful products from one corner to the other of the region.

So I think that I can tell you that as we are speaking we have been reducing subscriber acquisition cost in the double digit arena and we will keep trying to do that same in the future. So I think that the trend is solid, as I was saying at the beginning.

Luis Prota - Morgan Stanley

It's Luis Prota from Morgan Stanley in Madrid. Two questions if I may. First of all on shareholder remuneration, now that you have 70% of the buyback done what are the chances of increasing the buyback before year-end? The second question is really a follow-up on the question on Telecom Italia, but the speculation on a capital increase was also on the Telco level requiring a capital increase because the covenant could be reached if the Telecom Italia share price comes down to levels around 1, 1.05. If you could elaborate a bit on that, it would be helpful. Thank you.

Santiago Fernandez Valbuena - Telefónica

On your first question on the shareholder remuneration, we have spent more than 90% of the free cash flow that the Company has generated on shareholder remuneration on the first half. And on the second half we still have the second leg of the dividend coming up and we shall have one-third of the 100 million share buyback pending execution.

As you recall, we have always said that share buybacks will be determined depending on free cash flow generation and the share price certainly continue considering the share price is very attractive. And to the extent that we think almost at certainty that the cash flow generation ability of the Company will continue, we will complete that and we'll update you and the market on future increases in remuneration later on in the year. As for now we think that remuneration is high enough and attractive and we still have one-third of the program pending execution.

Julio Linares - Telefónica

Luis, this is Julio Linares. Regarding Telco, we do not see right now any need for any additional increase of capital, based on the covenants and based on the fairness opinion, external fairness opinion we have about the Company.

Terry Sinclair - Citi

It's Terry Sinclair from Citi. Three very quick questions. First of all on Spain, the top end of your guidance implies that you still think it possible that you may grow sales at 5% in the second half. And I'd just like some reassurance that there were no trends within the quarter that diminished your confidence in that, specifically has there been any deterioration across the second quarter?

Secondly, you mentioned a number of issues in Spain which had helped wireless ARPU to fall, and one of them was trending spin down towards SMS instead of voice. There are some SMS promotions out at the moment and I wondered how long you expect to have special promotions around SMS and perhaps data growth? And third and very quickly, I just wondered when you are expecting unbundling in Sao Paulo is to have an impact on Telesp?

Guillermo Ansaldo - Telefónica

Terry, this is Guillermo. Let me try to answer the first question. Obviously the environment is challenging, but the facts I mentioned at the beginning, the seven effects are positives that will help in any case. Obviously if the environment changed dramatically we will have to think about new things to compensate. But basically we are assuming that the operating environment is similar to the one we have seen in the second quarter going on. Also let me stress that many of the factors that I mentioned before are more loaded on the fourth quarter by definition because of the seasonality of the Spanish market.

Regarding the second question, I don't know if I got it right, but I think you were asking about the SMS promotion, the premium SMS, no? Yes, that was a very relevant factor in the first quarter and part of the second quarter. We don't have any premium SMS promotion right now in the summer and for the rest of the year, and sorry, we cannot disclose our strategy due to competitive reasons. But data growth is one of our priorities and we do have access to continue betting on that.

Terry Sinclair - Citi

Okay. Guillermo, I should work this out for myself, but what would the like-for-like boost be from the seven factors you mentioned in answer to David's question, a number of them involve an arithmetic list because the comparative number for Q4 07 is going to be easier than, for example, Q2 07. Can you just help us to quantify that?

Guillermo Ansaldo - Telefónica

Sorry, I don't have the quantification one by one. We're trying to do some estimates and some of these factors will depend on third parties. For example, the Yoigo, we do have the contract, but it depends on what Yoigo does. We do have a hypothesis but we cannot disclose that. The two factors that are related to the regulator like the universal service and the fiber, we are positive, we are optimistic, but of course it depends on the regulator and it will depend on how it is issued by the regulator. So we prefer at this point of time not to quantify it one by one and as soon as we have more certainty we will share this information with you for sure.

José María Alvarez-Pallete - Telefónica

Terry, taking your question about unbundling in Sao Paulo: first, there is already an offer of an unbundled offer in Sao Paulo which has not been successful or attractive for new entrants, but probably because of the fact that most of our major competitors have their own infrastructure in Sao Paulo. I don't remember exactly the number of operational networks right now, but it's something close to seven in probably the most intensive competition zones in Sao Paulo, not only in terms of cable operators like Net, but in Brazil Telecom and Telemar/Oi already have also their own infrastructure in Sao Paulo.

