Telefónica H1 09
Results Conference Call Transcript

30th July, 2009

Important Notice:
Although we try to accurately reflect speeches delivered, the actual speech as it was delivered may deviate from the script made available on our website

Introduction

María García-Legaz

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss 2008 full year results. I am María García-Legaz, Head of Investor Relations. Before proceeding, let me mention that this document contains financial information that has been prepared under international financial reporting standards. This financial information is unaudited.

This presentation may contain announcements that constitute forward-looking statements, which are not guarantees of future performance and involve risks and uncertainties, and that certain results may differ materially from those in the forward-looking statements as a result of various factors. We invite you to read the complete disclaimer included in the first page of the presentation, which you will find on our website.

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 Fernandez Valbuena, who will be leading this conference call.

Presentation

H1 09 results key highlights

Santiago Fernández Valbuena

Good afternoon, ladies and gentlemen, and thank you for joining Telefónica´s 2009 first half results conference call. Today with me I have Julio Linares, our Chief Operating Officer, Guillermo Ansaldo, head of Telefónica España, José María Álvarez-Pallete, head of Telefónica Latinoamérica, and Matthew Key, head of Telefónica Europe. During the Q&A session, you will have the opportunity to ask questions directly to any of them.

Telefónica has presented today a solid set of results that reinforce our differentiated profile in the industry. Our high diversification, our integrated business model and our proven execution skills backed our sound performance in a challenging economic environment.

We continue to deliver on management priorities for the year, with second quarter results showing similar underlying trends to those of the previous quarter.

The strong growth captured in Latin America and the robust performance in Europe continue to push revenue up in organic terms, outstripping the lower contribution from Spain.

As embedded in our guidance, organic OpCF year-on-year growth ramped up notably in the second quarter, driven by our discipline in OpEx&CapEx management. As a result, we have delivered benchmark profitability levels.

Solid operating results fully flow to the bottom line, with underlying net income posting double digit growth in the first half of the year.

Additionally, our balance sheet remains strong, driving our high financial flexibility.

And let me stress that we are on track to meet our 2009 guidance and our growing dividend policy is fully reaffirmed.

Solid performance across the board
Santiago Fernández Valbuena

Please turn to slide number 4 for a quick review of Group financial and operating performance.

In the first half of the year we continue to grow solidly in all major metrics in organic terms. Telefónica Latinoamérica continues to be the main growth engine of the Group, driving organic sales up more than 1% year-on-year, despite notable drags from regulation and seasonality in the second quarter of the year. Operating Income before D&A increased in organic terms by 3% and Operating Income by 4% on an annual basis, respectively.

Strong cost containment in the current trading environment and higher efficiencies from our scale allowed consolidated OIBDA margin to expand by close to 1 percentage points year-on-year in organic terms to 39.7%.

Please notice the negative contribution of forex across the P&L, dragging between 1 to close to 4 percentage points from the underlying performance of revenues, OIBDA and OI, though improved FX in the second quarter of the year, have reduced the negative impact recorded up to March.

Operating cash flow generation in the first six months of the year exceeded the 8 billion euros mark, growing nicely 12% year-on-year in organic terms, well ahead of revenue growth.

Overall, a solid performance on the back of our ability to maintain commercial momentum in slowing down markets, capturing new customers and extending their usage patterns to new services through bundled offers across markets. We ended June with close to 264 million accesses at the Group level or 8% more than a year ago, with a strong push in mobile and good traction in mobile broadband services.

Pushing underlying EPS up by almost 14%
Santiago Fernández Valbuena

Turning to slide 5, January through June 2009 net income topped 3.6 billion euros, posting an outstanding 11% underlying year-over-year growth.

Reported figure was flat year-on-year due to the positive impacts derived from asset disposals which were recorded in the first half of 2008.

Reported Earnings per Share reached 0.79 euros and continued to excel, with an underlying year-on-year growth of 14%.

Had we excluded the impact from PPA's, EPS would have reached 0.86 euros.

And FCF per share totalled 0.78 euros in the first half of the year, recording a notable 7% annual growth.

H1 performance in-line with year-end targets
Santiago Fernández Valbuena

Let me now quickly review our progress towards meeting our full year guidance.

Up to June, all metrics we have guided on are fully aligned with 2009 year-end targets.

After adjustments for guidance calculation, growth in revenues, Operating Income Before D&A and Operating Cash Flow were 1.7%, 3.2% and 12.1%, respectively.

CapEx up to June stood close to 3 Billion Euros. We maintain our target of CapEx below 7.5 billion euros for the whole year, with a big part of the budget expected to be executed towards the end of the year.

Generating healthy OpCF with a benchmark profitability
Santiago Fernández Valbuena

Let's turn to slide number 7...

We continue to deliver good conversion rate of revenues into cash generation across regions, with OpCF organic growth exceeding by more than 10 percentage points the growth rate of sales at Group level.

Trends up to June are similar to those recorded in the first quarter. Disciplined management of OpEx and CapEx allow to limit top line pressure and to post strong Operating Cash Flow growth both by T. Latinoamérica and T. Europe, while maintaining flattish T. España's strong cash generation.

Group OIBDA margin continued to be backed by efficiencies, underpinned by further margin expansion in Latinoamérica and Europe, and Spain's robust margin.

Managing OpEx & CapEx to maximize OpCF generation
Santiago Fernández Valbuena

Slide number 8 shows our steady focus to flexibly manage OpEx and CapEx in order to maximize cash flow generation without jeopardizing future growth.

Group CapEx decreased 10% year-on-year in organic terms and excluding the licenses acquired by Vivo in second quarter of 2008. Most items showed reductions. The high investments already made in past years across European markets drove down GSM CapEx, while lower commercial activity in the traditional fixed line business also led to reduce CapEx.

However, we continue to focus on capturing the broadband growth opportunities, both in fixed and mobile. As a result, CapEx devoted to these projects was up year-on-year, amounting to 28% of the total CapEx in the first half of 2009. We are heavily pushing the deployment of 3G, with 3G CapEx increasing 50% vs. last year's figure.

