



Telefónica January-September 2009 Results Conference Call Transcript

12th November, 2009

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Introduction

María García-Legaz

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss 9M 09 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

9M 09 results highlights

Santiago Fernández Valbuena

Good afternoon, ladies and gentlemen, and thank you for joining Telefónica's 2009 nine months 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, who is connected from London. During the Q&A session, you will have the opportunity to ask questions directly to any of them.

We have released today a strong set of results, on the back of our unmatched diversification and solid execution across businesses and geographies.

Despite the challenging environment, business trends in the quarter are consistent with the performance of the first half of the year.

Our focus to capture growth opportunities in our markets is reflected in the sharp increase in the Group commercial activity in the last three months, especially in the mobile space, with net adds excelling both in Spain and Latin America.

Solid customer growth in every single region of operations and increased usage have led to positive organic revenue growth up to September, despite notable drags from regulation and business cycle.

And we continue leveraging on cost management and significant synergies derived from our scale to further expand margins and deliver strong cash flow generation.

The solid operating and financial performance is combined with our balance sheet strength, allowing us to reiterate our full commitment to enhance shareholder remuneration through growing dividends, as we communicated in our last Investor Day. As announced, our intention to propose a 2009 dividend of 1.15 euros per share is confirmed, with the first tranche already been paid.

We also reiterate our 2009 guidance and, obviously all those targets communicated a month ago for the medium term.

A Solid set of results in 9M 09

Santiago Fernández Valbuena

Please turn now to slide number 3 to start with the detailed analysis of our nine month results.

Reported year-on-year growth rates have been negatively impacted by forex and impacts from capital gains recorded last year. Nevertheless, in organic terms year-over-year growth rates remain healthy and show an acceleration from top line to operating cash flow.

Organic sales in the first nine months of the year were flattish y-o-y to 41.7 Bn euros, while OIBDA growth was close to 2%, leading to a healthy 39.9% OIBDA margin. Telefónica Latinoamérica continues to be the main growth engine of the Group, already contributing 40% of Group revenues and OIBDA, respectively. Telefónica Europe also presented a robust performance, with both regions partially offsetting the lower contribution of Telefónica España.

As a proxy to cash flow generation, operating cash flow topped 12.3 Bn euros to September, more than 10% on 2008 figure, purely organic.

High single digit underlying growth in EPS

Santiago Fernández Valbuena

As in previous quarters, operating results are fully flowing into Group's net income, as you can see in slide number 4.

January to September net income exceeded 5.6 Bn euros, showing a 6.4% underlying annual increase.

Reported EPS reached 1.23 euros per share, posting a solid 9% underlying growth.

Excluding the impact from PPA's, EPS would have reached 1.33 euros.

Good commercial momentum, driven by mobile

Santiago Fernández Valbuena

Slide 5 shows the remarkable customer growth recorded in the third quarter of year.

Group accesses have already surpassed the 268 million mark. Net adds in the July-September period almost doubled the figure registered in the second quarter of the year and were close to the total figure recorded in the first half. This is due primarily to higher gross additions as well as churn containment despite renewed competitive pressure.

Mobile accesses continue to drive the growth in total accesses, pushing quarterly net additions in line with the first half. I would like to stress the sharp increases posted by Telefónica España and Telefónica Latinoamérica. And we continue to actively manage current industry levers, ending September with more than 13 million mobile broadband accesses across regions, after posting an outstanding evolution in the quarter.

Growth rates recorded by fixed broadband and Pay TV accesses are also to be highlighted.

Disciplined OpEx and CapEx to sustain benchmark profitability

Santiago Fernández Valbuena

Turning to profitability on slide number 6,

We are keeping a continuous effort on cost contention. Organic y-o-y OpEx change continues to trend down along the year, with a quarter over quarter improvement. The 1.3% annual drop in organic terms is mainly driven by lower commercial costs as a result of the decrease in handsets subsidies and advertising expenses, together with MTR cuts across regions. Obviously, economies of scale support this good performance.

As a result, cumulative OIBDA margin has consistently widen quarter-on-quarter to reach an almost 40% up to September, or 0.7 percentage points higher than a year ago in organic terms.

On the other hand, our CapEx flexibility to respond to changes in demand is reflected in the 16% year-on-year organic decline up to September, leveraging the high investment effort already made in past years. We continue to prioritise CapEx in growth platforms, as showed by the 56% year-on-year increase in 3G CapEx ex-fx.

A strict rein on OpEx and CapEx has led to an improvement in efficiency ratio for three consecutive quarters, from 75.3% in Q1 09 to 73.9% for the nine months ending September 2009 and posting year-on-year decreases throughout the year in the range of 1 to 2 percentage points.

Healthy OpCF across the board, with superior conversion rate of revenues into cash generation

Santiago Fernández Valbuena

Please turn now to slide 7, which shows the high conversion rate of top line growth into operating cash-flow expansion, reflecting consistent trends with those of the first half of the year.

Our levers to manage OpEx and CapEx allowed us to post a robust cash-flow generation profile in every single region of operation despite difficult trading conditions. As you can see, the gap between revenue and OpCF growth rates at Group level reached 10 percentage points.

This positions Telefónica as an industry reference by efficiency, with a large cash-flow over revenues margin.

And the slide shows again the benefits of our diversification: the strong increase in operating cash flow both at T. Latam and T. Europe are combined with a very healthy contribution from T. España.

On track to meet 2009 guidance

Santiago Fernández Valbuena

Let me quickly review guidance execution.

Under guidance criteria, consolidated year-on-year growth rates in revenues, OIBDA and OpCF were 0.3%, 1.9% and 10.3%, respectively, all within the guidance ranges.

CapEx up to September stood close to 4.6 Bn euros. We maintain our target of CapEx below 7.5 Bn euros for the year, with a big part of the budget expected to be executed towards the end of the year, as usual driven by CapEx seasonality.

Enhanced commercial activity while maximizing OpCF

Santiago Fernández Valbuena

And now, turning to the review of the results by region, let me start with Telefónica España on slide number 9.

In the third quarter we have recorded a remarkable improvement in our commercial performance while we continued to post a strong cash flow generation.

The effect of the increased commercial activity during the last two quarters on the top line is yet to come, but revenue decline slowed down quarter-on-quarter in both, wireline and wireless businesses. This seems to confirm the trends of the second quarter, when we started to notice a positive second derivative on comparable revenue year-on-year change, and might be an indication that we have already reached the bottom, although we still prefer to be cautious.

OIBDA margins continue to be solid and a benchmark in Europe despite the strong decline in high margin revenues, such as voice traffic, and the ramp up on the commercial side in the third quarter, which is not cost free.

Tight OpEx and CapEx control led to an improvement in the efficiency ratio: OpEx plus CapEx over revenues have come down 1.7 percentage points over the last twelve months, leaving operating cash flow for the nine months to September over 6 Bn euros, with a limited decline of just above 3% on a comparable basis.

This shows our ability to post a robust performance in a very difficult environment.

Commercial activity improves for second quarter in a row*Santiago Fernández Valbuena*

Let me now share with you, on slide number 10, the enhanced performance of operating metrics in the third quarter.

As Guillermo Ansaldo anticipated a month ago during our Investor Day, in the third quarter we increased sharply our commercial activity across businesses for a second quarter in a row.

- Fixed broadband net adds for the quarter exceeded those recorded in the first half of the year, with a remarkable improvement in our share of net adds in the quarter. As a result, we have consolidated our leadership with a 56% market share at the end of September.
- The incorporation of new football content into our Pay TV offer is proving of great appeal for our customers, leading to a quarter-on-quarter increase of pay TV net adds of close to 10 times in the third quarter, achieving record high net adds for the last 10 quarters.
- In wireless, we have again led the growth of the market in Q3, both on the total customer base and on the contract segment, on the back of higher gross adds and churn contention, especially in postpay. We gained customers from mobile number portability and total net adds have more than doubled quarter-on-quarter, with an even better performance in the contract segment.
- Fixed telephony losses have decreased 33% vs. previous quarter to 209,000 lines, so well below the figures reported in the two last quarters. Please notice that 62% of Q3 09 net line losses are compensated by a net increase in wholesale lines which generate revenue stream.
- Wireless data flat rates surpassed the 1.5 million mark, which is 2.2 times higher than September 08 figures, and our 3G customer base is the largest in the market and almost 50% higher than a year ago.

