



Telefónica January-December 2009 Results Conference Call Transcript

26th February, 2010

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Introduction

María García-Legaz

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss January-December 2009 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 Chairman & CEO, Mr. Cesar Alierta, who will be leading this conference call.

Presentation

César Alierta Izuel

Good afternoon, ladies and gentlemen, and thank you for attending Telefónica's 2009 full year results conference call. Today I have with me Julio Linares, Chief Operating Officer, Santiago Fernandez Valbuena, Chief Financial Officer, Guillermo Ansaldo, head of Telefónica España, José María Alvarez-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.

2009: Top quality performance in a very challenging environment

César Alierta Izuel

Now, before turning to the numbers, I would like to stress that Telefónica fundamentals remain very solid and we continue building value for our shareholders.

Today's results prove our differentiated profile in the industry.

In a very challenging conditions, in 2009 we have posted a very solid performance, on the back of our strong market positioning across a well diversified business portfolio, an integrated management model with a disciplined execution and our financial flexibility.

Moreover, in 2009 we have set the bases for future growth, pushing customer growth and fostering usage. And this strategy is already bearing fruit, as reflected by the better revenue trends recorded in the last quarter of the year in organic terms.

We have again met expectations, delivering all our commitments in 2009.

And we face better growth prospects from a great position, with benchmark profitability levels and a robust cash flow generation profile.

All this, with leading cash returns for our shareholders.

Robust set of financials in 2009

César Alierta Izuel

Moving to slide number 3 for a quick summary of 2009 financial results, please notice that reported figures include the impact of considering Venezuela as a hyperinflationary economy from 2009.

Underlying business trends remain solid, driven mainly by the good growth in T. Europe and T. Latam and the growing contribution of broadband connectivity, applications & new services.

In a year where growth has been scarce across industries, we have delivered positive organic revenue growth, with a significant ramp up from top line to Operating Cash Flow, which increased 8% year-on-year to exceed the 15 bn Euros mark in 2009.

Further growth in net income and EPS

César Alierta Izuel

On the next slide, 2009's net income reached 7.8 bn Euros, with a 2.4% year-on-year underlying growth, or 4.5% in terms of EPS, which reached 1.71 euros.

Reported figures show material impacts from several effects:

First, in 2009 we have recorded 630 million euros of higher financial expenses related with our investments in Venezuela that Santiago will explain later on.

Second, we have a lower income tax expense of over 590 million euros related with the tax amortization of goodwill generated from certain foreign investments made before December 2007.

And third, we have recorded the capital gain from the disposal of Medi Telecom.

Strong commercial momentum, setting the base for future growth

César Alierta Izuel

Turning to slide number 5, customer growth in 2009 has been a key lever for our sound performance.

Commercial activity in the last three months ramped up sharply, leading to very strong net adds in the second half of the year, tripling the volume recorded in the first six months of the year.

And this performance is not related with seasonality, but with a focused strategy to build the foundations to better capture the economic recovery.

Net adds evolution was powered by higher gross adds as well as churn control, with mobile net adds underpinning the increase, with a remarkable 70% year-on-year growth in mobile broadband accesses.

As a result of our commercial push, we reached more than 264 million accesses at the end of 2009, 5% more than a year ago on a like-for-like basis.

Sustained strong cash generation led by improved profitability

César Alierta Izuel

Moving to slide 6,

Improving underlying revenue trends vs. the first nine months of the year, and our disciplined management of OpEx and CapEx drove up our robust cash generation profile.

In 2009 we delivered a good conversion rate of revenues into cash generation, with OpCF organic growth exceeding by almost 8 percentage points sales growth at the Group level.

And our profitability continues to outstand, with a consolidated OIBDA margin of 40%, 0.3 percentage points higher than last year figure, purely organic.

Economies of scale, further efficiency gains and gearing CapEx towards growth and transformation led to an improvement in efficiency ratio of 1.4 percentage points.

Delivering our year-end targets for 7 years in a row

César Alierta Izuel

A snapshot on guidance execution is presented in slide number 7.

I am proud to say that once again, we have met our annual growth targets, targets that have been fulfilled for the seventh consecutive year despite a more negative economic scenario than originally anticipated.

Let me now hand over the call to Santiago.

Sustained top-line improvement and strong OpCF

Santiago Fernández Valbuena

Thank you, Cesar.

Let's review our regional performance, starting with Telefónica España on slide number 8.

In a very challenging environment, we have shown our flexibility to quickly adapt our strategy to market conditions, combining a very rich cash flow generation with a sharp pick up in commercial activity during the second half of the year.

The very good news are that underlying revenue trends improved for a second consecutive quarter across both businesses, confirming early evidences of a recovery.

Moreover, despite top line pressure and high margin revenues being the most affected, we posted benchmark efficiency metrics.

OIBDA margin in 2009 reached 48%, with a limited drop y-o-y on a comparable basis, reflecting our focus on costs contention and in spite of the strong commercial activity recorded in the last part of the year.

CapEx to sales in 2009 declined roughly 1 p.p. to 9.6%, as we managed our investment as a function of demand.

As a result, we sustained our efficiency ratio pretty much unchanged in 2009, leading to a strong Operating Cash Flow, which topped 7.9 bn Euros in the year.

Intensifying commercial activity, building foundations for 2010

Santiago Fernández Valbuena

In the second half of the year we intensified our commercial activity in the wireless arena, as slide number 9 shows, with a clear focus on value customers and mobile broadband, consolidating our leadership in the market, both in terms of accesses, and more importantly, in terms of revenue.

Contract net adds topped 640 thousand in the second half of the year, with year-on-year growth rates ramping up significantly along the year. This led to a 5.3% growth in contract customers from December 2008, which already account for 65% of the total base. Our focus on capturing growth opportunities is shown on the strong performance of wireless data flat rates, that reached almost 2 million in December, or twice 2008 figure.

In a more mature market and amid the mandatory process to identify prepay customers, total net adds in Q4 were hit by the disconnection of inactive prepay lines, with no impact in our financial results. Regarding this, please take into account that in May 2010 it will be mandatory for all players to disconnect prepay customers not identified. As a result of that, we expect to record from around 100,000 to 120,000 disconnections in the second quarter of the year with almost a nil impact in revenues.

Positive trends are also coming in usage. Mobile traffic growth in the fourth quarter not only improved sequentially 1.6 percentage points but it did post the lowest y-o-y decline in the year.

And pricing behaviour in the market continues to be rational.

As a result, and taking into account MTRs cuts, ARPU declined by 9.7% in 2009. However, excluding the impact from MTRs, ARPU has shown a recovery trend over the last two quarters.

