



**Telefónica January-September 2013
Results Conference Call Transcript**

8th November, 2013

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Although we try to accurately reflect speeches delivered, the actual speech as it was delivered may deviate from the script made available on our website

Introduction

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

Good afternoon, ladies and gentlemen, and welcome to Telefónica's conference call to discuss January-September 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 conference call.

Presentation

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

Q3 Highlights: Reaching FY 13 targets in advance

Thank you Pablo.

Good afternoon ladies and gentlemen and welcome to Telefónica's 2013 third quarter results 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.

The results released today show how a strong operating and financial execution enable us to achieve FY outlook earlier, as we have made significant progress in three areas: First, Q3 confirmed the acceleration of year-on-year organic revenue growth for a second consecutive quarter, with sales up to September turning positive to 0.4%.

Second, organic OIBDA stabilises. Top line growth, efficiency gains and cost control have proven to be successful, limiting OIBDA margin erosion to 0.2 p.p. despite intensified commercial activity.

The operational improvement, together with strong financial execution allowed FCF ex-spectrum to remain stable year-on-year in the first nine months, despite FX headwinds and changes in the perimeter.

The third key strategic pillar is on balance sheet improvement. Net debt decreased substantially in the quarter to €46Bn or 2.30x Net Debt/OIBDA. In addition, our focused portfolio management keeps progressing in the right direction, with the Czech Republic transaction being the latest example. Including post-closing events, net debt would stand below €45bn, implying a €14Bn reduction since Jun-12 when deleverage was established as a priority.

Finally, let me stress that we fully confirm our goals for 2013 and our dividend commitment, of which 35 cents were already paid on Wednesday.

Key financials

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

In organic terms and in July-September period, revenues posted the highest growth for the last twelve quarters at 2.1% topping €14.1Bn. OIBDA reached €4.7Bn and reduced its quarterly decline to 0.3% year-on-year while profitability stood at 33.3%, 0.8 percentage points lower than a year ago, impacted by commercial investments linked to revenue streams.

From a cash generation standpoint, January to September Operating Cash Flow stood at 9.1 Billion Euros excluding spectrum, virtually flat year-on-year.

It is important to highlight that reported headline figures and their year-on-year trends are negatively impacted by FX and to a lesser extent by changes in the consolidation perimeter. July to September period is impacted by the sharply weaker Latin American currencies, specially Brazilian real, which deducted around 10 percentage points of revenues and OIBDA year-on-year change.

Nevertheless, let me highlight that this negative FX impact is mitigated at free cash flow level as shown in the next slide.

Enhancing cash flow generation across the year

Moving to slide number 5, FCF generation before spectrum payments remains stable year-on-year in the first nine months at €4.7bn, absorbing the mentioned adverse FX impacts.

This performance is driven by an improving free cash flow throughout 2013 supported by better operating results and strong management of non-operating results flowing directly to cash. FCF reached almost €2Bn in the third quarter and €3.4Bn in the first nine months after spectrum.

Earning per share up to September was 0.70 euros and free cash flow per share totalled 0.75 euros, both providing strong comfort about our 0.75 euros cash dividend commitment for 2013.

Successfully acquiring and retaining high value customers

Slide 6 shows the solid results delivered by our strategy centered around high value customers.

The accelerated growth of contract customers set the basis to keep smartphone uptake acceleration. Smartphone penetration is up more than 8 p.p. year-on-year to 25%.

As highlights, I would like to point out that:

- First, Quarterly contract net adds were 1.6x higher than a year ago and 1.8x in the case of Latam, leveraged on very rapid smartphone adoption.
- And second, that our commercial proposition allows us to capture all profitable growth opportunities.

Our increased investments in UBB prove our commitment on quality growth, with coverage reaching 32% and with 11% of customers already connected at the end of September. We are also advancing on LTE in our main markets.

Accelerated revenue growth translating into OIBDA

In slide 7, I would like to show the improved organic performance year-on-year from top line to OIBDA in Q3.

Since the beginning of the year, Group revenues are consistently improving on a quarterly basis, a combination of very good evolution at Latin America and very robust mobile data. In addition, T. Digital maintained its accelerating growth trends while Europe continued with its progressive stabilisation. This performance led Group revenues to show a sequential organic improvement of 160 basis points and 50 basis points in OIBDA.

Good progress on profitability in the third quarter underlines the benefits of our best-in class diversification, balancing the capture of growth opportunities in Latam with the margin expansion in Europe.

Let me stress that if we exclude the negative impact of regulation, our revenues would have grown 2.0% and OIBDA 0.7% vs. the first nine months of 2012 (or +3.9% and +0.9%, respectively, in the third quarter).

T. Global Resources: Capturing value from our scale

Please turn to slide 8 for a fast review of some initiatives we are adopting to increase the benefits of our scale. On top of local and regional efficiency measures, T. Global Resources further enhances business profitability, and contributes to the fast and efficient development of networks and IT, adapting to the current needs of transformation.

This can be seen in the fast rollout of LTE and fiber, key tools to capture market growth, and in the virtualisation process that further contributes to the efficient digitalisation.

In terms of IT, we are also changing the way we operate and keep on taking transformational actions, with 33% of servers virtualised, 1,400 physical servers, 6 data centers closed and more than 700 applications decommissioned.