We do retain flexibility to manage CapEx. As of June CapEx committed is roughly 50% of the annual target. We do also keep our flexibility in terms of costs, as shown by the 6% year-on-year drop in commercial costs driven by lower handset subsidies, advertising and commissions costs in very competitive markets. Interconnection costs are also going down, driven by MTR cuts across regions.

The rein on manageable OpEx partially offset higher operating costs, mainly in Latam, derived from fast customer growth, high inflation in some countries and the negative impact from the appreciation of the US$ relative to local currencies.

T.España: Focus on OpEx and CapEx to maximize OpCF
Santiago Fernández Valbuena

Let's now review the performance in Spain, where we continue to focus on sustaining our revenue leadership in the market and maximizing operating cash flow generation.

And we are delivering. Operating cash flow reached close to 4.1 billion euros in the first half, remaining almost flat year-on-year on a comparable basis despite the 6.3% drop in revenues.

Underlying trends were stable overall compared to the previous quarter.

Good news is that the second derivative for year-on-year comparable change of revenues is positive for both wireline and wireless businesses. Top line deterioration slowed down in the second quarter. It's too soon to say this trend will continue, but despite current macro conditions, we are already seeing consumer and business confidence as well as other consumer related indicators starting to recover.

On the other hand, an efficient management of OpEx and CapEx is allowing to sustain robust margins and to reduce CapEx without jeopardizing growing businesses' prospects.

Wireline margins are down just 0.4 percentage points on a comparable basis to stay at 47.3%, while wireless margin went down 0.5 percentage points to 43.9%.

KPIs: improved performance q-o-q in most services
Santiago Fernández Valbuena

Going now to operating metrics in slide number 10, in the second quarter of the year we recorded sequential improvements in most of the businesses.

Broadband operations are posting a solid growth, with mobile broadband making up for lower wireline growth. Wireless data flat rates exceeded 1.2 million, over 2 times those of June 2008, and 3G devices surpassed 7.5 million, 1.5 times the figure of June 2008. This performance shows not only the Company's strategy is bearing fruit, but also our customers' willingness to get new services.

In wireline broadband, despite lower net adds, we are sustaining our market leadership, with an estimated 56% share. Moreover, effective retail broadband ARPU's performance was slightly better in the quarter to show a 6.6% year-on-year decline up to June, compared with a 7.2% drop in the first quarter.

In Pay TV we did also record an improvement vs. the first quarter, as we were back to positive net adds in the second quarter, while we maintain our market share.

The wireless business is also improving, as we have lead the market growth with close to 101,000 net adds in the quarter versus less than 10,000 net adds in the first quarter, driven by increased commercial efforts and churn remaining stable. This performance is even more impressive in the contract segment where our share of net adds in second quarter of 2009 was close to 40%. In mobile number portability we also posted positive results in the contract segment in the quarter, versus the negative one last quarter.

Traffic and ARPU declines, despite being slightly more negative than in the previous quarter due to seasonal effects, showed a significant improvement compared with the performance recorded between Q4 08 and Q1 09.

Retail fixed line losses also showed a containment vs. the previous quarter. And 55% of them were compensated by a net increase in wholesale which generate revenue for the company.

Q2 revenue performance shows similar trends to previous quarter
Santiago Fernández Valbuena

Let's now turn to slide number 11 to see main drivers behind revenue performance, which is showing a similar trend to previous quarter.

On the positive side, IT and Data wireline services continue to post very healthy growths both in the quarter and in the first half of 2009. Wireless data connectivity revenues are growing even faster in the second quarter, almost 57% year-on-year. Also it is worth to mention the stabilization of year-on-year decline of total wireless revenues.

On the downside, revenues related with customer consumption continue to go down due to the lower usage patterns across businesses, though excluding the negative impact from Easter Holidays the performance in Q2 would be pretty similar to the one recorded in the previous quarter.

Lower access revenue in wireline was mainly explained by the 20% cut in ULL prices and the reduction in the total access base.

Wireless incoming revenues derived from roaming-in and interconnection were impacted by lower usage and a significant drag from MTRs cuts.

As our core strategy, we remain focused on revenue share. Despite customers becoming more price sensitive and players reckoning this, we are maintaining our revenue share leadership in the market, both in wireline and in wireless.

OpEx & CapEx discipline to preserve OpCF generation
Santiago Fernández Valbuena

Finishing with the review of Telefónica España on slide number 12, let me update you on the numbers of efficiency we shared with you last quarter.

Total OpEx plus CapEx over revenues has gone down by 1.6 percentage points over the last twelve months, showing an improvement of 0.3 percentage points versus the figure reported in March 2009.

In the first half CapEx went down 30% year-on-year, explained mainly by the same drivers as in the first quarter:

- lower investments in GSM
- deployment of traditional loops has mostly halted, in line with construction sector
- broadband demand remains lower versus 2008, with subsequent related investments being adjusted. And fiber rollout has also been limited due to the current economic environment

These, together with per unit cost reductions benefiting from Group purchasing power and vendors adjusting prices to current economic conditions, and other initiatives aimed at increasing CapEx efficiency are helping us to deliver CapEx cuts while keeping investing in growth businesses such as mobile broadband.

On the OpEx side, reductions came to 5.5% year-on-year on a comparable basis due to commercial costs down almost 8%, expenses on mobile handsets dropping by 17% and interconnection down declining 12%. Finally, personnel expenses are also contributing to the decrease of costs, on last year's headcount reduction together with low CPI levels.

T.Latam: Solid top line growth and strong profitability
Santiago Fernández Valbuena

In slide number 13, we start reviewing the robust performance of our Latin American businesses, where we continue to balance growth and profitability. Our total customer base in the region expanded rapidly across markets, reaching 161 million accesses in June 2009.

Revenues grew a healthy 7% in organic terms in the January-June period, driven by the increase in mobile service revenue and Internet & Pay TV sales. OIBDA growth remained solid, with a 14% year-over-year growth rate in organic terms, in line with the previous quarter.

Our selective commercial approach, focused on quality and efforts to enhance efficiency paved the way for OIBDA margin expansion, both year-on-year and quarter-on- quarter, to 38.9%. Sustained advances in margin across mobile businesses more than offset the impact of a different revenue mix in wireline. Mobile OIBDA margin expanded by 670 basic points year-on-year in the first half of 2009.

