Telefónica January-December 2014 Results Conference Call Transcript

25th February, 2015

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Introduction

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

Good morning and welcome to Telefónica's conference call to discuss January-December 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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Now let me turn the call over to our Chariman & CEO, Mr. César Alierta, who will be leading this conference call.

César Alierta - *Telefónica S.A. - Chairman and Chief Executive Officer*

Thank you Pablo. Good morning and welcome to Telefónica’s 2014 results conference call. Today with me is José María Álvarez-Pallete, Chief Operating Officer and Ángel Vilá, Chief Financial and Corporate Development Officer, so during the Q&A session you will have the opportunity to address to us any questions that you may have.

Before starting let me briefly explain to you the agenda for this conference call. I will first explain the milestones achieved in our transformation journey to a Digital Telco in 2014 and the expectations that we have for the next two years.

Ángel will explain the 2014 results in detail and José María will provide details on the strategy and outlook till 2016.

Presentation

Our journey

Please turn to slide number 2 to start reviewing the business’ deep transformation carried out in the 2012-2014 period, which allows us to look on the next two years with great confidence that we will be back to sustainable profitable growth.

During the past two years, we have made significant advances. We invested in capturing growth opportunities in mobile data and digital services, took initiatives to improve efficiency through simplification, reinforced our asset portfolio and de-risked our balance sheet.

As a result of this, we have built a solid platform and we have clear proof points of this transformation, which allows us to upgrade our ambitions for the 2015 and 16 period. We will accelerate growth and investments, building stronger networks and monetising the data explosion coupled with increasing efficiency levels in addition to the synergies from Brazil and Germany acquisitions.

At the same time, maintaining Financial flexibility will be key for delivering growth. Finally, let me stress our intention to increase the Cash dividend after the execution of the proposed O2 UK disposal.

Clear proof points already evident in 2014

Some of the indicators of our progress are explained on slide number 3.

The average revenue per access returned to growth for the first time in many years, demonstrating the demand for high quality services and high speed connectivity. In Digital Services, we saw exponential growth in revenues, setting the basis for their increased uptake in the future.

We are proud to note the investments we made in expanding the reach of both FTTH and LTE, doubling figures in just one year.

We generated a run-rate of 300 million euros of gross savings in 2014 derived from a leaner operating model, reducing complexity and paving the way for further savings.

In Spain, we recorded a significant improvement in the year-on-year trends throughout the year and we are well on our way to returning to growth in 2015.

In terms of our Balance Sheet, we recovered robustness post-Venezuela adjustment and proposed O2 UK sale.

Consistent improvement in our fundamentals: top line acceleration, with a strong performance in Q4 14…

Turning to slide number 4, we can see the consistent improvement in our top line growth, with all the signs that this trend is set to continue. Q4 was particularly strong, as revenues grew by 5% year-on-year in organic terms underpinned by the steady increase in accesses and the better return per access.

As you can see from the graph on the left, the trend since 2012 is one of sequential growth, with a 2.6% year-on-year organic for the full year 2014.

… while improving OIBDA & EPS trends

On slide number 5, we continue to demonstrate how our fundamentals are steadily improving as shown by our OIBDA and underlying EPS increases.

In organic terms, OIBDA returned to growth in the full year 2014, showing a 0.2% increase year-on-year despite a more intense commercial activity aimed at high-value customers.

Underlying EPS reached encouraging results for the full year at 93 cents per share, improving solidly in Q4, and I want to remark that underlying net profit reached 4.5 billion euros in 2014, 4.5 billion euros for the year.

2014 guidance met on strong execution

Slide number 6 reviews how Telefónica fulfilled guidance given for 2014.

We have delivered on our operating outlook for 2014 leveraging on strong execution skills.

Net debt stood above our full year target, but let me stress that, including the proposed O2 UK sale, we would have reduced it to 31.7 billion euros, demonstrating our commitment to financial flexibility.

In addition, the high take-up ratio of scrip dividend translated into a cash dividend payout of just 55% of free cash flow.

2015 and beyond: positioned for growth acceleration

Looking ahead to 2015 and beyond on slide 7, we are well-positioned for further growth acceleration.

In Spain, one of our largest markets, macro and market trends look positive, increasing the appetite for higher value services. Also, our infrastructure and assets in fiber, Pay TV and LTE will continue to increase our differentiation.

At a Group level, we will be driving data monetisation by expanding a differential LTE experience across our markets and by designing propositions that lead to higher data adoption, including a push in prepaid smartphone penetration in Latin America.

Also, we will leverage network & IT upgrades to enhance customer insights.

Our focused portfolio management will create significant synergies in Brazil and Germany and it means we can upsell our customers to higher value and quality bundles, thus creating additional revenue streams.

We will also be concentrating on savings over the coming years and we will be delivering more than 1.8 billion euros synergy plan.

External factors: from headwinds to tailwinds

Turning to slide number 8, we will now touch on how external factors have turned from negative to positive for us.

In terms of regulation, we have been very active in voicing our opinions on regulation. As we have pointed out several times, we are in favour of in-market consolidation and precedent-setting examples in Germany and other countries are very encouraging. Continuing with Europe, current fixed regulation gives us certainty until 2020, while the Digital agenda appears to be favouring investments.

In LatAm, there have been also positive rulings by regulators in Mexico and Colombia to foster the sector development.

On the macro side, the economy in some of our key markets is steadily improving, as in the case of GDP growth in Spain and Germany, and both are based on stronger consumption fundamentals. In addition, financial markets are now back to normalised risk levels and rates have come down again.

Finally, the market structure in some key markets has evolved, which should allow us to move from a price deflationary competitive model to a quality of service model where differential infrastructure and therefore the investments made by telcos, are the key drivers in gaining more loyal and higher-value customers.

Driving a fair policy framework in the digital ecosystem

Turning to slide 9,

We at Telefonica have been working to drive a fair policy framework at the digital ecosystem. Level playing field should be a priority for policy makers and regulators. The current situation is not sustainable today where media, connectivity and Internet services are converging. Telco operators need a balanced scenario with other players in the digital ecosystem, especially with Internet companies. And our customers want to have a safe and open digital experience.

We believe there is clearly a window of opportunity to achieve a fairer and less-intrusive policy framework in Europe. The need for a level playing field and the need to recognise the investment risk with a more investment friendly framework are the key elements of our regulatory and public policy strategy.

We defend that policies and regulations should be revised, considering the whole Internet value chain. This is necessary to guarantee a better Internet experience for consumers, enterprises and public administrations, and have an Open Internet, a Portable Digital Life and a safe and enjoyable digital experience. But also, it is important to avoid any situation of abuse of dominance and ensure that users have choice in all layers of the digital value chain, which means that digital markets need to be watched carefully.

Capital discipline: financial priorities 2015-16E

Moving to the next slide, let me explain our financial priorities for the next 2 years. We have a firm determination to reach three interactive targets:

First, we will have strengthened our balance sheet after the proposed O2 UK disposal, in addition we have already de-risked balance sheet with Venezuela FX adjustment, which allows us to limit GVT capital increase up to 3 billion euros. On leverage, we aim to have a ratio in both years lower than 2.35x, including the proposed O2 UK sale. The result of this financial policy should translate into ratings stabilisation reflecting our regained financial flexibility.

