



# **Telefónica January-September 2014 Results Conference Call Transcript**

**12<sup>th</sup> November, 2014**

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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 and welcome to Telefónica's conference call to discuss January-September 2014 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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We encourage you to review our publicly available disclosure documents filed with the relevant securities market regulators. If you don't have a copy of the relevant press releases and the slides, please contact Telefónica's Investor Relations team in Madrid by dialling the following telephone number, +34-91-482-8700.

Now let me turn the call to over our Chief Financial & Corporate Development Officer, Mr. Ángel Vilá, who will be leading this conference call.

## Presentation

### Key points for the third quarter

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

Thank you Pablo. Good afternoon and welcome to Telefónica's third quarter 2014 results conference call. Today with me is José María Álvarez-Pallete, Chief Operating Officer, so during the Q&A session you will have the opportunity to address to us any questions you may have.

Telefónica published a consistent and solid set of results, reflecting further progress in our transformation strategy.

We are particularly pleased with the very strong commercial activity recorded during the quarter, with a significant boost in key growth levers and record net adds in smartphones and fiber customers.

We kept improving our top line performance, after accelerating organic growth to 2.8% in Q3 driven by enhanced trends in most of our operations. This evolution underpinned OIBDA evolution, which returned to growth in the quarter and resulted in sequential margin expansion.

CapEx maintained its upward trend over the January to September period, speeding-up network modernisation, evolving towards a full IP Company and driving access growth that will translate in future revenue expansion.

We continued to deliver a sound cash flow generation of almost 3 billion euros up to September, which kept strengthening the balance sheet. Net debt stood at €41.2Bn at the end of September. Let me note that the E-Plus acquisition will be impacting net debt level and financials in the next quarter, as it was closed on October, 1st.

In addition, we have reinforced our competitive edge in main markets through value enhancing deals. The recently closed German transaction is the best example and we are in the process towards closing the acquisition of GVT, expected for the first half of 2015.

Finally, we fully confirm our operating goals for 2014 and our dividend commitment.

**Financial highlights**

Let me summarise key financials on slide 3.

In organic terms, revenue growth improved to 2.8% in July-September period and 1.9% in January to September to 38 billion euros. OIBDA amounted to 12.3 billion euros, stable vs. the first nine months of 2013, reflecting the 0.8% growth posted in the third quarter. OIBDA margin stood at 32.5% up to September and 32.8% in the quarter, both posting a limited year-on-year erosion.

Net income totaled 2.8 billion euros and EPS reached 0.61 euros per share in the January to September period.

Reported year-on-year change reflected the negative FX impact and changes in the perimeter of consolidation. In the third quarter, FX headwinds softened, particularly in Brazil, dragging 6.0 p.p. to OIBDA year-on-year variation, while the deconsolidation of Ireland since the 1st of July increased the negative contribution of perimeter to 4.5 p.p.

Finally, net debt declined to 41.2 billion euros, -11% year-on-year, not including yet the payment for the E-Plus transaction, to be recorded in the fourth quarter, nor the already executed divestments of 2.5% stake in China Unicom and the remaining 5% of O2 Czech Republic.

**Stepping-up investments already fostering high value growth**

Turning to slide number 4, increased investments are fostering growth in the high value customer base capitalised on a right pricing strategy, customer insight and competitive tariffs. All these should contribute to improve customer retention, making the whole model more sustainable.

Commercial momentum remained high during the third quarter and translated in the following data points: smartphones net adds reached 8.5 million, doubling vs. last year and 1.6 times vs. the prior quarter while fiber net adds further ramped-up to almost 300 thousand, 1.8 times year-on-year and 1.3 times quarter-on-quarter.

Pay TV continued gathering momentum and quarterly net adds surpassed 450 thousand, up fourfold year-on-year boosting accesses growth to 41% year-on-year. LTE further advanced, reaching 54% coverage in Europe while in Latin America it is available in 8 countries, being a key driver for data monetisation.

**Q3 improvement across the board (% and absolute)**

On slide 5, we are particularly pleased with the improvement posted across the board in the third quarter, both in absolute levels and relative change vs. previous year.

Organic revenue growth picked-up in the third quarter to 2.8%, 150 basis points more than in the second quarter. This acceleration is based on increased growth rates in Telefónica Hispanoamérica, mobile data, digital services and lower declines in Spain and Germany.

Therefore, we keep improving our revenue mix towards a data & digital Company.

Organic OIBDA growth ramped-up also 150 basis points sequentially to 0.8%, supported by our continuous focus on efficiencies and strict cost control amid intensified commercial investments, network & IT costs. This performance led to a stabilisation in YTD organic trend and to a limited margin erosion of 0.5 p.p. vs. the same period of last year.

**TGR: Strengthening differentiation**

Please turn to slide 6 for a fast review on how we are enhancing our network and IT capabilities.

Telefónica Global Resources contributed with the rapid rollout of LTE and fiber, key tools to capture market growth. At the end of September, 12.5 million premises were passed with fiber, approximately 2x higher year-on-year and we had more than 16,500 LTE sites in service, 2.5x from a year earlier. Let me also highlight that more than 80% of 3G and/or 4G mobile sites are already connected with UBB technology. We continue advancing in network development as demonstrated by the launch of LTE-A in Spain while the network in Germany is already prepared for VoLTE.

In IT, we are delivering results on simplification. Year to date, we decommissioned approximately 300 applications and reduced by 10% the number of physical servers, meeting in advance the targets set by the end of the year. Additionally, we continue working on consolidating data center services and virtualisation of IT.

### **Digital Services: Enriching our digital solutions portfolio**

Turning to slide number 7, let me go through the evolution of Digital services.

In the Consumer segment, Video continued to accelerate one more quarter, with a revenue growth rate of 24% year-on-year. The new agreement signed with Samsung in Spain is contributing to further reinforce service capabilities.

Regarding Financial Services, I would like to point out the launch of “Yaap Money” in Spain, a new mobile person-to-person money transfer app, and the nationwide spread of “Movistar Dinero Móvil” in Peru.

In the global device management the focus continued to be on the smartphone adoption, with a clear spotlight on LTE, with already 72% of total Q3 shipments being smartphones and 30% being LTE enabled devices.

Additionally, in the B2B segment, M2M showed a solid performance with revenues up 44% vs. January-September 2013, on solid access trend and Cloud revenue accelerated its revenue growth up to 31%.

