Telefónica January-March 2013 Results Conference Call Transcript

8th May, 2013

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Introduction

Pablo Eguirón - *Telefónica S.A. - Head of IR*

Thank you.

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss January-March 2013 results. I am Pablo Eguirón, 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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Now let me turn the call to our Chief Financial and Corporate Development Officer Mr. Ángel Vilá, who will be leading this call.

Presentation

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

Q1 13 Results highlights

Thank you Pablo.

Good afternoon ladies and gentlemen and welcome to Telefónica's first quarter 2013 conference call. Today with me are the members of the Executive Committee, so during the Q&A session you will have the opportunity to address to them any questions you may have.

Let me start with the highlights of the first quarter of the year. It has been a quarter of delivering on our transformation strategy towards sustainable growth.

First, results up to March reflected business stabilisation, with similar organic OIBDA figures year-on-year for the second consecutive quarter, thanks to margin progression and with OpCF maintaining the organic growth trend initiated last quarter.

Second, we continue progressing in our transformation, which is already delivering tangible results. As an example, profitability in Spain stood at 47% and "Movistar Fusión" continues having strong traction in the market.

Third, we keep on diversifying the business, increasing the exposure to Latin America, which accounts for over 51% of total revenues, while Brazil has already become the main market by revenues.

Fourth, we continue taking decisive actions to reduce debt, offsetting non-recurrent factors and seasonality, which impacted our net debt as of March.

And finally, we are posting strong Earnings per Share growth of 22.2%.

Key financials

Please turn now to slide number 4 for a quick review of our financial performance.

Reported year-on-year growth rates are impacted by negative forex effect mainly due to Venezuelan devaluation, by changes in the consolidation perimeter and by the reduction in the value of Telco investment that we booked in the first quarter of 2012.

Revenues reached over 14.1 billion euros in the first quarter, down 1.6% in organic terms, while OIBDA was close to 4.6 billion euros, almost flat, organically year-on-year. Operating Cash Flow exceeded the 3.3 billion euros mark, growing 9.6% organically.

In summary, let me highlight that Q1 results are fully aligned with our internal expectations and, therefore, we reiterate our full year guidance.

Commercial progress; towards higher value & more sustainable customer base

In slide number 5, I would like to highlight the outstanding results of our focus on high quality customer base.

Smartphone penetration has increased by 6 percentage points year-on-year to 20%, driving contract base growth after adding more than 1.4 million customers in the first quarter. As such, contract mix further improved by 2 percentage points year-on-year to reach 33%.

In the fixed business, UBB penetration has expanded to 27% of fixed accesses with connection rate increasing to 10%. There is demand for higher speeds and we are progressively adapting our networks to capture it.

In Europe, we are launching innovative and simple propositions, offering the best value for money and with the progressive elimination of subsidies as a common denominator. This will allow us to capture the data opportunity with a sustainable model.

In Latin America, we are clear market leaders in the high value segments and we are in the best position to capture the data opportunity that lies ahead of us.

Revenues benefiting from unmatched diversification

Sequential top line stabilisation excluding calendar effects was driven by two main levers, Latin America and mobile data, as shown in slide 6.

I want to remark that Latin America continues its progression as the key engine to revenue growth and almost offsetting lower sales from our European businesses.

We continue to evolve our revenue mix, increasing our exposure to the fastest growth businesses, as shown by the increasing weight of data revenues over mobile service revenues to 37% compared to 34% one year ago. Non-SMS revenues are the main growth driver and already represent 62% of data revenues, 7 percentage points ahead of last year figure as a result of our pricing strategy, that is delivering positive data monetisation.

Transformation for a more profitable business

Please turn to slide 7 to review our achievements with regards to profitability. This is the third consecutive quarter of lower costs. The successful delivery of cost control initiatives, leveraged on scale and simplification are the main levers of this performance.

Sound costs control more than offset revenue pressure and drive OIBDA margin improvement of 50 basis points to 32.3%. Commercial cost efficiencies delivered by our new commercial model and further efficiencies achieved due to simplification and resources optimisation led this performance. This is specially remarkable in a context of increasing smartphone penetration and growing network costs related to the data centric businesses.

Lastly, and as I will explain in the next slide, I would like to stress our initiatives to capture the value of our scale.

Global Resources: Delivering OpEx & CapEx savings

Global Resources is further optimising scale benefits, delivering savings and helping to maximise business profitability.

As such, in Q1 the unit has been focused in certain priority projects to consistently progress in transformation, aiming to improve global operating and commercial processes.

To give some examples:

In Networks & Operations, a step forward in supporting operations has been achieved and we will ensure smooth implementation of network sharing agreements in Europe and extend them to Latam. A good example of this is the MoU with América Móvil in Brazil.

IT was key in the recent successful tariffs refreshment in UK and Czech Republic. We have also launched a new model for Application Maintenance in Latam and we have further advanced in executing infrastructure consolidation.

In Devices, we have simplified our catalogue reducing references by 25% vs 2012, concentrating 80% of value in 30 references.

Digital: Progressing in the digital world

Moving to slide number 9, let me highlight the progress made by Telefónica Digital to continue transforming Telefónica into a Digital Telco.

Firstly, strong momentum continues around Firefox OS with enlarged industry support. The first handsets will be on sale in Spain, Colombia and Venezuela in the coming months. Meanwhile, compelling content partnerships are already in place.

Secondly, M2M capabilities were bolstered with the introduction of a new platform for managing M2M communications, while new innovative services were launched and new partnerships strengthened our position.

Telefónica Digital is also driving innovation in over the top communications with “TU GO”, a service that will change the way people use their phone by allowing them to use a single mobile number across any of internet connected devices, seamlessly.

On top of that, Telefónica joined Sprint to create one of the largest mobile advertising alliances in the world and will become the first telco in Latin America to deliver end-to-end services in the e-health market.

T. Latam: Healthy growth on sound basis

Please turn now to slide number 10 to review our operations in Latin America.

In this quarter, commercial activity remained strong in the most valuable segments. The profile of our superior customer base places us in an unparalleled position to capture the mobile data opportunity in the region. This is reflected in the strong growth of contract accesses, with accelerated smartphone adoption.

As a result, revenues grew strongly by almost 7% year-on-year in organic terms, doubling accesses growth. Data services uptake progressively increases its contribution to total revenues. This reflects the quality and sustainability of our growth model.

Let me also remark that despite the higher commercial activity in high value clients and the accelerated smartphone adoption, OIBDA growth continued to outpace revenue growth, resulting in a slight margin expansion, as our efficiency efforts are delivering tangible results.

Brazil: Widening mobile competitive advantage

The next slide gives our view on the Brazilian business.

We continued widening our mobile leadership in the first quarter.

