Telefónica January-June 2012 Results Conference Call Transcript

26th July, 2012

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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-June 2012 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.

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We encourage you to review our publicly available disclosure documents filed with the relevant securities market regulators. If you don't have a copy of the relevant press release and the slides, please contact Telefónica's investor relations team in Madrid by dialling the following telephone number, +34-91-482-8700. Now let me turn the call over to our *Chairman and CEO*, Mr. César Alierta, who will be leading this conference call.

Presentation

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

Thank you, María. Good morning to everybody.

H1 Highlights

As you can see, our second quarter results showed a significant improvement quarter-on-quarter, with a better performance across all the metrics from OIBDA to net income in underlying terms.

OIBDA in absolute level rose on a quarterly basis and profitability enhanced sequentially, with quarter-on-quarter growth across the board.

These results today show the benefits of our diversification, our key strength to face very different realities.

We have posted positive revenue growth on the back of further commercial push and a very solid evolution in Latin America.

On top of that, we have undertaken bold actions to improve market dynamics and enhance our business model through efficiency gains, like the removal of handset subsidies in Spain, a gradual reduction in the UK and the network sharing agreements reached in UK and in in Mexico.

In addition, recent news about regulation in Europe point to a drastic change in the way the telco industry has been regulated in recent years and are a very very positive signal for the sector as a whole.

On the financial side, we have taken decisive actions to improve our balance sheet and defuse potential risks, including an exceptional adjustment of our remuneration policy, which allow us to have a full year refinance maturity behind the end of 2013. We are managing proactively our portfolio of assets with visible results year-to-date and we have decided next actions, including preparations for an IPO of Telefónica Germany in the fourth quarter.

And we continue making significant progress to enhance our growth profile and capture the significant growth opportunities arising in the digital space.

Key financials

Let me now review with more detail our first half performance, starting with the summary of the key financials on slide 4.

In the first half of both 2012 and 2011, we booked several significant exceptional items. So, to better understand the underlying performance of the Company we are providing a P&L excluding those non-recurrent effects and non-cash impacts.

January-June revenue grew 0.3% year-on-year to reach almost 31 billion euros, while underlying OIBDA topped 10 billion euros, with a better performance in the second quarter. Once deducted CapEx, Operating Cash Flow came close to 7 billion euros.

Underlying net income was over 2.8 billion euros and earnings per share stood at 0.62 euros in the first half. Let me mention that both metrics significantly improved their year-on-year performance in the second quarter.

CapEx to sales was 12%.

Enhanced profitability in Q2 12 across the board

The major highlight of Q2 results is the quarter-on-quarter increase in OIBDA across the main regions and key operations, as you can see clearly on slide number 5.

As a result, the consolidated OIBDA margin stood at 34.6% in the second quarter, and expanded 180 basis points sequentially, leaving a significant lower year-on-year erosion vs. the previous quarter.

In my opinion, OIBDA reached the bottom in the first quarter of the year, and I want to underline that. It is my total conviction that the OIBDA reached the bottom in the first quarter of this year and improved trends will consolidate in the second half of the year.

I'd like to highlight the better performance in Spain, where OIBDA was up 3% versus the first quarter of the year.

Risk perception decoupled from business fundamentals

Slide number 6 outlines how we are further enhancing our geographical diversification.

We have increased our exposure to Latin America significantly in the last twelve months, representing circa 50% of key financial metrics of our results, with significant contributions from individual markets.

And as you can see, we are not only highly diversified in terms of regions but also in currency terms, with a risk perception that is totally decoupled with the fundamentals of our businesses.

Our exposure to Southern Europe or even to the euro is well below the exposure of other European players whose headquarters are not in Spain. And importantly, OpCF in Spain remains pretty stable quarter-on-quarter.

Our revenues, results and OpCF clearly are one of the most spread and diversified of the whole industry, as it is shown very clearly in this slide.

Transitioning from "Telco" to "Digital Telco" model

And we are not talking only about diversification but also about transforming our business model from a traditional "Telco" to a "Digital Telco", where growth opportunities are very very large.

They lay in the upcoming transformation of wider parts of the economy, including security, education, public administration, heath, financial services, and other areas that represent between 35% to 40% of GDP, with an addressable market for us of up to 2% which is nearly the double today of the telco industry, represents a tremendous opportunity, and I can assure you Telefónica will not miss this huge opportunity.

We already kick started this journey

As you can see on slide 8, Telcos can use 3 models to capture the value coming from this digitalisation wave, as connectivity providers, as an enabler/retailer or as a service provider.

Connectivity plays in our strength: infrastructure, spectrum, among others. We expect this to remain our strongest play for the coming future. Digital services are "complements", the more are being used, the better clearly for us. Here, we have already made a number of announcements on fibre/LTE deployments, network sharing agreements and tariff initiatives.

We see enabling/retailer role very important. This is where our asset best complement other players in our ecosystem. This is about creating new markets, not taking markets from someone else. Here again, good progress announcement on many fronts.

Digital Services: we will need to maintain relationship and customer engagement on few selected services, for example Communications, Financial Services and others. We will be selective and focused on some of these services where we can make a difference, with further opportunities to come in the coming future. This will be about being innovative, develop and sell products beyond connectivity to solve social needs and to be a catalyst for change in business value chains, while re-enforcing our core business.

Our view of a "Digital Telco", not one of these 3 models, but it is really one of the combination of those 3 models, eventually with different weight depending on the local market conditions. This is the reason why we organised Telefónica the way did: different divisions working together towards a common goal with different roles, responsibilities, assets and skill sets. And we have done that clearly ahead of our peers.

And now let me hand it over to Ángel for a detailed overview of our operating and financial performance.

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

Regaining commercial momentum

Thank you César. Please turn now to slide 9.

In the second quarter of 2012 we continued regaining commercial momentum, despite strong competition across countries.

Our customer base surpassed the 310 million mark at the end of June, 6% more than a year ago, driven by the growth in key strategic areas.

Strong focus on smartphone adoption fuelled a solid 18% growth in mobile net adds vs. the first half of 2011. Smartphone net adds grew 40% vs. last year figure, with growth rate reaching 99% in Latin America.

In parallel, we are advancing in the transformation of our fixed line businesses, with a selective deployment of ultra-broadband services in those markets where there is potential demand and appropriate regulation and competition. Approximately 24% of our fixed accesses are currently ready for commercial ultra-broadband services and out of them, around 7% are already connected.

Positive top line growth, improved margin sequentially

As slide number 10 shows revenue growth was driven by the robust performance at Telefónica Latinoamérica and mobile data across the group, offsetting headwinds in Europe.

Data revenues continue to deliver a sustained ramp-up in their quarterly year-on-year increase and already account for 35% of mobile service revenues, on the back of a profitable data monetization, leveraging tiered pricing along with integrated tariffs.

I'd like to stress the marked sequential slow-down in OpEx in the second quarter of 2012, reflecting the continuous focus on efficiency improvements and eased commercial costs growth, on the back of the new handset policy in Spain.

As a result, consolidated OIBDA improved its year-on-year trend in the second quarter and OIBDA margin expanded 180 basis points sequentially. Year-on-year margin erosion also improved by almost 100 basis points vs. the previous quarter.