It is also true that the current environment, the regulatory changes in Brazil, because of the creation of the national champion, is fostering some additional changes in the regulation. But in terms of having a more intense competition environment in Sao Paulo, it's already highly intensive based on infrastructure-based competitors. So we do not expect any major changes on that regard.

Guy Peddy - Macquarie Research

Good afternoon, everyone, it's Guy Peddy from MacQuarie. A couple of quick questions. During the quarter Orange announced a significant plan to roll out a lot more distribution shops in Spain and a plan to increase the distribution network in the UK. Just wondering how you're going to respond to that.

Secondly, as you Orange UK clearly have performed very well in Q2 and they sort of cross up with O2 UK from a revenue growth perspective I was just wondering whether you feared that actually Vodafone and T-Mobile who are clearly under performers would be a bit more aggressive in H2.

And then finally, you've got comments saying that you're on track in Germany, but if I was going to be really critical your service revenue growth rate has actually gone backwards in Q2. So where can we find that confidence that you are on track and when do think you will be able to get to a more neutral service revenue growth position in Germany? Thank you very much.

Matthew Key - Telefónica

Hi Guy, Matthew here. I'll pick up the two Orange questions and then talk about Germany. As far as our distribution network is concerned in the UK we've got circa 450 stores, are very happy at that level, we think that's the optimal amount. And clearly also trade mainly through Carphone Warehouse, but a bit through Phones 4U. So do I see a need to respond to or Orange expanding their distribution network in the UK? Absolutely not.

As far as their revenue growth is concerned, yes, they've had a couple of quarters of about 9%, but I would just encourage you to look at the numbers they're lapping from last year which were actually pretty low in terms of that 1% and 4% where actually we're lapping numbers of double digit with double-digit growth. So yes, they're increasing against last year's number but from a lower base.

On Germany I think the key thing to understand about Germany is there are effectively two compensating factors happening at the moment. The first is that we're increasing our base by circa half a million a quarter and have done for the last four quarters which is clearly driving service revenue up. What's pushing service revenue the other way is migrating our existing customers onto the higher value or the better value tariffs that are in the market at the moment.

Now I think we've declared that actually of the base that will migrate onto the better value tariffs, we've now already done 75%. We'll complete that during this year. So as those two items move into a different level of balance, because they're broadly imbalanced at the moment, you'll see us start to go into service revenue growth during the second half of 2008.

Guillermo Ansaldo - Telefónica

Just to complement the Spanish part of the distribution question, you know we have a very capillary or large exclusive distribution network in Spain. The two initiatives that we are pushing last year and this year are twofold. First is to have as much stores possible selling both wireless and wireline products are going very well. And it is one of our synergies that we are bringing into the revenue side.

And we do have a program to improve locations, meaning we're trying in large cities to realizing which ones, which locations, premium location we should cover so we are changing locations or we are covering some holes. We call this a top distribution network that it is not the significant increase in the number of stores; it's mostly an increase on the quality and the profile of the stores.

Mitchell Collett - Cazenove

It's Mitchell Collett from Cazenove here. Three questions if I may. Firstly, can you quantify the effect of termination rate reductions in Spain on both revenue and EBITDA? And secondly, you mentioned in the presentation that the handset sales had flattened across the quarters. Can you give us a feel for why that's happened? And thirdly, you say in the presentation that GSM handsets in Latam are now 72% of the total. What can we expect that to trend towards? Thanks.

Guillermo Ansaldo - Telefónica

This is Guillermo Ansaldo. Regarding the handset sales, this is another volatile component of our income because it depends on the amount of terminals that we provision into the channels and the needs of stock of the channels, and also depends on the value of the terminals, the unit value of the terminals we provide. So it goes up and down quarter by quarter and month by month. But there's no change in trend behind those numbers. So that's something that I know, I know it's because it changed month by month, but it is no change in trend. And it depends on how the wholesalers are stocking and what type of terminals they are demanding.

Regarding termination rates, we have a decrease of 16% on our income side semester over semester, if that was the question. And obviously, when you look at the whole of Telefonica Espana you have to take into account that on the fixed side we have savings because we pay less in the traffic that is originated on the fixed side and on the mobile side and also on the mobile operation in the originated traffic we pay less. So at the end of the day, they impact the margin. I don't have the number right now, we can try to calculate it, but it's neutralized by the wireless and as particularly by the wireline business as a whole.