We base our market strength on the competitive advantage provided by our differential 3G infrastructure and our superior service quality. As a result: we captured 42% of market net adds in the contract segment in the first quarter, with smartphones growing strongly. Our contract customer base grew by 17% year-on-year, with smartphones rocketing by 88%. Meanwhile, we kept strengthening our position with new innovative multi-device data plans launched in April.

In the fixed business, we remained committed to our action plan aimed to improve fixed quality, mainly enhancing the mix of broadband speeds, while increasing the uptake of VIVO fiber.

Brazil: Solid revenue and OIBDA growth

Positive commercial results translated into financial metrics, as shown in slide number 12.

Revenues accelerated this quarter on the back of the outstanding performance in mobile revenues, growing by double digit year-on-year and bolstering top line growth, as they account for 2/3 of total revenues in Brazil. Let me also highlight that we keep leading MSR market year-on-year growth, owing to our strategy based on sustainable growth model centered on quality.

Similarly, profitability continued to improve year-on-year mainly driven by synergies derived from our businesses integration, along with ongoing efficiency efforts to bring further margin sustainability.

And let me also highlight that, once again in this quarter, we led OIBDA market share and we keep widening that leadership.

T. Latam: Key Metrics (I)

Now please turn to slide number 13, to review the results of other businesses in Latam.

In Peru very strong commercial momentum remained, flowing into top-line acceleration while maintaining stable OIBDA margin year-on-year.

In Argentina, revenue growth surpassed the 20% mark y-o-y while historical record in net adds for a Q1 affected profitability, but secured future growth.

Meanwhile, Chile remains as one of the most competitive markets in the region with revenues impacted by market dynamics and pricing pressure. We reshaped our commercial offer mainly to take the advantages of a low penetrated mobile data market. And in the meantime, we continue to work on the costs side, gaining efficiency to offset revenue decline.

T. Latam: Key Metrics (II)

Turning to our Colombian business in slide number 14: despite a tough competitive environment, we continued to post healthy growth in contract customers while enhancing our position in the fixed business, with the highest net additions in the last 4 years in both, fixed traditional and fixed broadband accesses. On top of that, benefits stemming from the integration of our fixed and mobile businesses continued to flow to the bottom line.

In Mexico, the new regulatory framework should improve the competitive landscape, creating the conditions to exploit all the market growth potential. In the meantime, Q1 results consolidated the positive commercial traction, with accesses growing after 4 quarters declining.

And to end with our Latam assets, in Venezuela, once again this quarter, operational performance remained impressive across the board.

T. Europe: Refreshed commercial approach, focused on value

Let me now review our operations in Europe.

Telefónica Europe continued to execute its strategy to focus on quality and increase business efficiency, amid intensified competition and economic headwinds.

We have been revisiting our commercial approach to reinforce our competitive position, launching an empowered portfolio, tailored to local markets' conditions, but sharing a common philosophy of simplicity, transparency, data-centricity and moving away from subsidies.

Incremental savings derived from transformation initiatives led for a second consecutive quarter to an OIBDA margin improvement year-on-year, of 210 basis points, despite ongoing revenue pressure.

Spain: Recovering commercial strength with Movistar Fusión

Moving to Spain, on page 16.

I would like to highlight that our convergent offer "Movistar Fusión" continued to be the key lever behind the Company's commercial activity in the quarter, sustaining strong market momentum.

"Movistar Fusión" surpassed 1.7 million customers as of March. It is specially remarkable that 47% of gross adds were from new customers, either new fixed or new mobile services, 17 percentage points more than in Q4. New revenues from these customers, along with upselling and increased additional mobile lines, allowed "Movistar Fusión" to reach revenue break-even from January.

"Movistar Fusión" is consolidating solid FBB and fiber net adds, as well as reducing fixed telephony losses, and on top of that improving customer satisfaction and churn.

Convergent offers in the market and market shrinkage affected mobile quarterly net adds. In particular, MVNO's integrated offers resulted in higher contract portability losses.

During April we introduced new commercial propositions to better compete in the marketplace: completing our convergent portfolio in the entry-level with "Movistar Fusión Cero", and addressing different consumption levels for mobile-only customers with "Movistar Cero" and "Movistar Total".

Spain: Further progress towards business stabilisation

Turning to slide number 17, we review Telefónica España financials.

Total revenues stabilised their year-on-year decline on a sequential basis ex-handset sales, which were affected by the new commercial strategy, against a difficult macroeconomic backdrop.

Regarding profitability, I would like to stress once again the healthy OIBDA margin of 47% delivered by T. España, improving 5.1 percentage points in organic terms year-on-year. This reflects the ongoing savings on multiple initiatives of cost cutting across the board, like a rational approach to subsidies, redundancy program, simplification, lower churn and lower customer care costs.

In the coming quarters results will reflect the benefits of the new social agreement, the insourcing of activities in different areas, and deeper transformation and simplification, which should lead to additional cost savings.

On top of that, and despite increased coverage of fiber up to 2.3 million households as of March, CapEx showed a 30% year-on-year reduction, flowing directly to operating cash flow generation, which remained stable year-on-year in organic terms.

UK: Back to OIBDA growth on sustained commercial traction

Turning to slide 18, in UK we have maintained commercial momentum in a highly competitive market.

Contract mobile net adds remained solid, as the Company continued capturing share of smartphones and the efforts on retention led to a record low contract churn. As such, we have improved our customer mix, with the contract segment representing already 53% of the mobile base, up 3 percentage points year-on-year.

I would like to mention the recent launch of an innovative, simple and transparent proposition "O2 Refresh". This tariff scheme offers the best value for money proposition and continues to be data centric while generating commercial efficiencies as it eliminates handset subsidies.

Mobile service revenue year-on-year trend excluding regulation improved for the second consecutive quarter, reflecting the better trading in 2012. With regards to revenues, I would also like to highlight the RPI price increase and the disposal of our fixed business that will start impacting from the second quarter.

Top line performance and further efficiencies around network sharing, focus on online customer care, and the benefits of scale led to a margin expansion of 1.6 percentage points leading to OIBDA year-on-year growth for the first time since the third quarter of 2011.

Germany: Solid progress in mobile data

In Germany, on slide 19, the first quarter has been impacted by tactical competitive moves on retention. This commercial environment led to lower trading volumes, with strong focus on the existing customer base and upselling activities.

Contract churn improved by 0.2 percentage points, leading to a contract mix of 53%. To further monetise the data opportunity, the Company has launched the new "O2 Blue" portfolio and is seeing encouraging adoption trends.

I would also like to highlight the ongoing expansion of the LTE network, with the high speed metropolitan areas of Munich and Berlin already operational since the end of March. Regarding the MoU signed with DT, we see the fixed business as key lever to develop our convergent strategy and this will allow more attractive high-speed bundled offers.