Regarding devices, we are proactively rebalancing Operating Systems by reaching agreements with key players.

Finally, Global E2E procurement transformation continued to provide very tangible results.

T. Digital: Building up new services & capabilities

Next, in slide number 9, I'd like to talk about programs in our key product areas showing our traction as a Digital Telco.

Firstly, we have successfully established products and services in new markets:

In August Telefónica was awarded with a £1.5bn contract to deliver smart meter communications services in the UK, clearly demonstrating our strong position in the machine-to-machine market.

We have also made some important progress in the Financial Services space. The JV we're setting up with Santander and Caixabank has been cleared by the European Union's antitrust authorities, paving the way for us to start to jointly create new digital financial services.

Secondly, we're continuously evolving our core communications proposition, building the best range of value-added services for our customers:

Firefox OS handsets were already launched this quarter in Spain, Colombia and Venezuela, in October in Brazil and in November in Peru. Meanwhile, in the UK we launched TU Go, our unique communications service, a commercial push with Telefónica UK's "Be More Dog" campaign, reaching 161 thousand active users.

Lastly, we have made investments and partnerships, like Rhapsody, Pinterest and Evernote.

T. Latam: Revenue & OIBDA growth acceleration

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

Commercial activity remained strong in the most valuable segments, with contract mobile net adds once more reaching a record high this quarter. This is key to continue strengthening our regional leadership in smartphones. At the same time, fixed services improved once again this quarter.

The strong commercial effort developed on recent quarters is driving revenue and OIBDA acceleration. Revenue growth ramped-up to almost 11% year-on-year on strong mobile service revenue performance, mainly boosted by data adoption. This improvement is quite widespread among different markets.

Regarding OIBDA, it is also starting to reflect the strong revenue acceleration, growing by almost 5% despite margin pressure mainly due to the more intense commercial activity.

Brazil: Strengthening leadership on high-value customers

The outstanding commercial performance is specially remarkable in Brazil where we keep strengthening our leadership on high-value customers, as shown in slide number 11.

Thus, we captured 64% of market growth in the contract segment this quarter reaching 1.5 million net adds, the highest quarterly figure achieved by a Brazilian operator ever. This growth is further improving the quality mix of our customer base and accelerating smartphone adoption, which already reached almost 15 million.

On the fixed services, commercial turnaround continues, with better operational momentum underpinned by improved quality and offers across services.

Brazil: Strong commercial effort for a sustainable growth

Turning to slide number 12, we provide more colour on Brazilian financial performance.

Mobile service revenue accelerated to 7% year-on-year in Q3, mainly driven by strong data growth and despite the 2 percentage points negative impact from regulation.

In the fixed business, revenue deceleration stems from the volatility on corporate IT projects and some specific factors negatively affecting traffic trends this quarter.

Finally, profitability is showing the effects of the strong commercial efforts.

T. Latam: Widespread revenue acceleration (I/II)

In slide number 13, we review other operations in Latam.

In Peru, gradual revenue and OIBDA growth consolidated in Q3, maintaining solid commercial momentum.

In Argentina, best ever mobile net adds fuelled top line acceleration while OIBDA trend also improved on easier year-on-year comparisons.

And finally in Chile, we are also posting enhanced trends as reshaped commercial data centric offers are driving KPIs recovery, underpinning solid revenue and OIBDA growth.

T. Latam: Widespread revenue acceleration (II/II)

Turning to slide number 14, in Colombia, commercial activity remained strong. Revenue ramped-up as a result of improved trends across services, while OIBDA margin reflected the strong commercial activity in the quarter.

In Mexico, the progressive adoption of new commercial proposals had a negative impact on revenue performance this quarter as customer base is repositioning to new plans. In the meantime, the process to change the regulatory framework keeps fulfilling scheduled steps.

Lastly, in Venezuela, increased usage is the main driver of the outstanding revenue performance, with voice traffic jumping more than 20% year-on-year and data traffic more than 40% in Q3. This growth is based on a differential quality proposition and is fueling revenue and OIBDA growth above 50% this quarter, ahead of inflation.

T. Europe: Transforming to lead a changing market

Turning to slide 15 we will review our operations in Europe.

In the third quarter, we enhanced our tariff portfolio with a clear focus on LTE, reinforcing our market positions. As such, we increased the value for money proposition in Spain, with a strong focus on fiber; we launched "O2 Refresh" in all direct channels in the UK, and we further pushed on the "O2 Blue" tariffs in Germany.

In terms of financials, top line performance improved sequentially, despite a higher negative impact from regulation, and profitability expanded year-on-year in organic terms for a fourth consecutive quarter, driven by sound cost control and efficiencies.

Lastly, let me remark that we continue adapting ultrabroadband networks to capture the demand for higher speeds, leveraging also on a rational CapEx approach, including network sharing.

Spain: Focusing on premium quality and convergence

Moving to Spain, on page 16, "Movistar Fusión", one year on, consolidated as game changer in the Spanish market and one of the pillars of our commercial strategy, reaching 2.6 million customers. It is specially remarkable that 60% of gross adds in the quarter were from new customers and upselling.

