Telefónica

Telefónica January-September 2011 Results Conference Call Transcript

11th November, 2011

Introduction

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

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss January-September 2011 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 newly appointed Chief Financial and Corporate Development Officer, Mr. Angel Vila, who will be leading this conference call.

Presentation

Ángel Vila- *Telefónica S.A. - Chief Financial and Corporate Development Officer*

Good afternoon, ladies and gentlemen, and thank you for attending Telefónica's 2011 third quarter results conference call. It is my pleasure to chair this call as new Chief Financial and Corporate Development Officer.

Today I have with me Julio Linares, Chief Operating Officer, José María Alvarez-Pallete, head of the new Telefónica Europe and Santiago Fernandez Valbuena, head of Telefónica Latinoamérica.

Also with me are the heads of the new global units Telefónica Digital and Telefónica Global Resources, led by Matthew Key and Guillermo Ansaldo, respectively.

Miguel Escrig, our Chief Financial Officer, is also attending this call.

During the Q&A session you will have the opportunity to ask questions directly to any of them.

9M 11 Highlights: Steady revenue growth and solid margin

The results released today show that our diversification and scale enable us to deliver strong revenue growth and solid profitability, despite ongoing economic pressure and severe regulation in some of our markets.

We are particularly pleased with the very strong commercial activity recorded in the last quarter, leading our customer base to reach the 300 million mark.

Revenue to September was up 5.4% year-on-year, on the back of outstanding performance of T. Latam and sustained growth in mobile data.

Despite increased commercial investment in contract and MBB, our underlying OIBDA margin was 36%, with limited erosion year-on-year, as guided at the beginning of the year.

By regions, Latin America is already the largest contributor to key financial metrics and quite soon will represent 50% of our results, driving Telefónica's growth.

Within Europe, stabilisation of underlying trends in Spain is to be highlighted, while the very good performance in Germany offsets the slowdown in other European countries. I'd also like to highlight the new organization announced in September, which will allow us to bolster growth and to further improve efficiency.

Finally, let me stress that we fully confirm our goals for 2011 and our shareholder remuneration commitments.

Financial Summary

Let me turn to slide number 4.

Both Q3 11 and Q3 10 are quarters impacted by very large extraordinary items that materially affect reported results. Therefore, in order to facilitate year-on-year comparisons, we are showing a P&L in underlying terms. That is, adjusting the distortions derived from such exceptional items, investments in spectrum and non-cash impact from PPAs.

In these underlying figures we are not adjusting the impact from changes in our consolidation perimeter nor FX.

In these terms, revenue rose sharply, at 6.8% if we exclude MTR cuts, ahead of our peers.

OIBDA exceeded 16.7 billion euros, flat year-on-year, as we decided to ramp-up commercial activity to foster future revenue growth. Excluding regulation impact, OIBDA would have grown 1% year-on-year.
Net income was over 5.4 billion euros, down 10.6% year-on-year due to the increase in D&A and financial expenses.

And as a proxy to cash flow generation, Operating Cash-Flow pre-spectrum topped 11.2 billion euros, and spectrum outlays were less than half compared to 2010.

Capitalizing our highly diversified portfolio of operations

Turning to slide number 5.

Our diversified portfolio allowed us to deliver solid profitability and healthy cash-flow generation.

Revenue growth was driven by our Latin America business, which already account for around 45% of consolidated figures in underlying terms, from revenue to OpCF.

It is important to highlight our lower dependence of Spain, which now is just 28% of our sales and 35% of our OIBDA.

And by services, we made further progress in enhancing our revenue mix, with broadband and services beyond connectivity already representing over 26% of revenues, on the back of their double digit year-on-year growth.

Financial Summary: Organic performance

In organic terms, as slide number 6 shows, revenue grew 0.3% up to September or 1.6% excluding regulation impacts.

OIBDA declined 4.6% while OpCF dropped 8.6% year-on-year, as we increased CapEx in FBB and MBB.

These organic results put us on track to fulfil our 2011 guidance.

Debt reduction in the quarter, with financial effective cost lower than last year

Turning to slide number 7, I would like to highlight that net financial debt has decreased about 1 billion euros in the quarter, falling slightly below last year end level. Over 2.5 bn euros of FCF have been generated in the quarter. FCF generated in the nine months to September was €5.7 bn, up 11.6% year-on-year.

Let me also highlight that up to September cash repatriation from Latin America has reached 1.7 bn euros.

So, net financial debt stood at 2.49 times rolling OIBDA at the end of the quarter, and at 2.55 times when including commitments, slightly lower than previous quarter after recent repayments.
Effective interest cost of our debt stood at 4.58%, excluding FX results. This is 24 bps lower than in the first 9 months of 2010 on a comparable basis, is only 37 bps higher than in the first half in spite of current unfavourable debt market conditions and is well below our guidance.

Limited FX impact despite recent volatility

Next slide, number 8, shows the limited impact from currencies' fluctuations year-to-date, benefiting from Telefónica's active FX management policy and adequate diversification. Our operating cash-flow has been adversely impacted from FX movements by just 34 million euros in the first 9 months, with appreciating currencies offsetting losses from those depreciating.

On top of that, such movement is compensated by reduction in debt not denominated in euros. In order to protect our solvency, we proactively manage the currency mix of our debt to reduce the FX sensitivity of our leverage ratio.

In this sense, as of September, our debt in non-Euro denominated European currencies approached 2 times OIBDA in those same currencies, and the debt in Latam currencies (ex-Venezuela) was slightly above 2 times OpCF generated in the region.

