



Telefónica January-September 2012 Results Conference Call Transcript

7th November, 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-September 2012 results. 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 in 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 dialling the following telephone number, +34-91-482-8700. Now let me turn the call to Ángel Vilá, who will be leading this conference call.

Presentation

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

Thank you María.

Good afternoon ladies and gentlemen and welcome to Telefónica's 2012 third quarter results conference call. It is my pleasure to chair this call.

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

Also with me are Matthew Key and Guillermo Ansaldo, heads of Telefónica Digital and Telefónica Global Resources, respectively.

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

Highlights: Visible results from execution of our strategy

During the last months we have continued executing our strategy, with significant progress and visible results in 3 key areas.

First, on the operational side, Q3 results confirm the consolidation of the recovery trend initiated in the previous quarter, with a sequential improvement in underlying EPS, underpinned by sequential growth in OIBDA, both in absolute terms and in margins.

Second, on the financial side, we have significantly improved our financial position, with a net debt reduction of close to 5.5 billion euros since the end of June, on the back of the substantial improvement in free cash flow and the fast execution of asset disposals. We are particularly proud of the successful IPO of Telefónica Deutschland, which has been the largest IPO in Europe year-to-date and has been executed in a record time.

On top of that, we have been very active on the financing front, with over 13 billion euros refinanced year-to-date, increasing our total liquidity to 18 billion euros.

And third, we continue making progress in our transformation into a "Digital Telco", achieving significant milestones in the quarter.

Key financials: improved performance from OIBDA to net income in Q3

Let me now start with a summary of key financials on slide 4.

In the first nine months of both 2012 and 2011 we booked several significant exceptional items, with Q3 11 results being particularly impacted by the provision for the redundancy program in Spain. Accordingly, 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 to September revenue reached over 46.5 billion euros, while underlying OIBDA totaled nearly 16 billion euros. Net income was over 4.4 billion euros in underlying terms.

The good news in the third quarter is that we posted a much better performance from OIBDA to net income, confirming the quarter-on-quarter improvement trend initiated in Q2.

I'd also like to highlight that, although material items such as assets write-downs are flowing into the P&L, there are other transactions that are enhancing our equity but not flowing through the P&L. For example, the restructuring of the Colombian operations, which increased shareholders' equity by 1.6 billion euros.

Second consecutive quarter of OIBDA growth and margin expansion q-o-q

As slide number 5 shows, we continue improving profitability across the group.

In absolute terms, underlying OIBDA grew sequentially for the second quarter in a row, with a consistent performance in Europe and Latin America.

As a result, consolidated OIBDA margin stood at 35.1% in the third quarter, up 230 basis points in the last six months, leading to improved y-o-y trends.

As we anticipated, OIBDA margin in the second half of the year would be better, and we are fully on track to deliver on our target.

Outstanding improvement in underlying EPS

Improved trends in OIBDA flow directly to the bottom line, leading to an inflection point in underlying EPS.

As you can see on slide number 6, underlying EPS reached 0.36 euros in the third quarter, with a significant improvement since the beginning of the year, both in absolute terms and on year-on-year basis.

Underlying EPS in the nine months to September was close to 1 euro, well above our 2013 dividend commitment. And we still have another quarter to provide further support to dividend sustainability.

Well diversified operations, growing exposure to Latin America

Strong diversification continues to be one of our key strengths, as shown in slide number 7.

We would particularly highlight the growing contribution from our Latin American businesses, which already account for 49% of consolidated sales and for the first time, exceed revenue generated in Europe.

It is also important to highlight our lower dependence on Spain, which now is just 24% of our sales and 32% of our OIBDA.

Continued revenue growth in strategic areas

Turning to slide number 8, in the first nine months of 2012 consolidated revenues grew 1.1% year-on-year excluding the impact of regulation, driven by solid growth in 2 key strategic areas:

First, Latin America, where revenue growth accelerated in the third quarter to 8% year-on-year in organic terms ex-regulation.

And second, mobile data revenues, which continue to enjoy a strong momentum with a 14% year-on-year growth and already account for over one third of mobile service revenues. This performance is driven by our data monetisation strategy, focused on increasing smartphone penetration with attractive data proposition based on tiered pricing and integrated tariffs.

Delivering targeted efficiency gains

On the efficiency side, on slide number 9, I'd like to highlight our ability to deliver cost savings, with OpEx down 1% year-on-year in the third quarter.

Key transformational efficiency initiatives are bearing fruit, with significant savings from more rational subsidy models across our footprint, commissions management and headcount reductions, among others.

We are fully confident on our ability to continue delivering significant cost cutting across regions, a key lever to offset top line pressures in some of our European businesses.

T. Global Resources contributing to capture the value of our global scale

On top of local and regional efficiency measures, Telefónica Global Resources is further exploiting scale benefits, helping to maximise business profitability.

The unit is consistently contributing to higher efficiencies and cost reduction, driven by new ways of sourcing, building and operating our networks and IT.

Evolved sourcing models and a clear focus on the right map of vendors are providing the expected results.

Additionally, Global E2E devices management is starting to provide tangible results, not only in terms of cost reduction but also in terms of stronger market relevance.

Latam: Diversified sources for revenue acceleration

Please turn now to slide 11 to review our operations by region, starting with Latin America.

In the third quarter, mobile commercial activity remained strong, maintaining a clear focus on high value customers. Contract net adds were solid, especially in smartphones, where we are doubling accesses y-o-y.

It is also remarkable the improved trends in the fixed business, with positive net adds in the traditional business for the first time in 2 years and higher FBB and Pay TV net adds in the quarter.

Revenue growth acceleration in Q3 to above 8% y-o-y was fuelled by improved trends in fixed revenues and robust mobile service revenues, up 13% year-on-year.

