Telefónica January-March 2016 Results Conference Call Transcript

29th April 2016

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Introduction

Pablo Eguirón - *Head of IR*

Good afternoon and welcome to Telefónica's conference call to discuss January-March 2016 results. I'm Pablo Eguirón, Head of Investor Relations. Before proceeding, let me mention that financial information contained in this document related to the first quarter 2016 has been prepared under International Financial Reporting Standards, as adopted by the European Union. This 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 release and the slides, please contact Telefónica's Investor Relations team in Madrid by dialling the following telephone number, +34 91 482 8700.

Now, let me turn the call over to our Chairman and CEO, José María Álvarez-Pallete, who will be leading this conference call.

Presentation

José María Álvarez-Pallete – *Chairman and Chief Executive Officer*

Q1 16 Highlights; a good start

Thank you very much, Pablo, and good afternoon to all of you. I am pleased to show on slide 3 this quarter means a very good start.

Our sustainable growth profile has once again accelerated, with organic revenue growth at 3.4% and 5.5% in OIBDA year-on-year, levered on an expansion in the higher-value customer base, which is enforcing digital experience and loyalty. All this, along with capture of synergies and enhanced efficiencies allowed us to maintain margin at 31% level, expanding 0.6 p.p. year-on-year.

We have continued to enhance our differential network experience through sustained investment.

Spain has returned to simultaneous organic revenue and OIBDA growth for the first time since 2008. Brazil and Germany are delivering strong OIBDA & Operating Cash Flow growth on synergies. Hispam is accelerating its top line growth on strong performance in value customers. This proves that our market positioning strategy is paying off. On the other hand, Telefónica UK has posted a continued strong profitability while continuing to lead the market in contract churn.

We start the year with a robust liquidity position, after achieving historically low rates on financing. Let me highlight we have €20bn liquidity, including the Euro bond issued in April, which covers all our maturities through to December 2017, and that's not taking into consideration any cash flow generation.

Our mid-term Net Debt/OIBDA target remains at below 2.35x and we reiterate our 2016 guidance and dividend.

Financial summary

To review Telefónica's key financials, please turn to slide 4.

Organic growth ramped-up in the quarter, with revenues, OIBDA and OpCF accelerating their year-on-year growth trends vs. the previous quarter.

Reported figures were negatively impacted once again by the devaluation of Latam currencies, though this impact was partially mitigated by the positive contributions from GVT and DTS.

It is important to note that the negative impact of FX at OIBDA level did not leak through into free cash flow as it was offset by lower CapEx, tax, interest and other payments. So, as in previous quarters FX impact is mitigated at FCF level.

Lastly, Earnings per Share stood at 0.14 euros vs. 0.37 euros last year, which was positively impacted by a 1.2 billion deferred O2 UK tax asset. Excluding this impact, EPS would have grown 21.7%.

Q1 performance in line with year-end targets

I am also pleased to confirm that we are fully on track to meet 2016 guidance as our Q1 figures are in line with expectations.

In terms of shareholder remuneration, on May 19th we will pay 0.40 euros per share in cash corresponding to the second tranche of the 2015 dividend. Our proposals for the cash dividend (subject to the receipt of O2 UK proceeds) or voluntary scrip dividend, of 0.35 euros per share to be paid in the second half of 2016, and the 1.5% of treasury stock to be cancelled, are both included in the agenda of the Annual Shareholders' Meeting, which will be held on 12th May on second call.

So again, 2016 dividend is confirmed at 0.75 euros per share.

Best quality customer base

On slide 6, we show how the quality of our customer base is incrementally improving.

The main pillars of growth continue to be high-value services that also drive data consumption: LTE, fiber, smartphones and Pay TV.

The penetration of these high-value accesses in the overall base is also noteworthy, as can be seen on the bottom left of the slide, with impressive growth across the board.
This shift towards higher-value offerings has resulted in tangible growth in customers' value, with Average Revenue per Access up 5.2%, and in customer loyalty, with churn down 0.6 p.p. quarter-on-quarter.