LatAm: Solid revenue growth driven by mobile

Please now turn to slide number 11 to start with our LatAm operations, where business fundamentals remain sound.

Organic revenue growth rates keep healthy levels, driven by a double digit growth in mobile, thanks to sustained commercial activity, with gross adds growing above 20% in the first six months. Smartphones adoption continues booming in our base, more than doubling its penetration on the base year-on-year.

Mobile revenue growth is fuelled by strong mobile service revenues, on the back of increased data consumption and growth in voice services. The weaker performance in the fixed business is strongly affected by specific factors in Brazil in the quarter.

Increase in mobile traffic is affecting traditional fixed business. However, our exposure to traditional fixed voice is just 20% of revenues in the region, while the remaining 80% keeps growing almost at double digit.

LatAm: Improved margin quarter-on-quarter

Turning to slide number 12, OIBDA in the second quarter showed a sequential improvement. It was higher than in Q1 in absolute terms, but it also improved both in terms of year-on-year evolution and margins.

In such a diversified portfolio there are as always negative and positive impacts affecting quarterly performance, with tower sales and some other specific factors in Argentina, Venezuela and Brazil affecting margin evolution. However, efficiency gains were visible in the quarter, supporting the quarter-on-quarter margin improvement.

In terms of year-on-year comparisons, profitability continues to be explained by the increased commercial activity in 2012 and the higher effort in transformation towards mobile data. Year-on-year commercial efforts will be more comparable in the second half of the year, leading to a lower margin erosion.

Brazil: Leading service quality & investing in future growth

Please turn to slide 13 to review our Brazilian operations.

We continue to lead the market, leveraging our differential propositions, both in terms of assets and strategy, our focus on providing superior service quality is clearly bearing fruits.

Telefónica Brazil maintained a strong commercial activity in the quarter, with mobile net additions up by almost 30% year-on-year. Smartphone users multiplied by 3 times versus June 2011.

Vivo is leading mobile broadband adoption in the market, on the back of its superior 3G coverage and network quality, which are clearly visible at revenue level. Data already accounts for more than 25% of mobile service revenues, a benchmark in the market. We aim to continue leading quality in the Brazilian market and for this we keep investing strongly for the future, as shown by the recent acquisition of spectrum.

In the fixed business we are accelerating the transformation, speeding up ultra-broadband connections with increased CapEx in the second half of the year to enhance commercial momentum in the fixed broadband market. I'd also like to highlight the successful rebranding, and just one quarter after marketing our fixed business under the VIVO brand, the Company is leading customer satisfaction in Brazil.

Brazil: Keeping growth on a balanced & diversified structure

In terms of financials revenue growth in Brazil continues to be sound, with marked differences between businesses.

Mobile service revenues kept growing very nicely at over 13% year-on-year ex-regulation, with pretty strong prepaid top-up levels and no signs of slowdown. In terms of fixed-to-mobile substitution it should be noted that mobile service revenues expansion is more than 2.5x the erosion in traditional fixed voice revenues, resulting in the net of both impacts being clearly positive.

Fixed revenue performance quarter-on-on-quarter was impacted by several issues, with 2/3 of the weaker performance explained by non-recurrent factors. These include the full consolidation of TVA from Q2 11, retroactively to 1 January of that year, which means that in Q2 11 we included six months of TVA's results instead of just 3 months. They also include the seasonality associated with different execution of projects in the corporate segment.

On the other hand, OIBDA improved sequentially, both in absolute terms and in margin.

LatAm: Diversified growth, revenue growth in all countries (i)

Moving to our operations in the Southern region on slide 15, the highlights are that revenue growth remains strong across key countries, mainly fuelled by a strong commercial activity and solid mobile data revenues.

Especially remarkable is the good growth recorded in Peru and Argentina, with top line in Colombia being hit in Q2 by seasonality of IT projects. Chile continued to deliver a steady performance amid increased competition.

At the OIBDA level, as we already explained, there are different specific factors impacting performance in the quarter, especially in Argentina and Peru.

LatAm: Diversified growth, revenue growth in all countries (ii)

On the next slide number 16 we summarise the results recorded in the Northern region.

Let me highlight that Mexico is already showing revenue growth in the second quarter, a significant progress from previous quarters, and just one year after the introduction of aggressive MTR cuts. In addition the recently announced agreement with Iusacell and our new commercial proposition will drive further benefits.

T. Europe: Improved commercial performance, growing OIBDA in the quarter

Let me now review our performance in Europe, starting on slide 17.

We have regained commercial momentum across our footprint over the second quarter, on the back of the good traction of our refreshed tariffs and churn reduction, which led to a strong performance in mobile contract net adds, up 22% quarter-on-quarter. Moreover, focus on expanding smartphones led to a 32% penetration rate.

Improved commercial results were compatible with a better OIBDA evolution. OIBDA reached close to 2.7 billion euros in the second quarter, up 6.3% quarter-on-quarter, leveraging a sharp cut in commercial costs, down close to 7% in the quarter. As a result, margin improved sequentially to 35.5% in the quarter, with further benefits to come from our recent decisions to improve profitability across markets.

Top line continued to be impacted by the intense macroeconomic, competitive and regulatory pressures.

Spain: Gradual progress in our turnaround plan

Turning to slide 18 to review our operations in Spain, I'd like to highlight that our plan to revert the situation is starting to yield positive results.

Our initiatives to recover competitiveness through a proactive migration of customers in the consumer segment to our refreshed tariffs have led to more than 2/3 of FBB customers and over 50% in the mobile contract business already enjoying better propositions.

The major benefit from this fast repositioning is the sharp churn reduction across services, which has become more visible in Q2, leading to a much better evolution of net adds quarter-on-quarter, especially in mobile contract segment. Please notice that net adds in contract voice accesses were already positive in May and June.

On the other hand, the rapid adoption of the new tariffs is negatively impacting ARPU, though we expect ARPU erosion to ease from Q4, on the anniversary of the new portfolio.

The second key lever of our turnaround plan is the implementation of a new industrial model to enhance efficiency. On this front, results are also evident. Our decision to remove mobile subsidies for new customers from March was followed by some competitors, leading to lower activity volumes in the portability market, with a better trend in our net results, despite the introduction of the 24h portability from June 1st.

The subsidies removal is driving significant net savings in commercial costs, which are already flowing into the P&L. Additionally, improved quality has led to strong reduction in customer claims, driving further costs savings.

Efficiencies gains are also coming from the rapid completion of the redundancy program in the fixed line business, positioning us well ahead of our peers to benefit from the sector transformation derived from the new regulatory framework in Europe. We have already done our homework to adapt the cost structure of the legacy businesses, with very material savings in personnel costs, close to 120 million euros in the first half of the year.

Spain: Improved profitability on strong cost savings

The gradual improvement in operating performance and a tight cost management make us comfortable to assess that our Spanish business reached the bottom in the Q1, with a better financial performance expected for the coming quarters, as we fully capture the benefits from the new commercial model and the headcount redundancy plan.

This better evolution was already visible in Q2. OIBDA reached over 1.7 billion euros in the second quarter, increasing sequentially. OIBDA margin also expanded quarter-on-quarter, reaching 45% in the quarter, with very limited y-o-y erosion.