So, very positive news: the market seems to be stabilising and customers are reacting when provided with the right value offer, and we are being able to deliver it.

Stable declines in usage and rational pricing competition*Santiago Fernández Valbuena*

Slide number 11 shows how usage is evolving in a rational pricing environment.

Although usage remains depressed, the third quarter shows signs of stabilization and even a little recovery from the second quarter helped by seasonal effects.

Mobile traffic is declining 3.8% in the quarter, 0.7 percentage points less than in the previous quarter, and both mobile outgoing voice and total ARPU declines have improved by 1 percentage point vs. the second quarter.

And I said a rational pricing environment because that's what figures show: outgoing wireless average revenue per minute decline continues to be in the 3-4% range, which is better than the expectations we gave at our investor day in London, from -5% to -7% per year, more than 2 years ago when we were not anticipating the crisis.

Wireline retail broadband connectivity ARPU is down 6.8% in the third quarter, in line with previous quarters and again, in line with the performance expected 2 years ago when we forecasted 4% to 7% annual declines for this metric.

Stimulating volume usage remains our challenge, and though some light signs of improvement in wireless, we keep working on triggering consumer elasticity to return to positive trends.

Trends in revenues similar to previous quarter

Santiago Fernández Valbuena

To finish with the review of the Spanish operations, on slide number 12, I will focus on revenue trends, which remain similar to the previous quarter.

Wireline IT and Data services keep posting sound growth rates in the quarter and in the nine months to September. Wireless data connectivity revenues continue to record outstanding growth rates at over 50% in the January-September period.

Although voice revenues related with consumer usage are still down, the good news is that at a lower rate than in previous quarters: that's the case for both, wireless outgoing revenues and wireline voice revenues. The same applies for wireless incoming revenue trend, that is roaming-in and interconnection, still impacted by lower usage and the significant drag from MTRs cuts.

On the downside, wireline access revenues keep declining in line with the fall in average lines in service. As quarterly line losses keep improving, average lines in service performance will ease and so will related revenues in the coming future.

We have not changed our core strategy and remain focused on revenue share. Despite price pressure and higher commercial activity in the quarter we maintain our revenue share leadership in the wireline and wireless markets.

T.Latam: A story of profitable growth

Santiago Fernández Valbuena

Moving to slide number 13 to review our Latin American properties, I'd like to stress the healthy revenue performance and strong profitability posted in a region where we have recorded a very high commercial activity during the last 3 months.

Up to September our customer base in Latin America has grown 6.9% y-o-y to reach close to 164 million accesses, driven mainly by fixed broadband and mobile services. This robust advance and the increased usage across our networks has led to a close to 6% organic revenue growth, supported by double digit growth in mobile and Internet and TV amid fierce competition.

OIBDA performed even better, posting over 13% organic growth year-on-year, leveraging on further scale economies, synergies and tighter OpEx control, offsetting the ramp up in commercial activity during the third quarter of the year that allowed to multiply by 2.4 times net adds quarter-on-quarter.

This strong performance drove OIBDA margin 2.7 percentage points up in organic terms in the first nine months of the year reaching 39.9%. CapEx over revenues remained below 12% and close to 3 percentage points below last year figure.

As a result, the efficiency ratio stood at 77% at the end of September, improving y-o-y and q-o-q and boosting operating cash flow to 4.7 Bn euros, a sharp 31% year-on-year increase in organic terms.

Wireless business: growing ahead of the market

Santiago Fernández Valbuena

Let me now quickly sum up the evolution of our wireless businesses in the region, where we are recording consistent improvements in market share, profitability and operating cash-flow generation.

Up to September, year-on-year customer growth remained very robust at 9% to almost reach the 130 million mark, despite the high penetration in some of our markets.

Net adds in Q3 were outstanding, with q-o-q improvements in most countries. We have added 3.3 million customers in the last three months or 1.2 times the net adds of the first half of the year, on the back of a ramp up in gross adds and the positive churn evolution, both quarter-on-quarter and year-on-year. As a result, we have gained market share across several markets in our footprint.

And what is even more important is that we are making good progress on one of the key levers for future growth, the improvement in the customer mix, as Jose María explained recently during our Investor Day. In the first nine months of 2009, over 20% of our net adds were post pay, and if we exclude Mexico from this calculation, as in this country we are still working to reinforce our post pay offering, that ratio goes up to 25%.

In parallel, our strategy to stimulate usage led to 10% increase in traffic. ARPU performance in organic terms slightly improved vs. the rate of decline of previous quarters, driven by the better outgoing ARPU. As a result q-o-q ARPU remained stable. Annual evolution is explained by fast customer expansion, lower MTRs and intense price competition in some countries like Brazil.

Finally, let me stress that mobile revenues sound evolution; up close to 11% y-o-y in the January-September period, mainly driven by the sharp increase in services revenues on the back of a 37% organic y-o-y growth in data services. When we look to revenue deceleration in the third quarter, it is worth mentioning that it is mainly due to lower handset sales; because service revenue growth is just 1 percentage point lower in the first nine months than the one accumulated to June, and data revenues have remained practically stable. MBB continue to gain traction and we

will further exploit it with a push on our 3G networks and mobile broadband offerings.

Wireline business: Ongoing transformation

Santiago Fernández Valbuena

Let's move now to slide number 15 to review our progresses in transforming our wireline businesses in Latin America.

We are advancing towards a different revenue mix generation by increasing the value proposition of the wireline accesses through bundles, limiting the pressure of mobile substitution in traditional accesses.

Obviously, Q3 performance has been negatively impacted by Anatel's decision to stop the sale of Broadband accesses in Brazil from the end of June to the end of August.

Fixed BB accesses reached 6.3 million in September, a 7% year-on-year growth, fuelled by the good performance recorded in Peru, Argentina and Chile. They already account for over 25% of traditional lines, up 2.3 p.p. y-o-y.

Pay TV accesses rose 16% year-on-year to 1.7 million. It is worth highlighting that after launching the Pay TV service in Argentina in the third quarter, all our wireline operations in the region have now 3P service capabilities.

More outstanding is the fact that already close to 55% of broadband accesses are bundled in a 2P or 3P package, 9 percentage points above September last year. Total bundles represent 61% of fixed line accesses when including traffic packages and controlled usage.

As a result, new revenue sources as Internet and Pay TV represent already 21% of total wireline revenues, 2.5 percentage points higher than last year figure in organic terms.

Sustained performance in most markets

Santiago Fernández Valbuena

Let me now outline the main topics across key countries:

- In Mexico, we have delivered a superior performance. The very strong uptake in the commercial front led us to increase q-o-q net adds by 36%, and service revenue accelerated in the quarter growing ahead of customers. As a result, we gained market share both in terms of revenues and customers to reach north of 20% in accesses. We have also increased profitability sharply, with a close to 12 percentage points y-o-y margin expansion and more than doubling operating cash flow in local currency, both in 9M 09.
- In Brazil, Vivo widened the gap in the market, consolidating its leadership in accesses, revenue and profitability. Customers grew 16% y-o-y and ARPU improved q-o-q driven by the strong rise in on-net traffic and solid data

revenue, which came along with enhanced OIBDA margin, up 3 percentage points y-o-y to 31% in 9M 09.

- In Argentina and Venezuela we continue to post a very good performance: revenues increased by double digit rates and OIBDA margin further expanded in both markets in a remarkable size.
- In Peru, both the wireless and wireline businesses, are posting robust results.