Second, we will maintain an attractive shareholder remuneration comprised of sustainable dividend payments, tactical share buybacks and shares cancellation to mitigate scrip dividend dilution.

Third, to support sustainable organic growth based on differentiation we will keep analysing inorganic opportunities to accelerate value creation, as our portfolio strengthening policy remains in place.

2015 guidance & 2016 ambition

Let me now highlight our guidance for this year and the ambition for 2016.

2015 is going to be the year when we will increase our revenue growth to more than 7%, while our OIBDA margin will present a limited margin erosion of around 1 p.p. to allow for commercial flexibility if needed. Our CapEx to Sales ratio will be around 17%.

For the period 2014-16, the CAGR revenue growth will stand at higher than 5%, with OIBDA margin stabilising in the year 2016 vs. 2015 and CapEx to Sales to be stable around 17%, reaching the peak in this period, as it will be 2 p.p. lower in 2017.

Revenue guidance in organic terms is compatible with our strategy to accelerate growth.

On the financial guidance, let me add that we will do all of this maintaining our dividend for 2015 at 0.75 euros per share, with the same mix structure as last year. The first tranche, 35 cents, will be payable in Q4 15 by means of a voluntary scrip and the second tranche of 40 cents in cash in Q2 16.

Moreover, our intention is to increase the cash dividend to €0.75 per share once the UK deal is closed.

In order to mitigate scrip dividend dilution, we will propose to the AGM the cancellation of treasury shares equal to 1.5% of outstanding capital in Q4 15, plus an additional 1.5% cancellation once the UK deal is closed.

Now, I will pass on to Angel to review 2014 results in detail.

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

2014 Results

2014: Highlights

Thank you, César.

2014 results clearly reflected the solid steps in our transformation strategy towards a Digital Telco, focused on accelerating long-term sustainable growth.

Commercial momentum, particularly in high-quality services, has gradually strengthened throughout the year, which, along with booming mobile data monetisation, has allowed Telefónica to recover strong revenue growth and increase customer value. Thus, in the fourth quarter, revenue growth accelerated to 5.0%.

All this, along with further efficiencies across the board, has translated into robust profitability, with OIBDA growth returning to positive territory in 2014 and limited y-o-y margin erosion.

CapEx was up 16.9% in 2014, focused on technological transformation, setting the basis for future growth and differentiation.

At the same time, we have strengthened our Balance Sheet, levered on solid free cash flow generation and active Portfolio Management. Let me stress that including the proposed O2 UK sale, the leverage ratio improves to 2.15x.

This proactive management of our asset portfolio has allowed us to lead in-market consolidation and bolster our competitive position in key markets, through value enhancing deals.

Finally, we delivered on 2014 operating guidance and confirm 2014 dividend commitment.

Financial summary

Moving to the next slide, let me summarise our key financials.

Reported year-on-year evolution is significantly affected by non-recurrent factors, FX headwinds and changes in the perimeter of consolidation.

Q4 is particularly affected by these non-recurrent items. Regarding, FX, we are applying to 2014 financial statements the exchange rate of the Venezuelan bolivar set at the previously denominated SICAD II at 50 VEF/USD. This decision has impacted OIBDA by 0.9 billion euros and Net Income by 0.4 billion euros. It is important to note that revenue contribution from this country is now reduced to just 1% and the net cash position is now below 0.4 billion euros, minimising the impact of any further potential adjustment.

Other non-recurrent effects include: 1) a provision for restructuring costs with the aim of increasing efficiency in the future, impacting OIBDA in -644 million euros and net income in -405 million euros, mainly affecting Germany with announced leaver program; 2) a value adjustment of our investment in Telco has reduced Net Income in 0.3 billion euros; and 3) asset sales in Spain, mainly towers with close to 0.2 billion euros impact on OIBDA.

These non-recurrent items provide a clean, sound and de-risked base for profitable growth going forward.

Q4 results impacted by non-recurrent, non-cash effects

To see these impacts in more detail please move to slide number 15.

FX has been the main factor, dragging 23.9 p.p. to OIBDA year-on-year variation, with the evolution of the Venezuelan bolivar explaining over 90% of this effect. Let me stress again that this impact is mitigated at FCF level.

On the other hand, the consolidation of E-Plus since the 1st of October turned the contribution of perimeter changes to revenues to positive and reduced the negative contribution to OIBDA, still affected by the deconsolidation of Czech Republic and Ireland.

Non-recurrent effects reduced Q4 OIBDA and Net Income by 1.4 and 1.1 billion euros, respectively.

Consistent improvement in growth profile

Turning to slide number 16,

Sequential top line acceleration of 220 basis points in the quarter to 5% year-on-year organically is explained by strong commercial momentum, particularly in value services coupled with churn stabilization on a yearly basis.

Mobile contract customers increased 11% vs. 2013, boosted by smartphones, which delivered a remarkable growth of 39%. Pay TV momentum remained high, with strong net adds of 437k in the October to December period and accesses increasing 1.5x vs. 2013, surpassing the 5 million mark. Fiber connected customers posted record net adds in the quarter and accesses doubled year-on year.

Best-in-class diversification and better revenue mix towards data explain the consistent improvement shown in sales performance during 2014.

OIBDA in the full year pointed towards sustainable growth reflecting revenue flow and efficiency gains. Organic OIBDA margin decline of 0.8 p.p. vs 2013 underlined higher commercial investments and network and IT costs.

Strong and clear progress on mobile data

Turning to slide number 17 we review the strong performance of mobile data.

Smartphone penetration reached 35% at the end of 2014 underpinned by increased LTE adoption. This, along with a strong year-on-year growth in average data consumption across our footprint, is driving the acceleration in total mobile data traffic, up 65% y-o-y in the fourth quarter.

The boost in data traffic and smart pricing are reflected in data monetisation and improved performance of Non-SMS mobile data revenues which grew 24% organic year-on-year.

I would like to highlight “Bundle Breakage” in 1/3 of actual customers, using more data than they initially subscribed to their data plan and 1/3 of them subscribing additional “data snacks”. This leaves us plenty of room to upsell, as we currently have just 1/3 of customers already on plans with more than 1 gigabyte of data included.

Capital intensity to structurally change the Company

Please turn to slide 18 for an update on our investment profile.

In terms of network investments, and in order to meet increasing customer demand for data traffic and to stimulate revenue opportunity & differentiation, both in fixed and mobile, we have devoted 75% of our investments to growth and transformation, 6 p.p. more than a year ago in organic terms, while at the same time we have reduced investments in legacy.

By concepts, fiber CapEx increased by 81% and investments related to TV increased by 79%. On the mobile side, 3G investment was 30% higher and 4G spend was 19% higher while we also advanced on transmission and IT investing 15% more than a year ago.