This performance was achieved despite increased top line pressure in the fixed business.

Mobile service revenues remained more resilient in April to June, with a much lower sequential deterioration than in the previous quarter, when we recorded a positive impact from the leap year. This performance is explained by a lower impact from our loyalty programs, which offset the negative drag from the termination of a contract with a MVNO in the quarter.

Enhanced quality and lower churn are also driving CapEx efficiencies. Despite a significant higher budget for fiber investment in 2012, 20% up year-on-year, total CapEx in Spain will be down versus 2011, further supporting an improved OpCF y-o-y performance vs. 2011 along the year.

On top of that, let me stress that the recent news on regulation will be particularly positive for our business in Spain, where ULL prices are well below the European average.

UK: Sequentially improving performance

Please turn now to slide 20 to review our operation in the UK.

Telefónica UK consolidated its improved market momentum in the quarter, expanding its mobile base on increasing contract gross adds, up 26% year-on-year in Q2 and a sustained contract churn improvement. As a result, contract net adds grew sharply, totalling 251 thousand in Q2, with further increases in the contract mix to 51% over the total base.

At the same time, OIBDA performance improved, rising quarter-on-quarter on the back of efficiency measures and contention on commercial expenses, as the Company gradually lowered handset subsidies and upgrades slowed down. This resulted into a sequential OIBDA margin expansion to reach 23.4%.

The better trading activity led to a consistent improvement of revenue trends, with mobile service revenues ex-MTRs consolidating their stabilisation trend. Non-SMS data sales growth accelerated to 19.5% in the second quarter, on the back of successful data monetisation strategy.

We expect to continue strengthening mobile service revenue in the second half of the year, despite competitive pressures in the market.

Germany: Growth across the board; basis set for the future

In Germany, our strong franchise continued to deliver a solid set of results, as slides 21 and 22 show.

Our new commercial approach, adapting our contract portfolio with the launch of O2 Blue, reinforced value for money propositions. LTE tariffs recently launched and a regional focus, are delivering continuous churn improvements and a steady mobile base expansion, with a better customer mix, as contract segment already accounts for 52% of our mobile base.

The strong commercial momentum has led to consistent market share gains, especially among higher value customers, reaching a 19% share in the contract segment and reflecting our market lead in smartphone penetration.

Additionally, the strong investments in recent years to expand our distribution channels, our solid network and the spectrum to exploit the mobile data opportunity leave us in the best position to capture future growth in the attractive German market.

Germany: Strong operating performance flowing into financials

We experienced solid trading momentum and ARPU growth year-on-year and sequentially, leveraged on better contract mix and higher consumer spend due to successful data monetisation.

All of these flow into financials, with mobile revenues growing 11% year-on-year in the second quarter, and total revenues accelerating their growth trend to close to 7%.

OIBDA is up close to 13% both quarter-on-quarter and in the first half, on the back of strong top line performance and efficiency measures, driving an OIBDA margin expansion to 25.7% in the second quarter.

January to June OpCF increased by 13.4% year-on-year, showing the strong acceleration in growth from top line to cash generation.

Updated revenue outlook, OIBDA margin and CapEx/sales targets unchanged

To finalize with the operating performance, let me update you on our guidance for 2012.

Last February we gave a guidance for revenue growth above 1% in current terms at specific FX assumptions. However, given weaker than anticipated macroeconomic conditions and a stronger drag from regulation than previously envisaged, we now expect to deliver flat to positive revenue growth by year-end.

Nevertheless, we do reiterate our expectation for OIBDA margin erosion in 2012, that will be lower than in 2011, with a better year-on-year evolution in the second half of the year, driven by better year-on-year comparisons in commercial activity, net savings in commercial costs in Spain and further cost efficiencies across countries. On top of that, operating synergies in Brazil will become visible in the coming months.

CapEx to sales guidance remains unchanged, at similar levels than in 2011.

Net debt evolution impacted by timing of dividend payment

Let's now move to the financial side, on slide number 24.

Net financial debt increase in the quarter is mainly related to the timing of the dividend payment and the execution of the share buyback which, coupled with negative FX movements, commitments cancellation and the impact of Telco refinancing, offset positive free cash flow generation and the 1.5 billion euro debt reduction from the closing of the Colombian restructuring.

Further positive impacts from our asset rationalization strategy will be visible in the short term. We have already got all the necessary regulatory approvals for the partial sale of our stake China Unicom, which will effectively reduce our debt burden from July 30th. This, coupled with the sale of our stake in Hispasat will contribute with 1.3 billion euro cash proceeds.

Free cash flow generation will improve in the second half of the year, on the back of a better operating performance and the unwinding of the working capital consumption recorded in the first half of the year.

Debt reduction will be significantly accelerated by the shareholder remuneration measures announced yesterday, that will generate significant cash savings.

Facing manageable coming debt maturities

We maintain a solid liquidity position, with debt maturities covered until beyond the end of 2013. This comfortable position is driven by our strong activity in the bond and credit markets since the beginning of the year and the recent adjustment of our remuneration policy, which improves liquidity immediately, and reduces refinancing risk.

We fully refinanced 2012 maturities in the first quarter, and we have also reduced 2013 maturities by nearly 1 billion euros to 6.7 nearly billion euros.

Our cash position, excluding Venezuela, stood at over 5 billion euros at the end of June, while total undrawn credit lines amount to 8.9 billion euros, with over 80% maturing long term. It is worth to highlight the geographic diversification of undrawn credit lines with about one-fourth of them signed with Spanish institutions, while American and Asian banks represent another fourth and the rest being widely split among diverse other European countries. Let me say that, although credit markets have deteriorated, we have demonstrated our ability to refinance and extend existing credit line maturities for an amount of 2.4 billion euros in the year.

We are also benefiting from our geographic diversification and in the current credit environment we have secured full underwriting of a $R 2bn facility that will be closed in the coming weeks.

Effective interest costs have increased in the quarter though continue to remain at the middle part of our guidance. And the acceleration in debt reduction will lead to lower than anticipated financial expenses, affecting positively the P&L.

Let me now hand it back to César.

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

Fully committed to increase financial flexibility, improve liquidity and defuse potential risks

Thank you Ángel.

Let me stress that we are fully committed to enhance our financial flexibility and to deliver our leverage target for year-end. In the current extremely challenging economic and financial environment, exogenous factors are creating severe instability and are exacerbating potential financial risks. Since those factors are clearly behind Telefónica's control, it is crucial that the Company takes definitive steps to effectively defuse potential risks.

In consequence, the BoD decided yesterday that under the criteria of prudent administration it is in best interest of Telefónica's stakeholders that the dividend and share buyback program corresponding to 2012 be cancelled as a one-time exceptional measure. The rationale behind this decision are: first, to further strengthen the balance sheet; second, to substantially accelerate debt reduction in the short term, third, to decouple from exogenous macro factors affecting our country of domicile; fourth, to immunize from debt markets liquidity conditions by having refinanced maturity behind the end of 2013; fifth, to de-risk the execution of the already announced portfolio management and sixth, to continue investing in profitable growth in our operations.