Initiatives to turn around operations in Telesp and Colombia mobile start to pay off
Santiago Fernández Valbuena

Slide number 17 shows that we are starting to notice positive results from the initiatives launched to improve the performance of two operations that for different reasons have been recording more difficulties in recent quarters.

In Telesp, the implementation of a quality plan to improve processes and service and to solve operating problems has allowed the company to post good broadband net adds both in September and October. Gross adds are still below the monthly levels recorded before Anatel's decision, as we are progressively resuming Speedy sales across distribution channels, no commercial campaigns have been launched until November and we are focused on capturing good quality adds. At the same time, the better quality and customer satisfaction is reflected in a promising churn improvement.

In Colombia, our wireless business is also showing signs of improvement. Contract net additions multiplied by 5 times quarter-on-quarter. Total gross adds are rising and churn has dropped 1.2 percentage points vs. previous quarter. In addition, local currency ARPU was 6.2% higher in the third than in the second quarter. And all this while enhancing OIBDA margin by 1.6 percentage points in the first nine months of the year.

In summary, despite the weak performance in some of our subsidiaries, Telefónica Latinoamerica continues to record sound top line growth rates across most markets, while further scale, our integrated management model and additional efficiency gains continue to bear fruit with OIBDA margin expansion across markets. This outlines one of the pillars of our strategy: diversification.

T. Europe: consistent approach showing a distinctive performance in key markets
Santiago Fernández Valbuena

Turning now to slide 18,

Telefónica Europe continued to outperform in its key markets, thanks to a successful management of customer acquisition and retention, mainly in the contract segment, where we haven't seen major changes in customer behavior, overall. Despite the economic downturn, we have continued to invest in the market in order to drive growth. Over the past 12 months, we have taken nearly 60% of all mobile net adds across our markets.

Mobile net additions in the third quarter were close to 900,000 lines, a significant increase over the previous quarter, with 72% of these being contract customers. Smartphones and dongles continued to drive growth for the business, with renewed propositions across markets, like the continued traction of the iPhone, which will be reinforced by the recently launched Palm Pre and other smartphones.

Revenue has sequentially improved to 3.0% year-on-year in the third quarter, ex-fx and also excluding the impacts from cuts in mobile termination rates in 2009, dragging 3 percentage points of growth in the third quarter alone. Non-SMS data revenues also continued driving growth, with a 37% year-on-year increase, ex-fx, up to September 2009.

The ongoing management of our cost structure is ahead of the curve. We are further progressing in the transformation of the Company, leading to lower non-commercial costs. It's about giving customers what they want, and saving for increased commercial activity, overall, which is helping the business to increase OIBDA margin by 0.9 percentage points in the January to September period, to reach close to 29%.

CapEx has reduced, year-on-year by close to 9% ex-fx, as 2G network roll-out plan is nearly completed in Germany and the ending of major IT projects has taken place. Please note the 12% increase over the previous quarter, which is helping to sustain the future evolution of the business on increased commercial activity.

As a result, operating cash flow continued to be strong, with Telefónica O2 Germany being again the major contributor to growth.

T.O2 UK: sustained outperformance through customer experience leadership

Santiago Fernández Valbuena

In the UK,

The business continued to clearly outperform the market on the back of insight led propositions and ongoing low levels of contract churn, accelerating commercial activity around Simplicity and the iPhone, as well as other high-end devices. Telefónica O2 UK now manages 21 million mobile lines, growing at close to 6%, year-on-year, from which 44.5% are contract customers, and no further deterioration of usage optimization is being seen, overall.

As a result, and adjusting for MTR reductions, mobile service revenue growth is ramping up to 6.1% in the third quarter in local currency, an encouraging behavior vs. past quarters, which is also capitalized on non SMS data revenue growth of 53%, in local currency, up to September.

In terms of profitability, it is important to highlight that the ongoing efficiency program in the business is helping to sustain OIBDA margin at 25.6%, excluding restructuring costs of 28 million euros recorded in the third quarter as part of the transformation process. Thus, underlying OIBDA evolution in the third quarter of 3.1% year-on-year in local currency reflected increased commercial activity in the contract segment, offset by an improved contribution from the DSL business and

further benefits from targeted customer retention activities leading to lowest market churn.

Operating cash flow is growing 11% in local currency in the January to September period, excluding restructuring costs, as the strong OIBDA performance is complemented with a tight CapEx management in order to sustain the already high quality levels of our network and service platforms.

T.O2 Germany: Delivering growth on solid foundations and focused commercial approach

Santiago Fernández Valbuena

To review the commercial and financial performance of Telefónica O2 Germany please turn to slide number 20.

The success of the customer oriented products led to contract net adds in the quarter of close to 216,000 customers, 1.5 times higher than in the previous quarter, driven by mobile broadband, the “O2o” proposition and the renewed activity in partner channels.

The continued growth of the customer base, as well as the positive evolution of non SMS data underpinned mobile service revenue growth of 2.1% year-on-year in the third quarter, excluding MTRs, ramping up from the previous quarter.

The Company continued advancing in terms of profitability, growing OIBDA by 25% year-on-year, up to September, and expanding OIBDA margin by 4.3 percentage points, driven by:

- Lower charges to third parties on national roaming, finalizing by year end. Our mobile network is now leading the pack in terms of quality.
- Improved profitability of the broadband business...

...and the new commercial approach from the fourth quarter of 2008, leading to a more efficient investment in customers, more focused in terms of product portfolio and promoting direct channels on the back of increased rollout of shops.

It is important also to highlight that you should not expect OIBDA to maintain the same year-on-year growth rate in the next quarter, as the new commercial approach launched at the end of the 2008 boosted OIBDA in the fourth quarter.

Hansenet transaction perfectly completes our strategy towards the integrated play

Santiago Fernández Valbuena

Before reviewing the financial profile of Telefónica, let me say a few words about the strategic rationale of the Hansenet acquisition on slide number 21.

The German market is characterized by growing trends for bundled products, and future growth opportunities rest on addressing this trend.

T. O2 Germany has the ambition to become a leading integrated player in the German telco market, and continue its growth story.

Currently T. O2 Germany has a sound mobile business but further growth potential in fixed-net broadband. Hansenet enables a leap forward move in fixed-net broadband as well as acquisition of fixed net capabilities, the best fit for T. O2 Germany's future aspirations.

Next to synergies from strengthened capabilities to sell bundled offers, know-how sharing in sales activities such as online and telesales would represent an additional benefit.

Further synergies would be possible through optimization of the operational model of both companies.

The already close relationship that T. O2 Germany and Hansenet have, proves the ability to work successfully together.

Benefiting from a prudent financial policy

Santiago Fernández Valbuena

Turning to slide 22 we can observe how we continue benefiting from our prudent financial policy.

Our net financial debt stood at 1.9 times OIBDA at the end of the first nine months, or at 2 times when adding cash commitments, which is in the low part of the range reiterated at our last Investor Day in Madrid. A slight increase could happen in the last quarter following the potential disbursement on M&A deals completion.

We have further increased our average debt life, even above 7 years if we were to include our recent 1.75bn euros 10 year bond issue.

Our interests expenses have stayed below 1.9 Bn euros, which is equivalent to 5.6% effective interest rate on our 45.4 Bn euros average total debt. FX losses, most of them due to USD needs in Venezuela, pushed total financial expenses just above 2 Bn euros.

Conclusions

Santiago Fernández Valbuena

To sum-up:

In the nine months of the year we have posted strong earnings, retaining benchmark organic growths in the industry and consistent trends with previous quarters.

Commercial activity has recorded a sharp recovery in Q3, driven by mobile.

The high cash generation delivered shows our ability to enhance efficiency on the back of scale economies and disciplined OpEx and CapEx management.

We maintain a robust financial position and we have posted high single digit underlying growth in EPS.