Comfortable refinancing, solid liquidity position

In slide number 9, let me highlight that we have a solid liquidity position that withdraws any pressure for refinancing of 2012 maturities. We can comfortably manage long term debt maturing next year, that amounts to 7.1 bn euros, as:

-First, we have an extension option on €2 bn preferred shares maturing 31st of December

-Second, the biggest maturity, a syndicated loan tranche for €2.4 bn, lies also in December, so with more than one year to address its refinancing

-Third, €1.8 bn equivalent debt matures in Latam, where local funding markets are not under stress

-Fourth, €6.4 bn credit lines maturing beyond 2012 more than cover the sum of banking and Latam debt maturities that year, and

-And fifth, only €1.0 bn Telefónica S.A. debt matures in the first 11 months of next year, and that has been already covered by the € 1 bn bond issued in October.

We also enjoy a €4.1 bn cash position excluding the cash at Venezuela and it is also worth mentioning that we have been reinforcing our liquidity position by increasing our un-drawn committed credit lines by €1.3 bn in the quarter, most of them long term, to a total of €9.2 bn.
In any case, we will continue with a prudent early access to credit markets, as we have done during this year, where we have raised close to 11 bn euros so far.

Very intense targeted commercial activity

Let me now review our operating results, starting on slide 10, where I would like to stress the very strong commercial volumes recorded in the third quarter.

Our strategy, targeted at increasing the value of our customer base, translates into two key data points: contract mobile customers accounted for roughly 50% of mobile net adds in the first nine months of the year, and mobile broadband penetration has already reached 15%. Figures for our European operations exceed by far the average for Telefónica, while the low data penetration in Latam is a huge upside opportunity for us.

Specially worth mentioning is the rapid expansion of the MBB base, up 76% year-on-year, being a key growth lever for the future of Telefónica Digital.

Accelerating data revenue growth

Moving to slide number 11.

Mass marketing of smartphones -which capitalises on the larger availability of handsets with competitive prices and on tiered pricing in all our markets- is bearing fruits, as showed by the sustained ramp-up in mobile data revenue, which posted an outstanding 20% year-on-year organic growth.

Mobile data revenue already accounts for 30% of mobile service revenue, with rates reaching 25% in Spain and LatAm, and over 40% in T. Europe.

Particularly strong is the booming growth of non-P2P SMS revenue, which stands now at 52% of total data revenue and limits the cannibalization risk from new applications, which so far continue to have a negligible impact in our geographies.

Actually, P2P SMS revenues continued to increase over 4% year-on-year up to September.

It is also worth highlighting that Latin America is delivering a sharp 32% growth in mobile data sales despite low MBB penetration.

Latam: strong commercial activity across businesses

Let me now walk you through the performance by regions, starting with Latin America in slide 12.

The most relevant feature of Q3 in the region is the very strong commercial momentum, with total net adds beating previous historical records, increased volumes across all businesses and even higher activity than in Q2.
Total net adds rose by 60% versus the third quarter of 2010, while the growth was over 10% quarter-on-quarter.

It is not only the absolute number what makes the quarter exceptional, but the good quality of the customer base expansion, with focus on the higher value segments.

In the mobile business, in Q3 MBB gross adds almost tripled 2010 figure and contract gross adds were 25% higher, while in the wireline business we continue delivering double digit growth in FBB, with a significant ramp-up in pay TV net adds and a successful protection of our traditional lines.

All this led to sustained acceleration in total customers growth, setting the basis for enhanced top line growth in the coming future.

Latam: solid top line, healthy profitability

Slide number 13 sums up the financial results in Latin America.

Reported revenue growth was over 18% up to September, on the back of the excellent top line performance posted by Brazil, which already accounts for 50% of our results in the region. Excluding Mexico, revenue would have risen a sharp 21% year-on-year.

Underlying year-on-year growth in OIBDA was 11%, again driven by the increased contribution from Brazil, leading to a solid 36.1% OIBDA margin in the first nine months of the year.

In organic terms, revenue growth was close to 5%, driven by the very strong performance of data and broadband across businesses, which already account for roughly 25% of fixed and mobile revenues, with outstanding and sustained acceleration in mobile sales.

OIBDA declined 0.9% year-on-year in organic terms, with the sharp increase in commercial activity dragging 4.4. p.p. year-on-year. On top of that, annual comparisons were impacted by the lower contribution of regional projects, the non-strategic towers disposals and by insurance compensations related with the earthquake in Chile a year ago, which together dragged 2.6 p.p. in OIBDA growth y-o-y. Finally, the weak performance of the Mexican business also drove OIBDA down. Stripping out these effects, OIBDA growth would have been very strong.

Brazil: good momentum, strengthened leadership

Moving into our Brazilian operations, we are very pleased to note that one year after taking full control of Vivo, we are now even stronger and we continue to widen our leadership in Brazil.
In Q3 we posted record commercial volumes, with mobile net adds up over 70% year-on-year, and 50% quarter-on-quarter. More importantly, we continue to gain market share in the high value segments, with close to 37% share in the contract segment and 43% share in the mobile data space. Improving volumes and quality at the same time would not be possible without our differential asset base, particularly in 3G coverage, where we are well ahead of our competitors.

It is also worth highlighting the launch of new products, like push to talk, which has gained lot of traction in just a few months, and the projected launch of fixed wireless services in 31 cities outside Sao Paulo along the fourth quarter of the year.
On the financial side, revenue and OIBDA performance was stellar in spite of increased commercial costs.

Total revenue rose 5.4% up to September, with a specially remarkable performance of MSR, which continue to ramp-up quarter on quarter, driven by booming data revenues. On top of that, fixed broadband and pay TV revenues posted a very strong annual growth, already accounting for 20% of total revenues.