Finally, in the Information Security area, the Company continued to improve the value of its products and services, with the launch of “Sinfonier” and with sales reaching a 42% increase year-on-year.

### **Spain: Gaining momentum on differential quality**

Moving to slide number 8, let me highlight the progress made in Telefónica España, where we continued to lead the market on quality differentiation.

Commercial momentum accelerated in the quarter despite summer seasonality. This operational strength, is based on our differential infrastructure and superior value proposition, and has allowed us to increase or stabilise the customer base of high-value services year-on-year, a remarkable goal that will underpin revenue going forward. As such, compared to September 13, Pay TV customers are 2.6x higher, fiber customers are 2.2x more, and mobile contract just decline 1%.

Meanwhile, “Movistar Fusión TV” continued to lead the convergent market growth and to increase the value of our customer base. Churn kept improving and the customer mix continued to evolve towards higher value packages, as a result of an increase uptake of high-end bundles. As a result, “Fusión” ARPU is increasing, up 1.2% sequentially from Q2 to Q3, reaching 70 euros.

Let me stress, that we remain committed to further enhancing our long term competitive advantage, mainly UBB coverage, reaching 8.8 million premises passed with fiber by the end of September, doubling last year figure.

**Spain: Top line improvement acceleration**

In terms of financials, let me underline that Q3 revenue posted a sequential improvement in its year-on-year trend to -6.6%, easing 2.5 p.p. quarter-on-quarter and halving its drop in the last three quarters.

This performance is mainly driven by the customer base stabilisation and the lower backbook impact, as a large proportion of the customer base is already convergent, with "Fusión" ARPU increasing.

Regarding profitability, Telefónica España delivered a healthy Q3 OIBDA margin of 46.0%, improving 1.2 percentage points from previous quarter. The main reason for OIBDA decline remains being revenue erosion. This is why in the current market context we have prioritised revenue stabilization.

Hence, we can say that that our plan to turn back Spain to revenue growth remains in place, and in the coming quarters should gradually reflect the benefits of "Fusión" ARPU increase, sustained trading momentum and market consolidation.

**UK: Outperforming the market & improving trends**

Turning now to slide 10, Telefónica UK posted strong customer growth, outperforming the market, with total customer base reaching 24 million at the end of September. Quarterly net adds were consistent and strong vs. prior quarter, with record market leading contract churn at 1%.

The strong commercial momentum was complemented by improving ARPU trends supported by:

Pricing stabilisation and data monetisation, leveraged on the increasing data usage of LTE customers, 2 times vs. non-LTE and high single digit ARPU uplift.

As a result, revenue and mobile service revenues performance continued to improve in the third quarter and grew 2.3% and 1.1% year-on-year respectively, excluding the impact of "O2 Refresh".

As a result, Q3 OIBDA expanded 2.7% year-on-year, affected by a positive non-recurrent impact of 34 million euros mostly due to the final settlement related to the disposal of the consumer fixed business assets in 2013.

**Germany: Keeping momentum; E-Plus deal closed**

To review Telefónica Deutschland, please turn to slide 11.

In a dynamic market, we posted very solid momentum in the third quarter, with contract gross adds growing by 30% year-on-year, leading to contract net additions 3 times higher vs. previous year. LTE is gaining traction, with close to 90% of shipments being 4G enabled and usage 3 times higher vs. non-LTE smartphones, demonstrating that there is strong demand for data in the market.

Revenue largely stabilised year-on-year in Q3, with a limited decline of 0.5% after posting a consistent turnaround throughout the year. This improvement is the result of better mobile service revenue trends, driven by data, and strong handset sales following the launch of new high-end devices.

Increased commercial efforts to support better trading momentum, initial restructuring costs associated with the integration of E-Plus and non-recurrent transaction costs pressured profitability.

Lastly, I would like to remark the closing of the E-Plus transaction on October 1st. As such, the fourth quarter results will incorporate the consolidated New Company figures.

**Brazil: Strengthening position in value segments**

In Brazil, turning to slide number 12, we continue strengthening our position in the most valuable segments, capturing for 6th consecutive quarter more than 1 million contract net adds and accelerating the adoption of data services.

As such, quarterly smartphone net adds reached a record-high, with almost 6m new data plans, outperforming the rest of the market and boosting data ARPU, that already represents 37% of total ARPU. At the same time, we kept pushing differentiation by expanding our 4G network, which is leading the market.

In the fixed business, we continued accelerating our transformation into a fiber Company, reaching 3.4 million premises passed and 322 thousand accesses as of September. At the same time, we are strengthening our position as a video player, with growing net adds of 40 thousand in the third quarter.

**Brazil: Growth acceleration in revenue and OIBDA**

Financial performance is shown on slide 13.

Outstanding commercial activity posted in the last quarters explained the consistent revenue growth trends, with positive contribution of both mobile and fixed businesses. The latest is growing for the first time in 7 quarters when regulation is excluded.

Let me highlight that this steady revenue growth in mobile implies that we have captured 68% of incremental MSR market share in the last 12 months.

And on top of that, ongoing efficiency efforts, are leading to a year-on-year cost reduction of 0.2% in the third quarter, despite higher commercial costs, and results in an acceleration of OIBDA growth for the 2nd consecutive quarter, to more than 5% in Q3, with a margin expansion of 1.2 p.p. year-on-year.

**Hispan: OIBDA +17.8% y-o-y, ex-Venezuela**

In slide number 14 let me highlight the strong growth posted in Q3 by Telefónica Hispanoamérica.

Commercial momentum, with levels of mobile gross adds above 11 million and increasing weight of smartphones, is driving a consistent double digit revenue growth.

This performance is leveraged on the growing contribution of data revenues, already accounting for almost 1/3 of mobile service revenue, fostered by non-SMS data, up 48% y-o-y in Q3.

On top of all of this, let me highlight the increased profitability across the board in Q3, and particularly in non-inflationary economies like Mexico, Colombia and Peru. As such, when Venezuela is excluded, OIBDA ramped-up y-o-y to 17.8% and OIBDA margin expanded by 2.2 p.p.

**Mexico: Quality assets & new regulation boosting growth**

Turning to slide number 15, let me go through the progress achieved in Mexico.

The combined benefits of our quality assets and the new pro-competition regulation are driving a significant improvement on operational and financial metrics.

Firstly, gross adds year-to-date are consistently higher versus previous years, growing by 45% when compared with the 9-months period of 2013 and 63% with the same period in 2012.