The healthy diversification by businesses was coupled with well-balanced contributions by our 3 Latin American regions, with all of them contributing to enhance growth.

Latam: Further OIBDA and margin expansion

As slide 12 shows, the solid revenue performance, easier comps on commercial costs and ongoing efficiency measures drove further improvement in OIBDA and margin expansion in the quarter.

OIBDA y-o-y growth in underlying terms ramped-up to close 5% in the quarter, with a significant progression from the virtually flat year-on-year performance at the beginning of the year.

OIBDA margin also consolidated its improved trends year-on-year and reached over 35%.

Brazil: Focus on quality paying-off

Please turn now to slide 13, to start reviewing our Brazilian operations.

Our focus on quality and the integration of the fixed and mobile operations have allowed us to materially widen the gap in customer satisfaction indexes versus our main competitors. There has been a marked turnaround in the fixed business since we launched Vivo as a single brand. On top of that, our new convergent propositions continue to underpin a better performance across segments.

Targeted commercial actions and our lead in quality resulted in additional market share gains in the mobile business, reaching 37% in the contract segment, combined with a very robust performance in the prepaid segment, both in terms of accesses and top ups.

Meanwhile, we continue to transform the fixed business, launching a new 200Mb fiber proposition to speed up uptake, while we are reinforcing our Pay TV business with a new IPTV platform already launched.

Brazil: Strong acceleration in revenue and OIBDA growth

On the financial side, in the third quarter Vivo delivered a strong set of results, with acceleration in revenue and OIBDA growth.

Top line rose 5% y-o-y and 3% quarter-on-quarter, driven by the sustained outperformance in MSR and the improved trend in the fixed business, both year-on-year and sequentially. Fixed revenues reflected the better commercial performance in the quarter.

The ramp-up in revenues coupled with increased efficiency led to an acceleration of OIBDA growth along the year, with Vivo retaining its best in class profitability despite the negative impact from regulation. As such, OIBDA margin reached 34.5% in the quarter, up both y-o-y and q-o-q excluding the specific factors booked in the second quarter.

Latam: Widespread improvement in OIBDA performance (i)

Please turn now to slide number 15.

The main highlight of the Southern Region is the margin expansion across the region, with a particularly strong performance in Peru, where the robust commercial momentum was coupled with a ramp-up in revenue and OIBDA growth year-on-year.

The only exception was Argentina where, despite the positive revenue performance, a high commercial activity dragged OIBDA margin in the quarter.

Latam: Widespread improvement in OIBDA performance (ii)

In the Northern region, as in the rest of the Latam, we delivered a widespread improvement in revenue and profitability quarter-on-quarter.

In Mexico, the turnaround process continues, with the strategy focused on quality growth driving ARPU acceleration and the inflection in MSR performance, with positive year-on-year growth in the quarter.

In Venezuela, once again operational performance was impressive, with revenue growth acceleration and margin expansion amid strong commercial activity.

T. Europe: Changes in business model delivering results

Let's now review our operations in Europe, on page 17.

I'd like to highlight that Q3 results reflect the benefits of the commercial and efficiency initiatives we have executed across our countries.

The successful tariff refreshment allowed us to compete better in the marketplace, driving mobile churn reduction and leading to a quarter-on-quarter increase in net adds.

Handset upgrades were down in the quarter, as customers delayed renewals ahead of the launch of new devices and we tactically reduced the pace in Spain ahead of the launch of "Fusión", our new convergent offer.

Our focus on value customers resulted in higher contract and smartphone penetration across our footprint, with one third of our customers already enjoying mobile data plans.

Our targeted actions on the commercial side together with a set of efficiency measures led Telefónica Europe to consolidate a sequential improvement in OIBDA and profitability, with over 37% OIBDA margin in the quarter.

Spain: OIBDA stabilisation driven by new business model

Turning to slide 18 to start with our operations in Spain, I would like to highlight that after one year of execution, there are visible results from our turnaround plan, which we are implementing in different stages.

The first step was the launch of new FBB and mobile tariffs, which had a great traction among our customers, leading to a sharp reduction in churn, the cornerstone of our initial push.

Once the customers were comfortably installed in the new tariffs, we took a second step forward and removed subsidies for new customers, leading to significant savings in commercial costs.

The third step was the implementation of several measures in order to increase efficiency, with an aggressive simplification of processes across the Company, from

workforce, to IT and handset portfolio, while increasing quality levels to improve customer satisfaction.

All these efforts have led to a radical improvement in our financial results. Though revenues continue to be under pressure, OpCF performance has improved significantly, reflecting our levers to enhance OpEx and CapEx efficiency.

Q3 OIBDA is up on a sequential basis for the second consecutive quarter, with margin higher than a year ago. Let me also stress that the double digit reduction in CapEx is sustainable without jeopardising our increased fiber rollout efforts.

Spain: Recovering leadership in the market

Our fourth transformation step in Spain is the launch of “Movistar Fusión”. This is a key milestone in our strategy to regain commercial leadership in the market.

“Movistar Fusión” is the best convergent offer in the market and the first time our customers will benefit from a single bill. It bundles fixed, broadband, TV and mobile services at very attractive prices and we offer add-ons to adapt the offer to our customers’ needs.

We aim at increasing the customer base who have all their telecommunications services with Telefónica, what we call “totalised customers”, leading to further churn reductions, and we also expect to capture new customers in the market.

At the same time “Movistar Fusión” will lead to lower commercial costs, on the back of the changes in our loyalty program and the introduction of handset financing facilities.

The best way to describe the attractiveness of the offer is customers’ reaction: just one month after the launch we have already reached 430k customers.

UK: Stabilisation of revenue trends

Please turn now to slide 20 to review our operations in the UK, where trading activity continued to be solid in Q3.

Contract gross adds rose 18% year-on-year, though lower upgrade activity, as customers delayed renewals in anticipation of the new devices launch at the end of the quarter.