Sustaining wireline leadership with limited BB ARPU erosion*Santiago Fernández Valbuena*

In the wireline business, as detailed in slide number 10, we are sustaining our market leadership with limited impact on BB ARPU.

Lines declined roughly 7% y-o-y, in line with our guidance for the year, while in recent months we are recording better results. The fourth quarter recorded the best performance in 2009, excluding the seasonality of the third quarter.

Let me add, to put in place financial impacts, that 66% of lines lost in 2009 were offset by wholesale line net adds, which generate revenue stream for the Company.

Retail Broadband figures also showed a better performance in the second half, as the y-o-y decline in net adds close to halved compared with the one recorded in the first six months of the year.

In 2009 we sustained our market share at 56% level, with retail broadband connections growing 4% up to 5.5 million, while carefully managing our connectivity ARPU. As in the mobile arena, pricing is going down, but in a rational and contained way.

In the Pay TV market we continue gaining market share with Imagenio, that despite having just a 60% household coverage has reached a 17% market share. We are recording good customer growth, with even a faster pace in the fourth quarter.

Evidence of top line recovery*Santiago Fernández Valbuena*

To finish the review of T. España in slide number 11, I will rapidly explain revenue trends, which support evidences of the recovery.

Wireline IT and Data services continue to deliver healthy growth rates, the first on new contracts been awarded and the second on higher retail sales and circuit rentals due to mobile data explosion, which is also reflected on wireless data connectivity revenues growth trend.

Voice revenues across businesses, although still down versus 2008 on lower usage patterns, are sequentially improving from the second quarter, thus trending in the right direction.

Wireline broadband revenues are stabilizing in the fourth quarter with a minor decline of 2.7% in the quarter.

Finally PSTN access revenues declined 7.0% in 2009, excluding USO in both years, due to lower lines in service.

In summary, in 2009 we focused on revenue share and OpCF, setting the base for future growth.

T.Latam: A story of profitable growth*Santiago Fernández Valbuena*

Let me continue with the review of our operations in Latin America, where we are successfully managing growth, while enhancing profitability.

I'd like to stress the healthy revenue performance, up 5% year-on-year in organic terms, on the back of double digit growth in mobile service and Internet and Pay TV revenues, driven by the sustained customer base growth in the region, where we have reached close to 169 million accesses.

OIBDA almost doubled revenue growth, ramping up by over 10% to top 9 bn Euros, expanding OIBDA margins in organic terms by 1.7 percentage points to close to 40%. Management of OpEx and CapEx efficiencies jointly with scale economies are reflected in the over 3 percentage points improvement in the efficiency ratio.

The value of our diversification best emerges when you look at our Operating Cash Flow contributors by countries, where Mexico and Brazil drove close to 40% of the growth.

Let me highlight the increase of 1.3 bn Euros in Operating Cash Flow during 2009, totalling 5.7 bn euros while we gained 11 million customers organically.

And we delivered this strong performance without jeopardizing a focused CapEx effort. Let me highlight that the y-o-y decrease is mainly driven by lower CapEx in mobile. Our ongoing focus on quality is reflected on the strong investment made across wireline operations, where CapEx to sales ratio have remained pretty stable over the last 3 years.

Wireless business: improving trends in Q4 09*Santiago Fernández Valbuena*

Slide 13 outlines our Latin American wireless businesses, where we continue with a strong commercial momentum.

Net adds ramped up along the second half of the year significantly, reaching in this period 3.3 times the ones of the first half of 2009. The fourth quarter showed a turnaround relative to the first nine months of the year, when net adds were down compared to 2008. Let me remark the quality of our growth, as 19% of the net adds were contract.

It is also important to notice the improved ARPU trend along the year on the back of traffic stimulation and the robust data expansion, which drove outgoing ARPU into positive territory.

As a result, mobile revenues posted a very healthy evolution, with a 12% year-on-year growth in service revenue, despite the drag from MTRs cuts. Data revenue

grew an outstanding 38% year-on-year organically to represent 18% of service revenues in 2009, as MBB continues to gain traction in the region.

Wireline business: stabilizing revenue drivers

Santiago Fernández Valbuena

Let's move now to slide number 14 to review our wireline businesses in Latin America, where the focus in 2009 has been on raising service quality to increase customer satisfaction and drive growth.

Along the last quarter of the year we have recovered broadband growth and significantly reduced line losses, stabilizing revenue drivers and setting the foundations for 2010.

Fourth quarter has been the best in broadband commercial activity, driving accesses up by 6% year-on-year to 6 million.

Traditional line losses also showed the significant improvement in Q4.

The transformation of the businesses is showed by the increased weight of bundles in our base as well as by the higher contribution of Internet & TV revenues to total revenues, that weighted across the region 21%, an advance of over 2 percentage points over 2008.

Let me now spend more time on Telesp.

Quality improvements in Telesp starting to pay off

Santiago Fernández Valbuena

Telesp continued focused on raising its quality metrics, and our efforts are already paying off, as reflected by the better commercial performance recorded in Q4 and the significant decline in the volume of complaints submitted to the government and consumer associations, as you can see in this chart.

Q4 09 has been the quarter with the best performance in terms of fixed line losses in the last 5 quarters, due to a lower churn on the back of improved quality standards.

In terms of broadband, net adds recovered in the last quarter of the year to close to 60 thousand, 2.7 times the ones recorded in the first nine months of the year. And this has been achieved despite the fact that gross adds are still below the monthly levels recorded before Anatel's decision, as advertising just started at the end of November, and we are progressively resuming Speedy sales across distribution channels, and we are very much focused on capturing good quality adds.

The increased commercial activity was compatible with an OIBDA margin stabilization on a sequential basis, despite the higher short term spending on transformation initiatives.

We need to keep working to further enhance Telesp's performance, and we are working in the right direction.

Sustained performance in most markets*Santiago Fernández Valbuena*

To finalise with Latin America, let me review quickly the performance in two key operations.

In Mexico we have posted very strong results. At the same time that we gained over 1 p.p. market share, service revenue grew 18% and OIBDA soared by 55%, expanding OIBDA margin by over 10 p.p. And I already mentioned the strong increase in OpCF.

Vivo's performance was also remarkable. In a very competitive environment, it was able to gain market share while increasing profitability.

T. Europe: improving revenue trends and increasing profitability in key markets*Santiago Fernández Valbuena*

Let's now turn to Europe, in slide number 17.

Telefónica Europe accelerated revenue growth in the fourth quarter in spite of difficult economic conditions and increased competition, overall. We saw positive progress in our German and UK businesses, where we maintained strong market momentum.