Secondly, revenue is steadily accelerating and mobile service revenues grew by 12.6% year-on-year, the highest growth in more than 4 years.

And finally, Q3 OIBDA rose by 50.6% year-on-year, showing the effects of the new regulatory framework and the economies of scale we are achieving as a result of the strengthened commercial positioning.

**Rest of Hispam: Steady growth across the board**

In the rest of Telefónica Hispanoamérica, on slide number 16, steady growth is the main reference across the board.

Specifically let me highlight the sound Q3 OIBDA year-on-year acceleration in Peru, growing by 17.4%, and Colombia by 25.3% on very solid revenue growth. Margin in Colombia expanded by 5.6 percentage points year-on-year.

In Chile, regulatory changes continued to drag revenue and OIBDA performance, but profitability, as in the case of Argentina, also improved year-on-year.

In Central America & Venezuela, OIBDA year-on-year growth deceleration is explained by the highest net adds of last 4 quarters and the effects of the inflation on costs.

**Net debt stable YTD despite E-plus payment & FX impact**

Let me now move to the financial side, on slide 17.

Net debt as of September, 30th stood at €41.2Bn, with a leverage ratio of 2.39x. This figure would stand at €44.9Bn or 2.52x including post-closing events, mainly the payment for the E-Plus acquisition, the sale of 2.5% on China Unicom and the already completed sale of our remaining 5% stake in O2 Czech Republic.

Leverage is negatively affected by the FX impact on OIBDA which has started to ease in the quarter. We are mindful on the need of executing further measures, such as the scrip dividend and other inorganic actions. We expect to continue progressing towards the €43Bn net debt target.

**Smooth maturity profile on long-term financing**

Slide 18 highlights our diversified €14Bn funding exercise in the year, with a more active role on the equity markets in the third quarter as we have raised €2.25Bn through the issuance of a Mandatory Exchangeable bond into Telecom Italia shares and a Mandatory Convertible bond into Telefónica shares, and we have executed the capital increase at Telefónica Deutschland for the E-Plus acquisition, reinforcing our capital structure while raising €0.8Bn from equity investors.

This funding has allowed us to keep a very ample liquidity cushion, above €18Bn even after paying for E-Plus. This has been complemented in October with the issuance of an €800m bond, with 15 year maturity and only 2.93% coupon, the lowest ever achieved by Telefónica for maturities longer than 10 years.

The average cost of debt has increased to 5.73% as we have kept an average amount of cash in euros higher than in the previous year, in anticipation of the E-Plus payment, and the relative weight of the debt in Latin American currencies has increased, following the amortisation of debt in euros and Czech korunas. Though this effect will persist in the future, it will be partially offset by savings from floating debt in euros.

**Summary**

To recap,

The successful execution of our transformation strategy is creating growth momentum into 2015.

We delivered solid customer base growth, focused on high value, enhancing the customers' lifetime value and building a more sustainable model.

Revenue growth accelerated in the third quarter; improving the top line profile and enhancing profitability. OIBDA returned to growth in the third quarter and margin expanded vs. Q2 thanks to Telefónica España, Mexico, Peru and Colombia.

Our balance sheet remained strong, reducing net debt YTD even after E-Plus payment.

We reinforced our CapEx effort, speeding-up network modernisation towards an all IP Company and driving access growth that will translate in additional revenue opportunities driven by further differentiation.

Finally, we are actively participating in the consolidation of two of our main markets, Germany and Brazil.

Thank you very much for your attention. And now we are ready to take your questions.

### **Q&A session**

#### **Georgios Ierodionou - Citi**

Yes, good afternoon and thank you for taking the questions. I have two, both financial related.

The first one is around your capacity to issue hybrids. I remember in one of the previous conference calls you mentioned around €7.5 billion as being more or less your capacity for hybrids. There was a report yesterday by one of the major rating agencies suggesting that could be as high as around €13 billion. So I just wanted to get a clarification whether you do have more capacity than the €7 billion we had in mind and whether you're planning to use it at some point.

And my second question is around E-Plus. It's commendable that you have stricter EBITDA recognition than some of your peers but I just wanted to understand once you've seen that there was actually a lower EBITDA and cash flow generation than perhaps was expected last year out of this asset, why you chose not to renegotiate the price and whether that means you see more revenue upside or other types of synergies that maybe haven't been identified? And if you could at all comment on GVT and whether there could be some kind of adjustment we need to make on the numbers for GVT also. Thank you.

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

Hi Georgios. On your questions regarding hybrids we have outstanding hybrids issued of €4.2 billion. Regarding the capacity to issue additional hybrids the treatment is slightly different between Moody's and S&P. We are taking the most prudent one, which corresponds to S&P, when we say that we have a limit of €7 billion despite Moody's report issued yesterday that indeed was getting closer to €13 billion. We have been using hybrids in order to support strategic decisions, such as M&A, acceleration on CapEx, and to protect from negative events such as devaluations like in Venezuela, and we would expect to continue using this type of instrument from time-to-time. And we may approach the market again in the near to mid-future.

With respect to the E-Plus accounting procedure, our colleagues in Germany have explained both in the roadshow and in the prospectus and in the several Q&A sessions, which is the nature of adjustment that we have done to convert what used to be E-Plus or potentially KPN's accounting policies to Telefónica policies. The different treatment has a clear impact at OIBDA level but does not affect at the free cash flow level, which in the end is what one would be looking at when thinking about valuation and therefore we decided that, given that the synergies case was there and that the cash flow generation was there, with a bigger customer base and therefore potential for increase revenue going forward, we decided not to renegotiate the price.

Regarding GVT we are not aware of any such type of adjustments that would be necessary to be made in the future and, as you were saying as we have seen in various deals, our accounting



principles seem to be prudent and potentially more conservative than some of our competitors, which we feel proud of.

**David Wright** – Bank of America Merrill Lynch

A couple of questions from me. First of all just on the Spanish ARPU, that's obviously a very strong number and is tending to stabilise, very encouraging. I think you said over, there was a comment about gross additions over €60 so could you give us any idea on how the ARPU should evolve into Q4? Would you be looking at something a little more stable? I notice your run rate of additions has stepped down now to sort of 170,000 or so, so clearly there is an ARPU short of premium you're now trying to collect. So should we be looking ARPU stabilisation in the next couple of quarters?