We retained a benchmark low contract churn levels, which together with increased gross adds led to solid net adds in the contract segment, with smartphone penetration growing 8 p.p. to 44% in September.

Top line pressure continued in Q3, with MSR reflecting impacts from MTR cuts and the new roaming regulation with total revenues posting stabilising year-on-year trends.

Profitability continued improving, with sequential growth in OIBDA, both in absolute levels and in terms of margin, which stood at 25.3% in the third quarter. The lower upgrade activity together with the positive impact from the ruling on ladder pricing drove the quarter-on-quarter margin expansion.

Germany: Sustained outperformance, additional share gains

Turning to slide 21, the recently listed T. Deutschland continued posting very good results, gaining value market share on the back of a strong commercial offer and the success of our data monetisation strategy.

Trading activity was strong, with a consistent momentum in net adds in the quarter.

In addition to this, data revenue grew at a faster pace than data traffic, with a gap between these two metrics widening year-on-year.

MSR growth remains strong, with stable ARPU trend. As a result, Telefónica Deutschland is now the number 3 mobile player in the German market by revenues.

In addition, OIBDA increased 14% year-on-year, with growth accelerating in the quarter, reaching an OIBDA margin of 27.2% in the third quarter, up 2.4 percentage points year-on-year. OpCF was robust, reaching 533 million up to September.

Further progress in our journey to become a Digital Telco

Let me now update you on the progress made in our journey to become a Digital Telco in the last few months.

To enhance our position as connectivity provider, we have recently launched new convergent propositions both in Spain and Colombia, while in Brazil we have strengthened our UBB and pay TV offerings.

In our enabling/retailer role, we have extended operator billing agreements to new countries and we have also launched new M2M services in key industries, while services like Kantoo are having a great traction with over 3 million Brazilians learning Spanish, English or French via mobile phones.

Finally, as a provider of digital services, we are also advancing rapidly. To be highlighted is the recent approval by EU authorities of our JV for advertising and financial services in the UK, the agreement signed with Aurasma, the world's leading augmented reality platform and the success of Wayra, with over 170 collaboration agreements with start-ups.

Substantial net debt reduction since June driven by FCF generation and disposals

Let's now move to the financial side, on slide 23.

Net financial debt has been reduced by €2.3bn in the quarter mainly due to the significant free cash flow generation since the end of June, coupled with the completion of asset disposals, mainly the sale of China Unicom stake.

As already anticipated in previous calls, FCF generation has been enhanced on the back of a better operating performance and the unwinding of the working capital consumption recorded in the first half of the year.

We continue to see further positive impacts from our asset rationalization strategy, with additional cash proceeds from the IPO of Telefónica Deutschland and Atento, Hispasat, Rumbo & other minority stake disposals. On top of that, the refinancing of the preferred shares (currently accounted as debt) will reduce debt by €800 million through the swap by treasury stock at market value. All these post Q3 events will contribute to reduce net debt by an additional €3.2bn.

Let me stress that, as of today we are pointing towards €50bn net financial debt by year-end compared to a debt figure of over €58bn at the end of last June.

Over € 13 bn long term diversified financing raised year-to-date

On slide 24 we detail how we are performing an excellent financing activity so far in the year, totaling €13.4 billion. This compares quite favorably with last full year financing activity at €11.5bn. This has been achieved despite the increased sovereign risk and a harder financial environment in 2012.

Since June, Telefónica has raised over €5bn long term financing in the credit markets, with a extremely strong support from credit investors, both in Europe and in Latin America, as shown by the heavy over-subscription of the bonds raised (nearly 11x in Colombia or Chile and above 9x in the euro market).

It is to note the broad diversification of our financing activity: Only 15% of total banking financing raised along the year corresponds to Spanish financial entities while American and Europeans ex-Spain have contributed 30% each, and Asians the remaining 26%. On top of that, 77% of total undrawn credit facilities are signed with non-domestic financial entities.

It is also to highlight the ample diversification by funding instrument, proving that Telefónica maintains all markets open. Roughly, 1/3 of the financing has been raised through bonds at the holding level, another third corresponds to syndicated loans, and the remaining third coming from bonds in Latin America and other funding sources from public entities.

Dramatically improved liquidity and interest cost contained

Slide 25 shows the benefits out of our proactive financing activity which has allowed us to build a significant liquidity cushion of €18bn, up €4bn since June.

Our cash position, excluding Venezuela, stood at €7.8bn at the end of September, while total undrawn credit lines amount to €10.1bn, with nearly 90% maturing long term. This places us in a quite comfortable position to manage debt maturities, which are covered beyond 2014.

I wish to highlight that all the efforts undertaken throughout our footprint have been completed while keeping effective interest costs in line with previous quarters and continue to remain at the middle part of our guidance.

And our average debt life is back again above 6 years, as per our guidance.

Closing remarks

To wrap up, let me stress that our strategy is delivering visible results.

Sequential OIBDA improvement across regions is driving an outstanding improvement in EPS, with 9M performance consistent with our full year guidance, which we confirm.

We are also increasing materially our financial flexibility, with a significant step forward in debt reduction in the second half of the year and a well-diversified access to financial markets, with the recent success in the IPO of Telefónica Deutschland providing a new platform for additional flexibility.

It is also important to note our progress to become a Digital Telco.

All in all, we are accelerating the transformation of Telefónica.

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

We are now open to any questions you may have.

Q&A session

Tim Boddy - *Goldman Sachs*

A question about Spain. Obviously, in the press, we read about Yoigo potentially being up for sale. Can you remind us what contribution to EBITDA Yoigo currently represents in the Spanish business? Secondly, given the very strong momentum you have achieved in deleveraging and refinancing as you highlight, does it still make sense to look at listing options in Latin America given it seems, relative to current trading multiples, you might not get the value for those attractive growth assets? Thanks very much.