It is also remarkable the effort made in acquiring differential spectrum in 2014 to secure valuable spectrum in Brazil & HispAm countries.

Spain: Rebuilt a superior franchise

Let me now review the performance of Telefónica España in slide number 19.

We are especially satisfied with the progress made in building a stronger franchise.

Our successful convergent offer enhanced in 2014 with a differential quality TV product, drove a sound commercial turnaround, leading to an acceleration of growth in high value; fiber customers doubling y-o-y, Pay TV tripling, and contract mobile resuming growth.

“Movistar Fusión” traction continued, reaching 73% of FBB base and 57% of mobile contract securing a larger revenue stream in the consumer segment, on more loyal customers with higher ARPU.

Lastly, we fulfilled the target of UBB coverage, with more than 10 million premises passed with FTTH and 58% population coverage with LTE, supporting structural differentiation, which was reflected in the investment effort made in 2014.

Spain: Improved revenue trend on solid fundamentals

On page number 20,

The sequential improvement of revenue year-on-year in Spain is a clear reflection of solid fundamentals, underpinned by ongoing commercial momentum, price stabilisation and a diminishing back-book impact.

Importantly, revenue decline improved 7 percentage points in the last four quarters, and this, along with savings from efficiency measures, limited OIBDA y-o-y erosion in the last quarter and delivered a healthy OIBDA margin of 45.6% in 2014, excluding tower sales.

Hence, Telefonica España is on a clear trend to recover revenue growth.

Germany: a solid start from a new leading position

To review our operation in Germany, please turn to slide 21.

The successful integration of E-Plus consolidated Telefónica Deutschland as the mobile market leader by customers, recording solid contract net adds with focus on data monetisation. Increased LTE coverage, 62% at the end of December, and attractive bundles, are driving an improvement in the bundle adoption mix. New tariffs launched on February 15th are further incentivizing increased data usage and upselling initiatives.

On financials, Mobile Service Revenue, now representing 70% of the combined Co., stabilised its year-on-year trend in the fourth quarter.

Q4 OIBDA margin was 18% in 2014 excluding restructuring costs of 401 million euros, reflecting higher commercial spend to capture market growth. Finally, the Company has already started to execute the synergy program with quick wins in places such as cross & upsell activities, aligned procurement, defined Network grid and personnel restructuring agreed.

UK: Strong customer growth & improving trends

On slide 22, Telefónica UK added 394 thousands customers, the highest of any quarter since 2008, underpinned by the contract segment, up 6% year-on-year. Market leading customer loyalty was reflected in contract churn at 1% for the full year and the quarter.

The rapid roll-out of LTE is translated into an outdoor coverage of 58% at December, with customers having 3x average usage vs. a 3G user. This led to ARPU stabilisation, with broadly flat year-on-year performance in the quarter.

As a result, mobile service revenue, excluding “O2 Refresh” was up 3% vs the fourth quarter of 2013, with total revenue 5% higher, also boosted by the increased trading of high-end devices. OIBDA margin grew 0.2 p.p. vs 2013 to 24.7%, with “O2 Refresh” adding 3.7 p.p. but negligible impact in the annual variation.

Brazil: Capturing the best customers

In Brazil, moving to slide 23, we have reinforced our market position in high-value customers in both businesses.

In mobile, during 2014 we strengthened our leadership capturing more than a half of new contract customers and almost 40% of new LTE accesses thanks to our superior network and our innovative services. This strategy underpinned outgoing ARPU in Q4, up by 6% year-on-year on increasing data adoption.

In fixed, we continue the process of transformation into a fiber company with connections and IPTV accesses accelerating throughout the year.

Brazil: OIBDA returning to growth in 2014

Slide 24 shows our solid Brazilian financial performance.

The quality-customer growth strategy is leading to sustainable revenue growth. Thus, mobile service revenue year-on-year organic growth accelerated in Q4 to 5.7% excluding Q4 13 one-off on strong data growth and despite negative regulatory effects.

In addition, despite the strong commercial activity, the efforts to achieve higher efficiencies resulted in an increase in costs much lower than inflation.

And consequently in full year 2014 OIBDA returned to positive year-on-year growth.

Hispam: Increased FY profitability amid strong trading

Turning to slide number 25 we review the performance of Telefonica Hispanoamerica.

Strong trading, with mobile gross adds growing year-on-year by more than 10% in Q4, and higher traffic volumes, leading to mobile ARPU growth, underpinned the steady double-digit revenue growth.

On top of that, full-year organic OIBDA margin was 0.5 p.p. up y-o-y returning to 2012 levels, with a special mention in profitability increases in Colombia, Chile and Mexico. Let me stress that OIBDA growth remains in solid double digit when excluding Venezuela.

Mexico: Increasing momentum; accelerating growth

Let me now go through Mexico where, as shown in slide number 26 we are gaining momentum and accelerating growth.

Strong commercial traction, with record gross adds once again in Q4, led to sustained revenue growth acceleration to reach the highest MSR growth in 5 years in Q4.

Let me also remark that the mix of top quality assets on strong CapEx efforts in the past, and the economies of scale starting to flow into the results, expanded profitability, with OIBDA almost doubling year-on-year in Q4.

Rest of Hispam: Solid top line growth boosting OIBDA

And turning to slide number 27 we review the performance of other countries in Hispanoamerica, where solid top line growth boosted bottom line performance.

In Colombia revenues continued outpacing inflation growing by 6% in Q4 amid strong increase in profitability. As such, organic margin expanded by more than 4 percentage points year-on-year in the last quarter of the year.

In Peru, revenues also consolidated the trend posted in last quarters while OIBDA was affected by high commercial activity to retain high value customers.

In Argentina, the main highlight is that along the year we managed to offset the inflation and FX pressure and profitability was slightly up year-on-year.

Strong FCF and net debt reduced ahead of O2 UK sale

Let me now move to the financial slides, on page 28.

First, I would like to highlight the strong cash flow generation shown in 2014 which has allowed us to reduce the comparable net debt figure as of year-end 2014 to 43.9 billion euros. However, by applying the SICAD II FX rate of USD 50 per VEB this figure increases to 45 billion euros.

Secondly, I wanted to underline the active portfolio management which is helping us to increase financial flexibility at the time we reinforce our strategic position and credit profile. In this regard, the proposed O2 UK sale will trim our net debt figure to less than 32 billion euros which will in turn bring our leverage ratio to 2.15x, comfortably below the 2.35x target.

Robust liquidity and ample diversified financing

Moving to slide 29, we continue delivering a prudent financial policy aimed at:

- Maintaining a healthy and robust quality in liquidity, which reaches close to 19.4 billion euros;

- Diversifying our funding, which reached nearly €15bn, with higher role for capital markets and hitting historical lowest coupons on our long term bond issuances; and

- Keeping cost under control, so that average cost of debt is 5.40% and remains nearly flat, below mid-point of the long term guidance range of 5%-6%. Changes in debt composition (due to increasing Latam weight and repayment of maturing lower cost debt in euros) would have increased cost by 0.47 p.p., but this has been nearly offset by 0.41 p.p. savings from lower interest rates.