At the end of 2009, Telefónica Europe's mobile customer base reached 44 million, an increase of 6.5% year-on-year. Of our new mobile customers, 80% were in the contract segment, a significant improvement over 2008.

The increase in the customer base, and the continued adoption of mobile Internet, which is helping to stabilize underlying trends in ARPU, resulted in positive organic revenue growth.

Improved efficiency and lower retention costs, led to an impressive 22% organic growth in Operating Cash Flow, of which 14 percentage points come from Telefónica O2 Germany.

T. O2 UK: continued outperformance*Santiago Fernández Valbuena*

In the UK, Telefónica defied a shrinking market to clearly outperform its competitors, gaining share in 2009 through a consistent approach to its core mobile business, with insight driven propositions, the continued migration of prepay to contract and its market leading contract churn at 1% in Q4 09. Mobile customer growth in the year was 5%, with contract customers growing by 14%.

As a result of this healthy customer growth and the increasing adoption of mobile Internet, mobile service revenues in the fourth quarter ramped up from previous quarters to close to 2% year-on-year growth in local currency, which translated into a strong 8% when excluding MTR cuts from the calculation.

OIBDA also accelerated in the fourth quarter to 4% year-on-year, clearly exceeding revenue growth in the whole year, as acquisition and retention costs grew less than implied by increased commercial activity, as well as due to higher efficiency in non-commercial costs.

CapEx in 2009 was reduced despite higher investment in networks to improve customer experience.

T. O2 Germany: the fastest growing operator in the market

Santiago Fernández Valbuena

In Germany, we capitalized on a best-in-class network, improved distribution franchise and a renewed portfolio to deliver market leading growth.

Contract net additions in the fourth quarter were 260 thousand; a significant milestone in the recent performance of the business, mainly boosted by the successful introduction of the “O2o” tariff and “My Handy” hardware model, with partner channels also contributing positively.

Mobile service revenues continued showing healthy performance in Q4 09, ramping up to 2.5% year-on-year if we strip out MTR cuts from the calculation. This was leveraged on 11% contract customer year-on-year growth and increased contribution from non-SMS revenues, stabilizing ARPU trends.

OIBDA showed a remarkable 19% year-on-year growth, with OIBDA margin increasing 3 percentage points on the back of the new commercial approach set up one year ago as well as the lower national roaming expense, as the deployment of our own network reached an end. This has resulted in a significant improvement in the Operating Cash Flow which has turned positive in 2009.

Debt: same quantity, improved quality

Santiago Fernández Valbuena

Turning now to slide 20, I would like to highlight that our debt size has remained broadly stable, while its quality has been improved: interest expenses target has been beaten, and the average maturity has been increased.

Our net financial debt stood at 1.9 times OIBDA at the end of the year or at 2.1 times when adding cash commitments, in the low part of the range reiterated at our last Investor Day. This will allow us to accommodate the effect of the recent devaluation of the Venezuelan Bolivar, that will push up the Total Debt-to-OIBDA ratio by circa 0.1 points on a pro-forma basis.

The effective interest rate has fallen by 46 basis points from 2008, benefiting from our floating exposure. The interest cost stood at 5.54% of our €45.2 bn average total debt, clearly below our 6% medium term target reiterated in the last Investor Conference. Even when adding FX losses, mainly due to USD purchases in Venezuela, the financial expenses stood below 6%, at 5.9%. Additionally, total financial expenses in 2009 have been pushed up by 630 million euros due to the recent events in Venezuela, but we do not expect this impact to be repeated in

2010, mainly as we will try to manage the net monetary position, with the aim to nearly eliminate the accounting charge on our cash due to inflation.

Finally, in 2009 we have continued lengthening the average maturity of our debt, that we will try to keep above 6 years in the future. To reach that goal in 2009, we issued €8 bn long term bonds and signed a €4bn loan extension option, focusing on prefinancing 2010 and 2011 maturities respectively. So we have increased our average debt life to 6.6 years, and built a cash position strong enough to exceed 2010 debt maturities.

Let me now hand back again the call to our Chairman

2010 priorities and outlook

César Alierta Izuel

Thank you Santiago. Let me now share with you our positive outlook for 2010.

During this year, our first priority is to boost revenues, capturing growth opportunities in our footprint. Against a backdrop of better economies across regions, we will capitalise our strong market positioning and execution skills to foster broadband adoption, both in the fixed and the mobile businesses, and to capture additional mobile voice potential, mainly in Latin America.

To secure revenue growth, we will reinvest efficiency gains without jeopardising a benchmark OIBDA margin, as we will leverage scale economies and synergies across the whole Group.

Positive customer and volume growth prospects and our financial strength paves the way for higher investments in 2010, driven by CapEx in broadband and mobile coverage and capacity.

As a result, and according to guidance criteria, Group revenue is expected to go up between 1% and to 4% in 2010, mainly driven by a strong top line expansion at Telefónica Europe, very solid growth revenues in Latin America and a lower underlying revenue decline in T. España compared to 2009.

We anticipate consolidated OIBDA growth between 1% to 3% in 2010. Please notice that this range incorporates the contribution from Hansenet from March, which is expected to be slightly below €100 m, and the negative impact of the new TV tax fee in Spain amounting to € 150 m.

Total CapEx should be between 7,450 and 7,650 bn euros this year, in line with our mid term guidance and still below the peak CapEx/sales ratio reached in 2008.

Please be aware that quarterly performance won't be linear along the year. OIBDA growth rates in Q1 are expected to be below full year targets, as:

- First; y-o-y comparisons will be tough in Spain, as commercial activity in the first half of 2009, and particularly in first quarter, was weak. We expect a better OIBDA performance in the second half of the year;

- the operating problems that we faced in the wireline operations in Brazil and Colombia hit 2009 performance mainly from the second quarter;
- Hansenet's contribution will start to be consolidated from March.

In summary, we will foster top line growth while maintaining a high cash-flow generation profile.

On the other side, in October 2009 we confirmed our 2010 EPS target of €2.10 on the back of the operating guidance provided and up to €1bn from further efficiencies in taxes and financial costs and potential assets sales. Despite several challenges have materialized since then (as the Bolivar's devaluation and hyperinflationary accounting in Venezuela) we maintain this target capitalizing on the following levers:

- Interest expenses for 2010 are now expected to be around 5.5% to 5.75%, below our previous expectations (which was 6% as we said in our Investor Conference).
- 2010 accrued tax rate is estimated to be around 25% to 27%, reflecting recurrent lower taxes on goodwill amortization and potential further tax efficiencies, as the Company continues to look for tax management opportunities. Previously, the accrued tax rate was expected to be at 27% to 28% in 2010.
- And we continue to analyze value creation opportunities maintaining an active management of our non core asset portfolio.