Eva Castillo - *Chairwoman & CEO Telefonica Europe*

Thank you very much. On your first question, as you know, we cannot disclose that figure. But, as you can imagine, we are following the process very closely and we are reviewing any thing as the outcome is known.

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

With respect to the second question, we continue our internal work of analyzing and assessing the options with respect to a potential IPO of our Latin American businesses. No decision has been taken on such a transaction, but we are working in the preparations in the case we decided to move ahead with it.

Tim Boddy - *Goldman Sachs*

Okay, thanks very much.

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

Next question please.

Luis Prota - *Morgan Stanley*

Yes, thank you. Two questions also on Spain. First, just regarding the "Movistar Fusión" on the 430,000 customers you were mentioning, I don't know whether you can give us some light on what percentage of these new customers are coming from your existing customer base and therefore will give rise to some revenue dilution and whether you expect the net balance of new customers taken from competition and cannibalization to give rise to any kind of short-term pressure in revenues and EBITDA.

And the second question is on margins. Your margins in the third quarter were very strong in Spain. I don't know whether you could give us some light on what savings were generated from the lack of subsidies, headcount cuts and others? And also with

the stronger commercial activity in the fourth quarter, whether we should expect margins to drop materially, and the third quarter margin to be considered as a kind of one-off. Thank you.

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you, Luis. And I think that, as you saw, the number that we are releasing is 430,000 customers year-to-date. I won't be able to give you more details around the mix on those customers, but I'd have to say that since the preregistration that we saw since late September until today, and all we are seeing are the right trends so we will definitely give you more details towards the fourth quarter.

It is for sure the best value offer that there is now in Spain, so as you know, we are starting to see the proper and the right reaction from our current customers, the ones that were already with us partially or totally, definitely the ones with whom we can uplift and foster new services and with the new customers. As you know, our aim is to go both for the current customers and also for the new ones.

With regards to the second question and regarding the margins, we are very pleased with the third-quarter result on the margin. It is a clear improvement and is showing that our strategy on the transformation journey since the beginning of the year, moreover since the end of last year is paying results.

What we need to focus is specifically on the cost reductions that are allowing maintaining these high margins, which we believe are sustainable. And in particular when you look at each of the contributions to this performance, it is both on the incremental savings and personal costs throughout the year. As you remember, this happens every quarter and through next year. It is also the cost efficiency initiatives that are not only removing the subsidies, but also creating new ways of operating within the Spanish operation.

I have to highlight that I have been in this new role for only seven weeks and it is very impressive to see how the Spanish team is leading this commercial strategy, it is leading effort within the business line and in the Spanish telecoms operations. They are also taking very seriously the efficiency program both on personnel and rest of the efficiencies within the network. And we believe this is a continuing program, so there is room for more efficiencies and we are working on that very closely.

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

Next question please

Mathieu Robilliard - *Exane BNP Paribas*

Good afternoon and thank you very much. I have two questions. Please, with regards to revenues, first, you are running slightly below your full-year guidance; yet you have

reiterated the guidance. So I was wondering where you expect the re-acceleration in Q4. It does seem to me that, in LatAm, despite the strong growth, comps are a bit tougher in Q4 and there is no acceleration in the growth when you look at the revenues, including the regulatory impact. So I assume it must be from Spain or from Europe, but maybe if you can give a little bit of color of where you expect the acceleration in revenue to come from.

And the second question has to do with cash flow development. I wanted to have a little bit more detail into one of the items that appears on page 23, which is FX commitments, cancellation and others. Quarter-after-quarter, this is a big consumption of cash. This quarter, it is EUR 900 million. Previous quarter, I think it was EUR 700 million and before that around EUR 400 million. Maybe if you could give us a little bit of color and guidance into that item. Thank you very much.

José María Álvarez-Pallete - *Telefónica SA - Chief Operating Officer*

Thanks for your question. Taking the first part of it on revenues on the guidance, let me first stress that the guidance was given under a certain framework of exchange rate that we are encouraged to check because this is the framework which you should review your projections.

And the second part, in terms of on a region by region basis, in Europe, we have revenue pressure. It is true that it has been affected by regulation. We are very focused on value on average margin per user. We expect OIBDA to continue improving mainly driven by efficiencies and the trends that we have been seeing in this quarter should continue. And in Latin America, we see revenues accelerating in Q4 due to a very solid customer base growth. And OIBDA evolution, you need to consider that it was impacted last year by tower sales. Therefore, excluding tower sales in the second part of this quarter of the last year, our OIBDA growth should continue to improve.

So, basically we see the trends that we are having in the third quarter being extrapolated to the fourth quarter and please consider the framework of the exchange rates in which we were giving the guidance at the beginning of the year.

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

Hello, Mathieu. This is Angel. With respect to your second question, in this column of FX commitments, cancellation and other, we have various effects. The first one is the impact of interest accruals over interest payments, which is basically reversing what we saw to the contrary in the first quarter of the year. These would be around EUR 355 million of the total EUR 899 million of this column. Then, we also have the mark-to-market of interest rate hedges, which is around EUR 270 million and the rest, FX is around EUR 60 million and the rest is a part of the employee retirement commitments that become due in the year and they become debt.

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

Next question please.

Keval Khiroya - *Deutsche Bank*

I have got two questions, one on Spain and one on Brazil. It looks like Vodafone is extending its handset subsidies beyond summer. Do you feel a need to respond to this at all? And secondly, on Brazil, your Brazilian fixed line revenues remain weak. They are still falling 9% and your KPIs in Pay-TV in particular are quite poor and what steps are you taking to improve this and when will the revenue trend improve with that as well?