We are on track to meet 2009 guidance and we confirm our proposed 1.15 euros per share for 2009.

Thank you very much for your attention. Now we are ready to take your questions.

Q&A session

Operator

The first question comes from Matthieu Robbiliard from Exane BNP Paribas. Please go ahead.

Matthew Robbiliard – *Exane BNP Paribas*

Yes, good afternoon. I had two questions. First, with regards to Latin America, when we see a substantial improvement in margins in countries like Chile and Mexico and Colombia and my question was: Is this something that you see as sustainable is the kind of OIBDA margins you expect in the future? And if that's the case; why such a big improvement now, what is driving it?

The second question has to do with Spain and mobile Spain; clearly very strong KPIs but we haven't seen the impact on service revenue trends and I was wondering, is it because for instance contract net adds are very back handed in the quarter or is it because prices on new contracts are much lower or is it because you continue to see deterioration of underlying usage? So really understanding why and if we can see a translation of that good KPIs at some point in the revenues. Thank you.

Jose María Álvarez-Pallete - *Chairman and CEO Telefonica Latinoamérica*

Well in terms of your first question concerning the margin improvement on the mobile side in Chile, Mexico and Colombia namely; let's take into account that the handset sales have been significantly reduced year-on-year in every three countries. And that has been contributing to an improvement in margins. On top of that, there are some underlying trends that are improving in terms of just the scale of the operations and the fact that from a commercial standpoint, we have been able to stabilize the levels of churn and even to reduce them in some of the countries. So you have a mix of effects.

First, there is a different mix in terms of revenues. We have less handset sales and second, you have improvement underlying, significant improvements on the commercial side with significant churn reductions.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Regarding the question about Spain, the mobile market; first, yes we did have a very good quarter with a particularly outstanding in postpaid, in contract. How will this translate into revenues in the future? Well, it is a positive effect, obviously. But given that we haven't seen yet a recovery in the traffic, there are some signs of stabilization but not yet a turnaround; that overall traffic effect will drag still the revenues in the mobile business. Regarding the specifics, new customers that we

are adding; they will provide new revenues. The amount of revenues depends on the promotion that we are, that we have been using to attract them. Contract churn also has been pretty stable, 1.2% percent; only a decimal of decrease so this is a very healthy increase in terms of stable churn and improved gross adds.

Matthew Robbiliard – *Exane BNP Paribas*

Would you say that the gross adds were back handed or front handed or no pattern there?

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Basically, regarding the third quarter, again first it's basically postpaid; second, it's an increase in gross adds given that churn is stable and this is a healthy trend. What we are not seeing yet overall is traffic improvement in the overall base. I'm not talking about the specific lines that we are adding in overall basis.

Matthew Robbiliard – *Exane BNP Paribas*

Thank you very much.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

Our next question comes from Jesus Romero from BAS-Merrill Lynch. Please go ahead.

Jesús Romero – *BAS-Merrill Lynch*

Hi. I had a question on the fixed line business in Spain. You highlight on slide eleven that the retail broadband connectivity ARPU is down 6.8%. The total ARPU just doing the average of the quarter is down almost 9%. Can you tell us what you expect the trend will be going forward and when you think retail revenue in broadband will become positive again?

And then a follow up question on China Unicom; I wanted to clarify that the investment is already been competed although I know the deal was closed on October 21st. I wanted to know whether the cash outflow for the shares at China Unicom received was already completed in the third quarter. Thank you.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Hi, Jesus. This is Guillermo regarding Spain. The broadband connectivity ARPU is evolving in the range that we were expecting and we commented in the investor conference between 5% and 7% per year; that's in terms of connectivity; in terms of other ARPU and looking forward, we expect first a change in the Imagenio ARPU given that we are changing some of the pay-per-view revenues for base revenues in the Imagenio. So we are going to have more customers, but less pay-per-view

revenues and more base revenues. So that will change the unit of ARPU in Imagenio but will provide more revenue from broadband.

And regarding the rest of the value-added services which have been very depressed given the nature of not first-need type of services and given the crisis in Spain; we expect them to start recovering in the following year.

Santiago Fernández Valbuena - *Telefónica S.A. – CFO*

Hello Jesus; this is Santiago. In terms of the China Unicom question; at the end of October, we completed the exchange of shares with China Unicom, so we gave them the 40.7 million shares that we had agreed. Part of those shares has been already bought at the end of the September. But a few of those have been bought during the month of October. But as we speak, this exchange has already been completed and both them and ourselves have already in our books the shares that we have communicated.

Jesús Romero - *BAS-Merrill Lynch*

Thank you.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

Our next question comes from David Wright from Deutsche Bank. Please go ahead.

David Wright - *Deutsche Bank*

Yes, just a couple of questions; first of all, I guess to Guillermo, the commercial activity much stronger in Spain. I'm just wondering to what extent, I think this was a question mentioned before, that commercial activity has come later in the quarter and whether there have been any price changes, any changes in tariffs, perhaps a little more promotional into September after the summer period. I'm just wondering if we should sort of assume a lower-- a little more ARPU pressure into Q4.

And then secondly, and very differently to Matthew please; just an update on how the Palm Pre is been selling perhaps versus volumes that have historically been sold in the iPhone; just your thoughts on that. Thank you.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Well David, regarding Spain, across the quarter in mobile it's been pretty stable. It has not been too weighted on September. It has been a very good July, a very good August due to the summer campaign and a very good September. So it's spread all around the quarter.

Regarding Pay TV, that's back ended. Pay TV is a very much focused almost exclusively on September, given the football league is starting in Spain in

September and we have the new offering of football starting in September. So it's basically almost 100% on September.

Regarding the fixed line improvement; it is a net loss and not a net gain; but it's an improvement compared to the previous quarters. You have to think there is an improvement, but also there is some seasonality in August given vacations; we have less disconnections than in other months. So usually we have an improvement in July and September but August is providing more improvement, but this is more due to seasonality.

Regarding broadband, it has been very spread around the three months. And that's due to the very good summer promotion that we have in August and in the first week of September; and then you have positive seasonality in September with the back-to-school campaign; a lot of families connecting or asking for broadband so the kids have the broadband that they had at home. So it's spread all across the segment, but Pay TV is much more loaded almost exclusively on September.

Regarding the nature of the improvement; in Pay TV is a content move. We decided to include football content on our base offering. So that's an improvement of value for the same price.

Regarding mobile, it's an accumulation of different actions. Some of those were launched in the second quarter like the semi flat tariff that we introduced in the second quarter. And in particular in the third quarter we had a very good summer campaign. The other thing was basically a free cost during the weekend. It's a similar campaign, not exactly but similar to the one we had in the previous year.

And in broadband, we did have an August campaign. This is different from other years; with a very good entry price for new customers and so that was much more on the promotional side. So it's a combination of factors, content on the Pay TV, promotions on broadband, and in the case of mobile it's a combination of different actions.

David Wright – *Deutsche Bank*

That's all very thorough. Thank you.

Matthew Key - *Chairman and CEO Telefónica Europe*

Hi, David. It's Matthew; just to pick up your question. Let me first start by saying on the iPhone in the U.K.; Orange and Vodafone now announced three or four weeks ago we've seen almost no change in our volumes in terms of the run rate; so very little impact to date, recognizing Orange only started selling it today, but certainly we've seen no change of customer behavior in customers coming to us which I think is promising for us.

On the Palm Pre, I'm very happy with the volumes we're doing. Are they at the level of the iPhone? No they're not and they probably won't be; but really happy with the volume and particularly the customer reactions that we're getting very, very low return rates and very few calls into customer care which means customers are buying the product and really like it.

David Wright – *Deutsche Bank*

And Matthew, can you just elaborate; is it the same incentive to the dealers to sell the phones or is that anything you can tell us?