2010 key priorities by region

César Alierta Izuel

Regional priorities are outlined on slide 22. All of them have the same focus: to foster top line growth by maintaining a strong commercial momentum. If I would have to differentiate among regions I would say that:

- In Spain we will continue executing the strategy already seen in the second half of 2009, when we have been able to revive our commercial activity and consolidate our leadership in the market.

- In Latin America, our focus on the mobile arena will be on expanding the customer base while improving the ARPU; in wireline we will enhance customer satisfaction and quality as key drivers to speed-up our transformation towards a broadband Company.

- In Europe, we aim to continue outperforming in our key markets, following the track record delivered in 2009.

In summary, our high quality and well diversified asset mix will allow us to deliver a very good set of results in 2010, stressing once again our differential growth profile in the industry.

Sector leading cash returns

César Alierta Izuel

Shareholder remuneration continues to be our first priority in the allocation of uses of free cash flow.

In 2009, we devoted 5.5 bn Euros or 61% of our FCF to shareholder remuneration.

We offer sector leading cash returns and we are fully committed to deliver on our highly attractive dividends for the coming years.

2010 dividend will go up 22% on year to 1.40 euros per share, and we have a 1.75 euros per share target for the fiscal year 2012.

Though we have not launched a share buyback program, we continue buying our own shares tactically. In this regard, we made a filing to the CNMV stating that as of February, 19th, 2010 we hold 0.6% of the share capital. This is in addition to derivatives on 150 million shares held at year end.

To ease some concerns, I would like to stress that our dividends are comfortably covered by our cash generation. And our dividend flow is not dependent on repatriation from any country in Latin America.

In summary, Telefónica is a very attractive investment proposition, with leading dividend per share yield, not only in the sector but among the top largest companies by market cap worldwide. We're the highest company between the 50 companies by market cap in the world with the highest dividend yield. At yesterday's price our dividend yield was 8.3%, well above our bond yield. In my view this is too high considering the attractive growth prospects we announced in our last investor Day and that we have reiterated today and that are clearly implied in the dividend growth path of our dividends.

We reiterate our selective M&A approach

César Alierta Izuel

Moving to slide 24, we do confirm our selective M&A policy, primarily focused on investments to support our current operations like getting additional spectrum and in-market consolidation opportunities. We also aim to increase further our stake in China Unicom to 10%.

Our priorities now are the spectrum auctions that will take place in the coming months in Germany and in Mexico. It's also possible that additional spectrum is awarded in Spain along this year.

Regarding in market consolidation, I would like to remember that 10 days ago we closed the acquisition of Hansenet, a transaction that completes perfectly our strategy in the German market.

Conclusions

César Alierta Izuel

To recap,

Despite the significant challenges and adverse conditions, we posted a robust performance in 2009 and maintained the track record of delivering on our commitments, which added to the positive outlook for 2010 and mid term, reinforces Telefónica differential profile in the industry.

We have the right strategy and we are a lower risk investment case.

The headwinds from Venezuela are already behind us.

We continue to be a shareholder oriented company with a selective M&A policy, offering industry leading cash returns for our shareholders.

Before we enter into the Q&A session, and taking into account recent rumours regarding TI, I'd like to stress that we keep working with Telecom Italia to maximize synergies through the current industrial partnership because this position is clearly the best alternative for our shareholders. We are very comfortable with the current 46% stake in Telco, and we are very pleased with the cash synergies that our alliance is already delivering: we have jointly captured over 620 million euros worth of synergies since March 2008. And during 2010-2012 we expect to deliver even more value than in the previous period.

I hope that with this statement we have clarified all the recent rumours about a change in our relationship with Telecom Italia and thus we can focus the Q&A session on our operating and financial performance. We won't make further comments on Telecom Italia.

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

Q&A session

Operator

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

David Wright – Deutsche Bank

Yes, it's David here. A couple of questions please. First of all, your EPS target, you mentioned about potential asset sales within that. Is there anything you could give a little more granularity on any assets, such as Atento perhaps?

And then, a question for Matthew, please. In the UK, obviously O2 UK I think continues to surprise all of us, probably not yourself, but all of us, on its excellent performance. But obviously, in Q1 we now have some additional iPhone competition from Vodafone and probably a little more momentum around Orange's efforts, too. So, with that strong Q4 performance in mind and looking ahead to Q1 in 2010, perhaps just your feeling on how the competitive edge is continuing there because I did also note some fairly bearish comments from Palm on sales of the Pre. Thanks.

César Alierta - Chairman and CEO Telefónica

Okay. David, thank you for the questions. This is César Alierta. As you know, we are very comfortable that we will reach the €2.10. And as I said on the presentation with regard to the efficiencies in tax and financial, especially which are too important, but also we will dispose of some assets which are non-core to our business. As you know, we always have capital gains in our balance sheet and some of these are not core to our business. And one of the most important things that can be is to take to the stock market Atento as everybody know, which we don't think is a core business.

Anyway, I would like to tell you at this moment that I have been through many crisis in my life and I can tell you that I'm very proud to say that Telefónica, if you look at our positions, we have not gone through any crisis. Everything we have in our portfolio are capital gains, so possible capital gains. So, that's a position that we feel so comfortable toward the future with the strong financial position and some balance sheet that it looks like we have been not going through a crisis.

David Wright - Deutsche Bank

Cool. Thanks. And, Matthew?

Matthew Key - Chairman and CEO Telefonica Europe

Orange cleared a number yesterday that they sold in Q4, I think they declared 222,000. And all I can say to you is I can't give you a specific number, but during that same period, we actually outsold them, so more than comfortable on that. And ever since Vodafone has started selling the iPhone in January, we see absolutely no

evidence of people leaving us, churning on the iPhone going back to Orange or Vodafone, so very comfortable with our iPhone volumes. We continue to out-trade the market and no sign of churn whatsoever.

On the Q4 net adds, I can comment on our trading activity. We're really happy with the value that we get and our customers that we get. And you will have seen how Q4 net adds held up with where we were in previous quarters. I would say that if you look at the UK market, total net adds of 1.4 million in Q4 doesn't stand the logical test. So, I would suspect that some of the other networks may be getting some churn coming back into Q1 or Q2 during 2010.

On Palm, yes, I saw the comments from John and the guys at Palm yesterday. All I can say is that in the UK, the volumes were broadly where we expected them and in Germany, actually we're very happy, it was our biggest selling handset during Q4.