Now I will turn to José María to review the outlook for 2015 and beyond.

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

2015-16 Back to profitable growth

Continue transforming the business

As you can see in slide 31, our business mix will be transforming, working towards our goal of growing average revenue per access. Services over connectivity and Broadband are both set to increase going forward, while there will be a slight reduction in Access & voice and Equipment, moving us away from selling minutes to selling Gigabytes. We will focus on creating voice bundles and variable data propositions for our customers, allowing more flexibility and quality of service.

Our portfolio, as I think we have proven over the last 12 months alone, is evolving towards a much stronger position in our key markets (Spain, Brazil and Germany) with bigger local scale. By the end of 2016 we aim to see the contribution from these markets to Group revenues increase to roughly two thirds.

Monetising the new mobile data & video wave

On slide 32 we have set out how we will maximise the mobile data and video explosion.

Telefónica will participate in and benefit from the digital revolution, capturing growing revenue streams.

Differential LTE will form the basis and we will advance towards higher LTE penetration and faster network, which will lead to more devices connected.

The right devices for our customers is also a critical piece: we will increase the penetration of smartphones in our customer base by broadening our portfolio, lowering entry price points and seizing upon the prepaid smartphone opportunity in Hispanoamerica.

As the network improves and devices' affordability increases, customers will consume more data, exceeding their allowances and thus upgrading to complementary bundles, bringing in extra data revenues. We will leverage this trend by creating tariffs and pricing structures that bring quality and satisfaction to our customers.

On top of this, we aim to create an environment where everything is connected, be it through multi-device or multi-user data plans, or through improving connectivity with FTTH and LTE, leading to the adoption of new data-based services.

On video, we are pursuing a focused strategy to fully capture the opportunity and where the uptake is key: multi-device accesses, new HD technologies and larger screen devices are all increasing the appetite for video services.

TGR: Differential future-proof network & IT ready by 2016

On slide 33, we show our main priorities in terms of network.

First of all I would like to highlight that our main focus is to increase the deployment of our future proof UBB networks, that will result in up to 22 million premises passed with fiber in 2016, that is nearly double those of 2014, but of course always subject to adequate regulation.

The number of LTE enabled base stations will be approx. 50 thousand, more than double vs 2014, and in Europe, this will mean a population coverage above 85% in 2016 and more than 55% in Latin America.

Network modernization and rationalization are the key pillars of our transformation to All-IP network. Technology benefits are expected to result in steady customers' adoption of IP access technologies and network capabilities: Voice over IP accesses, fiber based broadband and the rise of 4G.

Regarding IT execution strategy, our main priorities are: i) Accelerate the business transformation delivering more customer migrations to full stacks projects; ii) Simplification, including virtualization, which will improve business efficiency generating synergies; and iii) Enable growth businesses through digital capabilities, like online and multi-channel and big data, among others.

Leaner Co: Simplification program enabling growth & transformation

On slide 34, you can see the savings, including synergies that we will continue to capture under the new operating model.

Early quick wins from the different initiatives to become a leaner Company were already visible in 2014, with the realisation of savings above our initial expectation (€0.3bn vs €0.25bn). This was the result of several activities including simplification of corporate functions from a regional to global model and adapting the structure to the new operating model, SG&A global policies and outsourcing of support functions, for example in Brazil.

In Q4 2014, we booked a provision for restructuring costs as Ángel mentioned before. Additionally, we continue working with the simplification of the offer & channel optimisation, customer initiatives (self-care...), transformation of support functions, selective deployments based on analytics, network automation and synergies in Germany and Brazil.

By applying these initiatives we will be able to generate up to more than €1.8 billion OpEx and CapEx gross savings annually from 2017, with €0.7bn already to be achieved in 2015.

Spain: Strengthening differentiation

In Spain, we face a more positive scenario, with improved macro, market consolidation which should lead to more rationality in the market, and a pro-investment approach in European regulation.

Amid this backdrop, we plan to reinforce differentiation with an unpararelled CapEx effort to further increase NGN coverage to have the best-in-class network, and bring 4 years forward the fulfilment of the European Digital Agenda targets just with our Networks.

We aim to cover up to 18 million premises with FTTH and more than 85% of population with LTE by 2016. But, as we have always stated, this ambitious investment plan could only be executed in a scenario with adequate regulation.

"Movistar Fusión" will continue to be the key pillar of our strategy; accelerating the take-up of Pay TV and making Fiber the principal FBB technology in convergent households. Growing high-value services will increase ARPU and reduce churn, and ultimately translate into the recovery of top line growth from 2015.

Focus on OpEx control will continue and contribute to maintain a leading profitability.

CapEx in 2017, once the NGN is made, will go down and return to 2013 levels, as network structural transformation will be mostly completed.

Every business unit contributing to accelerate growth

Main priorities of the other business units are shown on slide 36.

Within Digital Services, we will focus on accelerating our capabilities in Cloud, Security and M2M in order to capture the full growth potential, especially refreshing the portfolio in the SME segment; while at the same time we continue to drive emerging Digital Services.

In Germany, we will base our strategy on 3 main pillars; first, setting market trends through a clear focus on stable mobile customers; second, monetisation of LTE opportunity, with tailored offers per customer segment and with a goal of reaching an outdoor coverage up to 90% at the end of 2016 and third, offer the best high speed experience with a flexible combination of the latest technologies. The execution of synergies (FTEs, shop footprint reduction and mobile sites decommissioned) will improve profitability. For 2015 we are expecting 250 million euros of recurrent OpCF synergies, approximately 30% of the target expected after year 5.

In Brazil, main focus will be on mobile data growth, increasing the penetration of high value customers on our superior network quality and innovative services. In the fixed business, we will continue deploying fiber, aiming to cover more than 5 million premises by 2016. As such, our strategy will be conducive to a more balanced revenue growth; while we continue working on cost reductions and on the significant synergies the GVT acquisition will bring, once we get the definitive approvals from regulators.

Finally, Hispanoamerica will continue to be one of the most significant levers for growth in a landscape of different business realities and a context of favorable macro conditions in core countries like Mexico, Colombia, Peru and Chile.

Now I will turn to César for the closing remarks.

César Alierta - *Telefónica S.A. - Chairman and Chief Executive Officer*

Closing remarks

Thank you José María.

To wrap-up, please move to slide 37 for our final conclusions. It has been a long presentation, but let me round up.
We have reinforced our growth model in 2014 with the right fundamentals to grow and transform further and in the fourth quarter we are just showing the first sings of the change. We have a very focused portfolio, with a very strong position in core markets. We are determined to maintain the financial flexibility recovered. And we are fully committed to offering very attractive returns to our shareholders.

Thank you and now all of us are open to take your questions.

Q&A session

Nick Brown - *Goldman Sachs*

Firstly, when you talk about Spain returning to growth in 2015, is it realistic to expect the point of inflection may be in the first half?