José María Alvarez-Pallete - Telefónica

Taking your question about the GSM handset evolution as a percentage of total handsets in Latin America, it's been a very natural trend. We are not forcing these or accelerating this pattern. We are just having a little bit like, something like close to 90% of our gross adds based on GSM and therefore it's natural rotation of handset which is helping us to decrease the CDMA-based effort.

And therefore we will provision the switching off the CDMA network. So probably you will see that in the next two years. We will have evolving this space to close to 100% and the full country by country will be switching off all the different networks and therefore that will boost also efficiency in terms of having one single network with all of our clients. You should expect that to happen in the next two years.

Andrew Hogley - Execution

Good afternoon. It's Andrew Hogley at Execution. A question about mobile broadband if I may. Can you outline your strategy and particularly how it varies between the UK and Germany where you're in a challenging position and can take share from the DSL providers versus the Spanish market? Thank you.

Matthew Key - Telefonica

Mobile broadband from our perspective is clearly a growing market in both Germany and the UK and in Ireland. I think the first thing, as your question implies, is you need to look at the status of the fixed broadband market. And in Ireland, for example, with a relatively undeveloped fixed broadband market we see a lot more potential to grow mobile broadband than in the other countries.

If you look at our approach in the UK where clearly we've got a mobile broadband offer as well as a fixed broadband offer, actually today we've announced that we've got a proposition that's going to combine the two. So you effectively get a home broadband with a mobile broadband subscription which is GBP20 a month. So very much depends on market by market as far as how far the market is developed and the relevant pricing in the market place

David Strauch - Oddo Equities

This is David Strauch from Oddo. I've got two questions. First is on Spain who you mentioned from the impact of outgoing revenues in mobile, impact of the promotional effect and also the economic slowdown with the optimization of tariffs. Could you give a little bit of a breakdown between the two effects?

And secondly is on Latin America, because in Q1 concerning our Argentina fixed you mentioned that the negative impact in the EBITDA margin was partly coming from the inflation. In Q2 we see a very good performance in EBITDA. So, since you are able to manage efficiently. And do you think you will be able to do that durably or do you see any risk from durable inflation in Latin America?

Guillermo Ansaldo - Telefonica S.A

Regarding the evolution of our wireless revenues, there are several factors to take into account. First is a regulatory factor which is the incoming voice ARPU which is down because of the mobile termination rate cuts. As you know, we have in April another cut twice a year. So when you compare year over year we are almost 14% in voice ARPU terms, voice ARPU terms down year-over-year because of this regulatory change.

When you look at the outgoing ARPU, we have a lower drop than the total, a total drop is basically 3.6% in the first half and 4.8% in the second quarter. And here we have different effects. One has to do with the nature of the promotions that we use in the second quarter, vis-a-vis the second quarter of last year. As you remember, I think we explained in the last conference call, in Christmas we launched a campaign, there was much more focus on churn, on improving churn which basically we give in to the customer that signed to the promotion one week free of on-net traffic at the end of each month.

And the number of months, the number of weeks they get depends on the number of years they have been with us with mobiles. So we have a significant base of clients with four, five, or six years of age with us to put it in some way. We have a lot of traffic, a significant part of traffic that is implied in a promotion. That's why you see also an improvement in minutes of use and some decrease in the average rate per minute. So this has to do with the promotion and not with the market.

Second, we launched in the second quarter of last year several tariffs schemes that basically were reducing price in order to improve also churn. This impacted on ARPU in the rest of 2007 and is impacting on this year since these tariffs are doing very well in terms of net adds.

The third is a change in use patterns and it has to do with the change in the operating environment, meaning that we are seeing that some segments of customers, especially what we call consumer market or residential market, they're moving the shift in traffic from more expensive traffic to less expensive. For example, shifting from mobile to SMS, we're doing very well in SMS and also this shift in traffic mobile to mobile to fixed to fixed.

In fact, if you look at our numbers, in voice traffic revenues in the fixed business you will see that our evolution is only a 1% decrease which is much better than before and obviously which much better than expected. So here you have a factor that is related with the overall market condition. Basically overall the outgoing traffic of clients in Spain grew 3.6% in the first half and there are some factors that are related with the market level.

I mentioned some factors that are related with previous decisions that were focused on improving churn. Churn is very stable and this is part of our core strategy. We will try to protect our customer base. We may suffer a little bit on other rate per minute or on ARPU, but we believe that we have to maintain and defend our customer base and then we will elaborate when the markets and the products are the right ones.

José María Alvarez Pallete – Telefónica

Taking your question about Latin America and inflation picking up in the region, first it is not homogeneous; there are some countries that are more exposed to that fact than others. But globally speaking, on the wireless side, as we have more commercial flexibility in terms of moving tariffs and playing with the different campaigns, we have been able to transfer part of that effect.