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

Next question please.

Operator

Our next question comes from Simon Weeden from Citigroup. Please go ahead.

Simon Weeden - *Citigroup*

Yes, thank you very much. I was also going to ask about the iPhone, but I wondered if you could touch on the impact it's had in Spain, where I think you may be pricing it a little higher. I wondered if that, how that compared to the other markets. And also, on Brazil and Telesp in particular, I'm thinking also about the assets you're making in Colombia. Can you tell us to what extent the one-off additional cost effort that you're having to put into those assets could come out of the numbers during 2010?

And against your advice perhaps a little, but I wondered if you wouldn't mind clarifying your situation with respect to Telco, given that is fine to say your 46% stake you're happy with, but I'm not sure that the other parties are altogether happy with their 54% stake. Is there a scenario where you could see that holding company disappearing and your stake being held directly in TI, for example? Thank you.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Thank you for the question. This is Guillermo Ansaldo. Trying to address your question about the iPhone in Spain, we're not allowed to disclose figures regarding our sales of iPhone, given the agreement we have with Apple. But I can say that sales volumes are going. are doing very well and that the iPhone and other 3G smartphones are contributing to the explosion of sales that we're having with mobile broadband, where roughly we end the year with almost 2 million, 1.9 million of flat tariff broadband, mobile broadband contracts and that's almost double what we have at the end of last year.

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

Taking the question on Telesp and Colombia, let me start by Telesp. We are progressively going back to a normal business, significant improvement in quality levels. I mean, we have increased significantly our call center capacity. We have ensured redundancy in the tollgate. We have increased the IP capacity of the network and we have redesigned our core IP network. As a result, quality levels are back to historical lows, I mean, historical highs.

Claims in Anatel and Procom are historically low. bad debt over total revenue have decreased to the lowest level of this year. Churn in traditional lines and ADSL have significantly improved. So, we are little by little getting back on track. And that's also being noticed or starting to flow through the customer base. Gross adds in traditional lines is back to the previous levels, positive sign. Line losses have been significantly reduced, as Santiago has been detailing.

Gross sales in terms of both ADSL and lines are also back on track, progressively back on track because we are pretty focused on the quality of the new adds. Market share has stabilized, both in the traditional lines. We have increased a little bit of our market share and we think that we have increased a little bit of our market share in ADSL in the region. A pending issue for us is still our TV offer in Brazil that we need to improve.

Voice traffic is dropping less in the last quarter of the year and that's something that we need to monitor because that might be very good news. A stable 20% of revenue coming from new businesses, 23%, almost 24% of the lines, of total lines with ADSL, a stable OIBDA margin in the last quarter of the year, significant effort in CapEx for third year in a row, in the neighborhood of 14% of our sales. And also, we are trying to improve our cost structure. In order to give you some guidance of January, of the first months of the year, trends keep being positive in terms of both net adds and in terms of quality.

In the case of Colombia, we are a little bit below that level of turnaround. What happened to us in 2009 is that we lost a significant amount of traditional lines because we were un-positioned or disposition in terms of the commercial offer. We have rebalanced our situation. We have also improved our commercial position in terms of market share.

But we need to do additional efforts. I think that we launched a new commercial offer in I think it was January 17th, which is paying very good results but still too soon to give so such positive signs as in Telesp. OIBDA margin has been stabilizing a little bit in the last quarter, so better news that we need to consolidate because we need them to turnaround to fulfill our 2010 target. But so far, we're on track.

César Alierta - *Chairman and CEO Telefonica*

With regards to Telco, we are very happy with the position in Telco and my position is that our Italian partners are also very happy. And the fact is that we renewed the agreement in January for the next three years. So, it's an agreement for the next three years and all the re-financing has been completed. So, that is the situation.

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

Next question please.

Operator

Jesus Romero - *BAS-Merrill Lynch*

Hi. Jesus from Merrill Lynch. Two questions, please. The first one is just giving us a bit more detail today on the 2010 guidance on slide 21. And if I do the math, the guidance for OIBDA, the range is EUR22.6 bn to EUR23 bn. But the devaluation of the Venezuelan Bolivar is a headwind of EUR900 million.

So, you're down to, let's say, an adjusted guidance of middle of the range EUR21.9 bn. That's EUR700 million below the reported OIBDA this year and you're still talking about EUR2.10 of EPS, which is a EUR1.75 bn increase in profit. So, how should we think about this? You see most of the improvements in EPS should come below OIBDA in 2010 and how much of that number if you could give us any more hints would come from a capital gain?

And the second question is related to some of the comments you've made recently regarding Google's potentially having to pay for some of the network usage and if you could also say something on the wholesale applications community you announced recently in the Barcelona GSM event. Thank you.

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

Jesus, this is Santiago. Let me answer if I can the first part of your question. We have consistently provided guidance on an FX-adjusted basis so that we can compare pears and pears and apples with apples. We think that despite the complexities of our group, this continues to be the right way to proceed. So, we will continue providing FX-neutral guidance numbers.

Your numbers are undisputable and I think when the Chairman made the statements during his call, it should've been evident that we do expect a significant contribution this year from both financial and tax management activities along with asset sales to contribute to the EUR2.10. Just where on that ladder we will end to achieve the EUR2.10 is still unknown.

But please do add the FX, your best FX assumptions to those numbers and your best assumptions on what could happen below the operating line to arrive at a sensible estimated EPS number that, again, is non-adjusted. It is going to be spoken of as reported. So, you know, it's still early days within the year. But we do think that it's going to be a year where most contributions, I'm sorry, that contributions will come from all fronts and not only from the usual sources.

César Alierta - *Chairman and CEO Telefónica*

The thing about Google, let me recap two things. 20 years ago, the telco industry generally was liberalized because there were phone monopolies, and because of that, all of us, we got an ex-ante regulation. And the ex-ante regulation, basically

the goal was to increase and foster competition. Well, we all know that this has been achieved. There is a lot of competition, we're many players and the competition is there.

So clearly, with regards to the operators in the telecommunications company, there is a clear necessity to go from ex-ante to ex-post regulation. But clearly, the new players, emerging players in this new value chain, I mean, the competition is not enough. So clearly, there is a need for an ex-ante regulation to foster the competition, which is good for the consumers and for everybody. So, we think it will happen to these new players like it is because the value chain cannot be asymmetrical. So, that's what we're expecting, that to give the quality of service and the network capacity, it should be in that sense.