Additionally, we are fully committed with the execution of the already announced portfolio management and asset divestment program, including the sale of Atento, and the IPO of Telefónica Germany in the fourth quarter of this year and the analysis of potential listing alternatives for Latin American businesses. On top of that, we are continuously monitoring market conditions to make further selective asset monetisations.

All these actions should help to reduce the Company's risk perception to levels that are aligned with our business' fundamentals.

Conclusions

To sum-up:

In Q2 we have delivered a better performance across metrics, from OIBDA to net income in underlying terms.

Our risk perception is clearly decoupled from business fundamentals and does not reflect our best in class diversification.

OIBDA improved materially quarter-on-quarter, with sequential increases across operations, and OIBDA margin performance in H1 is consistent with 2012 guidance, with a better evolution expected for the second part of the year.

We have taken further initiatives to optimise resources and improve business profitability.

And in the current extremely challenging economic environment, we are undertaking actions to improve balance sheet and defuse potential risks.

And we are clearly making significant progress in our journey to become a Digital Telco.

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

Q&A session

Torsten Achtmann - *JP Morgan*

The first one is on Spain. While the wireless business has stabilized on the quarter-on-quarter basis, wireline seemed to have accelerated the downturn. Could you explain what is behind that? And, is that something which will continue throughout the year?

And, second one would be on the credit lines. Are the credit lines tied to any rating? Or, in other words, could they be cut or pulled if your rating gets downgraded by two more notches, in any case?

Thank you.

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

Taking your question on the evolution of the wireline business revenues in Spain, let me say that this is actually due to an induced movement that we have been doing in actively migrating our most valuable broadband customers to a lower tariff. And, therefore, right now, more than two-thirds of our customers in broadband have already migrated to new tariffs. And, this has created a short-term impact on the revenue growth. But at the same time, we have been able to manage a better margin, an average margin per user performance.

Because churn has been significantly reduced and before that we used to have a probably 50% of the customers that were stepping out of a promotion, leaving the Company, for another supplier, right now we are able to preserve those customers and that, jointly with the fact that we are significantly increasing the quality of our services here in Spain, means that churn are at historically low levels in Spain.

So, it is true that has been affecting the short-term, additionally to the macroeconomic conditions.

Revenue performance in Spain would stabilize progressively, but we have a much more loyal customer base, much lower churn, much better operational metrics, and a margin evolution. And, on top of that, that is going to have a significant impact on lower CapEx, because the effort of preserving those customers in terms of installing or getting more customers from the outside was putting significant pressure on CapEx.

So, overall, it is true, and that has been affecting our revenues in this quarter. And, it's probably going to be affecting in the coming months. But, the overall equation is positive, and it is further contributing to a bigger margin per customer and to a lower intensity of CapEx.

By the way, the equation is solidly based on the fact that churn is at historically low levels.

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

Hello, Torsten. This is Ángel. We have no rating triggers in our financing, neither in the credit lines nor in the bonds nor in the long-term facilities. So, no rating triggers in our financing.

And, also, as you can see on slide number 25, we have very well diversified origin of counterparties for our credit lines.

Torsten Achtmann - *JP Morgan*

OK. Perfect.

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

Next question please.

Luigi Minerva – *HSBC*

Yes. Good afternoon. I wanted to go back on your positive comments about the European Commission's policy statement on fiber, and I wanted to ask you two things. Firstly, how that statement is going to change your fiber strategy, let's say, over the next 12 to 18 months? And, secondly, picking on the point that the Commission emphasizes that they endorse a technology-neutral approach, whether this statement will push your network architecture more toward the fiber to the node, compared to a fiber to the premises? Thank you.

Julio Linares - *Telefónica SA - Chief Operating Officer*

This is Julio Linares. Thank you for your question. Our view on the new regulatory policy for Europe is positive, as it is for the investment community. We really believe that there is significant change in the right direction that is addressing the first priority for the European market, trying to achieve a less-regulated policy framework that is the most adequate one in order to push and stimulate investment around next generation access network.

As you know, there are two new recommendations coming with this general policy. The first one for non-discrimination and, the second one around cost methodology to be applied for the determination of the regulated wholesale services. That will take several months and, then, it will be very unlikely that will have a direct impact in the next six months. But, of course, it will be very positive impact for the next coming months.

Saying that, in addition to this general framework, I think it is very positive to take into account that there are not going to be any pressure on the current unbundled local loop prices. On the other side, taking into account our prices in Spain, we have even an upside possibility here.

I think as you said that is very important that this policy is technologically-neutral, but we don't see any impact on our current strategy regarding the deployment of the different technologies. As you know, we will use the best mix of the available technologies in each market, depending on the current competition and situation of each individual country and market.

Luigi Minerva – *HSBC*

OK. Thank you very much.

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

Next question please.

Georgios Ierodiaconou - *Citi*

Yes. Good afternoon. I have two questions, please. My first question is on the country of domicile. This was one of the reasons you mentioned drove your decision to cut the dividend. And, as you highlighted it earlier on page 6, you are a lot more diversified than some of your peers yet the Headquarters seem to make all the difference. Can you clarify if it would be possible in principle to change domicile, if it's feasible in practice, and whether, if you were to make such a move, it would be enough to decouple your rating from that of the sovereign?

And, my second question is on the dividend. Can you please confirm that the 0.75 euros for 2013 onwards will be all in cash? Or whether you will rule out scrip dividends in future? Thank you.

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

This is Cesar Alierta. If you see the evolution of our debt, it is basically due to two factors; the buying of O2 and the operation in Vivo. So, we are being penalized for having invested outside of Spain, which is clearly to me a very clear contradiction; the increase of our debt is due basically to investing in Europe and in Brazil, to investing in some of the biggest growing markets. And, I see a very clear contradiction in the correlation between the financial risks they are giving to Telefónica, which is three or four times more than our peers, which have more revenues inside euro and less diversification than us.

We have the domicile in Madrid and we will keep the domicile in Madrid because we are in 25 countries and I think our business should be looked from the cash flow generated in the 25 countries. I remind you that Spain generated 25% of the revenues. So, that is very clear. And, that's the reason that, you know, anyway, taking the present situation, it was clear to the Board that we had to take an action to decouple and make the reality be related to the fundamentals of our business. And, that's the reason we took this decision on the dividend, extending the maturities behind 2013. And, that means that we feel very comfortable.

We will achieve the leverage ratios we said that we will reach at the end of the year, and we'll continue optimizing our asset portfolio and deleveraging Telefónica, while not affecting the growth potential of Telefónica. And, this is clear, and we can do both things. The things we have done in the first seven months of the year are very clear, with the optimizing of the portfolio, and what we're going to continue to do.

And, we are going to pay 0.75 euros in cash. And, I may remind you that 0.75 euros is less than 50% payout of our free cash flow we expect for the coming years. So, that's the answer to your question.

Georgios Ierodiaconou - *Citi*

Very clear. Thank you.

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

Next question please.

Mathieu Robilliard – *Exane BNP Paribas*

Good afternoon and thank you. First, a question with regards to your revenues, as you've shown that you still have good revenue growth in most of Latin America, yet there's been a slight slowdown when we compare it to Q1. There's also some slowdown in some European countries. And, so, my question was, how do we reconcile that with the fact that you have continued to invest over the last few quarters? And, is that the reason why you changed the revenue guidance, because you're seeing a slowdown already in some countries? And, related to that, where have you been disappointed? The reason why you downgraded the guidance, is it because of Latin America? Is it because of Spain?