Matthew Key - *Chairman and CEO Telefónica Europe*

I obviously wouldn't want to get into individual commercial relationships we've got with the channels. But in terms of structure; absolutely; we structure it the same on any of our devices which we make sure our objectives are aligned.

David Wright – *Deutsche Bank*

Thanks.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

Our next question comes from Mandeep Singh at Berenberg. Please go ahead.

Mandeep Singh - *Berenberg Bank*

Hi, thank you. A couple of questions, please; first of all, just on EBITDA, clearly, from a sequential perspective the revenue decline in Spanish fixed and mobile have improved somewhat on an underlying basis. But there still seems to be some acceleration in the EBITDA decline. So can you just talk about the margin pressure and what the drivers are there and potentially how that could evolve?

And then secondly, I just had the question really on Germany. I mean at the Investor Day, Matthew said that there was no denying the logic of potentially merging number three and number four, but obviously not to go in and write that you are going to buy E-plus. I'd just like to extend that question more broadly to KPN; I mean if KPN was available at the right price, is that something you would consider or are you maintaining your view that you've got the right scale?

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Yes, regarding OIBDA margins in Spain; we have, as we explained, very intensive commercial activity during the quarter and that has a direct on the OIBDA in the quarter. So the deterioration, this mild deterioration that we have in the margins, it's a very healthy margin but it's still a deterioration in the quarter, may be explained by the increase in commercial expenditures.

There are other items, along the same line, also an increase in equipment purchases, particularly in Pay TV, since we are connecting more customers we are rebuilding stock in set-top boxes for example. Same happens with broadband and routers. Also, we have a very good, as you can see, revenues increase in IT. IT revenues are increasing, but these are typically business lines with smaller margins than we have in traditional telcos.

So this impact on the revenue mix that also impacted the quarter; but the main driver there is commercial expenditure and other expenditure linked to revenue increase and connection increase.

Mandeep Singh - *Berenberg Bank*

Thank you.

Santiago Fernández Valbuena - *Telefónica S.A. – CFO*

Let me take the question on Germany and probably on KPN, perhaps Matthew would like to contribute something later on. Mandeep, our strategy in Germany is quite clear. We want to strengthen our mobile position and we wanted to go for an integrated product; and that's where the Hansenet acquisition comes from.

We have defended that we wanted to drive the value for money proposition that is escaping from the low end of the hard discount side of the market and build an integrated proposition. We think that we're now closer to achieving that end than we were before, and certainly the scale of the group helps us in doing so. We have no other plans in store for the time being.

Mandeep Singh - *Berenberg Bank*

Thank you.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

Our next question comes from David George at Credit Suisse. Please go ahead.

David George - *Credit Suisse*

Yes, thank you. Just a couple of questions on the '09 outlook; it seems in Q3 at the Group level organic revenue trends actually turned negative. Guidance is obviously still for growth for the year as a whole. Should we expect the good net adds in Q3 generally to literally rebound in growth as we look in Q4?

And then just on the Group CapEx numbers; we haven't seen much of a sequential pickup in Q3 to get towards EUR 7.5 billion for the full year would suggest a near doubling sequentially. Is that realistic or should we be looking at a number somewhat below the EUR 7.5 billion for the full year?

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

This is Julio Linares. Regarding the CapEx issue that you mentioned; you have to take into account that always in CapEx there is a seasonality effect, and on the third quarter was not heavy in terms of investment. The predictions that we have for the

fourth quarter taken into account the number that we already saw in our investment is that we are going to meet our commitment for the full year as we announced earlier this year.

Santiago Fernández Valbuena - *Telefónica S.A. – CFO*

Okay, in terms of guidance fulfilment; we feel confident that by the end of the year we will again meet those numbers. Please keep in mind that in terms of revenues, especially in Spain, we shall have to take in this year the Universal Service Obligation which is still unknown but unlikely to go below last year's number and that we have some properties in Europe which are likely to perform significantly better in Q4 this year than last year; notably Germany. And we also expect higher revenue growth in the Czech Republic as the year-on-year growth rates were last year impacted by negative Universal Service Obligation.

So, all in all, we do confirm that the revenue numbers will be met and I'll try to give you some colour as to why that is not so farfetched.

David George - *Credit Suisse*

Thank you.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

Our next question comes from Ivón Leal from BBVA. Please go ahead.

Ivón Leal - *BBVA*

Hello. Good afternoon, gentlemen. A couple of questions; the first one in Spain, when we go to slide number nine and you're telling about revenue decline in Spain we can see very, very slight improvement in the third quarter versus second quarter. So I don't know if you could give us; with the data of October and November, you can reaffirm now that the revenue decline trend is being confirmed in this fourth quarter.

And the second one is concerning Latin America. And looking at the region as whole, if I look at the subscriber growth at the end of 2008, you were running like 18% on the mobile side; now you're like a 6%. So if we look forward to 2010, I wonder that macro environment, which is performing better on the regions, so that can help you. On the other side, penetration rate is approaching 100%. So are there any thoughts in terms of subscriber growth in the region; do you think you can sustain current levels, you think that decline is going forward in 2010? And what is going to be the picture there?

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

This is Guillermo. Regarding the revenues in Spain, the outlook for the quarter; we don't see major changes in the underlying revenue trends, taking away the one offs. Regarding one offs, as Santiago mentioned a moment ago, we expect to account for the Universal Service Obligation of 2007 and maybe 2008; so that will be a one off non-comparable. But taking away the non-comparable items, we expect a revenue trend similar to the excluding one offs we had in the third quarter; maybe slightly better but it is too soon to tell.

I do have figures for October but I don't have yet revenue number for November; these are estimates for November and December; but similar trends when you take away the one offs; and in one offs, you have to take in account the Universal Service Obligation will be coming, we might be accounting for in the fourth quarter.

Jose María Álvarez-Pallete - *Chairman and CEO Telefonica Latinoamérica*

Taking your question on the subscriber growth; what we have experienced during the third quarter is, I would say, a significant improvement in terms of net adds. And those came both from a gross adds and from lower levels of churn. I do think that there has been an improvement in terms of commercial activity in the region, I would say all around the region. And also taking into account the fact that I would say that all of the players we have been subsidizing less the handsets; and therefore, we have been having probably a slower growth compared with the previous year if you take into consideration the fact that last year we were all subsidizing heavily handsets and we are not doing that for the time being.

And on top of that, you will see that minutes of usage, globally in the region in our case, ARPU, that has been stabilizing, and churn that has been improving. So, what we can say so far is that the third quarter has been better than the second one in terms of commercial activity. But I think it's too soon to say that it can be extrapolated for the next future.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

Our next question comes from Georgios Lerodiconou from ING. Please go ahead.

Georgios Lerodiconou - *ING*

Good afternoon. Two questions please; the first one is a follow up on the previous question on Latin America. I was wondering whether you could give us an idea of whether you expect a margin improvement you have consistently been delivering over the last four quarters to be sustained even when the comparisons get tougher as the commercial activities last year are already on a lower base.

My second question is on financial expenses. Is it possible to give us an idea of the impact of your net cash position in Venezuela on financial income; so whether you can give us comparable numbers for this year and last year and whether it's also

possible to give us the net income generated out of Venezuela during these two periods? Thank you.

Jose María Álvarez-Pallete - *Chairman and CEO Telefonica Latinoamérica*

Well taking your question on the margins in Latin America; you have two parts of that. The first one is on the wireline side, it's taking a significant effort to stabilize margin on the wireline side; and in fact we have been able so far to slightly do so in three out of the five operations, mainly Chile, Peru and Argentina; while we are having some problems in stabilizing margins in Telesp and in Colombia on the wireline side.

From the wireline side, overall we have been significantly reducing the rate of deterioration around this year, but with two pending issues like Telesp and Colombia.

And on the wireless side, we have been basically improving all around the picture. Part of that is due to the fact that we have been less aggressive in handset subsidies. But I would say that the most important one is due to the fact that churn is contained, that the commercial activity has been much sounder in terms of the right subsidies and the right promotions, so I would say that a significant part of that margin trend on the wireless side is here to stay.