Improved profitability and lower CapEx drove the significant 32% organic year-on-year increase in operating cash flow, which exceeded the 3 Bn Euros mark in the first half of 2009.

Wireless business: Healthy operating performance drives revenue growth
Santiago Fernández Valbuena

Slide 14 outlines the evolution of our Latin American wireless businesses.

Our customer base rose 11% year-on-year, in a region where penetration rate continues to expand at a healthy rate to 85%, 10 percentage points more than in June 2008.

Q2 09 net adds increased 7% versus the previous quarter, with 29% of the net adds in contract, 10 percentage points up year-on-year. This reflects our selective customer acquisition policy, which is focused on revenue share rather than in accesses share.

Solid net adds were driven by the sustained year-on-year churn reduction, on the back of the higher penetration of GSM services, that already reaches 85% of our customer base.

The fast customer growth drove traffic up 9.3% in the first half, which, together with the outstanding evolution of mobile data usage, allowed outgoing ARPU to remain pretty flattish vs. last year in organic terms. Blended organic ARPU dropped 2.9% impacted by lower MTRs.

Mobile service revenues grew more than 14% organically, underpinned by the remarkable 37% year-in-year increase in mobile data revenues, which already account for 17% of service revenues. The mobile data growth opportunity will be further exploited along the year with a push on our 3G networks and mobile broadband offerings.

Wireline business: Transforming our business
Santiago Fernández Valbuena

Let me now share with you how we are advancing in the transformation of our Latin American wireline operations.

We continue to record an outstanding growth in broadband accesses, leveraging our bundling strategy. During the first half broadband net adds reached 285 thousands to reach over 6.3 million customer.

Bundles already represent 51% of our BB connections and 61% of our fixed line accesses. Moreover, bundles have allowed to limit the decline of our fixed line accesses in the region.

Pay TV customers went up by more than 24% annually to exceed 1.7 million at the end of June.

As a result, new revenue sources like Internet & Pay TV increased its contribution to total revenues, with an average weight of 21% in the region, up 2.4 percentage points on last year figure.

Sustained healthy performance in most markets
Santiago Fernández Valbuena

To conclude with Latin America, let me highlight the performance in our key markets.

In Mexico, second quarter commercial results were strong on the back of the new initiatives launched. Gross adds in the second quarter increased 10% compared with Q1 09 and churn went down sequentially 0.2 percentage points. More importantly, service revenue growth posted an acceleration vs. Q1, with an increase of 240 basic points to over 19% year-on-year. Good OIBDA margin expansion continued, to reach close to 34% in the second quarter, while OpCF more than quadrupled last year's figure.

In Brazil, VIVO continued to outperform in a very competitive market. After adding 1.2 million net adds in the quarter, outgoing ARPU performed better than in Q1 09, with flattish ARPU quarter-on-quarter in local currency. In addition, OIBDA margin expanded by 4 percentage points in organic terms annually to reach a healthy 30%.

Telesp performance was weak, impacted by service quality and network issues in a market where competition is stiff. Nevertheless we have already executed an initial plan to enhance network operations and in the coming months we will be anticipating CapEx to enhance our networks and to improve service quality.

Peru recorded a good growth across businesses, with a notable expansion in margins.

Finally, results in Argentina and Venezuela continued to be outstanding, on the back of strong customer growth, increased usage and lower subsidies.

T. Europe: strong performance in key markets, driving efficiency higher
Santiago Fernández Valbuena

Turning to slide 17,
Telefónica Europe has maintained its market momentum and delivered a strong financial performance in the first six months of the year against a challenging economic backdrop, reflected in an ongoing optimisation of usage of traditional mobile voice and data, as well as lower roaming activity, overall.

Total number of customers reached close to 48 million at the end of June 2009, a 8.3% year-on-year growth. I would highlight that mobile contract customers made up 85% of total mobile net additions in the first half of the year.

Revenue continued to show a healthy ex-fx growth of 2.2% in the first half. It is worth highlighting non-SMS mobile data performance, with an outstanding 34% year-on-year growth in constant currency. On the other side, mobile termination rates dragged 0.8 percentage points to growth up to June. Further impacts will come from MTR reductions in the UK from the third quarter.

There is clear evidence that the rebalancing of our European business portfolio is continuing to bear fruit, especially with the performance of Telefónica O2 Germany, which has been the main contributor to our OIBDA and operating cash flow growth in the year to date.

Operating cash flow saw a significant increase of 17% in organic terms in the first six months of the year, leveraging P&L whilst driving long term value by satisfying customer demands.

T. O2 UK: strategic consistency, continued outperformance
Santiago Fernández Valbuena

In the UK, we continued outperforming competitors in a flat to declining mobile market by ongoing record low levels of churn in contract and best-ever customer satisfaction scores. The recently awarded “Best Network Operator” for a second year in a row is again confirming that strategic consistency is key for Telefónica O2 UK.

Mobile contract segment was again driving customer growth in the second quarter, with a year-on-year increase of 73% in net adds. Now 44% of total customers are contract customers. Simplicity, mobile broadband, high-end devices and new customer propositions around families are sustaining growth in this segment.

As anticipated, Telefónica O2 UK saw a slowdown in the year-on-year growth, with ongoing voice and traditional SMS usage optimization being partially compensated on a per customer basis by strong growth in data fuelled by mobile broadband and the usage of smartphones.

As a result of the increased commercial activity and the ongoing efficiencies in managing non-commercial costs, OIBDA margin remained stable, year-on-year, at 25% for the first half of 2009.

Operating cash flow growth in the first six months of the year was strong at 20% year-on-year in local currency, reflecting the above mentioned profitability of the business, coupled with 18% year-on-year reduction in CapEx.

T. O2 Germany: Gaining momentum in the market
Santiago Fernández Valbuena

Turning to slide 19…

Telefónica 02 Germany's commercial and financial performance in the second quarter continued to gain traction.

New and simpler core product portfolio combined with further churn reduction quarter-on-quarter pushed total net adds to 427 thousands in the second quarter, compared to 307 thousands in the January-March period, with a steady increase in contract net adds.