OIBDA growth stood at 7.8%, with margin expanding year-on-year to 36.3% despite increased commercial investment, as we are leveraging integration synergies.

Brazil: higher value creation through upgraded synergies

Regarding the Brazilian integration, and after finalising the corporate restructuring in early October, I'm pleased to announce the increase of the original guidance provided a year ago for the expected synergies.

After increasing in July our target for operating synergies, we are now upgrading the net present value of the expected tax and financial synergies to 1.7 billion euros.

So, all in all we expect now to reach synergies with a NPV between 4.4 and 4.8 billion euros, well over 50% of the total value of the deal, and ahead of initial forecasts.

Solid performance in other key operations

Let me now move to slide 16 and quickly review the performance of our operations in the Southern and Northern regions in Latin America.

In the South, commercial activity in the third quarter was strong across our footprint, with strong revenue growth in Argentina, Chile, Peru and Colombia, and sustained acceleration in MSR across markets.

In the North, our operations in Venezuela posted solid revenue and strong margins, while Mexico's performance continues to be weak.

We are already adapting our commercial proposition in Mexico to the drastic cuts in MTRs, having launched new tariff schemes that should contribute to accelerate the capture of mobile market share as well as to accelerate the cannibalization of fixed traffic in the coming future.

Spain: enhanced commercial offer and no further deterioration

Moving to Europe, I will start with Spain on slide number 17.

During the third quarter we launched new commercial offers across businesses to enhance our competitive position, which are already delivering positive results. The new integrated fixed broadband offer introduced in September has clearly set an inflection point in net additions, while the new mobile offer launched in July has led to lower churn levels.

Regarding financials, I'd like to stress the stabilization in comparable trends, as revenue recorded the same decline as in Q2, 6.6%, while OIBDA deterioration was contained quarter-on-quarter, delivering a marginally improved OIBDA margin.

Please bear in mind that 2011 results still do not reflect the benefits of the new social agreement signed in Q2, which should lead to additional costs saving.

Therefore, the healthy OIBDA margin reported is also reflection of our rational approach to commercial expenses, and particularly subsidies, in a context where some of our competitors are just focused on volume and are heavily deteriorating their margins.

Our strategy has allowed us to continue reporting revenue, OIBDA and OpCF shares well above accesses market share.

Spain: a new FBB offer capitalising on our integrated position

Turning to slide 18 to cover our Spanish fixed business.

In the broadband market, the new commercial offer launched in September has led to a significant ramp-up in gross adds. Therefore, we expect our FBB access base to record a better performance in coming quarters.

In Pay TV, our enhanced content proposition, including all the football league, is also being reflected in our strong net adds figures.

So, we are seeing improved commercial trends which are compatible with a better performance of our connectivity ARPU, which remains stable quarter-on-quarter.

Again, our new offers are very attractive for our customers but are not value disruptive for us.
In terms of revenues, Q3 year-on-year performance continues to be driven by similar factors to those we have seen in recent quarters, though we recorded a slight sequential improvement, on the back of the better broadband business already mentioned and improved trends in traditional revenues.

Spain: a new mobile offer to foster growth in data

Regarding our mobile business in Spain, and despite the adverse economic conditions, I'd like to highlight the very strong growth delivered in mobile data.

MBB accesses rose close to 50% year-on year up to September, while data ARPU recorded a solid improvement, driven by the strong performance of connectivity services, which already represent 75% of our data revenues in Spain.

The good data performance is also helping to manage ARPU in the contract segment, which already accounts for 69% of our customers, delivering stable ARPUs quarter-on-quarter.

Our focus on this segment is driven by our policy to maximize the value for customer base, with significantly higher relative ARPUs and lower churn versus prepaid. And churn should improve, as the new tariffs launched led to a 30% drop in churn for those customers who apply for the new rate.

Finally, a very strong performance in data should be further empowered by the new data-centric offer recently launched. We are bundling voice, SMS and data, being the first in the market to launch bundles with unlimited SMSs, and offering lower prices for those customers who have FBB with us, therefore, boosting cross-selling opportunities.

UK: Re-gaining momentum, mobile data strength

In the UK, in the third quarter we re-gained commercial momentum in a challenging environment, with no signs of competition relief. Contract mobile net adds increased over 3-fold quarter-on-quarter following the launch of the new smartphone tariff structure at the end of August, while we kept churn low at 1.1%.

Smartphone adoption continued growing, reflecting the good acceptance of our renewed tariff portfolio, reaching a 36% penetration in September. It is remarkable that 60% of the customer segment has already contracted one of our three bolt-on tiered pricing choices, the majority of them on the GBP 6-10 price range. This is central to data revenue growth acceleration to close to 10% y-o-y, driven by non-P2P SMS revenue increase of over 38%.
Top line continued to be under pressure, impacted by the slowdown in customer growth, sustained out-of-the bundle and tariff optimization amid customer confidence weakness and a significant hit of regulation.

Regarding profitability, we posted a solid OIBDA performance, up 5.1% y-o-y, with a 27.3% margin in the first nine months of the year.

Germany: delivering operating and financial growth

In Germany, turning to slide 21, we continue posting very good results, gaining value market share, as we leverage a strong commercial momentum on our renewed tariff portfolio, best-in class customer satisfaction, and the flexibility of "My Handy" handset commercialization model.

It is also worth to highlight our partner distribution channels, which are driving the low end smartphone segment with sub 100 euro devices.

We are very pleased with the remarkable contract mobile net adds, over 250 thousand in the quarter. This, combined with increased usage of data services, led to an acceleration of mobile service revenue growth from 5% in the first quarter to 9% in the third quarter, excluding the negative impact from MTR cuts.