Quality differentiation is another pillar to strengthen our market leadership as reflected in our decisive bet on fiber. Fiber adoption has doubled year-on-year and is contributing to foster revenues as well as reducing churn. Potential is huge, as reflected in our target to reach 8 million homes passed by 2015 if current regulation is maintained.

In mid-September T. España enhanced the value of its offer, leveraging on its differential advantages, namely Fiber, 4G and TV, widening the quality gap of its portfolio. Let me note that first positive signs of improved trading were already seen in October and the first week of November.

Spain: Improved revenue trend, record levels of profitability

Turning to slide 17 we will review T. España financials.

Total revenue ex-handset sales maintained its gradual improvement trend in the third quarter, once the regulation impact is excluded.

In Q3 OIBDA margin reached a record level at 50.2%, more than 3 p.p. higher year-on-year reflecting the deep business transformation. Margin improved also from previous quarter reflecting further cost reduction and the moderate commercial activity which, as said before was intensified from October.

On top of that, we continue taking decisive actions on priority projects, such as the insourcing of activities, the redefinition of CRM and the reshaping of distribution channels aimed at improving the quality of the sales while delivering further savings in the coming quarters.

On CapEx and despite the intensive effort in deploying LTE and fiber, a high level of efficiency is flowing to the operating cash flow, which is stable y-o-y in organic terms, with an OpCF margin close to 40%.

UK: Maintained momentum in a very dynamic market

Turning now to slide 18, Telefónica UK maintained commercial momentum supported by the success of "O2 Refresh". This is a promising trend considering that LTE was only available from the end of August. We are now accelerating the speed of LTE rollout, with 11 cities covered by now. Initial figures show encouraging results, with customers opting for higher value offers and a visible ARPU uplift.

We continued to gain high value customers, with contract customer base expanding by more than 9% year-on-year and, on top of that, market leading contract churn.

The strong commercial traction flows into financials with mobile service revenues posting a stabilising trend year-on-year despite the negative impact of Refresh.

In terms of profitability, OIBDA margin grew 0.2 p.p. year-on-year benefitted by the new commercial model.

Finally let me remind, that the Company continues working towards a more sustainable business model, based on increased direct distribution activity and optimising investments through the execution of network sharing agreement.

Germany: Building the fundamentals of data monetisation

To review Telefónica in Germany, please turn to slide 19.

With LTE gaining traction as a differentiating tool in a very dynamic market, we are optimistic on the increased opportunity to monetise data ahead of us.

We are seeing very positive signs of LTE adoption, with 55% of devices sold being LTE enabled and 3x higher data usage. Main metropolitan areas are already covered as we are doubling LTE related CapEx year-on-year.

MSR declined by 1.8% year-on-year in Q3 affected by a combination of trading momentum, tariff renewals and lower SMS volumes. On the positive side, we managed to improve the tariff mix and, as a result, ARPU decline stabilised. At the same time, OIBDA and OIBDA margin evolution reflect increased commercial efforts.

The announced transaction to acquire E-Plus is on track. KPN shareholders voted in favour and we are confident that merger clearance will be granted by the second quarter of 2014. This merger will give us the right scale to become an even more competitive player in the market.

Leverage and net debt targets achieved

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

Telefónica continues to harvest the benefits of bold actions towards deleveraging. Reported Net debt as of end of September stands at €46 billion, already below 2013 year end targets on both net debt figure and leverage ratio.

If we were to include announced divestments pending closing (such as Czech Republic and Ireland) but we were to exclude the hybrid linked to the E-plus acquisition, net debt would stand at €44.6 billion.

Let me summarise how we have reduced €7.5bn our net debt figure, compared to December 2012 net debt adjusted by the Venezuelan devaluation: half of this figure, €3.8bn, stems from FCF and FX savings and the other half, €3.7bn, comes from portfolio and financial management.

Outstanding liquidity while reducing interest costs

On slide 21, I would like to emphasise how we continue smoothing our maturity profile, so in 2014 and 2015 debt maturities are slightly above €5bn per year. We are also increasing our average debt life to close to 7 years, more than half year longer than in December 2012. All contributing to an outstanding liquidity cushion.

Telefónica's extended and diversified financing activity year-to-date has been an important pillar in reinforcing our financial flexibility. We have raised in excess of €10 billion including hybrids.

Again, this quarter, I would like to point out that effective interest cost continued its downward progress within the bottom of guided range, 18 basis points below December 2012.

Conclusion

To conclude, let me highlight that in the third quarter we have delivered solid financial and operating performance, meeting full year targets in advance.

We continued recovering growth, with organic revenues accelerating and flowing directly to OIBDA stabilisation.

FCF posted a strong performance along the year and is stable year-on-year before spectrum acquisitions despite the currencies volatility.

We are strongly reinforcing the quality of our balance sheet, progressing in our deleverage priority.

Moreover, by actively managing our portfolio we are improving our financial flexibility while enhancing our growth potential at the same time.

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

Q&A session

Singh Mandeep - *Redburn Partners*

My question is actually on Telecom Italia. I have got two questions on Telecom Italia.

The first one is in terms of the mandatory convert. Can you confirm what the Telecom Italia management said last night that you participated in the transaction and, therefore, you increased your exposure to Telecom Italia? That is the first question.

And the second question is: Can you sort of give us a bit more colour on your medium-term intentions regarding your TI position? Thank you.