Secondly, I think previously you were guiding for margin stabilisation in 2014. Are you expecting you may have to invest more in commercial costs in Spain now to support revenue growth or is there another market where you want this flexibility?

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

Thanks for your question. In Spain we are not guiding in which quarter we are going to be returning back to growth but the trend set during the fourth quarter indicates that we reaffirm our vision that within 2015 this should be accomplished.

The first information that we have for the first month of the year and the advance that we have for the month of February are also driving into this direction so, we cannot be more precise on which quarter, but reaffirm the trend that now Spain is set to be back to revenue growth in 2015.

In terms of margin, we are guiding for limited margin erosion on the basis of:

First, overall I am talking of the consolidated level, the improved revenue trends in all markets driven, as we have been presenting during the slides, by data monetisation and deeper smartphone penetration, LTE and fiber expansion and smarter bundling.

It is true that we are going to be encouraging higher commercial costs namely commissions and promotions as we see growth ahead of us and we want to capture these revenue trends. It's also true that we are going to have higher content costs, namely in countries like Spain and also in Brazil, where our TV offer is booming; and we are building best-in-class video offering and it is gaining traction. The more traction it gets, the more diluted this effort in content is going to be, taking advantage of the scale and network effect. We are also facing higher network costs as we keep deploying ultrabroadband networks, both fiber and LTE in all our geographies; but we are also seeing progressive, positive impact of synergies generation mainly in Germany and potentially in Brazil when the GVT transaction will be cleared.

Finally, let me stress that we are also seeing progressive, positive impact of the simplification programme. We already captured EUR300 million of savings in 2014 ahead of our initial expectation of EUR250 million.

So overall, we see OIBDA growing significantly in absolute terms and accelerating in 2015 with limited margin erosion as we see profitable growth ahead of us and we really want to capture it. Should that not be the case, we will be adapting our commercial strategy and therefore adapting our commercial expenses.

Mandeep Singh - *Redburn*

First of all just on Spain, just so we are very clear, are you guiding that Spain will grow for all of 2015 or it will return to growth at some point in 2015?

The second question is really on Brazil. Are you still supportive of consolidation? Do you think it's likely to happen and if not, what do you think the future is for Oi? And if you could maybe give some colour on concession renegotiations and how you think that might play out for the market as a whole?

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

Thanks for your questions. In the case of Spain we are guiding for growth at the end of 2015 on a cumulative basis, not just on a quarter on quarter basis but on a cumulative basis.

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

Regarding Brazil our focus continues to be getting the approvals for the GVT transaction and reach a successful closing, which we expect in the first half of this year.

In the meanwhile, we continue strengthening our position both in mobile and in fixed broadband and we are posting clear growth both in revenue and OIBDA. And GVT, when it finally closes, will reinforce our position, increasing our growth prospects and allowing us to have a convergent footprint and to reach significant synergies.

Regarding mobile consolidation, we have stated in the past that we are strong believers in the benefit of in-market mobile consolidation, which we would support and which could generate substantial synergies. But, at this stage we are fully focused on GVT and we maintain our full optionality regarding a potential consolidation in Brazil.

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

On the concessions, there are not many news around. We are pretty focused on what is going on. We think that as we have stated it's for all the wireline concessions, not just for our case. We think it's going to have a rational outcome but it's too soon to say. We are positive but too soon to say.

Georgios Ierodiaconou – *Citi*

I just had a question on Spanish regulation, on the wholesale fiber access that was announced earlier in the year and also on the Digital Plus acquisition, if you could give us an update.

And especially; a clarification on the Group 17% CapEx to sales. The way I interpret it is that this assumes you carry on investing towards 18 million premises passed in Spain. If you would scale that down, does that mean CapEx goes somewhere else, either in Spain or somewhere else in the Group or will you come a bit lower on CapEx to sales?

Then my second question is around Mexico, if you could give us an update of your options there, and whether you confirm that any M&A that will happen in Mexico will still mean you consolidate the resulting assets?

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

Taking the first part of your question on Spain, we are addressing our CapEx effort to the areas that have been considered to have already competition and we´ll take our coverage in other areas once it is clear what the rules of the game are. But we keep deploying and we keep focus on the areas that have been declared already with significant competition.

The CapEx over sales that we have stated includes this effort and the CapEx guidance that we have been giving for the future includes the assumption that regulation is going to be stable on this subject.

César Alierta - *Telefónica S.A. - Chairman and Chief Executive Officer*

With respect to the regulation, the important thing is that the main challenge of Europe is the digitalisation of the economy. And this is very clearly seen in every country in Europe. And I am fairly optimistic that this year there are going to be big changes in favour of investment in fiber and LTE.

The framework is going to be more positive for us investing in fiber and LTE. Having said that, my perception of how the regulation is going to be in Spain is very positive, in the sense that everybody wants more digitalisation of the Spanish economy, and this means that regulations have to favour it, so I am very optimistic on that.

With regard to Digital Plus, I am also fairly optimistic. I think that in the next couple of months it will be approved and we will fully complete the transaction.

With regards to Mexico, as Àngel and José María have been saying, we are focused on organic growth. The new regulations in Mexico favour us and this is our main objective. If there is any opportunity that we think is reasonable, we may do it but it has to be reasonable at a fair price. We are very consistent on that, so we are very enthusiastic about the future of our operations in Mexico.

Mathieu Robilliard - *Barclays*

First, on slide 2 of your presentation pack, one of the items you highlight is the strengthening of your portfolio, as opposed to the focusing of your portfolio in the past, so I think Mr. Alierta you just mentioned Mexico as an area potentially for strengthening the portfolio. Generally conceptually where are the regions where strengthening of the portfolio could take place? Do you see more opportunities in Latin America or in Europe?

The second question has to do with Brazil. The GVT acquisition is not closed, but just thinking about the next few years ahead, obviously one of your competitors on fixed is quite weak. When we compare the GVT coverage to one of Net Service, for example in terms of households passed there seems to be a big scope for an acceleration of the growth of the network. Is that how you're thinking about Brazil, by that I mean would GVT be a good platform to penetrate more households in the regions where you're not present or you would be more focusing on transforming the existing homes passed into more subscribers?

César Alierta - *Telefónica S.A. - Chairman and Chief Executive Officer*

We are very happy with the present footprint and this is where we are. And we are very clear that we are concentrated on our core markets. And our core markets are very clear. In Latin America, there are three countries in which we are not, which are Honduras, Paraguay and Bolivia, and we are not going to go to Honduras, Paraguay and Bolivia. In Europe, we are very happy with our position in Germany and Spain, and that's it. Where we are going to go is in those markets. We do not perceive going into other markets at all. The focus now is on our present footprint and growing there, in which we think we have tremendous opportunities. José María will elaborate further.

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

Thanks, César.