In terms of financials, focus on smartphones led to strong non-SMS revenue growth. Mobile service revenues excluding MTR grew 0.5%, decelerating their growth trend sequentially due to ARPU pressure as we continue our process of renewing the contracts of our customer base and as we have been impacted by lower SMS volumes.

Lastly, OIBDA margin increased 0.5 p.p. to 23.9%, allowing OIBDA to remain stable year-on-year.

Debt reduction absorbing bolivar devaluation and seasonal effects

Let me now move to the financial side, on slide 20.

Telefónica remains on track on its deleveraging process: Net debt including post-closing events decreases by €1bn compared to December 2012 net debt adjusted by the devaluation in Venezuela.

Positive FCF pre-spectrum has contributed with 238 million euros, nearly three-fold the Q1 12 figure. This has been complemented with several measures, such as the sale of assets and stakes for 1.2 billion euros: including the recently announced sale of a 40% stake in Central America, the divestment of UK retail fixed business and Hispasat and the placement of treasury shares.

In the opposite direction, we have suffered exceptional items such as the Venezuelan devaluation, the spectrum acquired in the UK and seasonal ones like the traditional seasonality of working capital in the first quarter, which should reverse in the coming quarters. So, we reiterate our target to reduce our net debt below 47 billion euros in 2013.

Strengthening liquidity and reducing financial expenses

On slide 21, I would like to highlight again that financing conditions are normalised for us. Several long term financing operations have allowed us to raise €7bn year-to-date and to increase our average debt life to 6.75 years.

This successful financing has contributed to an additional improvement in our liquidity position, reaching €21.4bn as of March, €0.4bn above the level of December 2012. We have further strengthened our liquidity position by repurchasing and exchanging short dated bonds by an amount of €0.8bn. So, we remain comfortably ahead of our target of 24 months of covered maturities.

It is also worth mentioning the decreasing effective interest cost during the last six months, almost by nearly 30 bps to 5.22%, close to the bottom of the range of our guidance and despite the strong liquidity position.

Conclusion

To conclude, let me highlight that in the first quarter we continued transforming our model:

We continued keeping strong commercial push, focusing in quality and innovation and avoiding subsidies, which will result in a sustainable growth model.

We continued stabilising the business, as reflected in the stable OIBDA and growing OpCF year-on-year.

And lastly, we continued with our debt reduction program, after taking decisive actions to increase financial flexibility.

Q&A session

Tim Boddy – *Goldman Sachs*

Thank you for the question. I wanted to ask a little bit about Spain, where it looks like the general KPI has weakened fairly materially sequentially from the fourth-quarter level, obviously with slightly slower uptake at "Fusión" with significant increase in line losses and obviously the mobile contract adds.

Where do you see these trends going over the next couple of quarters? Is there a kind of tipping point in your mind where you have to think again about the need for incremental price cuts?

Then the second point following that is really around the potential for ongoing cost saving in Spain, which you have highlighted. Is there any way you can quantify the kind of sequential, ongoing benefits through the year that we can see to the cost base in Spain? Thanks very much.

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you very much, Tim. I think that your question, your first question is to send again a message around what we are trying to achieve in Spain and what we believe is a very good evolution of our transformation strategy in first quarter 2013.

If we take first that message, the consolidation of this transformational strategy, what we want to highlight is that, first of all, "Fusión" on the base of our sustained commercial momentum is very clear at the moment. We have continued having a very good traction of "Fusión", which as you know is more than 1.7 million customers.

We have improved our customer mix with 47% of gross adds that are new customers compared to the 30% that we saw in the last quarter of 2012. We have improved our customer satisfaction, which has logically impacted on lower churn rate consequently, and importantly, as stated in our previous quarters, we have seen how "Fusión" has continued helping us to outperform in the fixed business.

For example, we have had very solid fixed broadband net adds with very much focus on value services and positive churn evolution. As you know, on the pure fixed broadband net adds we have had 52,000 in the first quarter of 2013 with improvement in the churn rate. But very importantly, the effect that we wanted to highlight in the last quarter is the take up in fiber, which is even higher value than the pure fixed broadband, with 60,000 in the first quarter.

Again, I know that you have seen the fixed telephony net loss is below historical average and we are seeing acceleration of mobile broadband adoption. What it is very important to highlight compared to the last quarter, and to see the positive evolution on those KPIs, that you think are below or decelerating, is that we admit that in the mobile business we are seeing some impact.

On the pure impact of those mobile net adds, we had to address very clearly, what was the reasons of that mobile impact in our business and we have done so. So when you look at what has happened, this is definitely a shrinkage of the market. We have also seen that the part of our loss of those net adds were to MVNOs and those were mainly happening at the low end, at the very specific segment of the low end, both on the convergence and the pure mobile.

So we addressed that specifically during the first quarter and we adjusted our tariffs in that specific segment. One, within the convergence segment, just launched what we call "Fusión Cero", which was introduced at the end of April, so we have very little results yet. And the others, which were very much focused on addressing the mobile-only business, which were the "Movistar Cero" and the "Movistar Total" which were introduced at the beginning of the month of April.

So, we believe that respect of the performance we have continued to show a positive evolution, and we have managed to address specifically the low end of the mobile business, which was affected so far. If I may, as you asked me specifically for going forward what we see, I can give you some of the results we are seeing in April. We see consolidated trends in terms of revenue stabilization, which were very important as you remember at the beginning of the fourth quarter and definitely during the first quarter. We've seen that April confirms revenue decline stabilization and we expect this trend to continue despite the ongoing challenging macro competitive backdrop, which is a reality.

In terms of our OIBDA margin, I want to confirm that we believe it is sustainable despite the top-line pressure and lower savings in commercial costs, but we are continuing with the simplification, as pointed out in the presentation made by Ángel, in-sourcing in Spain and personnel cost measures continue and will continue bearing their fruits.

We expect commercial trading improvement in mobile and maintaining this focus and momentum in fixed business fostered by the "Fusión" effect. And I think I could continue talking, but probably we should go to the next question.

Georgios Ierodiaconou - *Citi*

Good afternoon and thank you for taking my questions. I have two.

The first one is around the "Refresh" tariff in the UK. Is it possible to give us an indication of the level of subsidies you have today and, therefore, what could be a reasonable margin uplift on the back of these offers? And if you could also give us an indication if you plan to do any factoring agreements so we may even see a benefit on the net debt numbers as we progress through the year.

My second question is a follow-up on Tim's question earlier around "Fusión". Right now we've seen that most of your competitors replicated the offer, so I was wondering if you could give us an idea of how you plan to use TV in the future perhaps to differentiate. Right now there is no discount for adding TV into the bundle. Is there any specific constraint that will prevent you from putting a discount on TV and is there any issues around programming costs that may be perhaps the barrier to that? Thank you.