What we think is going to happen? Well, I think what we think is going to happen, that the model is going to work and will make the whole model, the whole industry, workable is what is called revenue sharing, the revenue sharing that is already in application and services and which I think it has been very important. And basically, there should be revenue sharing also on the search engines. And basically, that's our point of view.

And now, Julio will complete on the WAC.

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

Jesus, the announcement we made in Barcelona about WAC is a joint agreement between a lot of companies in order to provide global wholesale applications and services ecosystem, supported already by 30 operators, including the biggest companies and the four major mobile handset manufacturers.

This WAC solution provides to the applications developers community three kind of assets. The first one is standard APIs, testing, marketing support, information, statistics, and education and all of that across different devices. The second, it is the biggest commercial channel distribution of compliant applications because all the operators that we are behind this initiative. And third, we are providing to this developers' community access to an unparalleled scale of 3 bn customers, which I think is the best asset in order to compete in this new digital world.

So initially, this initiative is going to be focused on mobile widgets, but in the future will evolve in order to cover other platforms. So in my view, this is the right response of our telco industry in this new digital world landscape.

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

Next question please.

Operator

Our next question comes from Robin Bienenstock from Sanford Bernstein. Please go ahead.

Robin Bienenstock - *Sanford Bernstein*

Yes, thanks very much. Two questions: I guess the first question is you've talked a lot about your revenue growth in Latin America and yet Brazil, Chile, Peru, Colombia, and Uruguay are all shrinking in local currency terms. And I've noticed that your mobile prices are 25% to 95% higher than peers in most of your Latin American countries. So, the question is how are you going to get back to local currency revenue growth or are you? And are those prices sustainable? And that's on the mobile.

And then, my second question is about the Spanish fixed line, where I noticed that ICT is the largest part of your growth, so essentially enterprise services. Are these Spanish or are they international because I know that you're booking some international things in various places? And are you using contract accounting and if so, what margins are you booking yourselves and what are you assuming? Thanks very much.

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

Well, thanks for the question. In terms of our revenue growth, in fact, we would like to check the numbers on the premium because, I mean, those are not coincidental with the ones that we have because we are competing on the market. And there is significant competition now in almost every area where we are present. So, I would like to check those numbers in order to conclude.

Having said that, I think that in the last quarter, we have been trying to resolve the situation in our major market, namely Telesp and we have been back getting some market share, namely in ADSL, and to retain part of the line losses that we have been suffer before. So, I think that our offer is competitive. It was not competitive in Colombia and that's why we have been losing significant amounts of lines. But with the new campaign that we have been launching in January 17th, the numbers that we are getting from that looks appealing, though it's still too soon to say.

And both in Chile and in Argentina, we are competing with very strong players in each of the countries. And therefore, we don't feel the full market share loss that we are becoming uncompetitive in our commercial offer. So, that's why I would like to check the number with you and see them because we are not feeling the effects of that conclusion in market share.

And in terms of the contracts from the corporate side that you were mentioning in Telesp, of course, margins are significantly lower than the traditional business in the residential market. We have significant, we have a very large market share in the customer segment, in the corporate segment on all our wireline operations because we are the former incumbent. And we have very competitive offers in terms of infrastructure, deployment, and capillarity. Margins are in the close of the low double-digit numbers, but are highly contributors and are significantly big in terms of providing additional revenue growth.

And in order to conclude, I would like to mention that in 2009, it is true that we have been lagging growth on the wireline business. But it's also true that we have been facing a situation that was different from what we were budgeting at the

beginning. Remember that almost every country in Latin America had negative GDP growth with the exception probably of Peru and we don't know yet about Brazil. And therefore, I mean, the competitive environment in terms of consumption lower than expected.

But having said that, with the figures that we have been foreseeing in the market in the fourth quarter and the first week of 2010, we are still, we feel comfortable that we can turnaround the situation. We are pretty focused, as you might imagine, in Telesp and in Colombia because those are going to be largest contributors to growth if we turnaround the situation, and that's the expectation that we have for this year.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Robin, this is Guillermo Ansaldo. Regarding your question about ICT, it's a segment that is growing very well. Basically, we are providing services that are very close to our telecom infrastructure, for example, typically housing, hosting services, end-to-end desktop management, and so on. We are serving and our customers are companies or institutions that are in Spain. They could be public institutions or private institutions, national or multinational. But the services are those that are provided in Spain.

The volume size that you can see in the numbers is roughly half, 500 million euros. So, that's below the 5% of our revenue mix. So, it's growing, but the impact of this growth is limited to that size. Regarding margin that you're asking, the margin varies across operation, but it's roughly between 10% and 15%.

Robin Bienenstock - *Sanford Bernstein*

Thank you.

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

Next question, please.

Operator

Our next question comes from Jonathan Dann from Barclays Capital. Please go ahead.

Jonathan Dann - *Barclays Capital*

Hello. Two questions, one is, can you sort of comment and just remind us how much cash is left in Venezuela, and what the significance of, I noticed on one of the slides it talks about a different exchange rate before January the 8th, if you could update us there. And then secondly, I guess, just looking at, I guess, the relationship with Telecom Italia, are you rolling out any relationship where you might be able to acquire perhaps their Cuban assets, perhaps TIM Brazil? Are you sort of ruling out all permutations beyond the current shareholding and within TSU, within Telco?

César Alierta - *Chairman and CEO Telefonica*

With regard to Telecom Italia, I think I already said that we are very happy with the 46% participation in Telco, our industrial alliance, point.

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

Jon, let me take you on the cash balance in Venezuela. At the end of last year, that is before the devaluation, the dollar value for our whole cash holdings there was roughly \$3.3 bn, which of course is a much lower number after the devaluation that happened at the beginning of the year.

A couple of other things have happened at the same time and it is that the spike that has been opened, and we do expect to be able to claim back the dividends that have been declared and asked for at the local currency agency, CADIVI, at 2.6. This is you know, our expectation. It has been an expectation all along and that should assuage many investors' worries that the cash was trapped. It isn't. Not only that, we continue to expect it to come home and not only the full amount that we would do from the 2006 dividend if I recall correctly, but also the two other years' dividends that we have claimed.

We will continue to update you on those developments. But the devaluation has also opened this other more warm or more interesting line. Again, because we have claimed those dividends, we now have a local liability, which is what I was talking about when I said during the call that we would be trying to minimize or shrink the net cash position. We will both have assets and liabilities sitting in Venezuela at the same time.

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

Next question, please.

Operator

Our next question comes from Mathieu Robilliard from Exane BNP Paribas. Please go ahead.