On the GVT situation, once, and when, the regulators approve the transaction, we have shared what our ambition is. We are going to be combining the efforts of both companies and therefore, we are going to be significantly improving the network deployment of Vivo outside São Paulo in terms of fiber to the base station and we are going to be significantly improving both our backbone and our backhaul. You are right, in terms of our ultra-broadband deployment outside São Paulo, but also in São Paulo, we are going to be taking significant advantage of the GVT situation. In fact, in places where we are deploying fiber in São Paulo just today on the Vivo perimeter, we are gaining market share out of our competitors, including the cable operators, which means that we have a pretty competitive product, that the effort that we are doing in CapEx is paying off and therefore we will continue supporting the GVT effort outside São Paulo in the cities that were already considered.

So, overall we think that out of the approval of the GVT process you should expect us to keep investing and to keep growing both, and we aim to regain market share because of the fact that wherever we are competing with significant attributes like the speed and capacity, we are very relevant for customers and we are gaining market share. So pretty optimistic on the outcome, pretty confident that GVT will bring significant value and will foster our growth in Brazil.

Giovanni Montalti - *UBS*

What kind of competition especially on pricing do you expect in the content market in Spain going forward?

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

In Spain, as in other markets, but namely in Spain, we do see revenues accelerating or improving on the basis of a more rational market. Infrastructure-based competition means that all major players in the different markets, but mainly in Spain, are building more sophisticated all-IP networks, and that means that the sector is able to offer more sophisticated services both in core attributes like speed or capacity; but also in value-added services like Video, Financial Services, or others. That's why data traffic is booming overall, and mainly in Spain, with significant growth year over year, above 50% on average at the group level.

We have a product as a sector, data, that people love and need. And providing more value is what is driving effectively higher ARPU. So we see more rationality on the market on the basis of more sophisticated products, a significant infrastructure-based competition and, as a result of all of that, we see better trends in ARPU. This is what is driving revenue up, and also data monetisation part of bundling, in terms of out-of-bundle consumption.

So overall, I think that there is more rationality on the marketplace, focus on churn reduction and I think that we are going to see better fundamental trends in the Spanish market.

Giovanni Montalti - *UBS*

Sorry, if I may quickly follow up, in this context what kind of let's say inflation do you expect for the cost of content in Spain? Do you expect significant competition for example from the likes of Vodafone, Ono, or the players that in the past that were active in the content arena in Spain?

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

I think that, on the content side, you will see that, whenever the Digital Plus transaction will be approved, we will have a clear picture of what are the remedies that are imposed and therefore what are the wholesale offers that we will need to have.

So, overall I would say that it's probably going to go through wholesale offers, but I think that overall, the content cost is going to remain under a rational environment. But most of all, take into consideration that Pay-TV penetration is still very low in Spain and therefore the more it grows, the more diluted the overall content costs are going to be on the overall customer base.

César Alierta - *Telefónica S.A. - Chairman and Chief Executive Officer*

On top of that, you have to think that we are going to expand our Pay-TV in all Latin America, where the Pay-TV penetration is very low, which means the cost per user is going to go down for us very significantly in the coming years. Because if we look at the base of potential costs in Pay-TV in all the world, it doesn't have to do with total costs after what José María said, which is right, but we don't see the prices going up in Spain. But, the costs per user are going to be going down in the coming years. And that's very good news for us.

Pedro Oliveira - BPI

You provided in the last conference call the weight of "Fusión" in consumer revenues and the weight of consumer revenues in the total Spanish revenues. Can you please provide an update on this breakdown?

And the second question was regarding your working capital evolution. In the fourth quarter it seems to be around EUR2.5 billion. EUR400 million are explained by the provision in Germany. I was wondering if you could provide some detail on the remaining evolution.

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

Thank you for your question. In terms of "Fusión", we have reached 3.7 million customers with 1.4 million mobile lines on top of that. This is a 27% year-on-year growth. 73% of our fixed broadband is already in "Fusión". 57% of mobile contract is already in "Fusión". "Fusión" represents approximately 50% of the residential revenues in Spain, which approximately represent 50% of the total revenues in Spain. Churn in "Fusión" is 1.1%; significantly stable and significantly contributing to create value out of the product. So this is the overall figures that we have for "Fusión".

If I may complement, let me remind you that 80% of "Fusión" gross adds, are coming not to the basic product, but to a value-added service. Therefore, the accretion of "Fusión", so to say, in terms of value, keeps going up.

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

With respect to working capital, in the fourth quarter it has had a positive impact of EUR2.4 billion. Out of this, we have several factors; some of them are recurrent and some of them which are just one-time. Among the recurrent ones, we have the typical cyclicality of working capital and the evolution of CapEx accrual versus payments. We also have factoring.

But you have to take into account that there are also some positive impacts, which are not recurrent. One is the restructuring charge, not only the German one, but the overall restructuring charge. So something between EUR0.6 billion and EUR0.7 billion that has been taken from OIBDA but will be paid in 2015 and later. Second, out of the cost of spectrum that we accrued in Brazil, part will be the clean-up, that will be taking place in later years. And this is to the tune of EUR300 million. Then, we had also the advanced collection of some deferred payments that we had in the Czech Republic transaction. We had agreed some brand fees and some management fees to be collected across a period of four years from the buyer of the Czech Republic. And we negotiated with them in the fourth quarter to collect them in advance.

So, these would be some of the impacts that we have in this positive free cash flow figure in the fourth quarter.

Ivón Leal - BBVA

Maybe the first one in Spain. I think you've announced first price increase in broadband in January, to be applied in April. Do you think there's scope for further price increases in Spain, maybe on mobile and "Fusión" bundles?

And the second one on your financial cost. I don't know if you could remind us what is the average financial cost of debt, and if there is a scope for improvement going forward?

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

Taking your first question, we are seeing more upselling rather than price increases. What we are doing right now is, the more value we put into the offer, the more we see appetite from consumers to pay for that, and to value for that.

So this is part of the strategy that we are putting together. And this is especially relevant at the time that we are increasing coverage of, both LTE and fiber and on the TV side.

So overall, I would say that we do see a more rational behavior, both from operators but also consumers more willing to invest more value for more services. So that applies to fixed broadband, but that also applies to mobile contract; that also applies to value added services like voicemail or others. So overall, I would say better trends, more rational trends in the Spanish market, yes.

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

Regarding the interest cost. As you can see on slide number 29, we are seeing forces that are going in different directions.

On the one hand, we have the reduction of interest rates, which is clearly working in the direction of reducing our interest cost. But on the other hand, after we divested, for instance, Czech Republic in Europe and Ireland we have been cancelling some less-expensive debt in Europe. Also, we had some maturing euro-debt that had less cost than the debt that we have in Latin America. So the mix, in a lesser amount of total debt, is moving towards Latin America weighting more in the mix of our debt. And the cost of Latin American debt is 3.5 percentage points higher than the one that you can see in Europe.

We are still digesting the higher cost of debt in the refinancing exercises that we had to take through 2011, 2012, and partially 2013. But this impact is going to be fading away, and you will see, progressively, better interest cost flowing through our accounts.

We maintain a 5% to 6% range, but we're going to be, in 2015, in the lower part of that range. And in 2016 and forward, it would be improving.