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you. First of all, on your first question, we have seen some of our competitors going back to subsidies and as you know, this is our commitment within the Spanish strategy not to go back to subsidies, so we don't think it is necessary to respond on that front. In fact, our aim is to continue working on our transformation program and right now, we are in the fourth stage, in which the launch of "Fusión" has already impacted positively our clients and the reaction is positive.

I think that we show a very clean business, a very clean operation and we don't see any need to go back to subsidies. In fact, some of our competitors have replicated our offer, they came out very recently and our belief is that they are not so much using the subsidy in handsets anymore. But that obviously you need to analyze. I think that was the question. Thank you.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

This is Santiago. On Brazilian fixed, you know the situation there is very competitive. There are a number of one-offs that you might want to single out before making the final comparison and this has a lot to do with improvement that we have had in Q3. We feel much better about how things are going and we have a number of actions, including the deployment of our IPTV platform this month, launching some OTT products that are going to reinforce the value of our fiber and VDSL product and the launching or the renewal of the TV satellite product. So, it is not as good as it sounds, but it is certainly pointing in the right direction in the sense that once you exclude the one-offs in the second quarter, the improvements are quite real.

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

Next question please.

Torsten Achtmann - *JP Morgan*

Good afternoon. Two questions, please. The first one on Brazil, the competitive intensity is increasing and the regulator is introducing more aggressiveness on MTR reduction and on wireline asset opening up. Can you give any early indications how you think it will change the competitive landscape and your business and how you look to respond?

And secondly, on the buyback Telesp has introduced, is that more a formal flexibility measure or is it really that you are trying to implement that over the next year and therefore reducing the minority float of Telesp?

And secondly, on potential asset sales outside of LatAm, are you looking at further options of other assets where you could list minorities or sell partial stakes on assets you have in your portfolio? Thank you.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Thank you, Torsten. This is Santiago again. On the latest plans from the regulation, I think it is fair to say that after all has been said and done, it is lighter than we had feared, but it is worse than we had expected at the beginning of the year. I think the brighter part is that we finally have no bill and keep or partial bill and keep measure and I think that is the right development because it is going to make adjustments in the future MTRs easier.

And as to the pace of decline in MTRs, it is true that they are lower than we had expected at the beginning of the year, but they are also manageable. It is a bit early to understand what the full impacts are going to be, but remember two things. First, that if you have an integrated operation like we have in Sao Paulo, the final net effect is likely to be lower than if you are mobile only and second, that unlike in some of the markets, the Brazilian market is characterized by fierce competition and there are very small differences between the market share of the top player, which is us, and the bottom player. That helps to reduce the impact of any MTR at the end of the day. Once the tariffs are lowered or are very similar, it is difficult to make a lot of elasticity from one network to the next one.

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

Torsten, this is Ángel. Could you please repeat your second question?

Torsten Achtmann - *JP Morgan*

The second one was literally on potential further asset sales outside of LatAm. So are you looking at any other assets or stakes of asset you could potentially monetize next year if you decide not to do LatAm or on top of LatAm?

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

Okay, well, what we already communicated back in May-June we have been delivering. We also said that we would be analyzing the potential IPO of Telefónica Latin America, which, as I said before, we are still in the process of internal analysis. We do not need to do that transaction, but we may decide to do it depending on what provides the best value for our shareholders. We still maintain a small stake in PT which we are monitoring market conditions to see when is the best moment to monetize. And, we have received expressions of interest from potential interested parties in some of our assets, but we will assess those always with the perspective of seeing whether they provide value for Telefónica.

I would like to stress that all of the divestments that we have done this year so far have been done in such a way that they do not alter at all the equity story of Telefónica or the long term value perspective for the Company.

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

Next question please.

Ivón Leal - *BBVA*

Yes, hello. Good afternoon, everybody. My two questions are in Spain. The first one, since the launch of "Movistar Fusión" at the beginning of October, there are a number of competitors that have already mature offers. So actually now, how do you feel the new commercial proposition has improved your positioning in the market given the price? Others are already matching yours.

And the second one, maybe if you could help us how you expect to compensate the ARPU declines I guess you expect to get in 2013 due to this "Movistar Fusión". Could you give us a number in terms of what is the market share you need to increasing in fixed and mobile in order to compensate that or is the compensation coming from commercial cost reduction?

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you, Ivón. I think that, since the launch of "Fusión" at the very beginning of October, we are seeing the right evolution within our clients, as I mentioned earlier. We are able to give you the number of 430,000 customers year-to-date as fully "Fusión" customers. And I can give you another signal of how this is going in fixed broadband net adds, as we have 36,000 so far this quarter.

The positioning for the launch of "Fusión", as I mentioned earlier, is part of a program. Since we launched the program, we knew our competitors would have the capacity to react and some of them have done so. Analyzing the latest new offerings, obviously they were able to do the replicability of the offer, but we still believe that "Fusión" is the best value offering for clients that were already with us and the new clients.

Obviously, we cannot give you yet the mix of the clients because it is very early days. But, again, to reinstate that all that I am seeing is the right trends and hopefully, we will be able to give you more details very soon.

When you ask what can we do in order to compensate the ARPU declines or initial ARPU declines, I think that the offer is very well-studied so you go step-by-step. Some of the potential initial ARPU declines could be compensated as we have the mix of clients that we want within our offering, contracting fixed broadband or mobile. There is a positive impact from existing fixed broadband customers contracting mobile services as well as from existing mobile customers contracting fixed broadband and the fixed voice service. There is also a positive impact due to mobile additional lines, and of course, to the new customers.

Another very important factor is that the churn continues its trend of going down and overall, all the strategy that we had in mind is provoking a more dynamic market in Spain. We are happy to say that we believe we are leading that new dynamic market with this commercial strategy, which at the moment is leading the offerings in the market. I think that I answered altogether, no? I am not missing any? Okay, thank you.

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

Next question please.