On the wireline side, also it's worth it to mention that in spite of the fact that handset sales have been reduced, service revenue keeps growing nicely year on year. So it looks like on that side, in terms of revenue, it's also contributing to expand margins.

Santiago Fernández Valbuena - *Telefónica S.A. – CFO*

In terms of the contribution of Venezuela cash to financial income; what I can tell you is that it has been coming down as a consequence of the oversupply of funds in the Venezuelan market. And this year, it is very likely that we should end with an average financial income over invested funds close to 7%, which is a very small number relative to the high inflation prevailing in the country and in rates that we had been enjoying over the past couple of years.

This also naturally erases the average cost of debt in Latin America when you do the net in; because that 7% or thereabouts; is below the average cost of debt in the region, which is closer to 12% as we disclosed in our last Investor Day. So there is a drag of Venezuelan cash on the total and certainly as the business is doing well, the overall amount of cash that sits in Venezuela is likely to continue being a drag on the overall financial expenditure, but it is one which is well contained.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

The next question comes from Stanley Martinez from Legal & General Investment Management.

Stanley Martinez – *Legal & General Investment Management*

Thank you for taking my question. To Mr. Alvarez-Pallete; Telefonica's high proportion of contract net adds in the region, especially in Colombia and Mexico, Ecuador and Peru; it was quite similar to what you saw from your main rival in each of these markets as they reported their Q3 and have identified that their strategic focus is also on postpaid. Do you expect competition with AMX in the postpaid segment will occur more at the edge or at the core of your network? And if it's at the edge, should Telefonica investors like me be concerned about some near-term diminution in efficiency ratios as handset subsidies and/or retention costs rise on a per-subscriber basis? It just seems perhaps inconsistent to think about handset subsidies continuing to come down when both of the major competitors in the market are increasing their volume of postpaid handsets.

Jose María Álvarez-Pallete - *Chairman and CEO Telefónica Latinoamérica*

Well, thanks for the question. It is true that we have been improving slightly our position in contract in some of the countries but still we have significant room to grow, namely for example in Mexico or in Colombia where we are lagging behind our main competitors. The fact is that in terms of handset subsidies, we think that because of currency volatility, the market in general terms has become more prudent in terms of subsidizing. And therefore, as far as this volatility will still be in place; I think that we will all be more or I would say rational on handset subsidies. And therefore, competition is much more based on quality of the network in product in terms of quality of service. And on that side we feel very comfortable; both in, I would say, in all the markets that you have been mentioning, but mainly, increasingly in Colombia and for sure in Mexico.

And in fact, in Mexico we are driving a campaign to migrate customers from prepaid to contract. We are starting to get results. It's still far from the traction that we would like to have, but we are in the neighbourhood of 20,000 to 25,000 per month, which is much more than we were used to have. So I do not see, as of today, a major shift or a major change in commercial strategy on that front, but it might happen.

So it's too soon to say, but for the time being, and as far as October and the first week of November is concerned, trends have been similar.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please

Jonathan Dann - *Barclays Capital*

Oh, hi. At the Investor Day you talked about data. Could you comment on what sort of positive impact you're seeing in data in Latin America? What sort of percent to your revenue it is, what the growth rates are like?

And secondly, could you just sort of provide, I guess a bit of color on the Pay TV strategy based in Latin America? And also for Imagenio, if I understand you correctly, should we start to expect sort of multi-million numbers of the Imagenio customers over the next sort of two years? Is that the way to think about it?

Jose María Álvarez-Pallete - *Chairman and CEO Telefonía Latinoamérica*

Well, taking your question on data in the region and probably most specifically on wireless Internet; the third quarter has been pretty good in terms of customer adds. It has proven to be even stronger than the second quarter, even taking into consideration the fact that we didn't have the Mother's campaign. So on that side we have positive news in terms of the trends that we were anticipating at the Investor's Day.

And on top of that in terms of data revenues out of total ARPU; the growth is being steady. It has been growing all around the year compared with previous year; and in fact, the growth that we are having in 2009 is bigger than the one that we were having in 2008. So both trends in terms of share of adds and in terms of ARPU expansion in data are proving to be there. So yes, we think that this market is starting to accelerate. We will need to monitor that in terms of a quarterly basis because this is highly dependent on the commercial campaigns as it's a very incipient market. And therefore we are basically building it in each of the countries as a sector.

So yes, the trends are there and trends are growing. Third quarter has been stronger than the second one. So I guess that we are in the right direction.

And in the case of the Pay TV in Latin America, we are not satisfied with the level of customer adds that we have been having. It is true that we have been facing significant difficulties in two out of the wireline markets, namely in Colombia and in Telesp for different reasons. In Telesp because as you know we bundle, as we have not been allowed to sell DSL during two months; we have not been selling TV by itself. And in Colombia, because we are reconsidering our commercial offer once the cable operators are starting to be consolidated and be much more aggressive.

So I guess that from the Pay TV side in Latin America, we are not satisfied with evolution. We need to think about it and reposition our commercial offer. So we need to be, my view is that we need to be more aggressive.

Guillermo Ansaldo - *Chairman and CEO Telefonía España*

This is Guillermo Ansaldo regarding Imagenio in Spain; Pay TV in Spain. As we shared in the investor conference, we expect to double our customer base from December 2008 to December 2012; so roughly moving from 0.6 million, 600, 000 clients; to 1.2 roughly in 2012. So it's not a multimillion. I would love to have a multimillion, but it's double the base.

What are we going to do or what are we trying to do? First, to improve our content offer both in standard definition and in high definition; as we have done with our Gol TV channel addition both in standard definition and also high definition; and we will continue to take advantages of the IPTV interactive functionality. We will

continue developing a three-layer offering, standard offering which we call Imagenio Familiar, the Future offering over fiber with high definition and more value-added services. And also we are developing an entry level strategy with Over the Top. But basically we're going to double our customer base from again from the end of 2008 to 2012.

María García-Legaz - *Telefónica S.A. – Head of IR*

Next question please.

Operator

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

Tim Boddy - *Goldman Sachs*

Yes, thank you. Back to Spain; I wanted to understand, are you targeting a net OpEx reduction for 2010? Obviously the sense in this quarter is that you've had a shift in commercial strategy and I'm trying to get a feel for whether you'll continue with that and to what extent you have further cost savings that would allow net OpEx reduction in 2010.

María García-Legaz - *Telefónica S.A. – Head of IR*

Can you repeat your question, please? We cannot hear you very well?

Tim Boddy - *Goldman Sachs*

Can you hear me now?

María García-Legaz - *Telefónica S.A. – Head of IR*

Yes, that's much better. Thank you.

Tim Boddy - *Goldman Sachs*

Great. So the question is: in Spain are you targeting a net OpEx reduction next year? Just I guess setting in context your increased commercial activity this quarter, is this something we can expect to continue?

And then a similar question for Matthew Key; in Germany it feels that there may be more competitive intensity coming. Have you seen any sign so far of a change in the competitive dynamics? Thank you.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

This is Guillermo Ansaldo regarding efficiency in Spain; we are as you know, roughly with efficiency ratio which is the complement of operating cash flow over revenue

ratio; around 60%, having improved it 1 percentage point compared to same period last year. And we are a benchmark in Europe in terms of efficiency and next year we will continue working to be an even stronger benchmark in efficiency. And that will be part obviously of the focus and also the other side as I explained in the Investor conference, to strengthen our leadership in the market size and also to capture all opportunities that the market recovery will come.

But regarding efficiency, our goal is to still remain as the benchmark in Europe in terms of operating cash efficiency.