In addition, OIBDA posted a year-on-year organic increase of 2.3%, reaching close to 25% margin in the third quarter, with the benefits of business restructuring, enlarged scale and further efficiencies offsetting increased commercial spend.

C. Republic: lead market positioning, robust improvement across the board

To close the review of our European operations, let me highlight the sequential operating and financial improvement across the board posted by Telefónica C. Republic, as shown on slide 22.

Solid commercial performance in focused areas was maintained in the third quarter. In mobile, we outperformed in the contract market, after recording positive net adds, driven by MBB customers uptake. It is also worth to highlight the FBB performance on the back of the VDSL launch, which is helping to protect the existing customer base and to better manage ARPU. As a result, we have increased our FBB market share by 2 p.p. year-on-year. In addition, lines losses continued to decrease sharply.

In the Q3 CZ revenues showed a sequential improvement and in Slovakia, we recorded another strong set of results.

Profitability remained stable year-on-year thanks to cost efficiencies, consolidating the best in class margin in the CEE Region, while OpCF generation continues to be very strong, exceeding half a billion euros up to September.

New organizational structure for new development phase

Let me now briefly explain the new organization approved in September, which will accelerate the execution of the strategy presented at the ID.

The creation of Telefónica Digital and Telefónica Global Resources will reinforce our status as a global player and leader in the digital world and will allow us to capture the most of the opportunities afforded by our global scale and industrial alliances.

At the same time, we are simplifying and balancing the business' geographic mix, leading to the configuration of two large regions, Europe and Latin America.
Reporting along this new structure will begin in Q1 12.

T. Digital: The power to outperform in the digital world

The first global unit is Telefónica Digital, a brand new organization with the mission to create the power for Telefónica to outperform in the digital world and reinforce our profile as a growth company.

T. Digital aims to create new propositions and revenue streams, and provide value to customers beyond pure telecommunication services.

We are starting from solid foundations, placing in the same cluster both existing assets like Terra, Jajah, Tuenti, Telefónica R&D, and the "verticals", featuring digital services in key growth areas such as financial services, M2M, cloud, security, eHealth, media and advertising.

We are now in the process of assessing and prioritizing the opportunities where we can make breakthroughs and add value to Telefónica. Telefónica Digital will exploit our leadership position in markets where we are present leveraging on our 300 million direct customer relationships and will also explore over-the-top opportunities in the right markets with the right partners.

T. Global Resources: Increase efficiency by levering our global scale

The second new global unit, T. Global Resources, aims to leverage the full potential of our global scale to maximise business profitability. We have been making significant progress on global projects, but we aim to accelerate the generation of additional synergies and to maximize the benefits from scale economies.

We are already working on a few flagship projects, focusing our efforts on fewer but with higher value impact opportunities.

First, we will increase the level of standardization in global sourcing to further increase the level of aggregation in global purchases, leading to significant additional savings.
Second, we will further advance in the global management of IT infrastructures, progressing in transformation and providing enablers to the regions to carry out their businesses with competitive advantages in terms of cost and service quality.

Third, we will apply more radical approaches in the management of our operating assets. For example, we aim to further advance in network sharing, reaching new agreements and going beyond the traditional site sharing in some cases. And we will continue with the sale of non-strategic network elements such as towers in the areas where they do not provide a competitive advantage.

Finally, we will speed up the growth of our MNC business, reaching our natural market share.

Key management priorities in the short term

All these organizational changes are being implemented, and we have set clear priorities in the short term to drive growth and profitability and to improve our financial flexibility.

In Latin America, Santiago is focussing on maintaining our operating and financial leadership in Brazil, while negotiations with the Colombian government to merge our fixed and mobile businesses are underway. This transaction, when finally approved, should lead to significant synergies and debt reduction. Turnaround in Mexico is another key target for the short term.

In Europe, Jose María and his team are working to balance a stronger commercial momentum with FCF protection in Spain, while in the UK the main goal is to enhance our commercial activity. In Germany, the whole team is focused to keep on gaining high value market share, while in the C. Republic we aim to continue delivering a superior cash generation.

Regarding T. Digital and TGR, both Matthew and Guillermo are working fast to quickly launch their units to foster growth in the digital world and to fully leverage scale benefits.

Finally, my first priority in my new role is to improve financial flexibility, exploiting several levers and building our strong FCF generation. We will proactively manage our assets base. We will also increase our focus on profitable and efficient investment, while we will continue to have a very strict working capital and tax management.

All of this will allow us to reinforce our growth profile and to deliver on all our commitments, which we reiterate.

Conclusions: Management priorities focused on shareholder value

To sum up:

We are building the foundations for future revenue growth.
We are on track to meet 2011 guidance, leveraging our diversification and strong growth in mobile data.

We continue to have a sound FCF and a strong liquidity position.

The new organization will bolster growth and efficiency gains, enhancing execution.

We will pursue an active portfolio management to optimize use of capital & improve financial flexibility.

And the strong FCF generation will allow us to comfortably reiterate our dividend commitments.

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

Q&A session

Jesús Romero - *BofAML*

Thank you. The first question was on the P&L account. How concerned are you with all the austerity measures that could be introduced in Spain with a new government starting on November the 20th?. Do you feel confident on the possibility of maintaining the trend that consensus is looking at for EBITDA in 2012? And second, you were saying about the financial flexibility. How important is the current rating that Telefónica has right now and do you see the net debt to EBITDA declining materially over the next 12 months? Thank you.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

Well, Jesus, I'll take your first question on Spain and the overall economic situation. We do not expect any improvement in the short run. Competition is not showing either any sign of competitive relief. So, we are focusing highly on remodeling our commercial strategy through the tariffs. You know that we have been launching new tariffs on the contract side, on the mobile side. We have been launching a new fixed broadband proposition as well. And very recently, as of yesterday, we launched a full bunch of new tariffs on bundling mobile both voice and data. So, no major changes. We do not expect a major improvement in the short run, but we keep going and commercial activity is improving, our commercial momentum is becoming stronger. So we are not scoring and we are not considering improvement, but we'll keep going to the same direction commercially speaking.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

This is Ángel. On the leverage ratio, we have reiterated our target for leverage ratio for year end. The exact level by year-end will depend on the financial market rates, especially on FX but also on interest rates. It will also depend on further improvement targeted in working capital, also on the pace of commitments on new pre-retirement programs and the OIBDA evolution in the last quarter.