O2o was launched last May, changing the rules in the mobile voice market, showing an initial good level of acceptance. And Fonic has as of today exceeded the 1 million customers milestone.

From a financial stand point, we have delivered a significant improvement vs. our competitors. Excluding the drag from MTRs since April, year-on-year mobile service revenue growth improved sequentially to 1.2% in Q2. Moreover, data revenues increased its positive contribution to mobile service revenue growth, ramping-up in the second quarter to over 8%, underpinned by our mobile broadband offering, which is backed by the fastest UMTS network of the market.

Enhanced commercial efficiencies and higher proportion of gross adds through direct channels are paying off in terms of profitability, with a good acceleration in OIBDA growth in the second quarter and sustained margin expansion to close to 26%.

As a result, OpCF is growing nicely, with a positive contribution to Group figures, reversing last year's trend.

Longer maturity profile at a lower cost
Santiago Fernández Valbuena

Our financial profile remains strong.

Our net financial debt stood at 2 times OIBDA at the end of the first half, or at 2.1 times when adding cash commitments, just slightly above the first quarter level. This has been mainly due to the appreciation of several currencies increasing the value of our debt by 1bn euros due to translation effects. Please also note that we paid our last dividend in May.

This quarter we have been able to strengthen our debt maturity profile while reducing our financial expense.

During the second quarter we have issued close to 3.5 bn euros in bonds with more than 7 years average maturity, in order to pre-finance debt maturing in 2009 and 2010. This has helped us to extend again our debt average life from 5.9 years in December 08 to 6.6 years as of June 30. To be highlighted also, our un-drawn bank credit lines have increased more than 800 million euros, from €7.4bn total in December 08 to €8.2 bn total as of June 30th.

Our total financial expenses were close to 1.3 bn euros, equivalent to 5.7% of our average total debt of 45.1 bn euros (without annualising the foreign exchange results), just an improvement versus the first quarter (when interest expenses reached 5.95% of our total debt).

Closing remarks
Santiago Fernández Valbuena

To recap,

We have delivered another set of strong results, posting solid organic growth rates as we do leverage our diversification by geographies and businesses.

In the current environment, the performance recorded in the second quarter show similar underlying trends sequentially.

We continue to post best-in class profitability levels, with a strong acceleration in organic OpCF generation and double digit growth in underlying net income.

We maintain a robust balance sheet.

And finally, we fully reiterate our 2009 guidance and confirm our growing dividend policy.

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

Q&A session

Operator

The first question comes from Tim Boddy from Goldman Sachs. Please go ahead.

Tim Boddy - *Goldman Sachs – Analyst*

Yes, thanks for taking my question. You haven't reiterated your 2010 guidance in the presentation. Could you comment on that?

And then my second question would really just be about the trends you're seeing within Spain. Obviously, you've mentioned sequential stability. At the same time, there's obviously been quite a change in the dynamics of the market with more focus on prepaid and more success of unbundlers.

So if you could comment on whether those changes you see as being cyclical or structural, that would be helpful. Thank you.

Maria Garcia-Legaz - *Telefonica S.A. – IR*

Could you please repeat your question because there an issue with the line, and we couldn't listen it properly. Thank you.

Tim Boddy - *Goldman Sachs – Analyst*

Okay. So there were two questions. The first one is really around your guidance for 2010, which you haven't reiterated in the presentation if you could comment on that. And then secondly, in Spain, the increased focus, for example, on prepaid in the mobile market or the success of the unbundlers, are these structural changes in the market where people have become more price sensitive? Or, do you think these are cyclical factors that can improve with the economy at some point? Thank you.

Santiago Fernandez Valbuena - *Telefonica S.A. – CFO*

This is Santiago. Let me take the guidance question first. Well, the right time to think medium to long term will probably be when we meet for the Investor Day in early October. So far, we thought it'd be a good idea to reiterate the year we are talking about, which is 2009. And we have fully confirmed both our numbers guidance for this year and the dividend policy, and the growing dividend policy.

Just to update on the impressions, what I can tell you is that the last time we spoke; we have put a stress case that has received not insignificant attention by the analyst community. All of it has been mainly critical as to how did we get there. And when we produced it, we said that two things were behind it. One was the continuation of a rather severe economic downturn and, second, the currency effect.

I think it's fair to say that despite the fact that we're only one semester down the four semesters remaining through the end of 2010, the economy is no better than it was, although there are signs that it is improving or stabilizing, and that currencies, especially those that interest most to us, like the real in the Brazil and the sterling, have improved to our benefit.

So I think we could say that looking into 2010, first, we will update you in October. And second, beyond the fact that one quarter down and three more quarters of the period into 2010 still have to go, we think that the economy is doing no better and that some currencies are doing slightly better than before.

Guillermo Ansaldo - *Telefonica S.A. - CEO Telefonica Espana*

This is Guillermo Ansaldo. Regarding your question on Spain, we believe these are cyclical trends. We are seeing, as we comment before, more price sensitivity in some customers, some customers seeking predictability in their expenditure, and some others looking for simplicity. On the other side, on the large corporates and the mid corporates are more willing to outsource. So that's some things that are positive to us and some things that we need to adapt our offer.

So far, we're doing fine. We're defending our leadership. And again, we do believe that these are cyclical, typical cyclical change in behaviours that will revert one day when the economy reverts.

Tim Boddy - *Goldman Sachs – Analyst*

Okay. Thanks.

Operator
The next question comes from Mitchell Collett from Cazenove. Please go ahead.

Mitchell Collett - *Cazenove – Analyst*

Hello. Two questions, please. Firstly, I'd just like to know what the shape of the quarter was like in Spain. For example, was June better than May, which I think there's been some commentary that May was similar to April, which had in turn been better than March? And then secondly, I just wondered if you could talk through the issues in Colombia. I think there was a pick up in bad debt this quarter. Thanks.

Guillermo Ansaldo - *Telefonica S.A. - CEO Telefonica Espana*

Hi. This is Guillermo Ansaldo again. Regarding the shape of the quarter, when we looked, some of the variables, we tend to look very closely at the traffic revenues in mobile, for example, that gives a good indicator of the health of the consumption. And when you take away the seasonality effects, meaning in April the Easter effect and also the number of labour days or weekends and so on, the trend is pretty stable between April without these effects, June, and May. July is almost the same again.