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

Thank you for the questions. This is Angel Vilá. Yes, we participated last night in the mandatory convertible issued by Telecom Italia. We are indirectly the largest individual shareholder of TI and we decided to express our support to the new plan issued by Mr. Patuano and his team.

The amount that we invested in the mandatory convertible was EUR 103 million that allows us to mitigate dilution of our indirect stake. And for this, a waiver was granted by our Telco partners just for this specific purpose.

With regard to our intentions in Telecom Italia, and as we said in our previous conference call, we believe that it was important to provide stability to the Company with Telco as a reference shareholder and that is why we reached an agreement to recapitalize Telco.

Being indirectly the largest shareholder in Telecom Italia, we are the most interested in the Company's value creation, so our final goal as the largest individual shareholder is to support the management, to unlock TI's value potential. Yesterday, TI top management defined a new strategy which is in the right direction in terms of strengthening the domestic business and investing more in broadband in Italy. Also, there are actions to delever and regain financial flexibility and we believe that this plan, as I was saying, is in the right direction and we decided to show our support to it by participating in the mandatory convertible.

Luis Prota - *Morgan Stanley*

Yes, hello. Two questions, please. First, is on Brazil.

When should we expect investment for growth to slow down in that country and maybe margins to pick-up again? Or in other words, do you still see growth opportunities in that market going into 2014, which part of those growth opportunities, and should we expect top-line acceleration going into next year?

And the second question on Spain. With the big tariff cuts that we saw in the fourth quarter 2011 and then launching "Fusión" in the fourth quarter 2012 and with customers progressively migrating to the new tariffs, should we expect a big delta in terms of year-on-year growth in the fourth-quarter revenues in Spain thanks to an easier comparisons in terms of average pricing?

And you were mentioning in the presentation some positive evolution in KPIs thanks to the new tariffs launch in September. Can you elaborate a bit more on what are you seeing there? Thank you.

Santiago Fernández Valbuena - *Telefónica S.A. - CEO Telefónica Latinoamérica*

Hi Luis, this is Santiago. On the Brazilian question, two observations. One is that we manage Brazil for growth and transformation. Growth in the better part of the mobile world where we are making, we think, good progress; our margins ought to be stabilizing at a very sensible and healthy level going forward.

And the transformational part comes from the transformation of the fixed line in which we have longer period, longer duration investments that are being made especially in fiber that are going to be slower to bear fruit but that we think will eventually prove for themselves to be the right things. So we will continue to invest in the Brazilian business in 2014, although the final numbers have not been put together yet, because we do perceive that there is a lot of value in transforming the prepaid onto the postpaid base and accessing the data opportunity as we have been doing this year.

Eva Castillo - *CEO Telefónica Europe*

Thank you for your question, Luis. I think that with regards to how we've seen the offer, the market now is moving towards increasing the value of the offer, so what we call value for money. And price repositioning is actually expected to be less intense and we are seeing that already from September.

I think that when you ask about the repositioning we believe it is pretty much done and we are not seeing any new repositioning. In fact, we have seen very much stability in that and I have a lot of details I could give you off the line.

Regarding the new commercial portfolio, as you know, we have focused a lot on two items. One, the convergent offer and the second one in the mobile-only offering.

In convergent arena, including 4G in all "Fusión" products, including TV Mini, all "Fusión" fiber bundles, and increasing mobile minutes allowance in the band, that is already showing an increase in the take-up. Especially when you look at the fiber, which is not only since September doing really well, but just to anticipate that we have had record fiber net adds in October.

When you look at mobile-only space, we believe we have completed the portfolio with the Movistar 20. As you know, it is also getting 4G. Including 4G also in the Movistar Total, the EUR35 offer, and removing the mobile commitment in all the new and existing customers and also the SIM lock.

Another thing that might be interesting for you is we have improved the handset financing program, so we don't have any financial cost to customers and we have a better pricing.

With regards to trends, we believe revenue trends are to continue into the fourth quarter. And we have seen, as in previous quarters, the positive impact of the loyalty program already facing off and in the third quarter the impact is smaller than in previous quarters and this impact probably will be diluted, as we already stated, when we start the comparing on like-for-like basis.

I hope I covered all the questions.

Fabián Lares - *JB Capital Markets*

Good afternoon. Thank you for taking my questions.

With regards to the "Fusión" evolution in Spain, I would like to know a little bit more with regards to what the tendency has been with clients demanding, if any, the offering more in between; if there is demand for this, and if you are thinking about doing something about this, given that you are positioned both in the 10 Mb range in ADSL and in the fibre to the home 100 Mb range? That would be my first question.

With regards to the deployment of fibre to the home in Spain, I see that you are maintaining your target for 2015 of 8 million homes. Are you in any way considering that this target could fall short if the dynamics or the costs should change, or if in the review by the CNMC new obligations are made on fibre access?

Eva Castillo - *CEO Telefonica Europe*

Thank you very much. Let me start with the first question, and I think you know what the evolution of "Fusión" has been so far; it continues being the pillar of our offering here in Spain. We have reached the expected levels of total customers with 2.6 million at the end of September and also we have seen, as Angel and Pablo mentioned earlier, that we have the right mix with regards to the new up-selling customers in the gross adds.