David Wright – Bank of America Merrill Lynch

First of all, just on the net debt guidance. If you could just maybe talk us through some of the bigger sort of ticket items that you're expecting, so, for instance, the Hutchinson cash and obviously, we've got GVT cash out. Are you looking to exploit the option on E-Plus and also whether there are any convertible proceeds expected? So, just the big ticket sort of net debt items in the 2016 guidance please.

And then second of all, just a comment on Venezuela. You've moved to SICAD II but, clearly, the more commercial rate has gone way beyond that. Is this something that you could be forced to reconsider again in 2015 or is this something you tend to look at on an annual basis?

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

Thanks David. On net debt, the first outflow would be the acquisition of GVT. GVT is going to be financed from Telefónica Brasil with a capital increase to raise money in cash and then issuing shares to Vivendi. The cash portion would be consequently also financed by a rights issue at Telefónica parent level.

The capital increase in Brazil will be to the tune of EUR4.7 billion. Our percentage of that would be EUR3.4 billion. We are going to do a rights issue at Telefónica parent of up to EUR3 billion, less than those EUR3.4 billion because we feel that we have the room to do so. So, GVT basically is an equity financed transaction and should not have a major impact on net debt.

With respect to the O2 UK transaction, we are now in exclusive conversations. We are progressing nicely. I cannot comment on that because those are confidential but we are conducting due diligence with no surprises. The negotiations are progressing and we are highly confident that the deal will be successful. The figure is known, it's c.a. EUR13.5 billion. That cash inflow and debt reduction would be at the time of closing of the transaction, which would be subject to Phase II review in Brussels at some point in the first half of 2016.

Also another item that will impact our debt is the demerger of Telco. In the demerger of Telco, we´ll get 14.8% of Telecom Italia shares. Part of that, up to 6.5%, will be given in lieu of the mandatory exchangeable in TI shares, so that EUR750 million will not increase our debt, but out of the

EUR1.6 billion of debt that Telco has, our pro rata part of the debt of Telco, EUR900 million we will have to absorb in our balance sheet because we will not be selling 8.3% shares that we give to Vivendi. So we swap them, we don't sell them and that's about EUR900 million that will increase our debt.

With respect to the E-Plus option, it is out of the money. We have no intention to exercise it. What we could do potentially over time is gradually increase modestly our stake in Telefónica Deutschland.

Then, regarding Venezuela, what we saw is that events accelerated in the fourth quarter of last year. The last auction on the old SICAD I and SICAD II systems took place in October, there have not been auctions since then. And, in the first half of February there was a new FX system enacted in Venezuela where they joined the two SICAD rates and they created a new rate which is called the SIMADI marginal system of currency. So, we decided that the most prudent was to move to the most conservative of the official exchange rates prevailing in the country at the end of 2014, which was SICAD II at 50 bolivars per dollar.

SICAD has still not undergone any auctions of currency so far in this year. There have been some auctions of this new system, the SIMADI. Those are at much lower rates; to the tune of 150-170 bolivars per dollar. We are still assessing which would be the rate that we need to apply, but what is very important is that now Venezuela accounts for just 1% of our revenues. The cash that we have in Venezuela, after the move to SICAD II, is to the tune of €390 million equivalent, so any further devaluation that we could see in the country would have a negligible impact in our cash position. We have neutralised, we have mitigated completely this financial impact in our accounts while we continue to believe in investing in the country, obviously as much as we can, in local currency, because we are getting good operational traction in the country.

David Wright – Bank of America Merrill Lynch

That's clear. And just to come back on your comment on net debt, I think in the last conference call, when it was clear, you guys were maybe just heading a little bit over the original guidance for 2014. You did suggest you could look at hybrid instruments. I assume now with the O2 UK sale, that you would no longer need to go down that route. Is that correct?

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

Yes. That's correct.

Keval Khiroya – Deutsche Bank

Thank you. I've got two questions on Brazil, please. I mean, firstly, from an economic perspective, it sounds that the news from Brazil has become a little bit weaker. I think many expect it to be in recession for this year. What are your thoughts on how the Brazilian economy could affect your business in 2015?

And secondly, you've done a very good job at cost control in Brazil. OpEx was basically flattish in the second half of 2014 even though the latest inflation is now 6% or 7%. Leaving GVT aside, could you give us some color on whether you think that's sustainable and where maybe the OpEx trends should get to?

César Alierta - *Telefónica S.A. - Chairman and Chief Executive Officer*

With regards to Brazil, we are very optimistic, being realistic. We expect GDP to grow at least 3% in the medium-term and in the long-term growth of Brazil is going to be higher.

You have to take in mind that in the last decade, a large part of the population has become part of the middle class. Now, in the middle class and the upper income class there are 150 million people. This is one of the biggest markets in the world, 150 million people that are high consumers.

The position of the country is very good. The external debt is 21% of GDP, and the total net debt is 34%.

The reserves of the country cover 80% of external debt, so the financial situation that we're seeing, the potential is there; the market is there; and we are very happy to be number one in a market like that.

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

Taking your question on the cost structure of Brazil and the recent evolution. Overall, at the end of 2014, total operating expenses have been flattish, having declined 0.5% in the last quarter and flat year-on-year. If we open that split in terms of supplies, supply is roughly €2.7 billion out of the €7.7 billion total. They have been down 6.3% year-on-year and this is mainly due to interconnection. The interconnection drops that are significant in Brazil, that are affecting us on the revenue side, have another impact on the cost side and this is going to keep going as there is already a glidepath in place.

In terms of labour costs, which are roughly €976 million out of again €7,700 million, have been down 4.2% and will keep going down because we have been doing another round of efficiency in the first months of this year, so we are very internally demanding in terms of efficiency. You should expect us to keep focusing on efficiency on that front.

And then, on the other expenses which are €4.1 billion, they are up 6% year-on-year and those are mainly commercially driven. We are talking about handsets, we are talking about commissions and we are talking about promotions. And, again you should expect that to keep going because we do see profitable growth namely on the mobile side.

So overall, we think that we can keep going on the efficiency side. We have been able to absorb a 6% CPI in the country with significant focus on cost reduction; interconnection is positively affecting us in terms of interconnection expenses. We do think that on a standalone basis we can keep going into that direction.

Now, if you put in place the potential impact of the GVT transaction, we have announced an over €4.7 billion synergy programme which could significantly improve the situation as most of the other operating expenses are also network related. And, if we consider the fact that we need to connect more base stations with fiber, the backhaul synergies with GVT are very significant.

So, overall we are moderately optimistic on the trends of operating expenses in Brazil.

Luis Prota - *Morgan Stanley*

The first is a kind of a follow-up on Spain, and you were mentioning your expectations of coming back to revenue-growth in 2015. But it would be very helpful if you could give us some kind of guidelines, in terms of OIBDA margins in Spain. And I'm particularly interested in understanding the content cost. How much would that be on an annual basis? And how is that going to affect OIBDA margins in Spain in 2015 and 2016?