Matthew Robbiliard – *Exane BNP Paribas*

Good afternoon. I had two questions. First, with regards to Spain, you hinted to the fact that revenues would continue to decline; at the same time you expect to be a bit more active on the commercial front. So my question is: do you see opportunities to reduce other OpEx to mitigate the decline in revenues and the increase in marketing spend?

Second question has to do with Latin America. I note that in Mexico, there are spectrum auctions and possibly new entrants. I also note that in Brazil, to me at least, a surprising announcement that Telebras could be investing up to 10 bn dollars in broadband to provide broadband access to Brazilians. So, the question here is really: are you forecasting and including in your guidance the entry of new players in Mexico and Brazil? Thank you.

Guillermo Ansaldo - *Chairman and CEO Telefónica España*

Yes, this is Guillermo Ansaldo. Regarding your question about Spain, as we mentioned, we will continue in 2010 to try to foster the growth of our customer base, very much focused on value customers and obviously on broadband. That obviously puts some pressure on margins on the commercial expenses side. And of course, from the other side is our strategy, where we continue exploring all the savings opportunities, both on OpEx and CapEx. And as you have seen in 2009, our efficiency ratio, which combines CapEx and OpEx, was virtually the same we had a year before. So, it's tough, but we do believe that the effort is worth it because we will have more customers, value customers. And we will be better prepared for the future when the cycle turns around.

José María Alvarez-Pallete - *Chairman and CEO Telefónica Latinoamérica*

With regard to your question about the competitive landscape in both Mexico and Brazil, if we go first to Mexico and the spectrum auction, we already knew when the auction was designed, that part of the spectrum was going to be reserved for new entrants. And namely the names of Televisa was quoted and others. Since then, Televisa announced that they're under consolidation talks with Nextel and therefore, there's supposed to be a more consolidated market. So, those are the news that we know so far.

And in terms of that presenting some additional pressure, we don't feel that because Nextel is already a player in the market. So, we don't feel that the situation is going to be deteriorated in Mexico, but rather the opposite because we do need the spectrum in order to become much more competitive in mobile broadband and mobile internet. And therefore, I think that the auction being completed and awarded, whatever the result is, if we gain more spectrum, it would be good news.

On top of that, remember that there is another process in Mexico that is being run. The National Electrical Company is putting for sale dark transmission fiber with national coverage. And that's very good news because that's going to help to reduce down transmission prices in the country and therefore to be able to provide a more competitive offer.

So, whatever we approach Mexico, we think that the situation is improving in terms of the competitive landscape, even though it's true that new players might arise. But so far, so good and we think that this spectrum thing and the transmission is good news.

And in terms of Brazil, the announcement of Telebras is still pretty confusing. It is true that this figure has been mentioned and covered by media. But it is also true that it is not yet clear what is the strategy that this potential investment is going to be devoted to, if it is wholesale capacity, if it is retail capacity. What is the linkage between the legal contracts of the privatization process, so still too soon to say.

In our case, namely in Sao Paulo, remember that just in the Sao Paulo state, there are seven networks already operating. So, the level of competitive pressure is pretty high, at least in our landscape in wireline broadband. So, we are prepared for that,

and our main focus is again to turn back Telesp in good shape and that's what we are focused on and the reminder we will see.

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 Georgios Ierodionou from ING. Please go ahead.

Georgios Ierodionou - *ING*

Good afternoon. I have two questions, please. The first one is regarding the guidance. Given that acquisitions have been included for guidance in 2010, am I right in assuming that your four-year guidance also includes these items and does that seem like a change versus what was previously communicated?

My second question is on cash flow, particularly around the difference between net interest payments and net interest expenses, which was around EUR1.3 bn in 2009 and you stand out around EUR650 million related to hyperinflation in Venezuela. But could you give us an idea of what makes the rest of the difference between the two numbers? And is it something we should expect to see in the years to come or was it just limited to 2009? And also, whether you could talk around tax payments in the cash flow statement versus the P&L. Thank you.

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

On guidance, the short answer is Hansenet, was not included in our Investor Day's and now it is. That's the only change in perimeter that you should account for.

On cash flow, the difference between interest expense and interest accrual comes from mainly two sources. The first one is the concentration of coupon payments because they are annual coupons and there is a time difference because we did issue lots of bonds in 2008. That explains most of it. The rest is vastly explained by the Parapat payments in Colombia falling due at discrete intervals in the year and, of course, being accrued on a time basis. So, that fully compounds it and our Investor Relations team would be more than happy to provide better numbers.

In terms of tax payments, you may have noticed the pick up in tax cash payments in Q4, which comes mainly from the advanced tax payments that we must provide the local authorities, local tax authorities in Spain and that then gets evened out according to the tax statement in the month of July. So, we did have to make a very significant cash payment to the local tax authorities in December. That is now going to be around the summer clarified, you know, for good or for bad.

Georgios Ierodiconou - *ING*

Thank you.

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

Next question please.

Operator

Our next question comes from Stephane Beyazian from Raymond James. Please go ahead.

Stephane Beyazian - *Raymond James*

Yes, good afternoon. I'd like to come back on the competition in Latin America but with a different angle. How do you perceive the merger of America Movil with Telmex International? I mean, do you expect also to increasingly focus on integrated offers in some of your Latam position? Do you see it as potentially risk to some of your commercial position, where you don't have some a fixed asset? And I'm not only thinking about Mexico, I mean, do you basically perhaps meet sooner than expected to control some fixed assets, and also Brazil, I mean, on a nationwide basis?

My second question is regarding CapEx. Could you give some more color on where potentially there could be an increase in CapEx in 2010? And again, I'm thinking about Latin America. I mean, should we expect some increasing CapEx for 3G rollouts and also for some specific situation, I'm coming back on the Brazilian government national broadband plan, which as far, if I'm correct, it is also involving private companies to be investing in broadband assets, not a reach for mobile broadband. Thank you.

José María Alvarez-Pallete - *Chairman and CEO Telefónica Latinoamérica*

Thanks for the question. Regarding the announcement of the integration process of the wireline and wireless business of Carso and America Movil, we did that, years ago, I mean, in terms of whatever was that possible to be done, we did that.

In terms of aligning the interests of the different shareholders in the value chain, since 2006, we are running from a single point, both the wireline and the wireless operators. So on that side, we have been preparing ourselves for that. We know the markets where a quadruple-play offer is attractive for customers and some others where not. So on that side, we monitor the situation very closely as you might imagine, but we think that we are prepared.