What we are seeing that is improving is the commercial activity in terms of number of new customer adds in the mobile business, for example. And July is a pretty strong month. So across the quarter is pretty stable, July a little bit better on commercial activity.

Jose Maria Alvarez-Pallete - *Telefonica S.A. - CEO Telefonica Latin America*

Taking your question on Colombia, on the wireline side, we have suffered our line drop of 7% and a significant traffic drop, jointly with decreasing growth on broadband ARPU. But we have been increasing our growth on access by 45%. That drove us to have a decrease in revenues of 3.4% on the wireline side. Mainly reasons behind the poor performance of the level are high level of down-selling from our customer base, high cannibalization for mobile. We have also had some impact of bad debt. Let me stress that this is a highly competitive market.

Actions that we are taking to reverse those trends. First, we are upgrading our broadband offer. We keep pushing on the bundles and will be more aggressive on that side. We are repositioning our offer. And for sure, we are reviewing our cost structure. That's on the wireline side.

On the wireless side, the OIBDA performance is very weak with a decrease of 28.7%. But we have a significant nonrecurring impact, namely on a provision on one of our distributors that went down and the impact of some of the process, the legal process that we are suing and that we are having against ETB. Were we to correct those impacts, OIBDA margin has been significantly improved.

There are also some positive trends on the wireless side in terms of we have been able to reverse the trend of decreasing on the contract number of customers. And we have been slightly gaining customers on the contract side. And that's going to be paying off in future quarters. So still mixed signs and improving on the wireless side in Colombia.

Mitchell Collett - *Cazenove – Analyst*

Okay. Thanks.

Terry Sinclair - *Citigroup – Analyst*

Yes, thank you. Two questions from me; first of all, if I can go back to the 2010 guidance, which you've abandoned, are you also uncomfortable with the stress test? I mean, you've mentioned that the market was uncomfortable with the black box of assumptions behind it. But are you actually uncomfortable with, for example, the 2.1 EPS that you've put out there as the stress test for 2010?
Secondly, I wonder if we could just dig a bit deeper into the CapEx, the 10% fall in CapEx year on year. To what extent is that a seasonal adjustment into the second half? To what extent is that an adjustment into 2010? And to what extent have you actually reduced CapEx expectations since the beginning of the year?

Santiago Fernandez Valbuena - *Telefonica S.A. – CFO*

Terry, this is Santiago. Let me elaborate a little bit more on the 2010 numbers. We do reconfirm that the stress test 2.1 EPS number is still below us. And we think it's still doable, despite the challenging conditions that we will be above that number.

But because things have not improved from the economic front, although marginally, as I said, they have on the currency front, we thought it'd be a good time to talk at length about all those things when we meet with a lot of time ahead of us. Let me also say that, as you're probably aware, we've been trying to put the case forward to investors and with limited credibility.
And we think that the purpose of guidance is to anchor expectations for the future and have not particularly been successful at that. And so, we've decided to talk it down, but it is not an abandonment of the stress case. Let me stress that clearly.

Julio Linares - *Telefonica S.A. - COO*

This is Julio Linares. Regarding your second question about our CapEx, in the first half of the year, our investment slowdown was mainly because last year we had a very significant investment in 2G. And this year, it was not necessarily a big one as last year's. Also, because the commercial activity in the fixed business was smaller than last year. And in addition to that, we were able to continue doing a significant effort in all the global opportunities we see in front of us, like mobile broadband, ADSL, basically TV.
In the second half of the year, as we see our projects today, the CapEx is going to be higher than in the first half of the year. And because of that, we will be very close to the guidance that we provided initially for the whole year.
Regarding CapEx for next year and the following year, we will provide you more information in our conference in October.

Brian Rusling - *Cazenove - Analyst*

I was just hoping that, Santiago, you could update us on remittance of cash from Latam to Spain. And where are we in terms of cash balances in Venezuela at the moment?

Santiago Fernandez Valbuena - *Telefonica S.A. - CFO*

Sure, Brian. We've brought from the region slightly more than 500 million euros if my memory doesn't fail me, not from Venezuela, where as you know we have not been denied, but we have been delayed in getting the cash out. We have filed in 2008 for an additional dividend repatriation that is still pending. We continue to do our best efforts and continue to keep the slot open. To put it in the upward light terms, a drop in the case is not an option for us. We don't think that's the right thing to do. But we have no news to report.

Elsewhere in the region, there is no particular issue, other than those you are already familiar with of being watchful with taxes and not repatriating more cash than absolutely needed if there is any friction or cost on those.

David Wright - *Deutsche Bank - Analyst*

Yes, good afternoon. Just on Spain, I think Vodafone has said they're now pushing quite hard on the wireline side and taking share. I know you guys announced a DSL price cut to try and control some of the churn. What is the next step to try and

arrest this line loss that you have? And also, are your prices trending down? Are you purposefully lowering prices in mobile as well?
And maybe a question for Matthew as well on the UK business just about iPhone exclusivity if we could get an update of whether we still have good visibility on both the 2G and 3G iPhones and to what extent that can be sustained with the exclusive access to the Palm Pre. Thank you.

Guillermo Ansaldo - *Telefonica S.A. - CEO Telefonica España*

Well, this is Guillermo. Let me try to answer your question in Spain. Regarding competition in wireline in Broadband, for example, we had a better quarter than the first one with more net gain market share. We acknowledge that Vodafone is doing very well in this market. It's a new entrant here. And we have continued adapting our offer, adding some features on the entry level, but also improving our quality on the top line. ARPU in broadband--in our case, affected ARPU is down 6.6% I believe, which is almost the same number we have in the first quarter. So we are not in a different trend in terms of prices.

Regarding the product that you mentioned -- and it has some coverage in the press -- this is a specific product for specific needs and is below the 0.5% of our plant. So it's roughly 30,000 clients. It's a very, very specific niche product. So we are not into a price war. We continue with the approach of having an offer for each type of segment and providing the best quality as possible.