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you, Georgios. With regard to the "Refresh" tariffs, you know that we launched these new tariffs on April 16 and, as you know, they are a bold and innovative proposition for the commercial offer in the UK.

Just to clarify on the "Refresh" tariffs, customers can have, first of all, the latest phone whenever they want. Customers can also choose their device and the tariffs from the "O2 Refresh" range. That it is quite clearly stated in the offer.

Also, the customers can make a decision about how much they want to pay upfront and how much to spread over time, available over a 24-month contract. The truth is that it's a very early stage to give you results, but what we believe the impact so far is a positive one. We've seen people entering and understanding the tariffs. In fact, I can tell you that probably out of ten, nine are taking the "Refresh" tariffs. And although it's early days, we are seeing the positive momentum.

With regards to the factoring, yes, that's an absolute yes.

And probably going into the second question on the TV, when you look at the "Fusión" and what we were trying to achieve, it is clear that we have managed to convince the market with our converge offers and now we look into the totality of the clients in a different way.

We have to admit that Imagenio, or what we call the pay-TV within "Fusión", on the net adds front is under pressure and we believe there are a couple of analysis or reasons that we can take into account. No doubt that the macroeconomic environment is challenging and somehow people can look at the TV or pay-TV as a luxury good, although we are trying to adjust that in order to make sure that we get closer to our clients and we adjusted the offer.

The important factor is that ARPU has increased by 19% year-over-year, due to the price increase that we had to implement in October 2012. But, importantly, we analyzed that, as we promised in the fourth quarter, very specifically how to adapt to market conditions the TV offering.

So in April, exactly April 15, Telefónica launched a promotional offer which Imagenio can be subscribed at EUR10 up to September. We've seen the right traction, we can confirm this, and we are also expecting an improvement in the Imagenio performance in the following quarters based on this attractive promotion that is already being well taken by our customers.

Also, something that I stated in the last quarter of 2012, it was not just a matter of price but also a matter of adjusting our platform to a better look and feel, to a better technological offering and that we are already working on that. And I think we are quite ready to announce soon.

Importantly as well, as I mentioned in the last quarter, we have to improve our content, which we will be working on that. The TV is something that is important to us, for the whole firm, and very much for Spain as well, so we will continue working on it.

Ivón Leal - *BBVA Research*

Good afternoon, everybody. My two questions, the first one is in Spain, specifically on fiber. Are you satisfied with the 16% uptake that you are seeing in the fiber product? Is it how we should look at the market going forward with our 15%, 20% uptake in the product? Or eventually do you feel you have to do something this year in order to push more aggressively on that? And if this is the case, what you need to do and when are you going to do it? That's the first one.

The second one is on Mexico. I don't know how we should think about operations in Mexico going forward. Is it true that subscribers have performed a bit better than in the fourth quarter, but in expense of much lower ARPU? So I don't know if you could share with us, if you can leave that with the mobile-only business or eventually how the strategy changes after the perspective of a new regulation there.

Eva Castillo - Chairman & CEO Telefonica Europe

Thank you, Ivón. I think if we go first to the fiber performance, we are very happy with the fiber performance, specifically with the continued commercial traction of the fiber net adds quarter after quarter.

So just year-over-year, as you know, it's a 23% increase in the first quarter. When you look at each of the variable that we are looking at, as I mentioned earlier, this quarter we have had positive net adds of 60,000. We have added a new promotional tariff at levels of EUR 29.9 for 12 months in order to foster even more the fiber adoption, and this was launched as well on April 15th.

I believe that it is important to highlight for "Fusión", the important help that "Fusión" is making into the take of fiber overall. "Fusión", as we pretty much analyze from the very, very early stages, is fostering and improving the fixed business with positive impact on the fixed broadband net adds but, even at a greater pace in the uptake on fiber.

We see the 16% take as a very positive one, but obviously we will continue analyzing during the rest of the year and the quarters to come if there's any need to foster even more the fiber adoption. We believe it is important to see regulation being stable and being a regulation that fosters and helps us to continue investing, as you know, in fiber. But so far we maintain a flexible investment approach in the coming years with the goal to reach, as I stated last quarter, 8 million households by the end of 2015.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Yes, this is Santiago. Two observations from Mexico. First on regulation in the change of law. First, it has gone through both the Congress and the Senate, but important things are still unknown. And those important things are how are the bylaws or the lesser level laws going to be written. Not because we expect anything different, of course, from what it says there, but because the nitty-gritty, the minutia of the detail is going to be very significant to achieve the purposes of the reform, which basically should be favorable to the non-incumbents in Mexico. So, we are going to have to wait for the better part of the remainder of the year for that to actually transpire. We do think, however, that this is going to be a positive development, both for the Mexican market and for our operations in Mexico.

Addressing the quarterly numbers, you are quite right in pointing out that the lower ARPU numbers are a bit worrying. I am less worried than what the numbers show for two reasons. The strategy is working and it is working because it is basically getting what we intended, which is get stability in the newcomers, in the net adds to the base.

The hit rate there is almost on target with our expectations, but it is having a negative effect on the existing or prior customer base, which is taking advantage of the more attractive features and the more attractive tariffs and, therefore, is trading down. And that's where the ARPU decline is coming from.

So we think this is going to lapse throughout the year and that as the strategy unfolds it will show itself that it has taken us away from a pure price war, which is alive and kicking very strongly in Mexico. You may have noticed that some of our competitors, especially the big incumbent, have sacrificed a very severe part of their profitability just to counter that amount.

So all-in-all, we think we are on the right track. It's going to take some time for it to show that this is the case, and I urge you to look at the combination of the new additions to the base and the old degrading customers that are taking advantage of the new tariffs.

Frederic Boulan - *Nomura*

Thanks for taking my question. If we could go back to Spain, please, a couple of questions. First of all, at the time of the full-year numbers you had a message of an improvement in the business later in the year.

So can you comment here on if you expect that line to start to get better at one point? Specifically, what should we expect in ARPU dilution from migration to "Total" and "Cero", which are probably 50% cheaper than the previous price points. If you could clarify the exact impact of the loyalty program, we had handset sales decline doubling over Q4 2012. So how is that helping the top line?

Third point, can you explain the fading of the EBITDA versus what we saw in Q1 with much higher starting points and with margins especially in the second half of last year at 42%/47% margins already? Thank you very much.

Eva Castillo - *Chairman & CEO Telefónica Europe*

Thank you very much. Let me go first to the question around the back book or even the ARPU dilution. Let me just make sure that I address, it was ARPU, it was loyalty, it was EBITDA? Just to make sure.

Frederic Boulan - *Nomura*

Yes, that is it.

Eva Castillo - *Chairman & CEO Telefónica Europe*

Perfect, okay. I would say that in terms of the revenue, the environment continues being tough, so no one denies that, but I would say that despite that revenue pressure we see a better evolution in market share and net gains. Also, if you look at the fact that we have to do more repositioning, we believe those are very much focused on very specific segments and we believe global movements are from the past.