A second question has to do with your financing strategy. And, I'm trying to reconcile slides that you put out today about debt maturities, that's slide 25, and the equivalent slide you put in the Q1 results. At the time, you were talking about 40% of the 2013 maturities being prefinanced. That number doesn't show here this time. Maybe, it's just a presentation issue. If you can clarify that? And, also, I see that undrawn credit lines have declined from the previous quarter. So, maybe, also if you could clarify that?

Thank you.

Julio Linares - *Telefónica SA - Chief Operating Officer*

Regarding your first question, as we see that Latin America revenues are growing, and they will keep growing, the main reason to change our guidance for revenues is basically that we expect weaker macro conditions in some countries, not of course in all of them, but in some countries, and because we took into account as well the stronger drag from regulation that we are already facing.

Mathieu Robilliard – *Exane BNP Paribas*

But, sorry, the weaker macro, is that only in Europe? Is that also in Latin America?

Julio Linares - *Telefónica SA - Chief Operating Officer*

Basically, in Europe.

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

Hello, Mathieu. This is Ángel. With respect to maturities of 2013, you are seeing on slide number 25 a lower figure than in the first quarter, because we have been extending the maturities of some financing beyond. And, then, we have brought them forward. So, that's why the figure is lower.

And, also, what we said at the end of first quarter, that we had 40% of the maturities covered. Now, what we're saying is that we have 100% of those covered. So, we already have, even in the absence of divestments and once we have closed the China Unicom transaction, we have all debt maturities covered until beyond the end of 2013.

So, here we are in an exercise of expanding our liquidity cushion for the next period until the end of 2013 and beyond.

Mathieu Robilliard – *Exane BNP Paribas*

Sorry. If I can clarify that. By, covered, you mean, prefinance, as you meant in the previous quarter? Is that covered by the free cash flow? Or, is that covered by existing lines that are undrawn?

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

With the cash that we have, the cash that we are going to generate, and the facilities that we have, we would be covered until beyond the end of 2013.

Mathieu Robilliard – *Exane BNP Paribas*

Thank you very much.

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

Next question please.

Tim Boddy - *Goldman Sachs*

Yes. Thanks. I wondered if you could confirm whether you've spoken with the credit rating agencies about this decision and whether you have some reassurance that this can isolate you from the potential risk of a downgrade to the sovereign rating in Spain, reflecting the diversification you've been discussing.

It would also be helpful to understand whether with this stronger balance sheet, you are able to be more price sensitive on any potential asset disposals that you plan, for example, if market conditions become even more challenging, does it give you flexibility to delay potential IPOs? And, I guess related to that, does this change the way that you're thinking about German consolidation, given your balance sheet is again getting stronger?

Thank you.

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

This is Ángel Vilá again. My first observation about rating agencies should be one of coherence. All of us have read the latest reports from S&P, Moody's and Fitch which were issued in May, June, July, respectively. They are public, and they state objective metrics which would lead to stabilization of our ratings.

The results that we are presenting today, where we have a quarter-on-quarter sequential improvement, the expected improved performance in the second half, and the dividend action, would position us in compliance with those metrics. So, we would expect rating agencies to be coherent and properly incorporate these facts into their assessment.

The second observation is about decoupling from sovereign rating. As you know, certain agencies have methodologies that link sovereign and corporate rating, and a rigid application of such methodologies that would fail to take into account the geographic diversification, the solvency and liquidity of Telefónica, could create some potential undue damages to Telefónica. Therefore, we would expect that the methodologies that would be applied by rating agencies would be applied in a way that recognizes the diversification, solvency and liquidity of Telefónica.

By the way, we have had preliminary conversations with rating agencies after the announcement that we did yesterday, and they are showing, or interpreting this as a very positive movement from Telefónica.

With respect to the second part of your question, which relates to the divestment policy, we continue to be committed to the divestments program that we have but, obviously, since we have all our debt maturities covered until beyond 2013, even in the absence of those divestments, this provides us the flexibility with respects to timing, with respect to valuation of those divestments, to which I insist we remain fully committed.

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

Next question please.

Will Milner - *Arete Research*

Thank you. First question actually just following on from the last one on the need for an IPO in Germany, I mean given the cancellation of the 2012 dividend, which certainly doesn't seem have to led to a sharp move in the share price, I just want to understand why you're still committed to IPO-ing the best European asset? And, why would you not potentially also delay restarting dividends in 2013 to prevent you from having an IPO in Germany?

And the second question, actually, is on Brazil. Quite a bit more evidence, I think, in the quarter of tougher competition, especially on wireline. And I think, certainly adjusted for a big provision reversal and some tower sales, the OIBDA is falling high single-digits in reais. I just wonder if you can talk a bit more about the prospects for being able to generate consistent underlying OIBDA growth given the commentary you made about operational synergies being noticeable or coming through in the next couple of quarters? Thanks.

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

Hello, this is Ángel Vilá. Regarding the first question, we have not contemplated cutting the dividend beyond the one-time exceptional cut of 2012 because as we have tentatively expressed in the past it's in Telefónica's DNA to have an attractive and compelling dividend to its shareholders. And, the financial projections that we are having with the operation of the business and the different measures that we are taking, we can be comfortably covering such a dividend.

With respect to the German IPO, it's a project that provides not only a potential source of liquidity and debt reduction, it's a project that provides a platform in Europe that can allow us to highlight the value of such an asset, that can provide us a platform for capital raising in case there were continued financial volatility in Europe, and it provides us with a platform for further development. It's a very attractive asset which we have been highlighting that is growing in all its metrics from revenue to OIBDA to operating cash flow, has a very effective cash generation, even after taxes because of its tax position, and we believe that it should be very attractive for potential investors.

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

And let me highlight one thing: clearly, we want to highlight the value of the group and the IPO of Germany is one of the reasons. When you look at the sum of the parts, there is clearly a discount on the value of Telefónica because of having the domicile in Spain. We want to highlight the value of the group. And I want to reiterate you one thing, for Telefónica the domicile is the 25 countries in which we are. That is our domicile. Okay?

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Yes, Will, this is Santiago. Let me try and answer your question about Brazil. Well, number one, I appreciate that Q1 and Q2 have been quite busy in one-offs. I will not go into detail, but I'm more than willing to spend time on those. The one thing I can say is that two of those, the brand and launch, that was expensive but successful with Vivo now encompassing both fixed and mobile products, is clearly one-off event and it will not happen again in the second half of the year. And the restructuring coming from the putting together of the fixed and mobile businesses is also behind us. So clearly on those two fronts, the second half should be better.

You were right to point out that the weakness lies exclusively on the fixed-end of our businesses and they are in particular all voice. And we have two observations there. One is that broadband continues to expand that we continue to have an active presence in that market. And second, we are ready to launch around October our new IPTV product which we think is going to help us sell more to the upper echelons of the market and will show that, though we may be coming in a bit late into the growth of that particular segment, we are going to make a lot of noise.