Regarding line loss, as you've seen, it has been very stable across the year, almost the same number in the second quarter as in the first quarter. There, roughly 50%, 55% of those losses are compensated by wholesale lines. And this is more due to regulatory changes. And the rest has to do with a market that is not growing, as you know, and in some cases some competition from direct accesses, like cable operators.

Regarding price in mobile, if you see our ARPU, our voice ARPU, outgoing voice ARPU is pretty stable. So we are not into a price war. I think all the operators, what we're trying to do is to find elasticity in our customer base. That's the main value lever in order to promote revenues. Also, we acknowledge that we have some customers looking for predictability, as I mentioned before.

So we are, all the operators, trying to foster these bundles with minutes so we can give some predictability on the bills and also some simplicity in some cases with prepaid or SIM only. But again, our other rate per minute is pretty stable. And our voice outgoing ARPU is pretty stable. As you know, on incoming ARPU, we suffer with MTR cuts.

David Wright - *Deutsche Bank - Analyst*

So, Guillermo, can I just double check on the fixed side? I mean, for a long time, you've been sustaining a premium share of additions with superior service, superior products in fixed. But that does seem to have significantly deteriorated over the last, say, three to four quarters. Are we still not at a stage where we're looking to lower prices? Are you still pursuing a strategy of quality of service rather than lowering prices?

Guillermo Ansaldo - *Telefonica S.A. - CEO Telefonica España*

Yes, let me clarify that. Obviously, what's going on in Spain in the fixed broadband side, the market is not growing. So basically, we are taking share of a smaller market. That's due to two things in my opinion. One is the overall economic environment, which is tougher, and also the surge of the mobile broadband, which is exploding and from which we are taking a very good share of that market. As an integrated operator, that gain is a positive gain.

One thing that we're tracking very closely is our churn. Our churn is pretty stable, very stable in fixed broadband. So we are not much concerned -- we are concerned that the market is not growing that much. That means that we have to continue adapting our offer with promotions, like the one we have right now in the summer, where you can buy a 6-megabit Duo for EUR19.90 for one year. So it's a specific promotional offer for new customers. But we will continue along those lines. And we're tracking our overall ARPU just not to deteriorate our profitability.

David Wright - *Deutsche Bank - Analyst*

That's great, Guillermo. And, Matthew?

Matthew Key - Telefonica S.A. - CEO Telefonica Europe

Yes, hi, David. Let me pick up your smart phone question. So just let me remind for a start that our exclusivity on the iPhone is Spain, UK, and Ireland. And we range in Czech as well. I always answer the same on the iPhone, which is we've got a multi-year exclusive deal in each of those countries with Apple. They're extremely happy with us. And we're extremely happy with them.
To talk about specific terms, we've never gone towards and nor have Apple. The other thing I would say--in the UK, we recognize that our net connections in the quarter on postpay is also significantly driven by our record ever--lowest ever churn again.

On the Palm Pre, yes, you're right. We signed an exclusive on that as well, which we're really pleased about, across all of our territories in Europe again. We just think it gives a fantastic customer experience. We'll sell it before Christmas. And fundamentally for us, we'll give customers the choice of the best devices on the market. So if they come into an O2 store or a Movistar store in Spain, they can choose between the iPhone or the Palm Pre.

David Wright - Deutsche Bank

Do you expect to be challenged on the exclusivity of both handsets from a competitive perspective?

Matthew Key - Telefonica S.A. - CEO Telefonica Europe

I think virtually every operator in the world would like to have both the iPhone and the Palm Pre. The good news is that we are the only ones that have got both devices at this moment.

David Wright - *Deutsche Bank - Analyst*
Okay. Thanks, guys.

James Ratzer - *New Street Research - Analyst*

Yes, two questions please. First one possible back to Matthew again. I was wondering if you could give us some indication on when you plan to put through the termination rate cut in the UK. I understand you have a bit of discretion about when you implement that. So if you could give us the timing on that and then impact on revenues from that, that would be much appreciated.

And second question is just regarding EBITDA performance in Brazil. I've been led to believe in the past that EBITDA trends might improve as we've gone through peak losses from rolling out some of your TV products. It looks at the moment that that's not happening. So I wonder if you could give us an indication of how EBITDA will trend from here on. Thank you.

Matthew Key - *Telefonica S.A. - CEO Telefonica Europe*

Yes, hi, James. It's Matthew. Let me pick up your question on UK termination rates. We'll put it through during Q3. And as a very rough guide, it will deflate our half two revenue by about 4%, which will be about 2% full year impact for the UK. Recognize also that the flip side in terms of our cost coming down from our competitors also taking down the termination rates, which will happen in second half as well.

Jose Maria Alvarez-Pallete - *Telefonica S.A. - CEO Telefonica Latin America*

Taking the question on the OIBDA margin on the -- Telesp, on the wireline business in Brazil, let me stress the fact that during this first half of the year, we have suffered several impacts in terms of quality impacts, IP network interruptions, and also we have had some incidents on some data centers and some hackers' attacks. So we have been impacted by several processes that have been impacting both our revenues in terms of slowing down some commercial offers and also our cost in terms of getting back some revenues to customers and also some fines from Anatel.

Excluding all the nonrecurring items, we do see some stabilization on the margins. But it is too soon to say how much time are we going to be taking to reverse the trend during this year because remember that also Anatel imposed restriction to sell broadband in Sao Paolo. Until those problems are fixed, we submitted the proposal to Anatel a week ago. And we are waiting for their response.

So let me remind you that some unexpected events happened at the end of last year and the beginning of that. We are reversing those trends. We do have positive expectation on the recent trends, both in claims from customers and in terms of claiming Anatel in the Consumers' Defense Association. So we are working on that, and we keep being committed on reversing the situation.

James Ratzer - *New Street Research*

Thank you. And could I just ask you a quick follow-up question on the previous answer you mentioned in Spain that you were beginning to see a bit of impact from mobile broadband on the fixed business. I was wondering could you quantify that, please?