Robin Bienenstock - *Bernstein*

Thanks very much and congratulations because I think a breathtaking amount of work went into delivering those results. So two questions if I may. The first is about Spain. You are focusing on total telecom offers and clearly, these are going to put wireless companies under a lot more pressure and wireless only companies.

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

Robin, sorry, it's Maria. There is something wrong with the line. We cannot hear you properly. Can you repeat please?

Robin Bienenstock - *Bernstein*

Yes. So, can you hear me hopefully? On the total telecom offers that are going to put wireless only companies under a lot more pressure, I guess what I would like to know is whether or not you are going to face the same headwinds in Germany and Mexico where you are the wireless only businesses rather than total telecom businesses?

And separately, with Latin American MTRs falling, a lot more longer-term pressure on wireless revenues in Latin America, I am wondering whether that means you need more CapEx sooner in Latin America in wireline to reduce any eventual cannibalization.

Santiago Fernández Valbuena - *Chairman & CEO Telefonica Latinoamérica*

Robin, this is Santiago. The sound was not too good, so if I did not understand you correctly, please do correct me. If I understand what you're pointing at, you are talking about the headwinds facing some of our operations and whether or not CapEx would need to be deployed at a faster pace than we have done until now to compensate for that.

I think you probably may be right in terms of the fixed line, especially in Sao Paulo, as I think I mentioned in one of the earlier questions. But I think that we have almost everything we need to counter the possible headwinds on wireless as we have already done most of the investments, as we are already in the process of not seeding but harvesting some of those CapEx efforts, especially in the markets that you mentioned, namely Mexico and I cannot speak for Europe, but I would assume that my colleagues are probably going to be on time.

So yes, the environment is challenging. But no, I don't think we are lagging behind with the possible exception of a minor push that we have to do in fixed line in Brazil.

Eva Castillo - *Chairwoman & CEO Telefonica Europe*

And going back to the European question, starting with Germany, as mentioned earlier and yesterday in the German conference call, we have seen solid trading momentum in the quarter and a sustained low contract churn. With regards to the MTR questions, as you know, in Germany, we are not expecting them until December, different to the other markets. And what we believe as a whole in Germany is that we need to stick to a balance in between growth and the profitability of the operation.

With regard to the CapEx, as you know in the third quarter, it is an important increase of 40% year-over-year as a signal we don't expect similar increase in the fourth quarter. Although I have to reinstate that it is a continued investment process into our 3G network, as we want to ensure the stability and the quality of our network, as well as accelerating the LTE deployment in the country.

I don't know if you have seen the results coming from "Connect" magazine. This publication, is already giving us very important results of our German operation and I encourage you to look at them because they reinstate that the quality and the investment is proven as a good one.

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

Next question please.

Paul Marsch - *Berenberg Bank*

Yes, thanks. I just have two questions. Firstly, are you expecting the "Fusión" tariff in Spain to lead to a higher level of handset upgrades? And secondly, maybe you could clarify any progress on the tax and license renewal situation in Peru. How much tax has been demanded by the Peruvian authorities? How much have you paid so far? And has there been any progress actually on the license renewal in Peru?

Eva Castillo - *Chairwoman & CEO Telefonica Europe*

Well, starting with the "Fusión" question, I want just to remind that "Fusión" does not have subsidies within the offer. Actually, we started with that policy in March. And in the second question regarding "Fusión" upgrades, we are not expecting that to happen, as it is not within "Fusión".

Santiago Fernández Valbuena - *Chairman & CEO Telefonica Latinoamérica*

Yes, Paul, this is Santiago again.

On an update on Peru, nothing much really to update you on. We do expect that the license renewal process, that has gone through a rather long and convoluted administrative path, is coming to an end. I think the end may be very well satisfactory and I think some of the published statements by the ministers in Peru are pointing to that direction. Nothing finalized and nothing is done until it is completed, but certainly we do think that it is very likely that before the end of the year that process of license renewal will find a satisfactory completion on both grounds.

And on the tax side, there really is not much to talk about. This process has been going on for 10 years now. We don't expect it to close in the next weeks as it is a very long and protracted and might be complicated from the technical side. What I think is a welcomed development is that this is no longer a media issue. This all has been and will continue to be a tax-related issue with us and the courts and we will make some progress as time proceeds. You know that we did spend a lot of money at the beginning of the year paying down the partial payment, but no further payments have been done since then and no significant decision has been taken by any of the courts where we have this struck.

Let me remind that this started almost 10 years ago as a consequence of two things, which we feel very strongly about and that is why we have been challenging the tax administration's view. Those are related to whether or not we can take-off from our income the revenues that our customers cannot pay to us and the deductibility or lack thereof of interest when it is devoted to investment. Those two items are we think crystal clear. Any other constituency in the world would accept them as tax-deductible and the fact that the numbers might be so interesting is simply the fact that they have been compounding at a fast rate from the year we started, not because the number itself was very nice. My colleagues point to me that we did spend 134 million soles, that is about EUR 35 million at the time.

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

Next question please.

James McKenzie - *Fidentiis*

Hi, two quick questions on Europe. Firstly on Spain, your fixed broadband churn has ticked up quarter-on-quarter and we don't have a full series of these. Could you just discuss the reasons for that? Is the market getting more competitive or is there a seasonal tick-up as we have seen in, I think, other operators? And then secondly, the lack of handset upgrades in the UK, does that bode badly for fourth-quarter margins when presumably the upgrades are all going to come through?

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you for the question. With regard to Spain, I think that the key messages on the fixed line or fixed revenues evolution on the nine months is that, first of all, we believe that the 11% movement is broadly stable. And the reality is we have seen accesses and voice decline, driven by both a bit of a lower accesses and a higher weight of flat rate and bundled traffic coming in competition.