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

Next question please.

Paul Marsch – *Berenberg Bank*

Hi. Thank you. I have two questions. On Page 25 first, it sounds like I'm not the only one who is a little bit confused by how your liquidity situation stacks up. And, maybe one way of answering it is, could you perhaps give us your view of what that liquidity chart, the cash and equivalents plus the undrawn credit facilities, would look like if you hit your guidance for the full year. What would that look that at the end of the year? And then, secondly, a question on Germany again. Clearly it's been widely reported that you were close to a deal with KPN on E-Plus but couldn't get credit agency backing. Are you still working on resolving those credit agency concerns? And, is it still an option in your plan to revisit that opportunity if credit agencies can be pacified?

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

This is César Alierta. In regards to your KPN question, I mean, it's very, very clear that there were substantial synergies in the market consolidation in Germany. But, we said very clearly that the priority for Telefónica is deleveraging and to improve our financial flexibility. And that's the reason that this deal hasn't been done.

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

This is Ángel Vilá. With regards to the first question, we will not give guidance on what would be the cash position at the end of the year but clearly this will be influenced by the position that we have now, by the cash that we are going to be generating in the second half of the year, that will be substantially higher than the one that we have generated in the first half, and also on the financing exercises that we can execute in this second part of the year.

With respect to the evolution of cash between now and the second half of the year, the operating cash flow decline that you have seen in the first half will be lower, so the second quarter has already been better than the first quarter, the second half will be better than the first half and you should see a better evolution of operating cash flow.

Also the working capital consumption, which you can see on slide number 24, is cumulative close to €2 billion in the first half of the year. It will more than fully reverse in the second half. Working capital as you can see in every single one of the last years is highly cyclical and this will more than reversed. Third, on interest expense, we are having a higher interest expense because we have higher debt and we have higher interest cost.

Also in the interest expense and payments that we've had in the first half of the year, we had about over 200 million euros of non-recurring items. This financial expense in the second half would also go down because the debt will go down. And, we are saving on taxes so far, compensating the increases that we've seen in Spain with savings that we're getting in other jurisdictions. So you should be expecting a much better free cash flow generation in the second half of the year which, coupled with financing activity, will result in the position that we will have in cash and under own lines by the end of the year.

Paul Marsch - *Berenberg Bank*

Thank you.

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

Next question please.

James Ratzer - *New Street*

Yes. Thank you very much.

I had two questions, please. The first one was just regarding wireless in Spain, comparing your performance with that of Vodafone. I mean, it's been widely publicized you're both changed your subsidy policies. But, if I look at your average pricing per minute, Vodafone decided to give some of that value back to customers by cutting its voice pricing sequentially, whereas your average price per minute seems to have actually gone up sequentially from Q1. Do you think that differential in pricing trend is sustainable? Please, it'd be interesting to get your thoughts on that.

And, secondly, I had another question with regards to Brazil. It's now coming up through almost two years since the deal completed. I was wondering if you could just give a feeling of what's going on behind the scenes on the synergy process. Why is it now two years on that you feel confident the synergy is going to come through in this second half? And, why haven't we been able to see them in the first two years since the deal completed?

Thank you.

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

Taking your question on wireless in Spain, namely on the comparison that you're making against Vodafone, we don't see those differences. And, in fact, in market trends on average entry points, we think that we have become highly competitive. So, it's probably due to some of the bundle assignments that we have. So, I would invite you to check that numbers with our team. I'm more than happy to go through those, because we don't really feel that difference.

And, in fact, the market trends are very positive on our side on this part of the business. So, it might be some bundle assignments, but, on effective price per minute, we are very competitive, and we have been very competitive both in contract and progressively in prepaid. And, thanks to that, we have been able to show a significant improvement in churn. And we have been back to positive market gain, market net adds in contract namely.

So, we don't experience that difference. Please check those numbers with our team. We are more than happy to go through them, because those do not account for market reality today.

James Ratzer - *New Street*

And, do you think your price per minute hit could stabilize?

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

Well, in fact, what we see is that we have become competitive, as I was saying. The ARPU, if you measure that in terms of mobile service revenues, in Spain, it has been stabilizing somehow. So, we have been migrating already 52% of our total customers to a lower tariff. This difference of tariffs is roughly six euros, and the main comparison that you should drive is, what if we would not have done this? We are already passing the point in which our revenues are already stronger today than if we would not have done that, that because the churn levels that we were having before in the customers of above 60 euros were roughly 6%. And, now, we have historical low levels of churn.

So, thanks to that, the average margin per user is higher today than it was before. And, in fact, the revenue trends compared to the one that would have been if we would not have moved our entry points is today starting to be better.

So, I think that now is not just about subsidies. It's about the entry points. It's about the quality of services. It's about the fact that the number of calls that we are getting to the call centers has basically halved. And, therefore, the OIBDA margin trend is much more sustainable than before.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Yes, this is Santiago again. In terms of when the Brazilian synergies will show up, let me just make two comments. One is that it is almost two years exactly to the date that we signed the deal with PT on Vivo, on the second half of Brasilcel to be precise, but it's only a year and one-half or slightly less than since the deal closed. And, it's only been six months since the two companies finally integrated. And, obviously, a lot of the synergies are yet being shown on the negative side, as I just mentioned in terms of integration costs. And, from now on, I would commit to say that through the end of this year, we should be more specific about what those synergies have actually turned up being.

That should also include the tax synergies which are not insignificant as a result of this merger, which only happened in February.

James Ratzer - *New Street*

OK. Thanks very much.

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

Next question please.

James McKenzie - *Fidentiis*

Yes. I've got a couple of questions. Firstly, Ángel, you were talking about the interest expense. In the last couple of years, we've become used to interest payments being well below the accrued interest costs and, yet, in this first half of the year, that situation has turned around. I was wondering, could you give us some idea of what you're expecting for H2?

And, then, on the Spanish business, when I look at the churn, the churn has obviously come down to very low levels. Could you give us an idea of, for the new plans, if the churn is significantly below the average churn you're showing in these charts?

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

Hello, James. This is Ángel. In the first part of the year, we have recorded some non-recurrent interest expenses to the tune of 200 million euros. Part of this had to do with Colombia. One before we took all the debt reduction, there was one monthly payment that had to be put into the financial expenses that went into the first quarter. We also had some one-times related to Peru, and so on. Also, there is seasonality in the coupon payments. There is a concentration of coupon payments in the first part of the year that also make a distortion of that.

So, this is basically the, either a seasonal or non-recurrent items that were in the first part of the year. From here, you should expect debt reduction. As I said before, next Monday, on July 30th, we are closing the transaction regarding China Unicom. That will provide an immediate debt relief in excess of 1.1 billion euros. And, we continue with our efforts to divest assets.

And, the cancellation of the share buyback will result in us having the shares in our treasury stock. They will not be cancelled. And, we have all flexibility with respect to those. Obviously, we would not contemplate divesting them in this price, because it's not reflecting Telefonica's value.

And, then, the saving of the November, the 0.40 euros in November. That's around 1.8 billion euros, also saving.

All of this will result in a reduction in the interest expense.