When we look at the margins specifically, we believe that the improvement will be gradual and interanual as we improve as well our commercial cost and non-commercial cost. But to highlight the simplification measures that we are taking, and I can expand a lot on that, the new negotiations with the unions in terms of personnel situation and, very importantly, the insourcing capabilities that we are incorporating into the business, that permits us to maintain a margin, confirm the sustainability of those margins, and that despite the current tough situation on revenues.

I would like to go a bit on what it means simplification and what it means insourcing in our operation. I would like to highlight that this is a number one priority for our operation in Spain and is done with discipline and day-to-day care. I think that we have stated in the past the level of simplification in our operation in Spain, but I would like to give you some details.

For example, with regards to the product portfolio. In terms of references, we have gone down by more than 40,000 references which have been eliminated from our catalog. That is more than 60%, and we continue to do so. In terms of simplification of systems, more than 800 terabytes of information have been deleted from our system and we continue doing so.

The simplification of the services, I can mention at least 100 service applications have been switched off just in 2012 and there are more to come, and there has been clear switch off of obsolete networks. There are many other efficiency measures that are impacting positively our operation.

And this is not just one quarter or two quarters. As I mentioned to you, we look at this on a daily basis. Luis Miguel and team take this as a part of the daily activity. So that is investing in quality of customer service and getting more rational commercial expense, even in the advertising of our campaigns. We have reduced them substantially to just five during 2012.

If you ask me if this is sustainable, I can tell you and I can confirm you that we have still quite a lot of room to continue doing this and more. This is a matter of continuing this discipline and this way of working.

When we speak about other things that we are doing that are quite innovative, as you know, Telefonica Spain implemented at the end of 2012 what we call insourcing. Insourcing is innovative and is quite a bold movement in a country like the one we have today with tough economic conditions. We do have to be creative in order to produce not only employment, but also being able to get more productivity in our operations.

What we call insourcing, it is a matter of analyzing what were our outsourcing costs and our estimated OpEx related to that outsource. Just to give you an idea, we have targeted or we have analyzed around EUR1 billion or more of OpEx, which is around 60% of our total costs and also CapEx of around EUR350 million. So EUR1.3 billion targeted in order to improve those costs and to get more insourcing than the outsourcing which is critical in our operation.

We have targeted and we have already included 100 activities that have been insourced in several areas like commercial, technical, and support areas. We have already insourced 1,000 FTEs into our operation of Telefonica España and we have already started to generate savings for the Company. I cannot give you specific data yet, but you will be able to see the impact on the next quarter.
Just to give you examples of the insourced activities, for maintenance of data warehouse, quality audits, surveys to telemarket phone operators, design and maintenance model for traffic behavior, and many others. Insourcing at the moment, we think, will be an example in this country on how we can help not only our company to improve profitability but also to use our resources in a more efficient way.

I think the second question, which is really spot on in your analysis and we have read very carefully, yes, we have to say that the impact of the loyalty program is positive. And that you can compare ARPU on customer-based evolution versus service revenue and you can get the numbers.

But I would highlight that the material impact on revenues and figures is important and I think that it's fair to highlight it. But it's not the only factor to take into account, because we also know that subsidies have been removed and so the combination of both is what will make the balance of the model.

So the impact of loyalty program will definitely fade on following quarter as subsidies removal was implemented in March last year, so we will be still comparing with 2012, not homogeneous figures. From third quarter we will have a comparable year-on-year basis.

With regard to mobile ARPUs, those will be impacted by "Fusión" and we will see that positive impact in the fixed revenues.

Paul Marsh - *Berenberg*

Thank you very much. So it's really just back on the domestic mobile business, and I suppose the overall question is why is "Fusión" not helping your mobile churn rate? I understood that this was going to help the broadband side and the fixed side of the business, but I thought this was a trade-off of lower spend for customers taking a bundled package in exchange for lower churn rate, a longer customer lifetime, and a bigger customer lifetime value therefore, or at least a neutral customer lifetime value impact.

So why is "Fusión" not actually helping your mobile churn rate? And perhaps in your answer you could maybe give the mobile contract churn in the quarter as well. Thank you.

Eva Castillo - *Chairman & CEO Telefónica Europe*

Thank you very much. I think that when you look at the mobile business, and we look at it from "Fusión" and from the non-Fusión point of view, it is clear that is where we have to be more innovative and look at the offer quarter by quarter, almost day by day and month by month. So we needed to have a turnaround of the situation, but analyze first what was going on. And I think that there's a few things to look at.

When you look at the net loss, it is primarily due to MVNOs and it's primarily on very specific segment, on a very specific segment on the low end of the segment. So that's what we had taken into account and we have gone into looking how to address the issue.

So we have launched the tariffs, which are primarily different. One is on the converged offer, which is what we call "Fusión Cero", at the end of April. And we have also addressed specifically the mobile business outside "Fusión" with the "Movistar Cero" and "Movistar Total" at the beginning of April.

Again, those are all around the segment in which we were losing from convergence and from non-convergence to the low consumption area, or what you can call a very specific part of the whole chain. Our perception when I look, and I speak with the Spanish team all the time, is that we have now a completed offer in both mobile fixed including as well TV. And addressing specifically mobile, we believe we have addressed that with the new tariffs.

Just to give you an example, this weekend when people entered to look into the "Fusión Cero", quite frankly, the reality is that people want to consume more data so they end up buying more into the EUR 49.90. So it is quite an important factor to explain to consumers what it means to have the "Fusión Cero" or the specific new mobile tariffs.

Another point to look at, and that's why we feel optimistic about the future, is that once you have the completed offering in all the segments, in all the tariffs, and all the customer needs, we also look at their commitment. And compared to competitors, yes, in the new tariffs you have new commitments above the 12 months and that, I believe, also compares better with the rest of the market.

Also, when you look at what is happening in recent weeks since the launch of the tariffs is that when you look at customers entering and trying to get new tariffs or new offers, more than 50% of them are now within the converged offering, which is also a very positive sign. So I hope I answered the question.

Paul Marsh - *Berenberg*

Can I just follow on? Do you think then that the second quarter will be the quarter that we will see gross adds in mobile actually benefiting and the churn rates actually falling as a result of these new developments around "Fusión"?

Eva Castillo - *Chairman & CEO Telefónica Europe*

Yes, we expect so, quite frankly.

Luigi Minerva - *HSBC*

Good afternoon, thank you for taking the question. My first one is on Germany; KPN's CEO in the last conference call expressed his desire for a network sharing agreement and went as far as saying that they would be ready to reimburse you part of the spectrum cost. Is this something which would be of interest to you? And is it better to get part of the spectrum money back and give up some of the competitive advantage you gained through the spectrum auction?