With regard to specifically fixed broadband revenues, as you know, they were affected by repositioning of the new tariff portfolio and I can give you numbers. The proportion of the lines that have moved to the new portfolio is reaching 76% of residential fixed broadband up to September 2012. So, that is why the year-on-year evolution in the quarter has worsened a bit.

However, in September we have started to see a revamp in fixed broadband ARPU evolution as we have started to reposition in the same month last year. It is important to mention the churn, which is much lower, is minus 0.4 percentage points year-over-year and I think that is the best number, which finished at 1.9%.

The rest of the questions regarding the UK, it is important to say that, during the third quarter, we were awaiting for the new high-end devices to have the stock and to be positioned in the market, so we didn't have all the commercial activity that we normally use to have. The expectation in the fourth quarter is that we will have more activity, but we will watch very closely the margins and also that commercial activity.

What I want to restate that this is about normal activity. This is about having the right behavior in the market and as I mentioned earlier, we believe the UK market is also showing different behaviors and a more rational approach to handset commercial activity.

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

Next question please.

Justin Funnell - *Credit Suisse*

Thanks very much. You mentioned during the call a potential shift in Spain. I think you were mentioning less spend on handset retention. I guess for years you have had this loyalty scheme on, people use the phone and build up points and trade them in for new phones. Are you shifting away from that model? And you also mentioned moving into a handset finance deal. Is that going to be along the line of, perhaps, the "O2 My Handy" model -where you could see actually quite substantial handset deals offered, but done through working capital and factoring? Would that make you more competitive in the handset space?

And then secondly on Brazil margins, I guess I have been waiting a few quarters to see if your margins would benefit from the Telesp piece of the merger and margins remained pretty flat. Is that a trend or should we actually see some margin expansion in the coming 12 months?

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you for your question. Within Spain, as you know, "Fusión" specifically has no subsidies for handsets and that was also part of our commercial strategy set at the beginning of our transformation program.

When you ask me about the ways of being more efficient on handsets commercial activity, as you know, we have different approaches depending on the countries. But in Spain, it is a different system than "My Handy" in Germany. In Spain, what we have is an agreement with a financial institution that is working increasingly well. With regard to "My Handy", I think it is one of the best financial offerings and it is working well from the beginning to the end of the process.

So we believe this is a way going forward to make sure that the operations businesses look clean and that we stick to our main business operations.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

This is Santiago again. On Brazilian margins, I feel there are two forces acting upon them. One is structural, as you mentioned, and it is the cost reductions as a consequence of the integration of our operations. This is going to have a modest, but long-lasting effect on margins. And then, there is the result of the commercial activity of the quarter, which really coincides with the sales. So you should expect some stabilization of the structural points going forward, but you should also expect us to continue pushing or pulling from the commercial lever depending on what the market is demanding there.

Right now, as I think I have mentioned throughout this call, we are putting a lot of emphasis on everything fixed and broadband related and we probably should spend a little bit more there. And we are satisfied with the way our commercial measures are

acting and the results we are getting on the wireless, especially on the high-end contract and on the smartphone end. So, we are probably not going to be pushing too hard on that one. But take those two observations as temporary and tactical, not as structural.

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

Next question please.

Frederic Boulan - *Nomura*

So firstly on Spain, you seem to focus our attention on sequential improvements in this business. So my question is, in the mobile ARPU, ARPU has been flat in the last four quarters at around EUR21.5. Do you expect to be able to hold this level going forward or we should expect the usual drop in Q4? And similarly at the OIBDA level, you show sequential growth in Q2 and Q3. Is there any message for us for Q4?

And secondly, back to Latin America, if you could elaborate on the type of structure you are thinking in terms of a potential IPO? Do you plan to use Telefónica Brazil as a platform to drive this consolidation and how do you think about TEF Brazil minority shareholders in this process? Thank you.

Eva Castillo - *Chairman & CEO Telefónica Europe*

Thank you, Frederic. You are right. I think the sequential improvement in OIBDA, in the mobile business is a reflection of all the measures that we are taking since the very beginning, from refreshment of the tariffs to the handset subsidies changes and to the higher efficiency programs that we have across the operation. What that is giving us is much better results, with the satisfaction of clients, improved quality, reduction of claims, which, at the end, is an increase on the average margin per user.

What we are working from that moment is that the refreshment of tariffs has produced a 57% penetration within our clients within the mobile business and there has been an impact on ARPU. So in the quarter, mobile service revenues were affected by the ARPU declines, as well as interconnection declines. In the slowdown decline that we see in mobile service revenue in the third quarter there is a positive effect, as you know, from lower handset upgrades and a related impact on the loyalty program. As you know, contract handset upgrades is minus 32% year-over-year.

And the underlying mobile service evolution, as mentioned earlier, worsened in third quarter as the ARPU declined almost by 16% year-on-year. What we have in the contract, in the postpaid contract revenues, is a very clear seasonality of third quarter situation with respect to the connectivity. The seasonality effect seen in 2011 didn't happen this year due to the high penetration of the flat rates and the lower weight of the big screen due to the migration to multi-SIMs or tablets, that we are seeing more

recently. And just to mention again the continued increased penetration of the new portfolio with 57% residential segment.

Anyway, looking into what is happening today, the "Fusión" strategy I think it is the best strategy going forward to counter fight with some of these trends that we have seen in the third quarter.

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

With respect to the second question, as I said before, we are still analyzing various alternatives for the potential listing of our Latin American businesses. The different alternatives have different potential implications both from regulatory, tax and other implications. None of them are more clear or differential than others. We have not taken a decision, not only with respect to any structure, but also with respect to whether the transaction would be performed or not next year. As soon as there is progress on this potential transaction, we would provide further clarity to the market.

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

Next question please.