James McKenzie - *Fidentiis*

Sure. Any guidance with respect specifically to payments versus accrued interest, i.e., the cash flow interest rather than P&L interest?

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

I can say that payment will be lower than accrued, in the second half.

James McKenzie - *Fidentiis*

OK. Thank you.

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

Taking your question on the Spanish business and churn lows, the answer is, yes. On the customers that we are retaining on what we call the evaporation rate, which is the early signs of churn of the customers that we are acquiring and the ones that we are retaining, on voice, which means that we are effectively having a better performance than the churn levels that you are seeing on the slides on the voice part of the business.

We are still suffering from some dongles impact coming from previous years, coming from previous campaigns, that is still affecting our churn levels. But, if you ask me about the customers responding to the new policy, yes, the churn is even lower than the levels that you are seeing there.

And, that's why we think it is a sustainable trend. As you might imagine, we are monitoring that, because this is the compensating factor of the fact that we have been reducing the entry points, the prices. And, that's why this equation is working in terms of average margin per user.

If you include on top of that the fact that the quality increase is having, as a result, a much less intense call center activity and, therefore, a significant cost reduction, the overall equation is becoming very positive.

James McKenzie - *Fidentiis*

You mentioned voice. What would that include? Would you include fixed broadband in your churn calculations?

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

No. We are talking about voice plus smartphones. I'm just excluding the dongles, I mean, because it was a specific one-off.

James McKenzie - *Fidentiis*

Is the fixed broadband churn also well below what you're reporting as an average churn for broadband?

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

No. On fixed broadband, it's an average similar, but again, remember that we were losing the most valuable customers. In both sides of the business, wireline and wireless, the effective result of this strategy is that we have been stopped exporting high valuable customers to the portability market. And, that means that the portability market has been significantly reduced and, in fact, it has been focused on the less valuable customers, because we have been preserving the most valuable ones.

James McKenzie - *Fidentiis*

OK. Thank you.

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

Next question please.

Luis Prota - *Morgan Stanley*

Yes, thank you. Two questions please. First, on Spain: The question is on the VAT increase we are going to have in Spain in September, whether you are planning to pass it on to customers at least for mobile contract and fixed broadband, or you are planning to absorb VAT within your margin? And the second question is on Brazil. We've seen recently some regulatory action from ANATEL, which was leaving Vivo in a very good position, relative to peers. The question is whether you think that this is suggesting that the regulator is more vigilant now and could take action in other areas, maybe forcing Telefónica to invest further, and interest CapEx maybe in fiber or any other area? Thank you.

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

Thanks Luis, I'm taking your question on the VAT in Spain. Our prices, the market prices in Spain are always before VAT, and therefore, I think that the market prices will keep the same structure and therefore, VAT will be passed on to the customers. So we do not expect to change that strategy.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

And on the Brazilian regulatory action, the only thing I can say is that we're happy not to have been included on that list. But we don't have any further comments on whatever the regulatory actions are. It has also been a very demanding and very vigilant, as you said, regulator. And we don't expect that to change. However, I think it proves that over the past couple of years, we've been investing just about right, in order to prevent these things from happening. Although we will continue to monitor all the quality indicators, that are numerous and not always easy to manage, so that regulatory hurdles are not an obstacle.

Luis Prota - *Morgan Stanley*

Sorry. If I can follow up on the VAT question, and thank you for your answers. Obviously it's quite difficult to pass onto prepaid customers, VAT. So I presume that you will be giving less minutes for the same price? Are you expecting a very direct relation between VAT increase and reduction in prepaid ARPU?

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

Well, you're right. Customers are used to top-up a specific amount of money and therefore, effectively, they will have fewer minutes for the same price. So the answer is yes. How this is going to be affecting elasticity is still not clear, but we'll keep you posted.

Luis Prota - *Morgan Stanley*

Ok. Thank you.

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

Next question please.

Frederic Boulan - *Nomura*

Hi. Good afternoon. Two questions on M&A. First of all, to follow up on the question on E-Plus. So I guess the market can appreciate that acquiring assets is difficult in the current credit environment, but will you consider reopening discussions with them based on different structure, around merger or JV for instance? And secondly, on Latin America, you mentioned Germany as a kind of platform for further operations in Europe. Would you consider Brazil as a similar vehicle for Latin America IPOs? Or would you plan to work on an individual asset basis? Thank you very much.

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

Regarding Latin America, we are still in the internal phase of analysis of several alternatives. Clearly, we have a very good collection of assets in the region, second to none, and they are many different possibilities on how to structure it, i.e. country-by-country basis, regional or semi-regional. All the alternatives have pros and cons and we are still in the internal analysis phase of the course of action.

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

And in the case of KPN, that was very clear. The priority for Telefónica is to deleverage and get the goals. And that's our priority. And as I said in my previous comments, I mean, the synergies are very clear. But we had to opt, and we opted for the priority, which is the deleveraging of Telefónica.

Frederic Boulan - *Nomura*

Ok. Thank you.

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

Next question please.

Jonathan Dann - *Barclays*

Hi there. Two questions. The first relates to, I guess, have you spoken to the rating agencies about, I guess, if you raise debt at any of the subsidiaries? Or, I mean, are they still worried about subordination as a negative credit event? And, as part of that, if you could remind us where you are on cash repatriation from Latin America?

And, then, my second question, historically a strong part of Telefónica's DNA has been management's commitment to share ownership. You mentioned there were treasury shares. Will management be acquiring more shares?

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

OK. On the first question, we have got positive informal responses from rating agencies to the move that we announced yesterday.

With respect to LatAm repatriation, we have been repatriating in the first half of the year over 600 million euros.

And, with respect to the share ownership question, I pass to César.

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

Key management of Telefónica is heavily invested in Telefónica shares, and the reason we are heavily invested in Telefónica shares is we believe that Telefónica value is much higher than is today. We know the fundamentals. And, I think we can look at exogenous factors but at the end of the day, the important thing are the fundamentals, and we are fully committed and very happy with the purchases of shares we made. I cannot say any more on that, we believe and I want to stress that the real value of Telefónica is much higher than today. And, we know the cash flows and you know the numbers.

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

OK. I just realized. This is Ángel, that my response previously was incomplete. We have room for debt in subsidiaries. At this stage, about 15% of our total gross debt is sitting in subsidiaries. So, we still have room to increase the debt that we have in those subsidiaries, even up to around 10% before we hit any concern that ratings agencies may have regarding structural subordination.

Jonathan Dann – *Barclays*

Thank you very much.

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

Next question please.

Stanley Martínez - *Legal & General Investment Management*

Good afternoon to everyone, and thank you for taking my call. My first question returns to the Spanish fixed broadband business, and, Jose Maria, would you characterize your strategic repricing to new ADSL tariffs as substantially complete? Because, it appears that your realized average broadband ARPU in H1 is now broadly level at about 38 euros per sub per month with Jazztel and ONO, much as your domestic mobile realized ARPU is now lower at 20 euros across the piece for all major carriers. So, my question is, do you feel that the new tariff in domestic broadband is now broadly affordable for current market conditions? Or, does the price-value equilibrium for Telefónica and the whole Spanish broadband market still need to reprice lower over several more quarters?