Guillermo Ansaldo - *Telefonica S.A. - CEO Telefonica España*

Let me remember. I think that we did some analysis a few months ago. And basically, we are trying to identify which cases are cannibalizations and which cases are complementary. And basically, two-thirds were complementary cases, meaning customers that are getting both. In the other two-thirds are split in two, one of customers that are dropping the fixed broadband and the other one fixed of the total are customers that instead of buying fixed broadband in our opinion are buying the mobile one. So it's two-thirds complementary and one-third you can say not complementary.

Our overall numbers show that this positive value creation for integrated operator. And we are combining offers in all segments in order to get customers to buy and test and use both products, which in our view are for different uses. And so they are complementary.

James Ratzer - *New Street Research - Analyst*

Thank you very much indeed.

Jesus Romero - *Merrill Lynch - Analyst*

Hi. Thank you. I had a question for Guillermo regarding your key strategy. Imagenio is almost not growing. And the 1 million target you had for 2010 seems pretty far. So if you look at some of the other companies in the sector, some of them are doing really well with TV. Can you link that with your fiber rollout as well?

And then a question with respect to auctions in Mexico and some of the other countries--can you give us an update on what you expect to have to invest in the next 12 months and tie that up with the buyback so far? Thank you.

Guillermo Ansaldo - *Telefonica S.A. - CEO Telefonica España*

Thank you. This is Guillermo. We're going to be, as you have seen the numbers, we are roughly 600,000 customers. We are back in positive net adds this quarter. But that is small positive in that. So the market, the TV market is decreasing in Spain a little bit according to our estimations. So we are getting more share back since the crisis started. This is the market that is not behaving very well.

So despite the fact that 2010 is not yet tomorrow, it will be tough to get those numbers, as you mentioned. We will continue improving our market share. But we will depend a lot on how the overall market consumption conditions evolves.

Regarding fiber, we have, as we have mentioned in the past, we have adapted the rollout to the specific with the new market conditions. So we are still passing homes. We are connecting new customers. We are testing services. And we have focused a lot on larger clients, rather than smaller clients. So we are investing less than we previously thought when we--before the overall economic crisis. But we continue working to develop our product base and offering and improving quality. So we have adapted to the cycle.

Jose Maria Alvarez-Pallete - *Telefonica S.A. - CEO Telefonica Latin America*

Hi, Jesus. Taking your question on the spectrum, let's say that the most important process that we are monitoring right now is the Mexican one, in which we are interested in acquiring further spectrum. The rules of the process of the auction has been already been issued. But no major news on that in terms of timing. We don't know when that's going to happen. But we are ready to bid for that. And the price for that is always going to be compared to the alternative of investing or reinforcing or reintensifying our network. But yes, we are interested in spectrum in Mexico. But we don't have a clear picture of what the timing is.

Jesus Romero - *Merrill Lynch - Analyst*

Okay. Thank you. On the buyback, Santiago, perhaps?

Santiago Fernandez Valbuena - *Telefonica S.A. – CFO*

Not much news to report on that front, Jesus. When we meet in October, we will update on the Company's shareholder remuneration policy. Let me just reemphasize once more that we continue to think of ourselves as a shareholder-oriented, shareholder-friendly company and that the rules that we try and apply are first to get the cash flow, once the cash flow's there to take its uses

Our current policy is one of increasing dividends. You've just heard that cash flow has been online with expectations and with our plans for the first half of the year. But there is not much room to do much, especially now that debt has increased a little bit for all the right reasons, which is that currencies have appreciated relative to euro. And that has a beneficial effect on our P&L but has a small detrimental effect on the size of our debt. More on that and about the Company's financial policy on the Investor Day.

Jesus Romero - *Merrill Lynch - Analyst*

Okay. Thank you.

David George - *Credit Suisse - Analyst*

Yes, thank you. A couple of questions on Germany -- firstly, obviously, you're still getting some good margin trends in Germany. Last time, you hit 25%. I think you cautioned a bit on the sustainability of that. I wonder how you feel about the margin outlook this time going into the second half.

And secondly, on service revenues in Germany, obviously, you went negative in Q2. And there were some comments from one of your competitors pointing perhaps to a little bit more competition and macro pressures in recent months. So I wondered if we can still see positive revenue for the full year or if you think we'll remain negative in the second half.

Matthew Key - *Telefonica S.A. - CEO Telefonica Europe*

So, Dave, hi. It's Matthew. When I got asked that question last time, I said there were four key drivers of profitability in Germany, which was largely off the foundation that we built last year -- Telefonica Deutschland, number one, with more throughput moving into profit, high proportion of direct sales versus indirect sales, lower reliance on T-Mobile as far as their roaming contract is concerned with them, and fourthly, the new propositions that we're starting to launch around things like O2 o.

We're obviously really pleased with our performance from a profitability and a commercial momentum perspective in Q2. What I would say not on margin percentage but in terms of OIBDA growth, recognize that in quarter four last year I think we delivered about a 40% year-on-year OIBDA growth. So to maintain the pace of OIBDA growth year on year is going to become extremely difficult.

On our negative revenue growth in the quarter, recognize there was significant mobile termination rate cut that impacted in the quarter. And once you back that out, actually, our underlying growth was better than Q1. So in Q1, we reported 0.6. In Q2, our underlying is 1.2. So actually, we're moving in a positive accelerating trend.

We won't take anymore or any additional termination rate cuts for the back end of the year and obviously hope to increase our commercial momentum off the back of our new propositions. But as whether we're going to be positive or negative, I wouldn't want to get drawn on that specifically.

Mathieu Robilliard - *Exane BNP Paribas - Analyst*

Yes, good afternoon. Two questions on Latin America, first with regard to Telesp -- as you mentioned earlier, the regulator is preventing you at this stage to sell broadband products to new customers. So how much of an impact do you think that could have on your top line trends in Q3?

And second and more general question on that, when we look at the CapEx at Telesp, you've been extremely efficient in past few years. But isn't there a case now that broadband is growing significantly and given what is happened in terms of quality that you may have to increase more than you thought and substantially more than you thought CapEx at Telesp?
And the second question has to do with trends in the quarter in Latin America. Maybe you could give us a sense if towards the back end of the quarter and July you've seen an improvement versus the beginning of the quarter. Thank you.