My second question is just a little more on the UK, we had Vodafone announcing yesterday its ambitions to launch a fixed product, I'm sure as a pre-emptive move against BT. You obviously still stand as a mobile-only operator having divested your fixed assets, so are you feeling exposed given Vodafone and EE are now both out there with a fixed product? Could that be even prompt you to consider an M&A exit or even trying to consolidate the market for more scale? Thank you.

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

Thanks for your questions. Regarding Spain, in Fusión we have seen a slight ARPU increase during the quarter, namely coming from two major factors. First, the gross adds, the new or upselling customers keep growing. Now they account for 78% of total gross adds; and 67% of gross adds on packs equal or above €60, which means that with the existing commercial trends we are seeing a move towards not the basic product and therefore some movement for accretion, a slight accretion compared to the second quarter. It is also important to note that churn has also stabilised in the neighbourhood of 1% on the Fusión customers and therefore the lifetime for a customer on Fusión is more than two times of the ones on fixed broadband and more than two-and-a-half times of a pure mobile contract. The underlying commercial trends of Fusión, even with a slightly lower net adds that in the previous quarter, are growing to the direction of a slight ARPU uplift. Considering that Fusión is roughly now more than 50% of residential revenues and residential revenues are 50% of total Telefónica España revenue, this is a very sound anchoring factor for revenue stabilisation in Spain.

We are also accelerating as you know fiber deployment and LTE coverage and, therefore, with the new data packages that we are putting and the revised pure mobile offer are also helping to stabilise or to improve the trends of pure mobile ARPU. Therefore, from both sides we are seeing better trends in the underlying revenues of Spain and that explains the year-on-year improvement or the decrease in the rate of decrease.

So for the fourth quarter and according to the figures that we have for October it looks like it is going to the right direction. We have also very sound move in terms of the TV commercial effort, even though we would like to accelerate even further, it is going well. Therefore, all the elements that need to be in place for a further ARPU uplift on Fusión or on the pure independent offers, which is namely data monetisation through the video offer and more data bundles and more data packages are going into the right direction, both in wireline and in wireless.

And on the UK, convergence in the UK will depend on several factors, one of them being the strategy that BT will take on its mobile launch, the aggressiveness that BT will take on their mobile launch and the kind of commercial offers that they will put on top of the table. We do not see today the UK as a strong convergent market and we anchor that statement into the fact that consumer's behaviour for the time being has shown limited interest on the converged proposition. Distribution of wireline and wireless has different market structure and there is already some quadruple play offers on the market like the one coming from Virgin and it has been showing limited traction. But as you said during your question, Vodafone and Everything Everywhere have moved into one direction, it looks like they're being prepared. In our opinion, this is just the anticipation of their potential launch of BT and we will monitor very closely the evolution.

**Luigi Minerva - HSBC**

First question is on Germany. The pricing momentum in the market seems positive. I know DT has refreshed their tariffs in September, cable has raised their access prices. I wanted to get your view on these pricing dynamics and whether you believe Drillisch has the ability to derail or disrupt these pricing dynamics on the back of the wholesale agreement with Telefónica Deutschland?

The second question is on Brazil, if you can elaborate to the extent possible when you say that you are actively pursuing consolidation opportunities?

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

On Germany, you are right, we are seeing a much better commercial momentum with more rational commercial approaches by the different players. We are also seeing some stabilisation on the increase of the ARPU uplift coming from LTE offers and also data volumes. Data traffic is also going to the right direction. So for us trading keeps positive in terms of momentum. The net adds were very sound because we have had this quarter three times more net adds than the same quarter of the previous year. It is true that we are also investing heavily on the market and this is impacting OIBDA.

We are also seeing positive performance in handset revenues after the launch of the iPhone 6. So overall, yes, we see a sounder commercial momentum in Germany overall for the whole of the sector and mainly for us.

In terms of the potential disruptive movements coming from Drillisch after our bit-stream access agreement with them, after the remedies agreed with the Commission. Remember that our agreement with Drillisch and agreed with the Commission, is a variable pricing which means that prices applied to Drillisch for the wholesale bit-stream access contract are going to be depending on technology and therefore the potential impact that this is going to have on potential tariffs down to the market is significantly more limited that if that agreement was to be at fixed prices.

So what we wanted to prove with the German transaction that 4 to 3 consolidation was doable in Europe without compromising data monetisation for the future. We think it is going to the right direction. From our standpoint we think that we all need to show a more rational behaviour in terms of data prices and that is what we intend to do to our brand new Telefónica Deutschland after their combination with E-Plus. So I think that you should not expect from us disruptive movements on that landscape.

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

Regarding Brazil, our focus is getting the approvals for the GVT transaction. We are in the process of having a very constructive dialogue with CADE on the technicalities of this transaction and its interaction with the Telco demerger transaction and we believe that this will be solved satisfactorily and we would expect to close GVT in the first half of 2015.

In the meanwhile we continue, as I said in the presentation, strengthening our position in Brazil in the value segments, leading in the mobile market, growing in fiber and video. We are accelerating growth both in revenue and OIBDA, so we are in a very good position and we expect to consolidate GVT and see the synergies flowing from the transaction.

Having said this and we have stated many times in the past that we are very strong believers in the benefit of the in-market mobile consolidation and when and if that happens we will be supportive of such a consolidation.

**Luigi Minerva - HSBC**

If I may follow-up, if there were something on the mobile side, would you play an active role or a passive one?

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

We have been actively participating in processes in our core markets so it would be our duty to explore actively any potential opportunity.

**Fabian Lares** - JB Capital Markets

Hi, good afternoon guys. Two questions please. With regards to the recent announcement in Mexico by AT&T that it was acquiring lusacell. I was wondering if you could give us your thoughts on what the possible impact is on the evolution of the Mexican market. In the third quarter results we saw some really positive evolution out of Mexico; would this be somehow undermined by the increased competition both from AT&T as a buyer of lusacell and the possible divestment by América Móvil of some of its assets to a newcomer? That's my first question.

And second, with regards to the statement made by Ángel with regards to the possible inorganic operations to reach below €43 billion net debt target, could you shed more light if possible as to what we should consider aside from the scrip dividend? Would you consider divesting the remainder in China Unicom, for example, despite your strategic alliance? Would that be undermined in some way, shape or form? Thanks.