When you ask me specifically about "Fusión" Mini, the lower-end of our offer, we have seen limited impact. At the moment we have more than 66% of our convergent gross adds opting for the standard "Fusión" product. Or if you look at the customer base, 10% would be "Fusión Mini" and the rest would be at 90%.

Again, I would highlight, like I would always continue to highlight, that the fibre continues to show strong commercial traction and we expect to accelerate deployment into the fourth quarter. We believe there is a strong upside potential at the moment. We have around 12% of Fusion customers in fibre bundles, so you can see what the potential upside is.

I pointed out that the third quarter had strong adds, net adds of 63,000 versus 59,000 in the second quarter and anticipated that October had record fibre net adds.

I think that in terms of the fibre plan, we have committed greatly to our established 8 million households by 2015, and always we are happy to evaluate based on the take-up and the regulation situation. We believe we are on track and doing quite well there.

Akhil Dattani - *JPMorgan*

Good afternoon. Can I ask two questions, please?

Firstly, on Spanish mobile: If you look at the CMT data that has been provided over the last year we seem to have seen quite a strong improvement in the net add momentum. The market was losing about 300,000 customers a month at the beginning of the year and now the market seems to be relatively stable. So, I am just quite keen to understand from you what you feel is driving that change and whether within that you think there is any signs that, either from this or any other metrics that you seem to be tracking, whether you feel that there are signs here that economic or customer spending behaviour is now starting to inflect?

And then, secondly, just in terms of the whole theme of consolidation: if I understand correctly a couple of quarters ago, the suggestion or the feeling from yourselves was that the Irish deal would close by year-end. So, I would be just keen to understand if you are surprised that the deal has gone to phase two and whether you see that having any significant implications. And from that, any other colour and commentary around when you expect the TEF Deutschland E-Plus review to be completed would be useful as well. Thanks.

Eva Castillo - *CEO Telefonica Europe*

So if I start with this first question; on the mobile trading environment the contract net adds are still a concern for us due to the number portability deterioration, which is a result of a strong competition in the quarter. But the Spanish market, as we are seeing it, is about convergence and we believe we have a strong position there.

With the launch of Movistar 20, we believe we have filled the gap at the medium level and now we address the customer needs with a complete and competitive portfolio, we believe. Additionally, as you know, we have enhanced our mobile-only portfolio and we are giving more value for the same price. We are seeing positive preliminary results in October and overall we believe we have a very complete offer there.

With regards to the macro environment that we are tracking very closely, we are seeing a very slight improvement in some of the macro parameters. To start seeing a positive impact on our business, we believe it is necessary that the disposable income shows a recovery trend that would foster the private consumption, which is so key for our sector.

We believe that the recovery consumption to the pre-crisis level will take much longer. And in the meantime what it is clear to us is that the Company is very well positioned, with the fibre and a very solid convergent offer, to capture the growth when those households start getting more consumption or they can improve in consumption levels. Hope this is answered.

José María Alvarez Pallete - *Telefónica S.A. - Chief Operating Officer*

Taking your second question on the consolidation and the Irish and the German transactions, we are not surprised that the Irish one went into phase two. That could happen.

This, as you know, is being headed by Hutchison Whampoa being the buyer. They have submitted the case. We think they have a solid case for approval because it really makes sense in the Irish market to consolidate based on the fact that the joint entity will have more financial power to invest more heavily and more rapidly and, therefore, to increase competition on that market.

And exactly the same case applies for the second one, for the German transaction that we are heading, as being the buyer, in the European Commission. Our case in Germany, I think, is very solid in terms of presenting a joint entity that is going to be a much stronger third player and therefore being able to compete more fiercely and more intensively with probably the best, or one of the best, mobile networks in Germany and therefore being much more competitive, namely on the SMEs and corporate markets.

So we are not surprised things are going on track. We keep having the same message: there is no room for so many players in Europe, therefore, consolidation makes sense. And I think now it is to the European Commission to rule and to finally clear these transactions when the time is convenient. So, everything is on track and

therefore, both transactions are going into the direction that was foreseen when structured.

Giovanni Montalti - *UBS*

Good afternoon. May I ask you if you have had discussions with the Brazilian regulator to assess the viability of your market consolidation there? Thank you.

Santiago Fernández Valbuena - *CEO Telefónica Latinoamérica*

There are no discussions going on at the official level. Everyone is using the spreadsheets and understanding what might happen there, but there are no official or unofficial open conversations about that. We can all make our assumptions. We certainly think it is not impossible that the market eventually consolidates, but there is no movement at this point in that direction.

Giovanni Montalti - *UBS*

Should you have a time horizon for such a scenario would you look for 2014, 2015? Do you think there is still a lot that has to happen before we can see a materialization of a consolidation in the market? Thank you.

Santiago Fernández Valbuena - *CEO Telefónica Latinoamérica*

We have no time horizon or anything like that. The rules are quite clear. The laws have been written and they could be changed, but certainly not by us. And that is not something we think is necessary for us to continue doing business the way we are.

So should conditions change we would have to adjust our behavior and so far we think that the rules are quite clear.

Justin Funnel – *Credit Suisse*

Three quick questions please. I think Jazztel was rest recently saying that it was encouraged by its experience with its fiber JV with Telefonica that it would like to do more than the original 3 million shared households. So, are you open to Jazztel extending the footprints given that you seem to actually be perfectly capable of going to 8 million on your own?