Jose Maria Alvarez-Pallete - *Telefonica S.A. - CEO Telefonica Latin America*

Well, thanks for the question. Taking the first one on the Anatel restriction of selling broadband in Sao Paolo, of course, we will have an impact because we have not -- we are not going to be able to add new customers until this restriction is over. And therefore, it will have an impact.

But most of the impact we have also been suffering because of these quality concerns because in fact we have been reducing commercial activity. And that is why the level of broadband connection has been slower because of those of quality issue. So we have been preparing the network. And we are preparing the network for when this restriction is over to be back on the market with strength. And therefore, I mean, it's hard to quantify. It's going to be highly dependent on how long this restriction is going to last.

They asked us for a plan. And they gave us 30 days. We present that in 20 days. And we are awaiting for the response to the auditor or our action. So it's going to be directly linked to how long this restriction is going to last.

In terms of the CapEx, in fact, we have been investing significantly in Telesp in the last years. CapEx 2007 increased more than 11% compared with 2006. And 2008 increased by more than 20% compared with 2007 figures. So we have been investing significantly in Telesp in the last years. And in fact, most of the issues, most of the incidents that we have been having have been precisely being produced when we were upgrading our network.

So yes, we will be putting additional efforts on Telesp's networks. But the impact in terms of CapEx is not going to be highly significant because most of the effort was already been done. So you should not expect significant pickups in CapEx in Telesp.
And in terms of recent trends, as I was telling before in Brazil, it's too soon to say in the second quarter in Brazil, has been on the mobile side weaker than the first one. But in terms of commercial activity on the wireline side, from our -- from the market as a whole, from the sector as a whole has been pretty strong.

In the other parts of the region, it highly depends. I mean, Mexico has been weaker. And the other parts of the region have been stronger. So it's mixed. It's too soon to say what the trend is going to be for the second half of the year. And it is too soon in July to really tell you what the direction's going to take.

But in terms of macroeconomic trends, what we can tell you is that expectation for growth for 2010 has been revised upwards and that some of the trends from the macroeconomic point of view have been improving recurrently in the last months. So we do expect a better outlook for the region in the next quarters.

Mathieu Robilliard - *Exane BNP Paribas - Analyst*

If I could just follow up on the Telesp CapEx, should we then expect CapEx levels to come down as you fix these issues? I'm talking as a percentage of revenue, obviously. Or do you think you still have to continue to invest to have good quality and see your broadband customer grow?

Jose Maria Alvarez-Pallete - *Telefonica S.A. - CEO Telefonica Latin America*

We'll keep investing. But again, you should not expect significant pickups with the levels that we have been having in the last year. What happened in Telesp was precisely when we were upgrading the network in the upper part of the network, in the most mdern part of the network. So you should not expect CapEx over revenues to pickup significantly in the next years. Okay?

Ivon Leal - *BBVA - Analyst*

Hello. Good afternoon, gentlemen. Just a couple of questions, first one in Spain for Guillermo--I was wondering, specifically in the month of June and July, you have seen your share of net adds in the mobile business and broadband business improving after I guess the interesting retention offers that you launched end of May.

And the second one is on CapEx in general terms. I was wondering if business conditions were to remain tough in 2010, do you think that 2009 CapEx levels are sustainable or really maintaining this CapEx level would affect mid-term growth?

Guillermo Ansaldo - *Telefonica S.A. - CEO Telefonica España*

Well, regarding June and July activity in terms of mobile, yes, we are improving in June. And July is a good month. And in broadband and fixed broadband, June was better than the previous two. And July is okay. Fixed broadband is not booming. It's--we're better than the first quarter. But we are not booming. The market overall is not growing. It's roughly 50% of the net gain that we have as a market on 2008.

So it's not a booming market. And the changes that we're seeing in our net gain share are positive. But they are small changes. And regarding wireless, it's a much more elastic market and depends a lot more on the offers that--and the effort that you put in the market and also on the offers and efforts that the competitors are also placing.

So we're having a good June and a good July. And this is a very competitive and dynamic market. And we'll continue doing so.

Regarding CapEx, roughly the first half of the year, we are investing 7.5% of our revenues. As you know, as we mentioned before, this tends to increase along the year because of seasonality. The savings are geared--coming from different sources. First, there's a structural change that we finished some of the GSM investments. So that's something that will remain. And we're investing more on 3G.

Second, we obviously, sadly, we are investing less on access in the fixed business because we're having less new lines, a cooper lines, broadband lines, and also TV. So that's just something that I hope will revert in the future. And we are getting better prices, leveraging our scale from the group. And that's something that will remain and will continue improving.

So I think these levels are sustainable. Obviously, we have to see what happens next year. I hope that we can invest more because the market is improving. And -- but if it's not happening, we can continue managing this way.

Ivon Leal - *BBVA - Analyst*

Thanks very much.

Julio Linares - *Telefonica S.A. – COO*

Well, in general regarding CapEx, first of all, as Guillermo said, we really see that we have some benefits, clear benefits on our scale. So today we are able to manage prices quite well, helping us to reduce CapEx. Second, you have to take into account that 25% of our CapEx is to maintain our business.

And this is the area where we are doing higher effort in order to keep this amount of CapEx and to try to reduce it as much as possible. 75% of our CapEx is related with growth opportunities or transformation opportunities. But also, opportunities depend a lot on the demand. And of course, we always try to compensate our investment with the demand, specifically to cover 2G demand in the different countries and ADSL demand.

In addition to that, we continue doing a significant effort in order to try to improve our 3G coverage because we believe that this is really needed for future growth. And we are evolving permanently our networks toward fully IP networks. So we are not stopping any investment related with growth of or transformation and taking into account that I think we could manage our capital levels to the right market conditions.

Ivon Leal - *BBVA - Analyst*

Okay. Thanks very much. It's very helpful.

Santiago Fernandez Valbuena - *Telefonica S.A. – CFO*

Well, ladies and gentlemen, thanks a lot of attending this first half results. We expect to see all of you that are able to join us in 70 days. That is October the 8th and the 9th of this year. Therefore, we will be able to spend a longer time giving you more clarity. So we'll see you all or at least hear from you in 70 days. Thanks very much.