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

Taking your first question about Mexico. First, let me focus a little in the first part of my answer on the operational trends. We've seen significant commercial traction, which is boosted by the effort that we have done on our own network in terms of deploying a better network and deploying also LTE. And that's why we've had a significant increase in gross adds, which have increased 45% in the first nine months of this year. We have significantly improved our portability figures with 94,000 in the third quarter and that has helped to boost revenue growth. Mobile service revenues are growing more than 12% and accelerating compared to the second quarter. Let me remind you that this is the highest growth that we have achieved since 2009 and this is almost independent of the regulatory changes which should start to affect, commercially speaking, from now on. This growth has been basically around the prepaid segment, with poor traction on post-paid which is our pending issue. And that has helped us to significantly improve our OIBDA evolution. OIBDA has increased 50% year-on-year.

I'm stating all of this because I wanted to make clear that the regulatory effects have not yet been flowing to our commercial traction. This is the effort that we were doing before the commercial regulatory changes and therefore before any structural changes in the market.

We believe that a consolidation of four to three players is always good for the market independently of who is going to be the third player or the second player, in this case being AT&T. We thought that lusacell at that price was not providing value for us and we would rather invest in our own platform, because we're showing significant traction. And therefore, we were scared of defocusing our team by doing an integration which was not providing clear value, compared to other examples that we have done in our footprint. So, we are not defocused by what is going on because commercially we're having more traction.

The regulatory changes for the first time provide a much more level-playing field. And therefore, I think that you should expect our trends in Mexico to keep going into this direction. And again, let me state that four to three consolidation would always be welcome and mainly with this new regulatory framework which should boost all the players to be much more rational and much more levelled in terms of commercial activity.

So overall, a much more positive outlook on the Mexican market than we had before, mainly due to our own efforts by turning around our own operations. And, we have significant expectations about the regulatory changes to further boost our performance.

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

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To complement, if I may, José María's answer, I would say also that the price agreed for the lusacell transaction clearly shows that our Mexican asset is undervalued in our sum-of-the-parts valuation.

Moving to your second question on debt reduction options, first, I would like to say that we envisage to continue working towards reducing debt. First, by free cash flow generation. That, as you've seen to September, has remained strong, close to €3 billion. Second, through financial measures. And here, the scrip dividend, we're expecting a significant acceptance on the share side as it's a voluntary scrip, and potentially, as I said before, issuing some hybrids in the near to mid-term. And third, through portfolio management. Our portfolio management has been very active and we have consistently been seeking to increase the value of our operations and improving our financial position. To demonstrate our commitment towards progressing in debt reduction, in the last weeks or even days we have sold our remaining stake in O2 Czech Republic and we have accelerated the payment of some of the pending amounts regarding services that we continue to provide to that Company, and we have sold a 2.5% in China Unicom. We reiterate our commitment to the alliance and we see opportunities to do more things in innovation and digital services with China Unicom. So, we would not envisage selling in the market additional shares, at least in the short-term. But we have several additional options to reduce debt and we are open, and we have proven that in the last quarters, to analysing strategic alternatives in several markets to generate value and improve our financial flexibility.

**Luis Prota** - Morgan Stanley

Hello, I have two questions, first on Spain on the competitive landscape; I wonder whether you have noticed already any change for the better in the market since the acquisition of ONO and Jazztel were announced, particularly in the mobile space helping the market performance and your evolution in this space in the third quarter?

Then on Venezuela, I don't know whether you have any updates on currency, whether there's any particular recent change from SICAD I to SICAD II, and if you could probably remind us how the rating agencies are treating your exposure to Venezuela? So what I'm trying to figure out is whether, if tomorrow you decide or you are forced to move to SICAD II, or the currency is floating in the market, whether that's a bit negative for rating agencies, or they are already treating this in a different way or taking that into account? Thank you.

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

Hi, Luis, José María here. Taking your question on Spain, the competitive landscape, we don't presume to see any major action coming from the recent consolidation of ONO into Vodafone, or potentially Jazztel into Orange.

But overall in the market we see pressure in prices slowing down during 2014 due to a very high convergent penetration by the main operators and if we were to project that through the consolidation processes that are already in place, it suggests that price stabilisation should at least be expected in the mid-term.

On top of that, as 4G is being deployed as we speak and all the players are trying to accelerate the use of 4G data by increasing the data allowances, you will see, in our opinion, another stabilisation of contract mobile with an increased data usage proposition. On top of that, subsidies have fallen deeply in the last two years after our first signal more than two years ago. All other players have gone into that direction and therefore subsidies which appear to be kind of a structural commercial feature three years ago have now become much more tactical and, therefore, also the commercial effort overall in terms of subsidies has become much more selective, including players like Yoigo.

So overall, if you ask me to give you an overall picture of the Spanish market, we see a much more rational behaviour of the market. It has been painful because we have been provoking this convergent process and now it looks like we are reaching a point with the different players, namely

the consolidated or convergent players of the market -ourselves, Vodafone and Orange-, would have similar ARPUs to defend on the existing customer base both on the wireline and on the wireless side. So, we forecast a more rational Spanish market and this is starting to flow through the stabilisation that you saw in the ARPU of Fusión. So we think this is the way to go. This is the way we, as the leaders, are going to try to drive the market and I think that the consolidation processes are going to be one more step into that direction.

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

Regarding Venezuela, we continue to record the figures in full accordance with our auditor at SICAD I rates. At this moment we have at the rate of 12 VEF per USD at the close of the quarter, the equivalent of €1.4 billion of cash in Venezuela. SICAD II continues to be very illiquid and the volume of dollars traded is not referential. We see that the equilibrium rate of the VEF, taking into account internal and external opinions, would be closer to SICAD I than SICAD II. But, given the growing scarcity, the inflation pressures and the double-digit deficit, we do not disregard the government allowing for higher trading bands in the coming months. So, rather than a movement from SICAD I to SICAD II, it would be possibly a movement in the rate of the SICAD I, at which we would continue reporting.

Rating agencies are already making several adjustments on this. In their liquidity ratios they exclude the Venezuelan cash from liquidity, as we do in our presentation of our liquidity position that I presented before. They also adjust partially the ratios. When they calculate solvency ratios, they partially adjust for the cash in Venezuela and they also increase the levels of the ratios that they put for us as a reference for a specific rating. So, we continue obviously to explore every alternative option that we can think of to invest and deploy that cash, and protect it from inflation, as close as possible to SICAD I and we will continue to do so.

It's quite relevant to see that in the results that we have presented, we are posting growth acceleration and improvement in margins ex-Venezuela.