The second question is on Latin America. The organic revenue growth is 6.8%, but if I exclude Venezuela and Argentina, I'm left with 1.5%. I am wondering if this is a growth rate we should extrapolate for the rest of the year, and if you see an improvement, where it could come from. Thank you.

Jose María Alvarez Pallete – *Chief Operating Officer*

Thanks for the question. Taking your first one on potential consolidation in Europe, mainly in Germany, we do think there are too many networks in Europe. We do think that consolidation makes sense and we do think it will happen.

We don't have ongoing conversations with KPN right now. As you know, they are in the middle of a rights issue process. We do think that our 800 megahertz spectrum is a significant competitive advantage in Germany and, therefore, we are not willing to give it away at a marginal or at a limited price, because we do think it's valued even more than at the time of the auction.

And at the same time, we keep improving our competitive position in Germany. As you know, we have been reaching some agreements namely with Deutsche Telekom, with T-Mobile on the transport side to connect with fiber at all our base stations. And more recently, this proposal to consolidate our wireline infrastructure into their infrastructure and ramping back all the capacity that we need to bundle our products and services in Germany.

So we've been keeping advancing. We will wait and we will be open and receptive to a specific proposal that might create value. By the way, we think that on top of negotiating agreements the value creation of our potential consolidation in Germany is on top of a just network sharing deal, but to say yet there is no ongoing conversation today with KPN.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Yes, Luigi, in terms of the difference between ex Venezuela and Argentina and the full line in organics we do expect three things to happen. First, there is to be revenue growth, so we are confident that the Latin American region will continue contributing on organic terms to revenue growth. That is a strong and firm statement.

Second, we do not expect the gap between the more inflationary and the noninflationary markets to widen, but to shorten. The reason is threefold: Number one, we will be able at some point to increase tariffs and to improve revenue growth in the more backward markets. I am thinking of Chile, I am thinking of Mexico that I mentioned before, and I am thinking of the expected recovery in the Brazilian market. Finally, because of the effect of the devaluation having happened in the first quarter of this year, it is unlikely that there will be a sizable devaluation like that in each and every quarter of the remainder of the year. So the gap between the two should narrow, some underlying fundamental factors, especially in Chile and Mexico, should contribute along with Brazil.

Then, finally, inflationary nature of the cost paths and nature of some of these increases will be more visible as we go on. And certainly there will be growth.

Will Milner - *Arete*

Thanks. Just to continue the theme on Spanish mobile, I just want to come back to the impact of the loyalty programs, because it does look, for the last three quarters that you enjoyed a very beneficial impact on the mobile service revenue trend from writing back points accrued under the loyalty programs that are no longer needed given the elimination of subsidies.

And I just, I mean, looking at the sort of ARPU-based revenues, so if I take your ARPU and I multiply it through by the average subscribers, it sort of suggests that revenue based on ARPU is down 26% in the first quarter compared to the service revenue decline of about minus 13%, minus 14%. And the difference is the beneficial impact, as you say, of the loyalty points. But given that this is going to lap in the third quarter, would you expect the mobile service revenue trend in Spain to trend towards the sort of minus 26% level without that benefit, or is there a reason why it should be close to minus 14%?

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you, Will. I think that, as I stated earlier, the loyalty program has had a material impact on our revenue figures. But for us looking into how our business is today, we will look now at fixed and mobile revenues all together. It's a totalized component, a totalized concept.

In any case, it is clear that mobile ARPUs will be impacted by "Fusión". But, on the other hand, what we see is a positive impact that comes from the fixed business.

We also are seeing that, I mean, if you look at the operating revenues (the total revenues versus the fixed revenues) you see clearly the different lines in operating revenues, minus 16.4% in the first quarter, versus the operating revenues if you take specifically the fixed business, which is minus 10.9%. So we see that balance, that compensating factor, between the mobile reduction in ARPU and the increase of the fixed.

Overall, we will be able to see like-for-like from the third quarter. And I can tell you from the figures we are seeing on these weeks of April that the trend is the right one.

Will Milner - *Arete*

I have one follow-up again on Mexico. I appreciate there are uncertainties, I guess, in terms of what the Telecoms Reform Act specifically, and what the new laws drop out. But I guess the question would be what would you like to see dropping out from those reforms, given your current position and given your current trends? Obviously, that is a very difficult task competing with Telcel.

And then, I guess related to that, do you see any potential acquisitions specifically in that market that could improve your position there, that could add value? Or are you still very focused on disposals over acquisitions in the region? Thanks.

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Let me take the question on reform. As I said, and I was not trying to avoid the question, it's difficult to paint the whole picture until the full law has been written down and explained in detail.

What do we expect? We expect a level playing field to obtain, which is not what we think we have today, and so any obstacles that now prevent us from competing fairly, as we do elsewhere in the region, we expect them to be removed as the law is passed. Just exactly what those things are I would rather not comment publicly.

But it is not very difficult to look at Mexico as an anomaly, because elsewhere in the region the difference between the first and the second and the efforts that all of us have put into competition have yielded some results, except Mexico. Maybe Mexico is the rara avis, is the rare bird rather than our own efforts.

We do expect, as I said, that many of these things will happen and exactly which remains an open thing. As to whether or not in Mexico or elsewhere there will be opportunities, it's probably not for me to say, but we continue to scan anything available and, in due course, we will inform you if there is anything. But we do not think that a major combination is needed in order for us to fulfill our goals.

Justin Funnell - *Credit Suisse*

Yes, a couple of questions please.

First; on Brazil. You mentioned that you've introduced multi-device plans in Brazil; that has been a very successful strategy for Verizon in the US. Could you just elaborate a little bit more on those plans and what you expect the effect could be on your growth over the next couple of quarters please?

Equally on Brazil; fixed line. Your revenue trend got a bit worse there. As I understand that now your focus is to speed up your broadband to build more fiber, where do you think your fiber build will be by the end of this year? And do you think you will have pretty much fixed the problem by then or is it going to take longer?

And finally, it was a slight sort of surprise to see the fund raising, the capital increase, the share issue earlier this quarter or earlier this year. I understand that it is important to hit your debt targets, but the stress on your balance sheet and your bond yields is far, far less than it was a year ago. So it seems you are pretty determined to reduce leverage come what may.

I was just wondering what your priorities are here. Is it to, perhaps, create more of a gap between your credit rating and the credit rating of Spain? Is it to hit your dividend promise or actually starting to try and create more balance sheet capacity for acquisitions in the future?

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Justin, this is Santiago. Let me take the question on Brazil first, or the two questions on Brazil.

First, on the new plans. While Vivo continues to try and be at the forefront of innovation, I think the latest plan, which is barely three weeks old, is actually pointing in that direction. What it is, is a combination of data plans that allow a single payer to exhaust multiple users: typically a family with one payer and multiple members in it now being allowed to combine, at a price, their data usage.