Matthew Key - *Chairman and CEO Telefónica Europe*

Hi, Tim. I don't know whether you've picked up something from one of our competitors, but as far as the market is concerned, we haven't seen any change in competitive intensity that is worthy of note. I think two things I would say; clearly "020" for us was a ground-breaking proposition. We haven't seen any reaction really from the other competitors yet to "020". And secondly, the data market is clearly an area of huge expansion for us in Germany and as far as growth is concerned it's looking a bit like a three-player market. So I'll be more than happy with that as far as the performance of our network and the performance of our mobile data share which is looking at about 30% at the moment.

María García-Legaz - *Telefónica S.A. - Head of IR*

Next question please.

Operator

Our next question comes from Terry Sinclair of Citigroup. Please go ahead.

Terry Sinclair - *Citigroup*

Good afternoon. Can I ask two questions on Mexico please? First of all, can we assume that your interest is in acquiring more spectrum next year as spectrum becomes available? Secondly, when I look at the net add performance relative to AMX, your performance is obviously rather stronger, but it's considerably stronger in prepaid. And I wonder if you've relaxed your postpaid strategy for Mexico.

Jose María Álvarez-Pallete - *Chairman and CEO Telefónica Latinoamérica*

Thanks for the questions, Terry. The answer to the first one is for sure yes, we will very much like to have more spectrum because we are eager to do more things, especially namely on wireless Internet in Mexico Capital City and for that we need more spectrum; but no clear path in terms of the timetable. The agenda has been fixed and it's in the hands of the regulator to set the timing and it is not yet clear what that timing is going to be, but we think that timing is approaching. We are closer, but not a clear picture of when that's going to happen.

And in terms of net adds; it is true we have been having a pretty good third quarter, basically in prepaid where our distribution network; the capilarity that we have been able to put in place and also the incentives that we have put into our sales channels in terms of fostering or motivating the quality of our net adds is paying off both in terms of the total amount of gross adds and in terms of churn reduction. We have had a historically low churn level in the third quarter in Mexico.

So we are very happy on the prepaid side. On the contract side, we keep doing efforts as I was saying before, we have been able to migrate in September and also in October between 20,000 to 25,000 customers from our prepaid base to contract; still fighting to find the right value proposition on the market. So not satisfied with the outcome, but I would say we're in better shape than a quarter ago, especially on the migration side, but still a long way to go to be successful on the contract side in Mexico.

Brian Rusling - *Cazenove*

Yes, a couple of questions please. The first one is on Spanish mobile and on the sort of the contract net adds in the quarter; where have those come from? Is it upgrade from prepaid? Is it taking customers from other operators? It seems a little bit odd it's so high, despite your promotional campaigns.

The second one is for Matthew on data in Germany. If we look at the data ARPU, it actually fell, it went from 2.4% down to 4.7% down in Q3. How are we going to see that coming through with these new products to be sold in the marketplace? Are we going to see the data ARPU take up at some point?

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Yes, this is Guillermo Ansaldo. Regarding the postpaid net gain in Spain, it's a combination of factors. We continue, as before, migrating prepaid customers to postpaid, not at a great rate but we continue adding. We roughly are around 62% of total base which are postpaid. In terms of portability, we have a positive number in the quarter at plus 2,000; that's a change in trend compared to previous quarters. So that it is not a significant number but helps a lot. Particularly, before we were on the negative side and now we are on the small positive side.

Then, also we have the push of mobile broadband, big screen, which is adding also customers with high value. And also churn has been very stable, and best in class. So we are increasing gross adds while defending very well our churn.

So, to give you some flavor regarding churn in postpaid, we were 1.4% churn in the first quarter, 1.3% in the second, 1.2% in the third. So, we have continuously improved our churn across the year.

Matthew Key - *Chairman and CEO Telefonica Europe*

Hi Brian, two things I would point to. The data ARPU going down is actually driven by SMS rather than internet, actually. If you look at our non-SMS data, it's actually going up about 33% over the nine months. Obviously it's on a smaller base than the

SMS base. What's really happening in the SMS ARPU is: prices are going down through competition. What we have yet to see, which we did see in the U.K. market, is that elasticity of usage as SMS prices go down. So, it's certainly what we're hoping and one of the things, that SMS usage actually responds in the future to the price movements.

But as we go forward, clearly non-SMS data will start to take up a higher proportion of the overall data revenue.

María García-Legaz - *Telefonica S.A. - Head of IR*

Next question please.

Operator

Our next question comes from David Strauch at Oddo. Please go ahead.

David Strauch - *Oddo Securities*

Sorry. I've got two questions. One is regarding Telesp and Colombia. We've seen some improvement in terms of KPIs. I was wondering if we could start seeing in Q4 or in 2010, a translation in revenues and OIBDA?

And the second question is regarding the trends in OIBDA and operating free cash flow in Q3. They are a bit down compared to H1. A part is explained by your stronger commercial activities. I was wondering whether you consider to decrease a little bit your commercial activity in Q4 and see an increase in the trends in OIBDA and operating free cash flow, or if you prefer to keep being quite aggressive in terms of commercial aggressiveness to be there in 2010?

María García-Legaz - *Telefónica S.A. - Head of IR*

The last part of the question is for any country in particular or any region or is it for the Group as a whole?

David Strauch - *Oddo Securities*

It is for the Group as a whole but more specifically regarding Spain and Latam.

Jose María Álvarez-Pallete - *Chairman and CEO Telefonía Latinoamérica*

Well, I will take the first question on Telesp and Colombia. The answer is different in both cases. Well, I would say that in Telesp we have been experiencing significant difficulties during this year because of some non-recurrent issues but also some structural ones. The main drivers of the revenue slowdown in Telesp in the third quarter, is the acceleration in traditional line loss. We have been losing year-on-year 4.5% lines, while we were losing 3.6% as of June. We are facing a significant MOU drop. Traffic, excluding SMP is falling 7.1% due to fixed to mobile substitution. Tariffs, you know that tariffs review is applied once per year in wireline in Brazil,

normally in July. This year it has been much more in September and in a much lower amount than in the previous year. And also the new businesses, broadband, data and TV and fixed to mobile traffic, that are growing less than in the previous quarter.

I do see there are factors I would say more structural, and some others that are much more linked to Anatel's decision of banning the sale of Speedy offer of ADSL during two months. And that's having an impact in also OIBDA which has significant impact. We think that the part that's linked to the Anatel decision is under solution. We have been able to renew and to retake our efforts on the ADSL side, basically at the beginning of September. We have been prudent in order to retake that commercial activity while, at the same time ensure quality standards in order not to face again the same difficulties. And that's also impacting our OIBDA because our commercial efforts have been much more intense.

And we are starting to get some results. In terms of ADSL net adds, we are getting closer to the figure that we were having before the ban. Churn on the broadband side has been reduced to 2.5% which is a similar level than before the Anatel decision. But MoU trends keeps under pressure, so, in terms of traffic we have not yet seen a reverse on the trend. And it is true that we are also seeing some quality indicators. So, in Telesp we are starting to get results. But some of the intrinsic factors, such as traffic, are still there during the month of October. So it's still too soon to say that the situation is going to be reversed totally.

But the one that is related to Anatel is under solution, the other one is still to be reversed.

And in Colombia, the situation is different. We are facing a total change in the sector in terms of new competitors entering like Telmex on the cable side, consolidating the cable operators. And the mobile prices, in terms of ARPM, being already lower than the wireline prices in Colombia. If you add on top of that, the fact that from a geographical standpoint in Colombia, we are an incumbent in small and medium-sized cities and new entrant in large cities, we are being forced to totally reshape and reorient our commercial efforts, and also the organization of the Company. We have appointed a new CEO, who is coming from our Peruvian unit, and we are starting to set the pillars of the new strategy in terms of being much more geographically oriented; and also repositioning our offers both in terms of traditional voice and in terms of bundles of voice plus program plus TV. So I think that in Colombia, it's going to take longer than in Telesp.