Secondly, obviously very successful at deleveraging and that starts to raise question marks on where you are heading over the next 12, 24 months. Do you want to continue to delever so fast, or could we start to think about dividends rising from the current level at some point? Is a dividend increase totally off the table?

And, thirdly, I think Mr. Alierta met with the President of Italy recently. I was wondering if there were any takeaways; does Telefonica feel welcome to proceed in Italy?

Eva Castillo - *CEO Telefónica Europe*

I start with the Spanish question. With regard to our current agreement, we are quite happy with it and we are happy with our commitment on initial 3 million. Obviously, if there is a need we will be happy to discuss.

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

Regarding debt reduction, deleveraging and dividend, we have already achieved our 2013 leverage target. We keep committed to continue in the direction of deleverage, while at the same time strengthening our operations and fostering growth. And as such, for instance, we have structured the E-Plus transaction in such a way that it would improve leverage metrics, while at the same time we are expanding and strengthening our position in Germany.

We don't have any urgency regarding execution of new deals for any deleverage. We have many opportunities to keep improving if that is the case. Regarding dividends, after we suspended it in 2012, we resumed shareholder remuneration. 2013 we have set a firm commitment of EURO.75 in cash. We already paid EURO.35; the second tranche is going to be paid in cash in the second quarter next year.

At this stage we are not announcing a new remuneration policy, because we prefer to be prudent. Our strategy is to keep an attractive shareholder remuneration and to have a reasonable level of debt. So, this future dividend will be announced when we do the full-year results presentation at the beginning of next year.

Regarding Italy, what I can say is that we have proven to be a loyal and stable shareholder of Telecom Italia. We believe that it was important, as I was saying before, to provide stability with Telco as a reference shareholder. We have shown our commitment by investing even in last night's mandatory convertible and we are supporting new management's plan, which is showing in very few weeks clear ideas and is showing execution.

And it has moves which we believe are in the right direction. So we are supportive of Telecom Italia and we feel that we have been a loyal shareholder in the company and we will continue to be.

Robin Bienenstock - *Bernstein*

Thanks very much, two questions if I may.

First, I'm just wondering if you can tell me, Brazil specifically, but Latin America more generally where I saw margin weakness, how much of that is being driven by increased commercial investment and how much of that is being driven by wage inflation. So, to what extent do I have to worry that you were actually suffering from the effects of inflation in Latin America?

Separately, are you worried at all that Telco could dissolve as early as June 2014 and do you think that would be a risk or a potential problem for you? Thanks.

Santiago Fernández Valbuena - *CEO Telefonía Latinoamérica*

Hi, Robin. This is Santiago.

If I understood your question correctly, you were asking about the breakdown of wage inflation and the other costs. I would say it is about 50/50, although it is very uneven depending on the country you are talking to.

The further you go into the more inflationary economies the more difficult it is to pass costs on to prices, but we are more than happy to entertain further details offline.

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

Regarding Telco, when we renegotiated agreement back in September none of the shareholders requested the demerger. We set up a window in June 2014 and then the

shareholder agreement expires in February 2015. We don't know what is the intention of the partners. My assumption, my personal assumption would be that they would rather look at February 2015 than June 2014.

Robin Bienenstock - *Bernstein*

And would it be a problem for you if they changed their minds?

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

No, I don't think it would be a problem.

Frederic Boulan - *Nomura*

Good afternoon. Two questions from me.

Firstly, on the UK, if you could explain the full-year benefits on the EBITDA of the change in handsets accounting. Handset revenues were up about EUR100 million in Q3 year-on-year; is this a good guide of the positive impact on EBITDA for this quarter and, therefore, suggesting a full-year run rate of EUR 400-500 million?

On cash, maybe we can ask the question the other way, looking at how much negative working cap we should expect for the UK business this year and next.

And, secondly, just on Venezuela, if you could just update us on how much cash you have there in Euros and just to confirm that you used the rate of VEF 8.5 per euro in this calculation? Thank you very much.

Eva Castillo - *CEO Telefónica Europe*

If I understood correctly, and I can explain our OIBDA performance in the UK and specifically because of "Refresh", is right now impacted by two important issues. Of course, the launch of "Refresh" and our commercial decisions to move volumes into the direct channels.

As you understood correctly, the "Refresh" proposition allows our customers to change their device whenever they want without penalty and enhance our competitiveness in the market. But that at the same time has an accounting impact for the full recognition of handset sales upfront instead of a monthly recognition into the MSR as part of the tariff.

Also, and at the same time, as we are moving more volumes to the direct channel you well pointed out that on one hand improved efficiency of our distribution model, but also the direct channels have higher upfront costs than the indirect. Going forward, and I think I said this in the previous quarter, we expect that the positive impact of "Refresh" will normalize and we will just see the impact of moving volumes to direct channels increasing efficiency of our distribution model.

Frederic Boulan - *Nomura*

And just to clarify, can you just confirm the numbers I mentioned, about EUR 400 million full-year? Is it a good mark?