We think this is flying very well. It is very early days, but it is flying very well. We will continue and delve deeper into what is that customers need, expect, or could have a better service with us for.

Not everything will last forever and successful products or plans are immediately copied. We do expect that to continue being the case. But this plan is expected to be ARPU accretive; it is expected to be service-enhancing, and certainly the first reaction from our customers show high satisfaction and high praise for the plan, so we are very happy with the first three weeks of this product.

In terms of fixed, the plan is the one you probably have already heard us talk about. It is to develop broadband at the high end, including fiber.

We do expect the Sao Paulo market to be covered with 1.8 million homes passed, which is significantly better than what we have today. Including both fiber and cable, the cable that we have with minor overlapping. So the rough numbers are 1.2 million, 1.8 million in fiber; 1 million in cable; and the overlap is around 0.3 million.

So by the end of this year we should be able to access almost all the households that we think are worthy of the investment. And so it should be by the end of this year that, if we have been successful, we should be able to raise the flag and say here we are. And at that time, broadband might be at a better position than it is today.

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

With regard to the second question, Justin; hello, this is Ángel. We decided to place a treasury stock at the end of the quarter just with the motivation to reduce debt. We had seen that our net debt position had increased due to the Venezuela devaluation. We also had the cash outlay in the first quarter regarding the payment of the UK spectrum, which came very nicely at around 50% of what the market had been estimating the bill would be, but still it had to be paid. And then we have traditional seasonal elements in the first quarter, particularly working capital consumption from CapEx accrued in the last quarter of the previous year. And also some impacts on interest payments or financial payments ahead of accruals due to the concentration of some bond payments in the first quarter and some fees, upfront fees of new facilities that appear in the first quarter.

So at that point what we had realized is that there could be a moment of increasing net debt compared to the end of last year. We wanted to send a clear signal that we remain committed to reducing our leverage and achieving our target and commitment to market of less than EUR47 billion, to be below 2.35 times net debt to OIBDA, and then we decided to place those shares.

We also wanted to send a signal to the market that we were committed to pay the dividend in cash and no scrip dividend to be contemplated. And this was the reason of doing the transaction in a moment that was prior to the closing of the quarter so that we could record, as you have seen in our net debt evolution, an evolution in the trend of the decline that we wanted.

After the closing of the quarter, we have continued progressing. We have managed to close the second tranche of the Hispasat divestment, which is now completely divested. We already got the payment for the sale of our UK broadband asset and last week we announced the sale of 40% to strategic investors in the Central American region of our assets. And we have continued to reduce our stake in Portugal Telecom, which now lies below 2%.

So we continue committed to deleveraging and this is the reason behind the placement of the treasury stock, which was not a new equity raising it. It was just a placement of treasury stock.

Robin Bienenstock - *Sanford Bernstein*

Thanks very much. Two questions, if I may. The first is that you are clearly working hard to improve your own balance sheet, but various press reports suggests that you are less enthusiastic about Telecom Italia improving its balance sheet with investments from offshore, the CDP. And I am wondering to what extent there's growing conflict of interest between you and the other stakeholders in Telco and whether or not that sustainable.

And my second question is we have seen a clear desire from the European Union to see a reduction in pan-European data roaming costs for consumers, and we think we're starting to see the beginnings of consortia like Star Lines consortia in airlines that could compete away a lot of those revenues. Is that something you are interested in participating in proactively in those sorts of consortia, or are you more interested in trying to resist the regulation? Thanks very much.

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

Hi Robin, this is Ángel. Let me take your question on Italy.

We have, we are happy with our position in Telco. We have a very good relationship. I think we have a relationship of trust with our partners in Telco and our position in Telecom Italia. As such, we will be supportive of actions that improve the value of Telecom Italia because we are among the first beneficiaries in that situation because we are indirectly the largest shareholder in that company.

Some of the topics which are being widely speculated in the media, it's difficult for us to give clear details, probably this is better to ask to Telecom Italia tomorrow. But from our position as Telco shareholders, for instance, with respect to a potential in-market consolidation in mobile in Italy, I should say that no specific proposal has been made to Telco. And if and when such a proposal were to be made, Telco would have to analyze its merits and its risks, including aspects such as valuation, deal structure, and diverse implications, credit rating implications, and other. But it's early to say and we don't have information to have an opinion.

With respect to network separation and a potential CDP investment, the situation is similar. We don't have, as Telco shareholders, information to give an opinion on that. It's clearly an unprecedented move in the Telco space, particularly in Europe, and as such when the standard Telecom Italia is analyzing it very carefully, as they should. But probably the question is to be addressed to them tomorrow.

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you, Robin, with respect to your second question, and I will ask Jose María to complement my introduction in the answer, I think when we look at Europe we are focusing on the new commercial activity, on the new tariffs which are pretty much data-centric, LTE taken for those countries that are there, and they are incorporating roaming.

For that effect I think that that is what we have to do remaining regulation the way it is. So trying to be very innovative and focused on commercial activity that way. I think, Jose María, maybe you want to add something else.

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

Yes, hi Robin, Jose María here. Remember that we already launched on market roaming tariffs in Europe for our own customers. So we already have that in place and we already see the effects of that roaming data, data roaming products in our own catalog of products and services for our own units and business units in Europe.

And for the reminder of the competitive landscape, yes, we are open to conversations. We think this is something that needs to be structured jointly with the regulatory effect. So part of the effort is already being done through our own product and service catalog and, yes, we are open to participate in a joint effort.

Fabian Lares - *JB Capital Markets*

Hi, good afternoon. Thank you for taking my questions. With regards to the Spanish evolution, I know Eva has been mentioning that they believe that the margin is sustainable. I would like to focus more on the CapEx situation.

Over the first quarter the decline has been substantial. Considering you have ahead the deployment of LTE and fiber to the home and the likely acceleration of it, would you, would this figure, is this a seasonal kind of figure that we should be expecting? Or how much of this should we consider to be sustainable going forward in order to project our operational cash flow estimates?

And second, also in Spain, with regarding with the evolution of pay-TV, you mentioned over this week the relaunch of Movistar Television. Maybe if you could comment more exactly if it's possible to mention whether there is any intention to integrate further with your participation in Prisa's Canal+. Are you going to get more content? What does that agreement that you have with Prisa report to you in terms of not only being a minority shareholder in Prisa TV but also being a shareholder in Prisa itself in the future? Thank you.

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you very much for your question. On the first part of your question, last year or at the beginning of the year we already said that CapEx would be below the level of last year for 2013, but the commitment of this year's CapEx will continue being intact. It is absolutely true the first quarter gets and takes some seasonality effect.

There's less during the first quarter that has been taken, but we maintain our commitment on all the investments that we wanted to do and in fact, as you know and I stated earlier how important it is today, specifically in Spain, the investment on the new generation networks and specifically in fiber. So just to confirm on that.