And in terms of the commercial activity taking place in Latin America, well, as I was saying before, we have been less intense in terms of handset subsidies, but we have been more aggressive in terms of promotions and in terms of incentivating the sales channel. We think that with the right incentives. And in spite of that, we have been able to improve margins and efficiency. So I think that considering that the third quarter has been a highly intense commercial quarter, I think that in terms of the margin side, the direction is consistent and coherent. We will keep you posted. But, for the time being, we feel comfortable.

Guillermo Ansaldo - *Chairman and CEO Telefónica Espana*

This is Guillermo Ansaldo. Regarding commercial activity and margin evolution in Spain, we are not going to decrease commercial activity in the fourth quarter, provided that in fourth quarter we have strong seasonality in terms of Christmas campaign, particularly in the mobile business.

Traditionally, if you track our quarterly margins in the past three years for example, you will see that in the fourth quarter, it's a minor decrease in margin because of the higher commercial activity; particularly in mobile where we have a lot of handsets and equipment that have been subsidized in order to foster the campaign. So like for like and taking away the one offs, again we expect in universal service coming in the fourth quarter, but taking the one offs, we expect a similar decrease or evolution as we had in previous years, meaning that the modest decrease that we're seeing in the third quarter will be similar in the fourth quarter, but with a lower base, because traditionally the fourth quarter has a rather smaller margin because of higher commercial activity. And again, let me stress that we are not going to slow down our commercial activity.

Torsten Achtmann - *JPMorgan*

Two questions on Brazil, please. First on Vivo; over the last quarters, there seems to be an opening up growth gap on service revenue between Vivo and Claro, and I wonder if you could explain what the reason for that is and if that is something you are going to or you have to address going forward?

And secondly, on Telesp, as part of the regaining of broadband activity in Brazil, you had to invest a bit more in trained staff which reduced margin. Going forward, is that something, what is the priority, getting top line back into shape and growing or is it improving the margin? Thanks.

Jose María Álvarez-Pallete - *Chairman and CEO Telefonica Latinoamérica*

Sorry, could you repeat the first question on Vivo? I was unable to understand you, sorry.

Torsten Achtmann - *JPMorgan*

All right; one second please. Is it better now?

Jose María Álvarez-Pallete - *Chairman and CEO Telefonica Latinoamérica*

Much better.

Torsten Achtmann - *JPMorgan*

Okay; perfect. The first on Vivo was literally the difference in service growth rates between Vivo and Claro and if you could explain where that is coming from? if that is something you have to address in the future?

Jose María Álvarez-Pallete - *Chairman and CEO Telefonica Latinoamérica*

Okay, in terms of service revenue comparing ourselves with Claro; we have launched a commercial campaign in the last quarter that accounts for a significant

amount of promotion in terms of minutes. The way we account for those minutes is that we first account for the free minutes and only then when the customer recharges, then we account for additional revenues. So I guess the promotion, the way that we are accounting for those promotions is also affecting the evolution.

In terms of OIBDA, we are having a better comparison and I think that those trends are going to be much more similar when our promotions are going to be stabilizing in terms of the way we account for them in terms of the free minutes. Because if you see the trends in minutes of use, we are having positive growth in minutes of use in the last quarter, while competitor is having a significant decrease; and in terms of ARPU, the evolution is quite similar. So I think that the trend will be converging at some point once this accounting issue is normalized.

And in terms of Telesp broadband activity, the focus right now and the priority right now is to ensure that we grow and that we grow soundly in terms of quality. We cannot afford to have the same issues that we had been facing before. And on that side we have been much more demanding in our sales in terms of the quality metrics that we are applying all around the processes end to end; from the commercial to the network side of that. That means implicitly that we are being much more selective in the entry filters in terms that we transmit to the customer the speed of access that he's able to have where he is living before he's installed the product. We only account for revenues when the product is installed and correctly functioning. Until now, we were accounting for revenues immediately after the selling process. And in fact the churn that we are having in net adds, the new net adds after retaking our activity is much lower, is significantly lower than before.

So the first priority right now is to ensure quality to make sure that we have the right level of quality and the right level of customer satisfaction and to retake growth on that side. And that's why you have seen that we have been having margin deterioration in Telesp in the quarter in order to ensure that quality was at the core of everything that we were doing and that growth will come in a stable and sound manner.

María García-Legaz - *Telefónica S.A. –Head of IR*

Okay, time for the last question please. Thank you.

Operator

Our final question comes from Will Milner from Arete. Please go ahead.

Will Milner - *Arete Research*

Thanks very much. Two questions; firstly on Spanish wireline; could you just talk about what's actually driving the acceleration in growth in data services revenues which I think was 13% in the quarter? How much of it is one off and how much of it potentially is being generated outside of Spain?

And the second question on Latin America for Jose Maria; could you talk a bit more about the open Telefonica initiatives since these are becoming quite material; I think EUR 137 million of EBITDA; most of it in the third quarter. So it looks like it

could be annualized EUR 400 million of EBITDA; I'm just very interested to hear sort of what that is and who your partners are there. Thanks.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Okay. This is Guillermo Ansaldo regarding data in wireline; all the services are in Spain. They are not international data revenues in our P&L in wireline; a very small fraction in wireless but not in wireline. There are two types of configurations in data services; one is what we call virtual private networks that basically are solutions that we provide to large corporates with a lot of tranches; typically banks, public administration and so on. And then also we have wholesale. The chapter that this is providing more volatility is wholesale; wholesale for example are the circuits that we sell to the mobile operators and that has some volatility depending on the number of new circuits that we are getting. These are typically driven by the increase in mobile broadband and we have more sales of data services, not only to competitors but also to our own mobile operation. This number obviously disappears in the consolidation.

Data services on virtual private networks which are retail data services; are very healthy. They are growing one digit, but upper one digit and this is basically based on our success at offering network based on ADSL and also on fiber and as we explained in the previous investor conference, we have roughly 40,000 connections meaning premises, or branches or sites that are connected with fiber in virtual private networks type of solutions. So that's growing healthy. It has a lot to do with IT solutions that we are providing on top of connectivity, but again going to the beginning, there is some volatility and an increase in the third quarter that is due to the wholesale side.

Jose María Álvarez-Pallete - *Chairman and CEO Telefónica Latinoamérica*

Taking your question on what we have called Open Telefonica; we have realized like a year ago that the size and the scale of the group was pretty relevant in terms of generating or being able to generate a significant value-added and a significant advantage. At the time, when we need to develop and adjacent and new businesses, which I want to say by that is that we have launched an initiative where we have been regionalizing and at some part of the Group making global initiatives. At the time when we are ready to launch new products and services and we look and we ask for partners in order to develop and accelerate those business models, once again adjacent business.

In fact, we have been closing agreements in the last years, and namely the figures that you have seen in the report accounts for the nine months of this year, not just last quarter; namely with for example ZTE, LG, Microsoft, Kodiak and others to launch a wide range of products and services such as location-varied services, security, mainly integrated in platforms, mobile operating systems, software development platforms; a full range of products that allows us to take advantage of the scale and the addressable market that we can provide to potential partners; and at the same time, to foster and to develop ARPU or revenues in our businesses.

As they are getting more and more important and they have become I would say recurring year on year in terms of new products; before this year, those initiatives

were launched and generated and managed at the local level. But now we have been up scaling or upgrading them at the regional level in order to generate more volume and to integrate more scale.

Again, also some of those projects are helping us to improve some key operations metrics such as for example recharges, logistics or roaming. They have taken such a scale that we think we have thought it was good to have a specific chapter on that and to report them and to keep you posted on the evolution because it is a prove that the scale of the Group is paying off and is helping us to accelerate new adjacent businesses.

Santiago Fernández Valbuena - *Telefónica S.A. – CFO*

Well with this, we'll bring this conference call to an end. We really want to thank you all for listening in and for attending this Telefonica's nine months of 2009 Conference Call Results. Thanks and we'll see you and we'll hear to you in the full year results later in February. Thank you