Eva Castillo - *CEO Telefónica Europe*

I think that also regarding your question of the "Refresh" effect on the working capital, and as I said last quarter, we expect to factor the handset receivables as we have

done in other quarters. And the effect on revenues that we have disclosed goes down to the OIBDA levels as we also pointed out in the previous quarter. We will see higher upfront of direct volumes as we are moving more into the direct channels. I hope it is clear.

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

Regarding Venezuela, our cash position in Euros equivalent at the official exchange rate amounts to EUR 2.4 billion. This figure is not included, or has been excluded of the liquidity, figure that I previously presented on slide 21 of the presentation.

Frederic Boulan – *Nomura*

So is this included in your net debt number?

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

It is in the net debt number.

Georgios Ierodionou - *Citi*

Hello. I've got two questions please. The first one around Telco and I was wondering regarding the conversion of the Class C shares to voting shares, if I am not mistaken you have not yet asked Cade for approval. Is there a reason for that, and should we expect that will happen between now and January? And based on the conversations you had with them, would there be any problems for the status quo at Telco to continue after the conversion?

Then, secondly, on hybrids can you give us an idea of the capacity you have left to raise hybrids after the E-plus transaction, whether you would be looking at this option in case of acquisitions and if you would make any adjustments to your leverage ratios to reflect the use of these hybrids? Thank you.

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

With regards to Telco, we have not started the discussions with authorities regarding the potential conversion of the C shares, the non-voting shares into voting shares. We have just, as we announced in September, announced a transaction which has gradual steps and those gradual steps are at Telefonica's option, obviously subject to regulatory approvals. They are not an obligation.

And as we see fit and depending on the developments, we will be requesting the possibility to exercise such options. But I can confirm that as of now we have not entertained discussions with the authorities towards that conversion.

With respect to hybrids, we have issued this EUR 1.75 billion transaction as part of the financing of the E-Plus transaction. At the time of the transaction we announced that 50% to 65% of the financing of the transaction would be done via hybrids. We still have, therefore, around EUR 0.5 billion regarding this transaction that could be issued in other currencies potentially different from euro, and we are monitoring when would be the right market windows to go ahead.

Apart from this, we are not contemplating at this stage any other hybrid issuance for the time being.

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

Thank you, Georgios. Next question, please.

Will Milner – *Arete Research*

Thanks. I have got a couple of questions. Firstly, on the OIBDA and free cash flow composition.

I think in the quarter you quoted 50% organic OIBDA growth from Venezuela and 25% in Argentina, and every quarter I guess it seems as though those two operations contribute more and more to your quoted organic trends. I'm just in that context wouldn't mind understanding how much cash you have been able to repatriate from those two markets over the last 12 months. I know Venezuela I think is zero, but I would like to get a view on both of those.

And then, secondly, internally do you consider those cash flows when you strike the dividend that you have struck?

Then the second question is just a bit on Mexico. AMX obviously called out economic weakness in that market and I wonder if you could give us your thoughts on the outlook in Mexico and the prospects to returning to OIBDA growth there? Thanks.

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

This is Angel Vilá. Regarding the first question we have not repatriated money from Venezuela or Argentina, so far this year. Repatriations from Latin America in the nine months have amounted to EUR 757 million, up from EUR 677 million last year. And for the full-year repatriations we are aiming over EUR 2 billion, in line with last year.

When we analyze the coverage of our dividend we do not need the free cash flow from Argentina or Venezuela to be able to pay such a dividend.

Santiago Fernández Valbuena - *Telefónica S.A. - CEO Telefónica Latinoamérica*

This is Santiago. On the Mexican outlook it is true that the market is a bit weaker than it was. Not substantial, but a bit weaker. We do not attribute toward market weakness the numbers that we have. We are continually repricing our prepaid base. We are not done yet, but we will in the next five to six months I hope.

We are all expecting the details of the constitutional reform that has now become a secondary law, and this is going to be substantial for the future developments of the Mexican market and we do expect to make significant progress in the wholesale market over the next couple of months. I think all these three things together should make us be hopeful that we will return to positive growth sometime next year.

James Ratzer - *New Street Research*

I had two questions, please. The first one was just going back to the question earlier on the UK business. I was wondering if you could give us just two specific numbers please. In the Q2 presentation you said that the margin uplift from the new commercial model was 2.3 percentage points in Q2. Can you please just give us the number that that is for Q3? And, secondly, you also reference in your documentation a one-off in Q3 last year, a positive of the court appeal ruling. Could you quantify how much that was please?

Then, secondly, I just had a quick question on China Unicom. I mean it is a small investment you made recently; you kind of increased your stake. I was wondering if you could just explain the rationale for that transaction, and if that is still a core holding? Thank you.

Eva Castillo - *CEO Telefonica Europe*

Thank you, James. I think that continuing with the question earlier to confirm that the effect on revenues that we have disclosed goes down into OIBDA. And that obviously we need to consider the higher upfront cost coming from the direct volumes.

James Ratzer - *New Street Research*

But so the 2.3 percentage points in margin in Q2 that you quoted, do you have that in Q3, please?

Eva Castillo - *CEO Telefonica Europe*

I think there is a combination of the two effects and, as you can imagine, there are maybe moving parts in this moment so I cannot disclose that number now.

James Ratzer - *New Street Research*

Okay. Did you have the court of appeal ruling from Q3 last year, please?