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

With regard to the second question on Digital+, as you know, we own 22% in the company along with Prisa and Mediaset. We are happy with that investment. There are continuously rumors from the market, but there is nothing concrete to report on this front.

Luis Prota - *Morgan Stanley*

Yes, thank you, two questions please. The first is on regulation and the request from Vodafone and Orange to get access to Telefonica's fiber network. I don't know whether you could give us some light on what are exactly their requests and how this request or the agreement they want to achieve differentiate to the agreement that you reached with Jazztel and whether you expect any regulatory intervention on the back of this any time soon, forcing access to Telefonica's fiber network.

And the second question is a follow-up on the debt figure and the debt target of being below EUR47 billion year-end. The question is whether this target is achievable this year without further asset disposals or asset sales being required. So from what we know so far in terms of asset disposals, whether in an organic way you can get to this level and any further disposal could be on top of and I don't know whether you can mention on recently comments on potential IPO in Colombia, reduction of the stake in Cesky Telecom, selling Ireland. Are any of these contemplated?

Thank you.

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Thank you, Luis. I think that the question around regulation and about some of our competitors' messages, I think it's important to clarify that our existing agreement of co-investment in fiber with Jazztel is happening and is happening in the terms that we agreed with Jazztel and as you know, we compromised in both players granting accesses for 3 million premises in 18 months, 1.5 million each. And that is happening and we are quite satisfied with that.

This agreement was from the very beginning open to other third-party players. I believe that it is very important to state in this market the conditions that we have, that you have to be willing to invest. And that's what we are just requesting.

That our agreement is open; I think it would be a good idea to get other third participants in it. The willingness for them to invest is a must and for that I guess that that wouldn't alter at all any of our plans of investing in the fiber business.

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

Hello, Luis. Regarding reduction of debt towards the target that we have for the end of the year, we plan to achieve that debt reduction in two ways. One is organically with free cash flow in excess of dividends.

As you have seen, we are going and now it's formally proposed to the shareholder meeting; we're going to pay EUR0.35 in November of dividend in cash. This would be the first tranche, the interim part of the dividend, of the EUR0.75 that we committed to the market. The second tranche would be paid next year.

Our estimates, most updated internal estimates of free cash flow, exceed significantly the cash commitment that we have with dividends, so there will be organic debt reduction and deleverage due to that.

And second, we continue to very actively manage our portfolio of assets. We don't feel comfortable commenting on market rumors. And we have, as you know, traditionally been shy about commenting on specific situations and transactions, because it's never easy unless in the times that we are living to get deals to the finish line. So we don´t want to create uncomfortable situations in our operations.

Having said this, we are managing our portfolio aiming to increase the value of the businesses where we are present. We are not in an expansion mode but, yes, we can be in a strengthening mode in some of the markets where we operate. Some of those markets could benefit from in-market consolidation and, you know, there are several examples. Jose María has spoken about one of them before. Ireland could be another one.

In Colombia I want to stress that we are not sellers. In Colombia we are seeing very good growth, as you saw in the presentation, in my remarks reading the presentation. And here we are just initiating the talks with our partner, who is the Colombian government, about possibilities to capitalize the Company to accelerate growth. And in doing so, providing liquidity to the partner.

And the Czech Republic continues to be a very strong cash generator. You should expect us to actively manage the portfolio. You saw the Central American transaction, you saw the UK broadband so you should expect us to continue doing things and, therefore, reduce debt organically and inorganically.

Luis Prota - *Morgan Stanley*

Thank you, Ángel. If I can follow up on this Colombian comment you made on the government, talks with the government to capitalize the Company to foster growth. Would that imply that Telefonica is putting or has to put more money?

Or when you said you are not sellers it could be that you are just giving an entrance to the government, putting more money and diluting your position, reducing debt but keeping still the majority and reducing net debt at the end like it happened last year? How would that be structured? Thank you.

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

It's too early to say. We are assessing different options. Obviously, we are talking with our partner on that and whenever there is definite structure and steps going forward, we will duly communicate to the market.

Jonathan Dann - *Barclays*

Hi there, it's two questions. One, if you look across the various assets, you've got multi-device in markets like Germany, Brazil, but not, for example, in the UK. And then vice versa, you have network sharing in some countries but not others.

Is there a plan to, for example, do multi-devices in the UK? And why the delay? And secondly, network sharing, say, beyond simply Brazil?

And then a final, I guess, philosophical question. Is the right way to monitor Latam to ignore inflation? Do you guys incentivize local management with, perhaps, real revenue growth? I guess otherwise you're sort of better off managing Venezuela than Brazil.

Eva Castillo - *Chairwoman & CEO Telefónica Europe*

Hi, Jonathan. Yes, with regard to the multi-device and the new potential in the UK market, definitely like in the other markets. For example, we could use that opportunity when trying to price LTE appropriately.

On the other question regarding network sharing, as you know, we have already shown that we are open for innovative network sharing situations and, in fact, we will not lose out any opportunity in order to give our clients better service and better options. I think the beauty of current market in Europe is that this is one way to continue having a good network and being open to also share it with the others and get benefits both sides, as we are seeing currently in Germany, Spain, or in other markets.

I'm not sure if there was anything else for me.

Jonathan Dann - *Barclays Capital*

No, everything is covered. Thank you

Santiago Fernández Valbuena - *Chairman & CEO Telefónica Latinoamérica*

Jonathan, on the philosophical question, and at the risk of stating the obvious, two pieces of information. One is we assess the quality of local management in local currency, so the Venezuelans are judged on bolivars and the Brazilians are judged on reais, as we think they should because we do manage centrally at headquarters the currency risks associated with our investments and our operations.

And then, again at the risk of stating the obvious, there are two sides to how inflationary economies are treated. One is; are you or are you not able to pass higher costs on to higher prices? There, management is sometimes at odds with trying to pass on the increases in its costs to the revenues, and at a highly regulated sector like ours this is especially difficult.

But, if you look at a country like Venezuela, you see that all-in-all we have been very successful in doing actually that. Probably not on a day-to-day basis, but, yes, on an event-by-event basis as you see by the margins not having contracted.

The second effect, which is more difficult to manage locally; it is managed centrally, is how many euros or dollars these highly inflationary economies actually deliver in the way of FX. But that's not what we do locally. That's what the currency risk management team does centrally.

So managers are judged on local currency. Passing inflation, cost inflation, on to products is difficult, but so far so good. And the risk of devaluation or depreciation is always present, but we try and manage that to the extent wanted or needed centrally.

Pablo Eguiron – *Telefónica S.A.- Head of IR*

With this we have to finish the call. Thank you very much for your participation. We certainly do hope that we have provided some useful insights for you. Good afternoon.