The only play, and do not underestimate the fact that this process has execution risk and requires significant focus. So, having the same focus on the commercial side and integrating process is a complex matter and we know that. But namely in the case of Brazil, which is probably another of the market that you might be thinking of in terms of this integrating process, again, our main value point that we can

provide to our shareholders right now is to turnaround the Telesp situation. We are focused on that.

And at the same time, remember that Vivo has been performing a very good year I would say. So, we need to be sure that we keep the focus of Telesp management team on readdressing the situation and the Vivo management team of delivering another outstanding year, before thinking about further potential joint of commercial offers or whatever. So, we do not feel that need so far.

And in terms of CapEx, what it is included, well, in most of the countries where we are operating on the mobile side, we have already been deploying during 2009 3G networks very aggressively. In the guidance, it is already included additional deployment, aggressive deployment I would say of 3G all around the region. Namely in a country where we were significantly lagging behind, like Colombia in 2008, we did catch up significantly in 2009. On that side, we have increased by 13 times the number of places where we are present in terms of the technological deployment of 3G. So, it's already embedded in our guidance.

The only thing that is not embedded in that figure is the spectrum that it might be allocated in Mexico. All the rest, including some initial movements on the fibre deployment in Sao Paulo and in Chile, is included in the guidance that we provide you.

Stephane Beyazian - *Raymond James*

Thank you. The increase in 2010 is mostly coming from which region, Latin America, Spain, O2?

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

The increase we have on CapEx for 2010 is coming mainly from Latin America and Spain. In Europe, we expect a slightly decrease because we made already the effort we needed in Germany in order to have the network. We did it. And then it will come from these two regions.

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

Next question please.

Operator

Next question comes from Torsten Achtmann from J.P. Morgan. Please go ahead.

Torsten Achtmann - *J.P. Morgan*

Hello. Two questions, please, one for O2 Europe, you are, let's see, pushing integrated products more and more. So, do you feel a need in the UK and in Germany to add a TV product to your offering to compete more efficiently? And the second one is to fixed line in Spain. Could you give us an indication where the line losses are coming from, except the wholesale line loss? Is it disconnections or is it business access line loss? And do you have any visibility when that could turn around? Thanks.

Matthew Key - *Chairman and CEO Telefonica Europe*

Thank you. Let me pick up the Europe question on TV. I think when we look at both markets, they both look pretty difficult from a TV perspective. Clearly, you've got Sky in the UK, which are a dominant operator and have most of the premium content tied up. In Germany, some pretty good cable companies but also a lot of free-to-view channels in Germany. So, is it a major focus for us? Probably not. May we test some things? Maybe, but certainly not a major focus for us over the coming few years.

Guillermo Ansaldo - *Chairman and CEO Telefonica Espana*

Okay. This is Guillermo Ansaldo. Regarding the fixed line, in 2009, we lost roughly, had a net loss of 7% of our total fixed line base. These are retail accesses, by retail means whenever we have a built-in relationship with the end customer. When we look at total line loss, meaning wholesale plus retail, the decrease is only 2.4%. That means the difference is basically wholesale lines.

This is new regulatory figures, where allows more connection between third parties and the end consumer. The whole market, we estimate that decrease a little bit during the last year. And basically, the disconnections, total disconnections 2.4% and retail 7%.

Looking into the future, we do believe that this trend will ease up a little bit and that we'll start seeing better numbers in 2010 and 2011 and 2012. You've seen in the second part of last year that the volume of disconnection is lower. And that we believe will ease up in the future taking into account the economy will start to improve and we'll have more gross adds into this market.

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

We have time now for the last question, please.

Operator

Our last question comes from Luis Prota from Morgan Stanley. Please go ahead.

Luis Prota - *Morgan Stanley*

Yes, thank you. Sorry to come back to Venezuela, but I don't think that I fully understood the comment on negligible impact on net income from monetary adjustment and having now a liability which is offsetting or netting off this cash position. What's the nature of this liability? How do you created this? And also, regarding margins in Venezuela and the comment made that most of the risk is behind us, something that I would like to understand is whether you have still flexibility to increase prices aligned with inflation.

And also, what percentage of your costs in Venezuela are in hard currency and whether you see any kind of operating margin pressure? And finally, regarding Germany and the upcoming spectrum auction, KPN has made clear that they are open for partnering after the auction. I would like to get your view on this as well. Thank you.

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

Luis, let me try and explain. I was alluding to the asset and liability impacts after the devaluation. So what is going to happen this year that we still, what happens is we still have cash in Venezuela that has suffered, is going to suffer a significant correction in dollar or euro terms. But at the same time, we have claimed the dividends. So, we have north of VEB6 bn in cash. And we have north of VEB6 bn in claimed dividends that are now a liability of the Company to the extent that they are approved. This is the liability asset offset that I was talking about.

We do not claim that the exchange rate is going to be the one we expect. But certainly, we are not going to need if my accounting is correct an additional adjustment because of the net cash value of our investment there. So, no more idle cash means no need for further cash adjustments.

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

Yes, hello, Luis. Jose María Alvarez-Pallete speaking. Taking the question on the margins on Venezuela and what is going to happen after the devaluation, still unknown. The main uncertainty right now is inflation, what is going to happen with inflation because this is really what is going to affect our business in terms of need of having some tension in pricing schemes or in terms of the cost. So far, and it's too soon because it's just one month or almost two months away. It's too soon to say. But so far, we do not feel significant tension in terms inflation. But again, it's too soon to say. We need to monitor that.

In terms of what is the cost structure and therefore how this inflation can affect us, remember that we were already not subsidizing handsets in Venezuela, precisely because the cost of internalizing those handsets. Remember that already in year 2009, the handset imports were carried out in parallel market and therefore was already in terms of dollars being adjusted. And that's why we were not subsidizing handsets in Venezuela and this is mainly the main impact of the devaluation.

Other parts are basically denominated in local currency, labour costs, interconnection, or other commercial, like commissions and other commercial expenses. So before concluding, we need to see what is the evolution of inflation. So far, it doesn't look concerning, but still too soon to say.

Matthew Key - *Chairman and CEO Telefónica Europe*

I'll just pick up the German question. In principle, network sharing is something that we like as long as it doesn't restrict our commercial flexibility witnessed by the sharing agreements we've already got with Vodafone in the UK, Germany, and Ireland. With respect to Germany specifically post auction, the depth of that potential agreement and who with, clearly depends on the outcome of the auction and who ends up with what spectrum. So in principle, yes, we're in favour but who with and to what depth to be determined.

César Alierta - *Chairman and CEO Telefonica*

Okay. This is César Alierta. On behalf of all of us, we want really to thank you. Appreciate very much your attendance and your questions and wish you a very good weekend. Thank you very much.