I should say that we don't have just the ambition of generating cash flow to pay the dividend, but to have some leeway for other purposes including some debt cancellation. So we reiterate the leverage ratio for year-end as we have expressed.

Tim Boddy - *Goldman Sachs*

Yes, thanks. Two questions, first of all, in LatAm, it seems like the cost of growth for a couple of quarters now has been consistently higher than expected. Is this a sustainable trend or could we see a point perhaps next year where we start seeing EBITDA growth accelerating faster than revenue growth as opposed to obviously this year's trend?

Secondly, just on what you're saying around disposals, it would be helpful to understand how broadly you're thinking. Is this all of the current assets and scope, including things like the China Unicom stake? Then just to clarify your dividend guidance in relation to that, I know you're saying you want to pay the dividend out of cash flow. Could that be cash flow that includes cash generated from disposals? Thank you.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Tim, this is Santiago. Let me take your question first of all as to when and if the EBITDA decline that you've seen this quarter might turn around. I think the answer is twofold. First, the market is growing faster than we had originally planned, and we are doing better in general terms than what we originally thought and that has required, especially in a place like Brazil, that we step up our commercial efforts. This is a welcome development in the sense that acceleration in growth is going to mean higher penetration and a better result for those already present at relevant market shares like generally tends to be our case.

On top of that, we have had on this quarter a number of different irregular events that have coincided in the sense that they're non-recurrent or they don't happen every quarter. That might have blurred the OIBDA picture which I think that underlying you can say is proceeding at the right pace. Whether we will regain acceleration in order to grow sometime next year will continually depend on what happens with the market growth and with the attitude of other competitors who are of course also trying to reach the same goals.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

With regard to divestments, we're working on several projects to maximize the value of non-core assets and to optimize the use of capital. Given the volatility that we're seeing in the markets, we would rather not disclose which are those projects or the timing of those executions. But I should say the final target of these sales is to optimize our portfolio rather than a “must” to accomplish our remuneration commitments.

Georgios Ierodiaconou - *Citi*

Good afternoon. Two questions from my side. The first one is on the EBITDA trends. Obviously we're seeing just over 1% decline in the margin. Your three-year guidance suggests a small decline more or less flat margin. I was wondering whether you can give us some color on how you expect the margins to progress beyond 2011 and will the improvement be a result of specific efficiency measures beyond the one you announced in Spain or whether that is a result of lower commercial investment in Latin America and other parts of the footprint.

My second question is on the Spanish business. The regulator reported close to 90,000 mobile number portability deficit for every one of the three months in the summer. I know, in the past, you were very focused on churn but it has been rising this year. So my question is: would you be willing to allow churn to increase further or do you believe, at this time, the priority is to stabilize the KPIs? Thank you.

Julio Linares - *Chief Operating Officer*

Regarding your first question, this is Julio Linares, when we provided our guidance for this year; we prioritized top line growth, an effort to capture growth opportunities in our footprint. Because of that, and taking into account the uncertainties that we saw in the market around macroeconomic, competition and consumer behavior, we provided a flexible guidance to be able to manage those uncertainties. Reality has been tougher than we thought. And we saw that it was tougher because of the macroeconomic evolution, because regulation and because of competition. Additionally, the consumers were very sensible to pricing and indeed optimizing their tariffs.

On the other hand, it was great the growth in mobile broadband, though it has a significant impact on the cost side because of the commercial effort regarding smartphones. And because of that, we have this kind of margin and OIBDA evolution.

And of course, we are using all of the levers we have in order to improve these efficiencies, particularly now, taking into account our new organization for Global Resources.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

Taking your question about Spain and churn. For us, we focus on churn on the different segments and as a result we do answer on different fronts. First of all, in terms of the new products and services that we have been launching, we are starting to get traction as I was telling you before and that's showing significant improvement in net add figures and reducing down churn namely on the fixed broadband side. So you will see some traction and some improvement in the coming months.

Well, on the contract side, with this €0.06 tariff that we launched a few months ago is starting to show good signals as well and therefore on the contract side, the churn on the mobile side is getting better. The new tariffs again that we launched yesterday bundling voice and data on the mobile side again will help us on that direction. So the pending issue would be on the prepaid side where we are going to become become very tactical. You will see some campaigns from us from here till year-end, but we won't be disclosing them now.

So churn is always our focus, but we are also very keen on value and therefore for us, we are managing churn on the different segments. So you will see some improvement on the different products and services and we will keep you posted.

Will Milner - *Arete*

Thank you. I guess the first question is just on shareholder returns. On the commitments to pay shareholder returns at a similar level beyond 2012, so I think €8 billion annually. I guess just in the context of the organic EBITDA trend today which is over minus 4% and rising interest costs, are you still confident in your ability to pay that level of shareholder returns beyond 2012 and what might cause you to think differently about that?