And also to take into account this market concern, we decided at the beginning of the year to set our guidance ratios excluding Venezuela, so that impact would not be "flattering" our numbers. We are not hiding from this exposure to Venezuela, we are managing it. We are trying to invest that cash in the way that would allow us to preserve the value.

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

If I may Luis, complementing Ángel on Venezuela, we have also decided from an operational standpoint to accelerate CapEx, to transform part of this cash flow generation into an accelerated CapEx deployment namely on 3G capacity, because we felt that as we are accelerating our revenue growth in Venezuela, we are also improving our traction in terms of OIBDA. That return that we are getting by transferring that cash that cannot be repatriated and therefore is not accountable for debt reduction purposes at the group level, into an accelerated CapEx deployment in Venezuela, is also helping us to foster the operational performance of the unit. So overall, growing better in Venezuela and investing more than we were anticipating at the beginning of the year precisely because we cannot repatriate the cash and we generate more return by investing that into the business than having it at the bank.

**James Ratzert** - *New Street Research*

Yes, good afternoon, thank you very much indeed. The first question I had is just regarding your post-events closing net debt which you quoted at €44.9 billion. I was wondering if you could let us know how you are going to be accounting for the spectrum purchases in Brazil, and also Argentina, which didn't seem to be included in that figure and, from the comments you've made earlier on this call, is it right to conclude that you will need to do some form of hybrid issuance before year-end in order to reach the €43 billion net debt target?

Then the second question I had was regarding O2 UK. This is the first quarter, first full quarter where we've now been lapping the O2 Refresh launch from April last year. It seems like underlying EBITDA in that business was down around 5% year-on-year. I was wondering if you could just let us know whether accounting effects are still being a drag on that performance. What do you think is a good steer for the underlying EBITDA performance within O2 UK?

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

Hi, James. With respect to your first question, when we have been posting these post-closing events adjustments it has always been regarding M&A transactions. We are not trying to do what would be the pro-forma taking into account business evolution, spectrum and everything else. We have just included and we have been consistent across the last few quarters' presentations, just including M&A transactions because we thought that the €41.2 billion figure as of the end of September would not have been giving the full picture of the debt situation given that E-Plus was bought the 1st of October. So, here you only have the impact of M&A transactions.

With respect to spectrum in Brazil and Argentina, it will be part of the free cash flow calculation in the fourth quarter. As you see on slide 17, in the bottom part we have all the waterfall that leads from operating cash flow to free cash flow. And there is one of the blocks which is spectrum accrued, which up to September has been quite a low figure this year compared to the previous year. But in the fourth quarter, as you rightly pointed out, Brazil and Argentina spectrum is going to be a significant component of the free cash flow calculation.

With respect to the hybrid, it's not that we need to do it. Depending on the market conditions, we will decide if and when it's the appropriate time to make such a potential issuance. But, I agree with you that, in order to get to the €43 billion target, we will need in addition to free cash flow (given that in the fourth quarter we have spectrum and we have the cash component of the dividend as it finally may be) to complement with some inorganic options: be it portfolio management or be it financial measures like a hybrid. We don't need to necessarily issue the hybrid, we may do it in a combination of other measures.

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

With regards to your question on the UK OIBDA margin and potential impact of non-recurring effect and Refresh, let me state that, for the fourth quarter for example, we expect similarity in margin performance versus previous quarter excluding the positive non-recurring effect that we have had, mostly related to the disposal of the fixed business assets a year ago and this is €34 million net impact in the third quarter of this year, and also remind that we have a €10 million impact in the fourth quarter of the previous year and this is the only major one-off that we have. In terms of Refresh and unwinding effects of Refresh and the accounting impacts, we have seen that the positive impact on the stabilisation of top-line in terms of revenue will be offset by the unwinding of the Refresh accounting and, therefore, we foresee similar levels of OIBDA margin for the next quarter compared to the third quarter once you net-off this effect of the €34 million of the one-off.

**Fernando Cordero** - *Santander*

Hello, good afternoon. Thank you for taking my two questions. The first one is related with Spain. I know that it is going to be a progressive and long-term process but I would like to know what are your views on the potential savings and also potential realistic value to show up with the progressive copper network switch off in Spain, process that has already started in the third quarter?

The second question is related with Germany and again on convergence. Given your current spread between mobile market share including obviously E-Plus and your fixed market share in Germany, should we expect any kind of short or mid-term initiative to reinforce your market share in fixed, either organically or inorganically?

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

Thanks for your questions. Taking your question on potential OpEx coming from central offices closure, well it's totally true that the fiber network requires less central offices and therefore we should expect as we deploy fiber to have savings coming from the elimination of those stations and therefore also less costs in energy, call centres and potential service failure attention. But so far we have just closed 2 small central offices which had no unbundling local loop players, one in Barcelona and another one in the surroundings of Madrid.

For 2015 we expect to start closing 132 additional central offices but it is also true that it is too soon to disclose potential savings because those will only be on the long run and that's because the fact that according to the regulations in Spain we need to have just a small percentage of unbundling local loop players in each central office before being allowed to close the station. So yes, we foresee that in the next 3-5 years we'll have significant savings coming from that effort. You should not expect that major impact in 2015, it would require a significant effort because of the existing regulation in Spain but it is totally true that in the mid-term we need to do an effort to generate savings coming from that. Those are going to be generated again in the mid-term, namely from 3-5 years.

In terms of our situation in Germany, first of all let me say that we do not see today a major threat of convergence in the German market because namely of the situation of the leader on that market, Deutsche Telekom, which has signalled that they are ready to offer some discounts on the potential triple play or quadruple play offers but it is also true that the level of ARPU is already high and discounts are limited.

So, in our opinion it's going to be very focused on our own behaviour on the mobile data monetisation strategy and they are showing that they are ready to go on that route, if we were to become very aggressive on the other side. We have already stated that we want to be a rational player, being the leader in terms of customers in the German market.

It is also true that if the market was to become more convergent, we are technologically hedged thanks to the agreement that we have reached with Deutsche Telekom when we sold them our wireline business and that agreement includes technological evolution and therefore if the market wants to move from VDSL to fiber, we will also have access to the Deutsche Telekom potential deployment of fiber. So we feel that we are in a good position in Germany for the current market structure but also if the market was to move more aggressively, we have a hedge from the indirect access that we have signed through our contract with Deutsche Telekom.