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

OK. Thanks for your question. Well, remember that we have been taking the entry point down from 39.90 euros to 19.90 euros, the basic offer, and 24.90 euros, the basic offer plus value-added services. Today, the take up of customers is that the vast majority, being more than 70% of them, are going to the 24.90 euros offer. And, that means that we have become competitive. If you add to that the fact that we have been turning positive in net adds in this quarter, that means that we are back on track being competitive.

We are commercializing the fiber at a higher entry point, and when we will be massively as we are massively deploying the fiber today in Barcelona and in Madrid, we'll keep you posted about this entry price. But, today, we feel competitive.

The next step for that is probably going farther into what we call the totalization, which means that bundling further the broadband products with voice and with wireless and potentially with TV and having a single approach to the customer would help us to become even more competitive and to increase the perceived value for money for the customers.

So, the answer is, yes, we feel we are competitive. We think that the commercial fields that we are getting and the traction that we are getting support that assessment. The fiber is the next step. And, you should expect from us totalization strategy to increase our competitiveness and an attraction of our overall prices.

Stanley Martínez - *Legal & General Investment Management*

Well, that's very encouraging. If Maria will just oblige me one other question if I may, to Ángel, on the financial model. I just wondered whether you could provide me and other investors with some realizable upside potentially from higher ULL pricing. And, also quantify some benefits that we may have from the various active network sharing arrangements that would support the Chairman's viewpoint that we have reached through in European OIBDA here in H1?

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

Well, it's Jose Maria (Ángel transferred that question). I mean, I am more than happy to go through it at any point. I mean, in terms of unbundling, we feel comfortable with the current prices. Remember that the prices today in Spain are below the 9 euros that has been established by the European regulator. So, we'll keep you posted on that potential upside at any point.

And, on network sharing, we have done a very aggressive network sharing. Aggressive mean very ambitious, active and passive, negotiating agreement with Vodafone in the UK. That is going to help us to do two things at the same time. First, to catch up with the best network in the UK in a shorter period of time, and to do it in a much more efficient manner. We think it is a very valuable agreement, and we intend to extend wherever we can do it in Europe, because we think it is the most sensitive way of deploying the new generation networks.

And, I think that Europe doesn't have room for so many as there are too many networks in Europe today. So, we need to work very intensively for those agreements, because it provides time to market and significant amounts of synergies and, therefore, a huge amount of value for the customers.

Stanley Martínez - *Legal & General Investment Management*

All right. Great. Very good. Thank you very much, indeed.

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

Next question please.

Jerry Dellis - *Jefferies*

Yes. Good afternoon. I've got two questions, please. Firstly, in Spain, Vodafone said that a side effect for them of the new subsidy model was that they found that gross adds is coming under heavy pressure. And, they said on the conference call the other day that they may have to take a few measures to regain commercial traction in the weeks and months ahead. If Vodafone were to increase subsidies, how would you potentially react to that?

And, then, in Germany, your recent margin growth momentum is obviously very strong. OIBDA margin is almost back at 30% now. Do you believe that margin expansion is sustainable, bearing in mind the repricing that's really hitting the market from a number of your competitors, particularly 20 euros flat rates?

Thank you.

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

Thanks for your question. In terms of the overall market in Spain and without willing to comment on what might be the intentions of one specific competitor, I think that the model is starting to work. And, what am I saying that? Because in fact, remember that Vodafone starting this thing one month later than we did and, therefore, the benefits of churn reduction will take a little bit more to flow to their own accounts.

But, basically, the goodness of the model is not just on the subsidies. For us, the attraction of the model, the subsidy is one part of that equation, but the lowering of the entry prices, the lowering of the entry points, retaining the most valuable customers, getting the kind of churn levels that we are getting, getting the number of calls that we are getting, which are significantly reduced, basically half in six months, we are entering into kind of a virtual cycle, and the subsidies is just one component of that.

So, we will monitor permanently the situation, but if the portability market might be one proxy of the short-term impact of any of those strategies, we have become pretty attractive, we have improved significantly our portability metrics. And, on top of that, we have been able to significantly dry up that market.

So, we'll keep you posted, but subsidies is just one part of the equation. I mean, the sustainability of our market is not based on that.

Remember that this is not just affecting margin. It is only positively affecting CapEx in Spain, because the fact that we are having a much lower level of churn means that we can do the same kind of market share with a significant less CapEx intensity in terms of routers in the homes of new customers. So, it's starting to have a significant impact on capital allocation.

We'll keep you posted. We will monitor that significantly. But, for the time being, it is starting to get traction.

And in terms of Germany, we think it is sustainable. We even ambition a little bit more. We have changed the model in Germany as well. Remember that we are not subsidizing handsets in Germany, that we have this My Handy instrument which is a factoring instrument that the customers decide how they want to finance their own handset. We have been changing significantly the approach to the market. We are getting traction on our customer base and everything on postpay and, therefore, it will have the accumulative benefits of the recurrent revenues.

And, on top of that, we have learned that it is very valuable to change our strategy and to become much more regional, because being more regional because of the tariff structure in Germany means that we can enjoy a better margin on the on-net traffic, even on the off-net traffic, in the German market.

So, we have several levers that we are tracking and monitoring. We are learning a lot on that market. Churn is coming down significantly again. So, yes, we ambition to have, to preserve those levels of margins in Germany.

Jerry Dellis - *Jefferies*

OK. Thank you.

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

We have time for the last question, please.

Simon Duff – *M&G Investments*

Hi. I've got two questions, one on liquidity and one on cash repatriation. On the liquidity, could we get further clarification on this 5.1 billion euros cash and equivalents, ex-Venezuela, because I'm struggling slightly with that on the basis that the consolidated balance sheet only shows 4 billion euros cash and equivalents? So, does the 5.1 billion euros include some of the 8 billion euros that's included in your net debt definition? And, if so, can you just give us some idea of what the 8.3 billion euros consists of, if it's not normal cash and equivalents? And, what is the true cash and equivalents position, ex-Venezuela, as per the balance sheet definition? Because, clearly, it's lower than the 5.1 billion euros that's in slide 25.

And, then, the second question on the repatriation. I think, did I catch you earlier in saying it was 600 million euros to date. I think last year you did 3.3 billion euros. So, you're expecting an acceleration in the second half? Or, can you give us a feel there for of what the full-year expectation for repatriation from LatAm is?

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

With respect to the second question, yes, we have repatriated slightly above 600 million euros in the first half. We're expecting this to significantly improve in the second half of the year. We do not expect to hit the repatriation figure that we had last year of about 3.3 billion euros. But, we should be close to 3 billion euros for the whole of the year.

With respect to the second question that you're asking, I can only say at this stage that the 5.1 billion euros cash and cash equivalents, excluding Venezuela, has been calculated in a consistent manner with the way that we have been presenting this information every quarterly presentation. And, we would encourage you to get in touch with our IR department so they can give you all the details on the reconciliation.

Simon Duff – *M&G Investments.*

OK. Appreciate that. Thank you.

César Alierta Izuel - *Telefónica S.A. - Executive Chairman and CEO*

OK. This is Cesar Alierta. On behalf of all my colleagues of the Executive Committee, I want to thank all of you for attending our second quarter results and all your questions. Thank you very much.