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Okay, we are reiterating our shareholder remuneration in the light of the strong free cash flow generation that we are seeing. The first nine months, as I said before we reached €5.7 billion of free cash flow, which is up 11.6% year-on-year. We expect strong free cash flow performance for the full year. We do not provide free cash flow targets, so cannot provide the free cash flow payout for the next year, but as a reference last year after spectrum we generated €8.5 billion free cash flow. €1.75 per share would imply €7.9 billion of that. So that it would be 78% of free cash flow generated in a year like 2010. From 2013 onwards, we still have not decided what would be the split of shareholder remuneration between dividends or potential share buybacks and will be decided later on taking into account investors' interest and also market conditions.

Will Milner - *Arete*

Okay, thanks. My second question, if I could switch to the UK, it looks like minute volumes there are now falling 11% year over year, and the relative performance has deteriorated. I just wonder if you can talk around the prospects for improving that relative revenue performance in the UK. Thanks.

Jose María Alvarez-Pallete - *Chairman & CEO Telefónica Europe*

Well, thanks for the question. The answer obviously is yes. We keep focusing on volume rather than on value. But, we need to acknowledge that during the last month, the deceleration in service revenues has been mainly based on the reduction on the base growth, and therefore, we have already launched at the end of August a new set of tariffs namely on the smartphone field on the contract side where we specifically aim to readdress market momentum. And, in fact according to the latest figures that have, we are getting traction on that side, both in prepay and in postpay. So, yes, we are focusing on that and, yes, we are taking commercial action.

Jerry A. Dellis - Jefferies

I've got two questions, please. First one is regarding the workforce reduction on the new collective agreement in Spain. As the benefits of that come through in 2012, should we expect to see this invested in heavier commercial investment as we've seen in Brazil and in Mexico in the last quarter or should this feed through perhaps into a more stable EBITDA trend as you see market conditions at present?

And, the second question is just regarding mobile data. Back in April, you provided some very interesting information about the percentage of customers who were hitting the caps in their tiered data plans. I wonder whether you have any other updated information around that to give us some sense of what proportion of your smartphone customers are now trading up through the tier mix? Thank you.

Jose María Alvarez-Pallete - *Chairman & CEO Telefónica Europe*

I will take the first question on the workforce reduction in Spain. The process is being run and is progressing according to schedule. So, we will see the benefits of that reduction go through into the P&L account during 2012 progressively because it is going to depend on, at the end of the year, how many people will be registering for that and secondly at what time of next year they will be leaving the company, and therefore, we will have a time impact all along the year.

The use of those savings, of those efficiencies, is going to be decided on an annual basis depending on market and commercial conditions. But, you should expect those efficiencies to flow all along the year, not at the beginning of the year but throughout the year 2012. And, we will keep you posted on the process.

Julio Linares - *Chief Operating Officer*

Regarding your second question, I'm trying to answer for the whole Telefónica Group. Right now we have penetration of mobile broadband, I mean dongles, smartphones and tablets altogether of 15% of our total base. With this penetration, we are above expectations both in accesses and ARPU levels.

And, the ARPU that we are getting with this kind of mobile broadband customers is 1.5, average mobile ARPU, which is in line with information that we provided in our investor conference in London. Profit that we have seen in this mobile broadband customer base is better than average profit and it is well in line with information that we provided at that conference.

Keval Khiroya - *Deutsche Bank*

Good afternoon. Two questions from me, please. First, you reported 0.3% revenue growth in the first nine months. Do you consider this to be within the definition of up to 2% revenue growth? And, secondly, you have upgraded your Brazil synergy targets, which is a positive. But, can you give us some time, some colour on the phasing of the incremental synergies? Thank you.

María García-Legaz - *Head of IR*

Can you repeat your second question, please?

Keval Khiroya - *Deutsche Bank*

Yeah. So, you have upgraded your Brazil synergy guidance, which is positive. Can you give us some colour on the phasing of the incremental portion of the synergies?

Julio Linares - *Chief Operating Officer*

Regarding your first question, our revenue growth is within our guidance that we provided at the beginning of the year. That means that we will have positive growth up to 2%.

Keval Khiroya - *Deutsche Bank*

Okay, thank you.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Yes. And, in terms of the synergy extraction process in Brazil what we can share with you is that what we have upgraded is a non-operating part of them; now that we have been able to clarify a bit better how the full impact of the reorganization process is going to be. But, unfortunately, we are not in a position to disclose at this very moment exactly how are going to be flowing. Those will be, however, event driven; meaning, by the time we report the results and we file the tax returns or we refinance the synergy values will be more visible than they are today.

Keval Khiroya - *Deutsche Bank*

Okay. That's clear. Thank you.

Torsten Achtmann - *JPMorgan Cazenove*

Good afternoon. Two questions please. First, on Latin America, when do you expect to see the benefits of the higher commercial activity come through in terms of revenues and therefore when do you think we can see more accelerated revenue growth coming from Latin America?

Secondly, on Spain, it seems total voice traffic seems to decline, seem to have accelerated in the quarter compared to last quarter. Can you give an update? What is happening and is there any chance this could turn around in the near-term? Thank you.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

This is Santiago. Let me take your question on Latam first. The sequence of events should be: we get new adds, especially those related with contract, in the contract segment with new products like mobile broadband. That eventually translates itself into higher revenue growth and how fast that process happens depends crucially on how well penetrated the market is. So it will be very market specific, it is hard to generalize because I might be off in one market and in in some others. Brazil is probably at the tail end of that process and because Brazil weighs so much, I think it's going to be sooner rather than later that we can see some acceleration in growth.