And the second question is a bit more theoretical one on the scrip dividend, relative to the share-buyback of shares that you are announcing and the cancellation 1.5%, which is pretty much in line with the amount of shares from the scrip. So, why keeping the scrip dividend in 2015 instead of just going for an all-cash dividend if, at the end of the day, you are going to buy a similar amount of shares and cancel? I understand that some shareholders might like the scrip dividend; but I don't know, as the share buyback you are mentioning is a tactical one, I don't know whether that means that it might happen or it might not. So anything you could elaborate on that would be helpful.

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

Thanks, Luis, for your questions. Taking the one on Spain, and namely on the OIBDA margin going forward. We are not guiding, as you know, on margin in Spain. Having said that, I can give you some colour on the trends that we are seeing. Overall, the total expense figure of Spain, which is

EUR6,965 million, has had a 1.1% decline during 2014. If you open up that: supplies, which are EUR2.6 billion, have been up 4.2% year-on-year, mainly because of the content and also because of the smartphones that we have been putting into our offer. In terms of labour force, it's EUR2.1 billion. They have been growing 1.2% as the measures that we took in 2013 are fading away, in terms of the contribution to the pension fund. And therefore, this trend should keep going. And in terms of other operational costs, which are roughly EUR2.2 billion, they have been down 8.5% year-on-year, because of the simplification effort that we have been doing.

Keeping an eye on 2015, content cost will keep going up, because of the new content that we are acquiring. But we're also working on other activities in order to mitigate the impact in margins, namely on insourcing activities and also on reconfiguring the distribution model, namely the amount of direct distribution that we have.

If you take the overall into equation and you also put in top of the equation the churn reduction that we are also seeing, we think that we should be able to have an attractive evolution of margins in Spain in the next quarters.

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

Regarding the second question, the scrip dividend was designed temporarily to accommodate three interactive targets.

One, the increase in investments, derived from acquisitions and CapEx that are weighting on our free cash flow. From our presentation, you see that we're going to keep on with substantial CapEx intensity in 2015-2016 and that will be easing in 2017.

So we wanted to accommodate with the scrip this increased investment intensity with our leverage and the shareholder remuneration objectives.

The share buybacks: as you know, as we announced publicly at the beginning of January, we have 2.88% of our share capital in treasury stock. So basically, what we're announcing now is to clarify the destination of this 2.88% that we already hold in treasury shares; that 1.5% would be cancelled this year and an additional rounding 1.5% would be cancelled in 2016 once we close the O2 UK transaction.

It's not that we're planning to acquire the shares and then cancel; it's the use that we're going to give to some shares that we already have as treasury stock.

Luigi Minerva - *HSBC Global Research*

I have a question on Spain and on how convergence will influence the pricing environment as your competitors will aim to rebalance their fixed and mobile market shares. So, for example, if you take Vodafone-Ono, they have a lower national market share in fixed broadband than in mobile; they should target selling Ono fixed services to Vodafone mobile customers in order to rebalance their market shares. So how is Telefónica going to react? Will you accept some further loss in fixed broadband market shares? Or will you defend your market shares with pricing?

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

Thanks for your question. We see that from other perspective. The consolidation of the market, the example that you gave on Vodafone-Ono but potentially also the case with Orange-Jazztel, means that the major competitors in Spain on the convergence side are going to have similar overall ARPUs in the blended scenario, which means that the average mobile ARPU and the average wireline ARPU is going to become pretty similar once you put both things together. If on top of that you consider the fact that both companies, both Vodafone and potentially Orange, have been investing significant resources to acquire both Ono and Jazztel, that means that they would need now to defend higher ARPUs in order to make sure that the value that they acquire is not destroyed. And on top of that, let me also remind you that it takes a while before you have a clear picture of what is the blended strategy, because you need to combine systems that are not similar. It took us, in the case of Spain, being in the same company for a long while, almost 1.5 years to have a clear picture of the wireline customers that have or have not a wireless offer within the Group.

So overall, we think that we should expect a more rational performance and behaviour from our competitors as they become integrated and I think it's going to be shown not just in a more rational pricing scenario, but also in a more rational subsidies approach, in terms of being more focused on defending their core customer segments. And therefore, we think that the core of the subsidies is going to be devoted at the market level to retain existing customers.

This is how we see the market today. We will update you. But in our view, the trends are all going to a more rational behaviour in the Spanish market.

Jonathan Dann - *Royal Bank of Canada*

Fantastic results and I understand the Spanish turnaround very well. A question on cash flow and the EUR0.75 dividend. Going forward, will the decision on whether or not to have a scrip dividend be based on if the annual cash flow is higher than the cash cost of the dividend? I guess to simplify, do you think going forward you will have annual free cash flow of mid-EUR3.5 billion and, hence, be able to pay a full cash dividend? Or is there some other decision around the scrip?

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

The answer is absolutely yes. That's why we're saying that we will move in 2016 to full cash dividend of EUR0.75 per share.

Fernando Cordero- *Banco Santander*

The first one is related with the UK and particularly with the Sky agreement, MVNO agreement. I would like to know to which extent this contract is already similar in terms of the structure of the contract to the new MBA - MVNO contracts to be signed in Germany, just to understand to which extent this contract is already aligned with the potential remedies to be seen into the O2 regulatory approval process.

And the second question is related with regulation in Brazil. On top of the discussions, or the general discussions or talks on potential changes on the fixed concession framework, I would like also to know if you are expecting or foreseeing any kind discussions on other changes in the regulatory framework, like, for example, talks about the spectrum caps, about the spectrum re-farming in Brazil and so on.

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

Thanks for your question. On the UK question, on the Sky MVNO, the contract, as you might imagine, is subject to confidentiality clauses, but it's nothing different from the kind of contract that we have signed with other plays like TalkTalk. For us, the good news is that big wholesale customers like Sky, being able to choose between different options, decided to choose for O2. The answer to that is because we have right now the best customer experience in the world network.
In terms of if that can be considered a remedy for the potential outcome of the consolidation that is going on in the UK market; well, it certainly creates a new player in terms of the mobile side. But again, this is not a major game changer considering the current scenario of MVNOs in the UK.

In terms of the regulation in Brazil, we are holding discussions with the regulators because of the GVT transaction and also because of the concessions. We are discussing mainly on every single matter, but we do see a more, I would say, rational approach in all fronts in Brazil as well. The LTE spectrum has already been auctioned as you know; in 2015 we will be cleaning up the spectrum in order to prepare it to being exploited. And in terms of spectrum caps; too soon to say. It's all going to depend on the final picture on the Brazilian market, which is a moving target as we speak. So, no major news that I can share with you on that front, unfortunately.

Cesar Alierta Izuel - *Chairman and Chief Executive Officer*

Well, thank you very much for your presence in this conference call and for your questions, which have been very important.

I want to remark again that 2012-2014 has been a key transformation of Telefonica into a telco digital. We are very, very confident that 2015 and 2016 are going to be really growth years.

On top of that, I just want to add a comment that I think the chain of regulation in the digital ecosystem is going to change for much better in this year and in the next year for the telcos; and the value chain is going to be what it has to be. That will be very good news for all of us. Thank you very much.