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

Hi, James; this is Pablo. We will give you this later on, on the telephone. Thank you.

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

Regarding China Unicom, in September we increased from 4.99% to 5.02%. The rationale is that we were diluted involuntarily due to the issuance of new share capital of China Unicom due to conversion of some convertible securities. So we were just readjusting to the previous situation.

And then, on November 4th our percentage has decreased to 5.01% due to a new exercise of options. For us, and looking at potential future scenarios, to hold more than 5% would have better tax treatments than if we were to be below 5%.

Jonathan Dann - *Barclays Capital*

Hi, there, it is a question around bit stream regulation in Spain. Could you just explain what is happening? I think there is something going on with Digital Plus as well. And also, I am slightly confused about how the deal with Yoigo operates. And then a second question; has anything moved on renegotiating debt in Colombia? Thank you.

Eva Castillo - *CEO Telefonica Europe*

Well, with regards to Yoigo, if I may start, the program goes in four parts and I don't know if you want me to expand a lot. But first of all, we have an LTE rollout and this is purely a shared radio access over Yoigo's LTE network on the 1800 with the national roaming agreement until Telefonica deploys its own network which, by the way, we are deploying. As you know, we also have a wholesale agreement with them on the renewal of the current national roaming agreement until 2016. We have a retail agreement to commercialize "Fusión" through Yoigo and Yoigo distribution channels, and we have also a portion of tower sales. That is functioning well, and we believe

that if you refer to the claim of two of our competitors, the regulator had the way to open procedure. That is what they've done at the beginning of the week, and this would take probably a year, and we will explain to the regulator why this is a commercial agreement that makes sense for customers.

With regards to the current regulatory framework: that regulatory framework is providing, for fiber specifically, that for speeds above 30 Mb Telefónica competitors have to deploy their own infrastructure, which had established the asymmetric obligations of civil infrastructure access, and sharing symmetrical fiber verticals in buildings.

So, the opening of ducts guarantees the availability of any investor to undertake new project. Then, and according to market trends and the outcome of the inquiry to the market, Telefónica expects that the CNMC will confirm the limits of the current offers.

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

Regarding Colombia's debt, the big transaction that led to debt reduction took place last year when we combined the fixed and the mobile activities and some of the liability was reduced. We continue to see, as I said before in the presentation, very good growth in the Company and we continue holding talks with the partner, the Colombian government, to see what's the best way to capitalize and exploit that growth and potentially provide them some liquidity, but those talks are ongoing and there is no progress to report and when there would be, we would report that.

James McKenzie- *Fidentiis*.

Got a couple of questions on Spain, if I may. Firstly, just looking at churn; I wonder if you can give us any qualities they are feeling as to where churn on your Fusion product is. Is it below the 1.5% that you are reporting on fiber or is it closer to the 1.8% on contract mobile? And its tendency, if it is going up or if it is going down.

Then just looking on your cost base in Spain I see that subcontract costs continue to fall very sharply. Now we have now lapped the elimination of subsidies and I was wondering, one, what exactly is driving this in the third quarter alone, and are we going to continue to see big year-on-year quarterly reductions going forward?

Eva Castillo - *CEO Telefónica Europe*

Thank you, James. With regards to your first question, yes, the churn is way below those levels. And with regards to the anniversary of Fusion we are not seeing any issues at all.

With regards to the second question, I think that what we can say is that the OIBDA margin will be maintained high on the back of the continue effort and the cost discipline that you know that we are able to do in the operation, although we expect it to be impacted by higher trading activity and some more commercial push into the fourth quarter.

The sustainability of the margin going forward, actually I can give you many more of the measures that we are going to take and some of the benefits, but we continue doing simplification of call centers. We already have 64% of traffic in in-source and more than 70% of positions are already transferred to the regions.

But that we are optimizing the distribution model. We are focusing a lot in there and we continue doing in-sourcing in new capabilities.

Ivón Leal - *BBVA Research*

Good afternoon, everybody. Two very quick clarifications on Spain actually. I think you have said that you have seen success on the mobile-only Movistar 20 tariff. I don't know if you are also being successful on attaching more than two SIMs per Fusion contract.

The second one is on the loyalty programs you mentioned, I think you mentioned the impact on your growth is ending on the fourth quarter of this year or reducing. Am I right to say that reduction of that impact is going to have a negative effect on year-on-year revenue growth?

Eva Castillo - *CEO Telefónica Europe*

First of all, to confirm that what we call "Fusionitos", or those additional lines, are now 1 million and the trend continued being a positive into the fourth quarter. So what we are seeing is correct and you see that.

With regards to the loyalty, I think that there is two issues we need to take into account. First of all, and we said this in the previous quarter, the positive impact of the loyalty program is fading off. The third-quarter impact is smaller than in previous quarters and we believe also that this impact will be dilutive as we start comparing a more like-for-like basis.

We are preparing, as you well mentioned, the launch of new loyalty program, which is called "Por ser Movistar" with lots of benefits for our customers which we have a positive effect in customer satisfaction and churn evolution going forward. So we believe that to be positive.

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

Thank you very much, ladies and gentlemen, for your participation and we certainly do hope we have provided some useful insights for you. Should you still have further questions, we kindly ask you to contact our Investor Relations department. Good afternoon.