Also the cost structure of the wireless business of our companies are less exposed in terms to inflation movements. And therefore we have also been able to be more agile in terms of restructuring, in terms of producing that exposure. So basically speaking on the wireless side we think that we have been able and we should be able to keep going on that trend and absorb and increase efficiency in spite of inflation.

On the wireline side there are different environments and we have been able to increase margins in Brazil on the wireline side or in Argentina in spite of the fact that in Argentina we have a significant pickup in inflation. The only problem that we have in Argentina that is roughly 50% of our revenue has been with the tariffs frozen for the last six years. So we have been doing a significant effort of reducing the exposure to this tariff freeze in our products and that's why have been evolving to roughly 50% of revenues exposed.

And also, we have been running globally in all the wireline business a significant efficiency program. We have been reducing the labor force of the wireline business in Latin America of roughly 3,000 people in this first half of the year and we keep boosting efficiency through regional products. So, so far we have been able to absorb inflation and to increase margins in the second quarter and we feel that regionally speaking we should be able to manage the process.

Will Milner - Arete Research

It's Will Milner, Arete Research. Firstly, just thinking about Spanish line loss. Of the 600,000 new homes that used to be built in Spain every year, do you have any idea what proportion ended up coming a new line for Telefónica? And then secondly in Latin America, your year-over-year organic EBITDA growth jumped from 12% in the first quarter to 20% in Q2, which I guess looks, well, it's a great result, it doesn't look wholly sustainable.

Do you think and do you agree perhaps that some of the commercial activity has been held back and in the second quarter that would increase? And perhaps you could maybe talk about some of the promotions you've already launched in the some of the key Latin markets?

Guillermo Ansaldo - Telefonica

Regarding your question about new lines linked to new houses or new buildings, I have a figure which is slightly different but tried to explain that effect. What we have seen in the past, for example, two years is like, depending on the quarter, 30% to 40% of the new lines that we were adding to our plan in terms of fixed lines were linked to new buildings, the rest were linked to existing buildings.

There are still many people in many units or families without fixed lines and basically they are solving their needs with mobile for example, but they are joining the growth of fixed lines due to broadband maybe. But the figure that we do track in the past is that 30% to 40% depending on the quarter of our gross adds in fixed lines were linked to new houses. That's basically the exposure that we may have in the future.

José María Alvarez Pallete

I'm taking your question about Latin America and growth in the second quarter. In terms of commercial activity the second quarter is always more intense than the first one because of the Mother’s campaign which is the second most intensive commercial campaign of the year immediately after Christmas campaign. So yes, we have been having more commercial intensity, but in terms of the growth that we have been having in revenues, this is based on several factors.

First of all, the fact that we have been significantly increasing the average number of customers and, as a result, year on year the impact of the other number of customers is paying off and is reflected on the revenue side. Also because of the fact that we have been able to do that with stable ARPUs. And it's true that in the second quarter, because of the commercial intensity it has been picking down a little bit, but the fact is that globally speaking around a year, has been broadly stable on the wireless side.

And on the wireline side we have been able to contain line loss. We have also been able to expand broadband massively in the region and have been able to increase the ARPU on the broadband side. We have been able to bundle and to increase the bundle effect. And on top of that we have been able to combine all those effects with further efficiency. So I think that it is not a quarterly effect. We have commercial intensity because of that campaign. But globally speaking the trend in terms of our revenue growth is pretty recurrent I would say. It's not a seasonal effect.

Will Milner - Arete Research

Yes, I think it points more that you have EBITDA growth guidance in Telefonica Latin America of 12%, 16%. And as you say, the most heavily intensive commercial activity quarter, the second-quarter, you've done 20% organic growth. So EBITDA expansion in Latin America much better than you've expected across the full year? Should we be thinking 12% to 16% is actually too low?

José María Alvarez Pallete – Telefónica

It's too soon to say. And also you need to score the fact that during this quarter we have included in Telemig and Telemig was scored to the guidance calculation. So let's wait for the remaining part of the year and see how the Telemig effect is progressively diluting in importance in the next quarter. But yes, we are happy with the evolution, but it is too soon to say.

Santiago Fernandez Valbuena - Telefonica

All right, with this, ladies and gentlemen, we have to bring this conference call to an end. We appreciate and thank you for being here with us and we hope you will be able to join us for the Q3. Thanks a lot and, for those of you who have been on holiday, may you enjoy them as much as we have enjoyed your company today. Thank you.