You see for instance, this quarter, that we've had very good top line numbers in Brazil. That with the wobbles and the ups and downs that are to be expected from the very competitive environment probably should be the trend going on. We're also very happy that our leadership in the new products like mobile broadband is so far unfettered and it is going to be very hard to catch up on us because of the investments that we've been able to make in the past. Eventually, those revenues growths which will of course translate themselves when markets stabilize into OIBDA and in the rest of the account.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

Taking your question about voice traffic evolution in Spain, it is true the decline has accelerated a little bit in the third quarter and that is why we have reacted with this bundling strategy both on the wireline and on the wireless. As a result, because we have increased the attractiveness and the amount of minutes that we are bundling, we expect to have a better evolution of our MOU during the next quarters. In fact, after the launching of the launch of the 6 cents tariffs, we have gained some traction and we hope that, with the new tariffs and products that we launched yesterday, we will get some traction as well there. But you are right. During the third quarter, voice traffic declined a little bit more than in the second quarter.

Mathieu Robilliard- *Exane BNP Paribas*

Good afternoon and thank you. Two questions please. First, with regards to organic EBITDA trajectory, which has deteriorated throughout the year for the reasons you've highlighted, Q4 2010 on my numbers are going to be a tough comparable. So I was wondering in which part of the business you were expecting a recovery so that you can offset that tougher comparable and stay within guidance?

Then a second question regarding LTE auctions in Brazil. Apparently, the schedule is moving ahead and I think the Minister of Telecommunication was talking about the possibility of a new entrant in Brazil mobile through LTE auction. Maybe if you can give us a little bit of colour in terms of the timing and the kind of different players that you envision in the market? Thank you.

Julio Linares - *Chief Operating Officer*

Regarding your first question, what we expect is that, in Spain, we will not see major changes on revenues on EBITDA performance. We will leverage on our commercial activity that we expect to improve in this fourth quarter thanks to our new commercial proposition launched in the market, as well as the sales of some non-strategic assets.

In Latin America, we will see improved trends as we capitalize the strong commercial activity recorded in the last quarter particularly on the synergies in Brazil that are progressing well.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

In terms of the expected LTE auction, the Minister of Telecoms in Brazil has said that, by the end of April next year, there should be an auction that is not a full decision but it is an indication it will be in the 2.5 GHz space and we're still unsure about what the other conditions are about coverage, required investments or quality will be. As if it will be a few more of those. We have the intention of course to participate and whether or not there are new entrants or new bidders remains to be seen. We certainly think this is a good investment for the future although, quite frankly, it might come in a bit early relative to the recent auctions and the still ongoing deployment of 3G. Nevertheless, whenever it is auctioned, we will participate.

Jonathan Dann - *Barclays Capital*

Hi there. It says in the slides that so far you have repatriated EUR1.7 billion of cash. I think, on the second quarter, you might have said you were expecting EUR3.5 billion. Could you just update us on the amounts?

And then secondly, you've provided net debt in Spain, UK, Czech Republic, I believe Germany has to hold cash. Currently does it matter at the group level where the cash balance sits in terms of liquidity, or is it that are you able to manage refinancing, etc. without much larger dividends from Latin America?

Ángel Vilá - *Chief Financial and Corporate Development Officer*

OK, this is Ángel Vila. On repatriations, we have repatriated EUR1.7 billion from Latin America. Last year, by the same time, we had repatriated EUR1.1 billion. What we said at the end of the second quarter conference call, we by then had repatriated EUR1.4 billion and that we were expecting to double that figure by year-end.

Miguel Escrig - *Chief Financial Officer*

This is Miguel. Regarding your question about our cash, it is mainly located in Latin America as the cash that we have usually in Spain or in Europe is used directly to pay down the credit lines that may be later on. Anyway, we have a centralized cash management and so although the cash is owned by Latin American companies, a big part of that is lent and throughout our central cash unit management so that it can be used also at the holding level.

Giovanni Montalti - *Cheuvreux*

Hello. Good afternoon. Sorry, just coming back to Brazil, could you confirm if we can expect an improvement in profitability already starting from the next quarter? Thank you.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Giovanni, it's Santiago here. I think it's not prudent to say when the acceleration in trends is going to happen. I think the direction is quite clear though. It might be next, it might be the following, but certainly all of the requirements are in place. But I would probably not commit right now to an immediate acceleration in trends.

Giovanni Montalti - *Cheuvreux*

Ok so, can I quickly follow-up on the synergies? Is there any synergies already, I mean are you already taking, making use and executing a portion of those synergies on the fiscal and financial side? Thanks.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Well, most operational synergies are taking place gradually. They are happening after the integration, which is very recent, and some of them are going to be extracted by things like, let me talk to you as an example, by long distance being split between São Paulo and outside of São Paulo, which previously had to pay taxes because they belong to different companies and now there are all within the same company. This is an obvious and very clear tax saving but is, because it is not going to be internalized. There are many others like that, not thousands, but there are many others like that happen as services gets sold. The financial and the tax events, as I think I mentioned before, are more event specific and they will happen more likely next year than this year.

Luigi Minerva - *HSBC*

Yes, good afternoon. Two questions on regulation. The first one, in Europe, in a speech Neelie Kroes at the beginning of October mentioned two options or two possibilities with regards to incentivizing investments in the next generation access investments. The first one was a reduction in ULL copper prices and the second one was an inevitable increase in wholesale and retail fiber-based prices in the medium term. I was wondering what are your views on these two possibilities, on the first one, maybe in the short term and the second one whether it is acceptable over the medium term?

And my second question is on Brazil. Anatel launched this unbundling consultation process in August. I was wondering if you can give us an update if you have more visibility now on the priorities of Anatel, the type of cost methodologies they're thinking of, and whether Telesp or Telefonica Brazil would be interested in becoming an unbundler outside of São Paulo in the new framework? Thanks.