Guy Peddy - *Macquarie*

Yes, good afternoon, everyone. Just a couple of clarification questions please. In your net debt calculation, you use a number of non-current financial assets and investments of just over EUR 5 billion, but in the balance sheet you have a number of over EUR12 billion. So I was just intrigued to know what the difference is. And of your total debt, could you tell us how much of that is raised through Spain or through your Dutch debt vehicle? Thank you.

Miguel Escrig - *Telefónica S.A. - Chief Financial Officer*

Hello, Guy. This is Miguel Escrig. Regarding your first question, we have in the balance sheet EUR 12.1 billion of assets. We are including there the value of some of our associated corporate stakes. So, we just take from that what is really interest-bearing, which are essentially the mark-to-market of derivatives for close to EUR 5 billion and some other long-term deposits and the rest is excluded from that EUR 12 billion.

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

And with respect to the second question, 90% of corporate net debt is held at the holding level, being it at Telefónica parent or through the subsidiaries that we have to issue that.

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

Next question please.

James Ratzer - *New Street*

Yes, thanks very much. I had two questions please. The first one is just regarding your group wide commercial costs. I think at the Q2 conference call, you talked about those coming down year-on-year in the whole of the second half and it is very clear that has happened in the third quarter. I mean if I look forward to the fourth quarter, you obviously have the launch of "Fusión" in Spain, you have got the TV relaunch in Brazil. There are going to be costs related to the iPhone 5. Is it fair to say that commercial costs in Q4 group wide could be lower than Q4 last year as well?

And then the second question I have is just regarding Mexico. I mean AMX in Mexico continued to be a very strong competitor. They continue to outperform you on service revenue growth and again, in this last quarter, they saw a stronger pick-up in their service revenue growth ex-MTR. I mean what do you think you need to do to start turning that around? Do you need to rely on the current regulatory review to help you? I mean is that necessary or are there other commercial actions you can take to improve the revenue growth and if so, by how much? Thank you.

José María Álvarez-Pallete - *Telefónica SA - Chief Operating Officer*

Thanks for your question. On the commercial cost trend and the potential outlook for the fourth quarter, let me tell you that we are anticipating a similar trend than in the third quarter. Some of the trends that we have been observing in the group, namely in the case of Spain, as Eva was mentioning, are here to stay, are very sustainable because there we have radically changed the structure of the offer and therefore we have already been somehow educating the market. On top of that, we have been working very intensively on the quality side of our business and therefore, we have been significantly and structurally changing the number of calls that we get and the claims. We have reduced by half the number of claims in Spain.

The situation is pretty similar in other European countries like Germany or the Czech Republic in which the simplification process is paying off significantly. The only up-tick that we may get is from the iPhone 5 activity in the UK, which might tick-up a little bit in the fourth quarter. But, overall, in Europe, we see the similar trends and in Latin America, we see similar trends as Santiago was mentioning as well because we have high commercial activity, but we have been having significantly high commercial activity as well during the year.

So the outlook that we have for the fourth quarter in terms of commercial costs overall at the group level is pretty similar on the third quarter. We are working intensively to expand the model that we have been able to, that we are trying to create in Spain to other regions. Namely in terms of subsidies, we are basically out of subsidies in Germany, the Czech Republic and here in Spain and it has not been affecting our contract commercial activity. So we think that we have a lot of room to improve and to

go even more ambitious, but, for the fourth quarter, we are contemplating similar trends that in the third quarter of this year.

Santiago Fernández Valbuena - *Chairman & CEO Telefonía Latinoamérica*

Hi, James. Santiago again. On Mexico, we are pretty happy with the progress we are making. It may not look like a lot from the outside, but we are making progress on quality perception, on coverage, on reliability and on the tariffs, most preferred tariffs for the customers. So we changed the game.

What we are trying to do is make people and make customers alert that we are not only viable, but we have a good product and our targets are very difficult to beat by anybody else in the market. This is not going to be a one-off event, it is going to be a trickle-down phenomenon, but we are quite happy the way that all these things are progressing. We are not going to put the blame of our possible short-comings on the regulation, but essentially a more level playing field would be beneficial in that market as it might be in any other where the distance between the first and the second player is so large as to be nothing short of outstanding.

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

Time for the last question, please.

Luigi Minerva - *HSBC*

Yes, good afternoon. My questions are on the fiber strategy in Spain. I was wondering if you can tell us, of the 2 million that you cover, how many of those are with fiber to the premises and how much is fiber to the street cabinet?

Also I wanted to hear if you expect any other operator to join the co-investment agreement on the vertical so that you have signed with Jazztel and lastly whether you would consider a co-investment agreement for the horizontal infrastructures. Thank you.

Eva Castillo - *Chairwoman & CEO Telefonía Europe*

I think on the first question, it is just to confirm it is 100% to the premises. With regards to the agreement with Jazztel, as you know, this is an agreement that is part of our strategy of seeking for network sharing agreements. This agreement with Jazztel as it was the first comer to sign the agreement is, as you can imagine, efficient on CapEx versus being a standalone, and permit us to access the 1.5 million of fiber to the homes we have already deployed and the other 1.5 million Jazztel will do in-building development, and it will be up to 3 million customers.

We'll start in March and as you know, this agreement is open for other competitors in case they are prepared to join us. It is also following regulator's requirements and we

feel this strategy is similar to the one we have in other European countries and across the Company globally.

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

Well, before concluding this call, I would like to make an announcement regarding the position of Head of Investor Relations. After several years of very successfully leading IR, Mrs. María García-Legaz is being promoted to run the offices of the Executive Chairman and of the COO. I want to expressly thank María for the excellent work done heading the IR team that has won numerous industry awards. The position of Head of Investor Relations will be occupied by Mr. Pablo Eguirón and I wish both Maria and Pablo success in their new roles.

Thank you, ladies and gentlemen, for attending this call and look forward to seeing many of you in Barcelona next week.