**Justin Funnell - Credit Suisse**

Thank you, yes. Just coming back to Brazil and then a question on Spain. Obviously there's been a huge amount of press coverage of what sort of merger scenario we might get in Brazil and it appears there's a TI Board meeting next week, but two scenarios which seem to be either TIM Brazil merging with OI, or the famous break-up bid for TIM Brazil; I'm just wondering where your preferences lie these days. It would seem to be with the TIM/OI merger, you could get market repair without having to spend a penny and would that now actually be preferable to the breakup scenario, breaking up TIM Brazil.

Secondly in Spain, we've seen a sort of phasing over the last two or three years when Fusión was first launched you were going to see a turnaround in EBITDA before revenues turned around, it was very much a cost cutting story and then during last year and into the first half of this year there was a sort of a ramp again in marketing costs to turn around the top-line. I'm just wondering where you are in that phasing now that obviously we're seeing a reduction of competition, is there now a scope for the margins just to really start moving up again and potentially even outperforming the revenue trend in Spain?

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

Hi Justin. Regarding Brazil, I think we're in a comfortable position being the market leaders in mobile and with the GVT transaction that we have made. When we finally close GVT and taking into account the decision by Vivendi to take the Telecom Italia shares and the mandatory

exchangeable that we issued, we will stop being shareholders in Telecom Italia and therefore there would be no time pressures on our side to participate in any process, which is a good position to be while we continue to have very strong momentum in the market and acceleration in our magnitudes, in our growth, in our revenues, in our margin.

So there could be several scenarios which have been speculated of potential consolidation in Brazil. It's very difficult to see through all the noise because there are lots of moving parts and it's difficult to assess the timing and the format of transaction, but in the two scenarios that you described, in both we could be active, or we could be passive beneficiaries of consolidation.

I think we stand to be beneficiaries of any of the two scenarios that you described. We think that in such a big market with such relevant investments that will be needed going forward (we have already much progress on our 4G compared to our competitors) some consolidation still need to be there.

Synergies of consolidation could be very important and could create lots of value if the transaction was properly structured, but as of now we are very focused on GVT, on closing GVT, on executing and delivering on the synergies we have committed to the market on the GVT transaction and monitoring obviously all the market developments that we can on what could be the evolution in Brazil. As I said before, we would be supportive of in-market consolidation and in certain scenarios we would be active, but if there are scenarios where we are less active and we also benefit, so be it.

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

Taking your question on the OIBDA margin in Spain and frameworking that on the Fusión launch two years ago, let me remind you that it started before, before launching Fusión we did a significant price discount in all fronts, prepaid, post-paid, ADSL. Immediately after, we took out subsidies. It was the first quarter of 2012 and then we launched Fusión and another discount and that's why for a while, we were combining the effort of restructuring our commercial effort and even accelerating our revenue decline in order to bet on a significant churn reduction. Because we were exporting the most valuable customers to the portability market and we were bleeding to portability, with significant commercial efforts to try to retain or to try capture any customers with lower ARPU.

Once we did that, we have our first impact on OIBDA and the first impact on OIBDA was thanks to the savings that we were generating and at the same time, while we were launching Fusión, we still decline in revenues.

Mid-last year or the beginning even of this year, we realised that OIBDA margin was significantly picking up but at the same time we were still bleeding on part of our customer base, namely on the pure mobile contract customers. And that's why we decided to invest part of the significant savings, because remember that before the launch of Fusión and before this transformation effort, margins in Spain were in the very high 30s and in the very low 40s.

Margins went up to almost 50% and now they are standing somewhere between 44% and 46%, but thanks to the reinvestment of these four percentage points coming from 49% to 44% or 46% that we stand right now, we have been able to stop the bleeding on the contract side as well and that's why we have been able to stabilise the customer base and to slightly grow in access for the first time in a lot of time, in a long series of quarters. That effort is being based around the fact that we are betting for revenue growth in Spain, as soon as possible and for that we need to stabilise two things. First, the customer base and that's why we have been investing part of the margin; and second and also important the ARPU, and that's why stabilising the pure mobile and also the Fusión ARPU was so important.

So for the next quarter, for the fourth quarter we see levels of ARPU similar to the one that we have been seeing so far this year and for 2015 it's going to be depending on the effort that we're going to be doing in content. Therefore at the last conference call of the fourth quarter of 2014 we will give you more guidance of what would be the OIBDA margins in Spain.



So this is a little bit the journey that we have been going through. We think that now we are staying at a point where OIBDA margin is pretty stable and compatible with the stable and the slightly growing customer base, with some commercial effort, with more valuable customers coming from fiber, coming from contract and coming from Fusión. So we think the journey has been worth the effort.

**Jerry Dellis** - Jefferies

Yes, good afternoon. Thank you for taking my questions. The first one is on the UK. Again, to the backdrop of BT's mobile launch and the commercial cooperation that seems to be taking place between Sky and Vodafone, it feels as though your own attitude in the UK towards convergence is rather one of an observer, rather than proactively going out and pre-empting what your competitors might be about to do. I just wondered why you've chosen to adopt that attitude, if that is the right reading and whether, if the UK market were to consolidate perhaps behind a convergent trend over the next couple of years, the UK is a market in which you might be prepared to deploy significant amount of capital in order to participate in that consolidation theme?

Then secondly in Spain, following up from Justin's question perhaps, but asking it a slightly different way, I think the trend in your operating costs has gone from net 20% year-on-year declines in the first part of 2013 now to around a 3% increase. Accepting your point about the theme of higher content costs, is there anything else you can do within the cost base in order to limit the inflationary impact of those rising content costs? Thank you.

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

Regarding the UK, as José María stated before, UK is a very important market for us. It's at the forefront of innovation, of digital services, of optimization. It's not a strong convergent market as we perceive it today, and José María also elaborated very much on that. Of course, we are monitoring the market trends as you would expect that we should. Accordingly, we will be open to assess potential strategic alternatives depending on how the market evolves that would, as has been the case in all of our portfolio management, allow us to generate value and improve our financial flexibility.

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

I'm taking your question of what else could we do in Spain to try to mitigate the potential impact of the content strategy or other impacts. Let me step backwards a little bit before and state that the impact is 3% increase in opex. This year is mainly coming from several factors: firstly, the contents, also the impact on termination rates and also handset sales, that have become very tactical, and then the pension fund. You know that we have a 15-month agreement with the unions not to contribute to the pension fund and that we re-taken contribution this year. So part of that content on the pension fund is there to stay, the content depending on the intensity that we're going to be applying and is going to be depending on the kind of agreement that we're going to be able to close on that one and that's why I would like to update you on that side at the fourth quarter conference call.