Julio Linares - *Chief Operating Officer*

Regarding your first question, we really believe that to artificially try to reduce prices in the market through wholesale or through unbundling local loop is not the right solution to incentivate investment in the new generation. We really believe there are other frameworks that will be much better in order to stimulate that kind of new infrastructure development.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

In terms of, Luigi it's Santiago here, in terms of the unbundling process, in Brazil it just started. It was announced I think by early next year we should have much more clarity about how and when it's going to be applied. Prices are to the best of my knowledge, still not known and the Telefonica strategy, it's still not fully developed, but I can give you some indication, is that outside of São Paulo we have very little if any interest in using that instrument without knowing the prices. Maybe if the pricing is attractive, we have to take a second look at that, but our current strategy is to use the fixed wireless technology to access the market outside of São Paulo as we have just launched in some of the southern states of Brazil two weeks ago. So we don't have still full clarity, it is coming. The conditions are known and we will in all likelihood not participate heavily, at least not heavily on the outside of São Paulo market.

Luigi Minerva - *HSBC*

Ok, thank you very much.

Ivón Leal - *BBVA*

Hello. Good afternoon. A couple of questions in Spain. The first one is, given that you've highlighted in the third quarter the commercial investment in order to track, to gain commercial traction throughout the market, I was wondering if we should expect part of the savings generated in Spain as a result of restructuring to be reinvested in order to regain market share in 2012 or rather we should expect that to flow through the EBITDA line.

And the second one is you say that the latest commercial offering fixed broadband in Spain has given some good results. And actually if we look at the numbers released by the Spanish Telecom regulator it looks like it's a fixed, the Fiber deployment, which is really tracking very good results. So I don't know if your initial coverage target has changed at any point in time through the latest quarter. Maybe give us some color on your target coverage for 2012 and how the fiber deployment is working.

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

Well, on the first question about how we're going to be treating efficiencies next year, first of all, efficiencies are not just going to come from the voluntary reduction program on our workforce. We have other plans in Spain, namely on the handset reduction in terms of the amounts of handsets that we're buying externally in terms of the catalogue that we have. We have already announced that. And we will keep centralizing more of our purchasing effort and therefore we expect to generate more savings thanks to the action of Guillermo Ansaldo's team on Global Resources. So you will see more savings than just or more efficiency process running in Spain and all around Europe than just this workforce reduction. For sure we will reinvest some of those in commercial activity because we see the market; we see value in the market. We are seeing value in the commercial offer, as I was telling you before, on the fixed broadband both on fiber and DSL and for sure on the mobile side, namely in contracts. So, yes we intend to be much more efficient next year but not just with the reduction of the workforce, with other plans, and yes we intend to reinvest part of that on the commercial effort because we do see value and growth on that side.

And on the second question, on the results, we are getting traction on the fiber. We're happy with the fiber deployment and with the speed of deployment. It is not huge. We are growing step-by step, but it is going very well. On the EUR24.9 offer that we launched at the end of August, beginning of September, the numbers of the evolution of net adds that were negative for a while is starting to show better results and I hope that from here to year end you will see the traction on that product, but yes we are optimistic and yes we're getting better results.

Ivón Leal – *BBVA*

Could you give an update on homes-passed already?

José María Álvarez-Pallete - *Chairman & CEO Telefónica Europe*

I'm sorry, but we do not disclose that information in terms of both home-passed but we're getting very significant traction, namely in Barcelona and in Madrid. I will try to give you more color on the next calls, but for the time being we do not disclose that information.

Ivón Leal – *BBVA*

Ok, that's fine. Thank you very much.

María García-Legaz - *Head of IR*

Okay. We have time for one additional question please.

Fabián Lares - *JB Capital Markets*

Hi, good afternoon. Thank you for taking my question. Regarding the evolution of the Company debt and the amount that has been paid down by the nine months generated, I was wondering, considering that in the foreseeable future we do not see the capacity of EBITDA rising any stronger and obviously with CapEx commitments your capacity to generate more operational cash flow is probably limited. I was wondering whether, as of 2013, you are considering other shareholder remuneration formulas outside of the cash and the share buyback. Namely, I'm thinking of script issues.

The second item would be related to Argentina. I was wondering whether you will give us more color related to the possible hyperinflation or the excess inflation that could be happening in that market and whether you are able to contain that at the OIBDA level? Thank you.

Ángel Vilá - *Chief Financial and Corporate Development Officer*

Okay, with respect to the first question, regarding shareholder remuneration after 2012 we have still not decided which would be the split of such. And as I said before we would take into account market conditions and investor preferences when the time arrives. You spoke about a potential script dividend, but I can say that we are not contemplating in our agendas script dividend given the low valuation levels that we have in Telefonica share price.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

In terms of Argentina, two comments. One is that Argentina is still not a hyperinflationary economy by accounting standards. Inflation it is quite high but official inflation is slightly lower than whatever real recorded or expected inflation. This is not a new trend. This has been going on for a number of years and as a result of that, we've been able to adjust the non-inflation exposed part of our business quite dramatically, meaning non-regulated or less regulated prices have taken a bigger role in our basket of products.

There has been and there will continue to be an impact on costs, because costs are adjusted if not in full to inflation at least very much so. So it is a typical thing to comment.

On the other hand, the increased tendency of Argentineans to spend on the back of a better economy and high inflation is helping alleviate that trend somewhat. So while considering that inflation is not a welcome development, we still think that, in Argentina, it is a less unfavorable event than it might be in southern regions.

Ángel Vilá - *Telefónica S.A. - Chief Financial and Corporate Development Officer*

Okay, thank you very much for your participation and we certainly expect to have provided some useful insights for you. Thank you and good afternoon.