The effort that we're doing to try to absorb part of that internally are coming from basically two major sources. First, is insourcing as we have been able to eliminate significant amounts of complexity by cutting down references of prices by switching off applications, by also virtualizing servers and by doing a much more efficient network deployment. We are now able to insource part of the activity and therefore to reduce the weight of outsourcing costs in our structure.

The second point in which we are focusing is significantly optimizing our distribution channels. We think that we need to reshape our direct distribution, but also the indirect distribution chain, that we have in Spain. We think that we need to have a more efficient and different kinds of profile of distribution, mainly in the stores and we are aiming to have less capital because we have now the most distribution network in Spain. We think we can do the same or even more with less stores but displayed in a different manner and that's why we think that significant savings namely on the commercial front can come from a different approach to the distribution channel.

So the answer is yes, we think we have still room to go in cost structures in Spain, that we aim to absorb a significant portion of the different cost impact that we have been having during this year, so we'll keep you updated, but the answer is yes, we see further room for savings and efficiency in Spain.

**Mandeep Singh** - Redburn

Hi. Thank you, very much, for taking the question. I have a couple of questions, please. One quite specific: both Oi and América Móvil have said BTG Pactual is involved, talk of discussions with third parties has been mentioned. Can you just confirm or not whether you have been involved in any conversations with BTG? That's the first question.

The second question is really just around cash flow. I note that you've improved your working capital €700 million year over year through use of factoring and other initiatives yet, despite that, operating free cash flow is still declining in the high-teens percentage. How much more room do you have on working capital initiatives and what's the sort of underlying free cash flow trends we can expect once you've run out of room on working capital improvement?

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

Hi Mandeep. On the first question our Brazilian subsidiary has been asked formally by the stock market regulator whether we were involved in any negotiations, whether we had mandated any advisor and they have formally responded that we are not aware of any such agreement and we have not mandated any advisor for Brazil.

Regarding free cash flow, what you should be thinking, looking forward for the full-year, now that you have all the figures for the third quarter, it should be as follows: regarding OIBDA and CapEx, we are reiterating our guidance and you can make assumptions on where we're going to be there. OIBDA is already growing organically and this growth has been accelerating in the third quarter. The drag that we've had is regarding FX and regarding the reduction of perimeter. Both negative impacts are starting to ease, in the case of FX and that probably should be the trend given where the euro versus other currencies is trading right now (obviously this is ex Venezuela and Argentina); and the change of perimeter that has been adverse to us because of the exit of Cesky and Ireland from our perimeter. Going forward it's going to start adding because E-Plus starts from the fourth quarter, GVT from some point around mid-next year, so two impacts that you're seeing negatively affecting our OIBDA trend and therefore the operating cash flow. Going forward, organically we are growing, perimeter will help and also FX is going to be less of a drag. That's one point that will be seen across the following quarters.

Working capital, still as of the end of September was cash consumption, but was €773 million better than last year, less cash consumption. For the full part of the year, we're expecting positive contribution to cash flow for working capital, higher than the one we had last year. Just to remind you, last year it was around €700 million positive cash contribution from working capital. We're looking forward to something which is going to be higher than that, visibly higher than what we had last year.

Regarding the other components of free cash flow projection: on the cash tax rate, you should be thinking of something closer to 28% for the full-year. I spoke about in response to a previous question, spectrum in Brazil and Argentina is going to be there; and interest payments, you should be thinking that we're going to be in our 5-6% range, in the upper part of that range. Dividend to minorities is going to represent lesser leakage than what it was last year. We don't have for instance the Czech Republic minorities that we need to give dividend to.

All in all, free cash flow will cover dividend payment.

**Mandeep Singh** - Redburn

Ok. Can I just quickly follow-up on the first question, if that's ok?

So just specifically I appreciate you filed that you've not engaged any advisors but have you been approached by BTG because they said they have approached third parties?

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

I don't think we are responding to these types of questions. Thank you.

**Paul Marsch** - Berenberg

Thank you very much. Maybe if I can be a little bit cheeky and ask three questions instead of two. Firstly can you repeat the statistics that you gave on the Fusión revenues as a proportion of total domestic revenues? Secondly on the scrip dividend, would you intend also to offer a scrip for the full-year dividend? And then finally, maybe could you give some comments on what's actually happening with mobile data revenues in Spain which seem to be declining even excluding SMS. Can you talk about the various moving parts that are going on there and when might we expect to see that overall trend turning positive? Thanks.

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

On the percentage that I've shared on Fusión, I said that more than 50% of residential revenues are already kind of "Fusión-ised", so to say, which means that, considering that Fusión is showing from the second quarter a slight ARPU increase, at least 50% of the residential revenues are going to the right direction, considering as well that we have been able to stabilise the customer base. I was trying to point out into the direction that stabilising residential revenues is essential if we want to stabilise the Spanish revenues. Residential is in the neighbourhood of 50% of total revenues of Spain.

I will take the mobile data revenue and then I will hand it for Ángel for the scrip.

On the mobile data in Spain, I don't think it's that relevant because of the way we account for Fusión. The more convergent you become, the more revenues you allocate to Fusión or to the bundle that you include into the Fusión offer, the less relevant becomes the mobile data excluded out of the package of Fusión. So, I think that if I may guide you on what are the relevant figures to follow in this case of the Spanish revenues, I would strongly suggest to focus on Fusión ARPU, total amount of customers in mobile contract, because this is where it's going to be pointing towards revenue stabilisation in Spain. Data traffic in Spain is literally booming which means that we are not seeing in Spain a different pattern of behaviour from the other markets. So in my opinion it's just the way to allocate those revenues from the different elements, and therefore, I strongly suggest to focus on Fusión revenues and KPIs.

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

Regarding dividend, the dividend for 2014 is fully confirmed. It's €0.75 per share. This is composed of two parts. The interim, which is €0.35, is a voluntary scrip dividend, so shareholders can choose between cash or shares. This will be paid in the coming weeks. On October 10th we made a public announcement regarding such scrip dividend and on November 14th we will announce the details of ex-dividend date and the period for the selection between shares and cash. So, the first tranche is the interim, €0.35 voluntary scrip. The second tranche is final dividend €0.40 to be paid in cash in the second quarter of 2015. Not scrip, but to be fully paid in cash.

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

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