OIBDA growth across the board

On slide 7, we explain the drivers behind our 5.5% year-on-year organic OIBDA growth. Let me highlight that OIBDA grew for the 7th consecutive quarter and, more importantly, all of our regions are already growing, making this growth sustainable and diversified.

Revenues also proved their sustainable track record, expanding for the 12th consecutive quarter. New revenue streams are leading the way to becoming an Onlife Telco, with a strong performance in Connectivity. Organic growth is ramping-up vs. Q4, mainly on Hispam and Spain.

It is also remarkable that revenue growth is driven by an acceleration of service revenues in the quarter to +4.2% which is partly mitigated by lower handset sales and regulatory effects, thereby increasing the quality of our growth.

Operating cash flow accelerated to 3.6% year-on-year on the aforementioned OIBDA growth, deceleration in OpEx and margin stabilisation. The latter has been driven mainly by the savings arising from synergies delivery and efficiencies from our simplification program and cost rationalisation.

Further advances in data monetisation

Slide 8 shows the continued evolution of main data monetisation metrics. Smartphone traction continued and average usage per smartphone was up 13% year-on-year while LTE customers used 60% more data than 3G users. LTE penetration represents 15% of the total.

In addition, we have a strong upside in Hispanoamerica, where prepay smartphone penetration is at just 29% and ARPU uplift once a customer starts using data is approximately 20%.

All this translated into data revenue growth of close to 20% year-on-year as a result of the double digit LTE ARPU uplift.

In terms of fixed data, we are starting to address the opportunity as traffic expansion leads to increased demand for faster speeds.

Digital Services: monetising beyond connectivity

Digital services, as seen on slide 9, are driving impressive revenue growth, 19% up year-on-year, accelerating nearly 4 p.p. vs. the previous quarter.

This boost is built on our key digital pillars, Video, Security and M2M, which have all seen strong improvement.

Video continues to drive traffic and ARPU growth thanks to our expanding presence in Latin America, with high-quality services, and our own productions and exclusive content in Spain.

We are also proud to continue to offer customers an increasing number of digital services bundled into traditional connectivity packages.

TGR: Adding value through technology evolution

On slide 10, we demonstrate how TGR is adding value for the Company.

We have continued to accelerate our rollout of future proof UBB networks, with 32 million premises passed with fiber, up more than 25% year-on-year on FTTH, and LTE coverage of 50%, up 16 percentage points.

Our current progressions towards an All-IP network is solid, with VoIP accesses at 5.2m and VoLTE available in 3 countries after deployments in Peru and Colombia.

On the IT side, our E2E Digitalisation strategy is fostering transformation via Full Stacks projects and our IT transformation are having a significant impact on business, providing us with new digital capabilities.

Lastly, we deployed a new Big Data project to improve customer experience and a successful SDN-IP trial in Perú.

Now Ángel will give you more details about our performance in the quarter.

Ángel Vilá – *Chief Strategy and Finance Officer*

Spain: Focus on growing customer value

Thank you, José María.

Let me turn to slide 12 for a review of our business in Spain.

Commercial activity in the quarter slowed down and reflected a momentary pick-up in churn following tariffs repositioning. However, commercial momentum progressively recovered, as net adds and churn improved throughout the quarter and normalised in March.

"Fusión" delivered a strong quarterly ARPU growth to 78 euros (+14% year-on-year) underpinned by a better customer mix, tariff adjustment and the end of the TV Premium promotion on December 31st. I would like to highlight that around 75% of customers who had subscribed to the promo have stuck to at least one TV add-on.

Overall, this outstanding increase in customer value is the result of the strong effort devoted to building a leading proposal, placing us in a very solid market position. The FTTH network now reaches 15m premises passed, LTE coverage 83% of population and the quad-play offering is the most complete and competitive nationwide.

Spain: Revenue & OIBDA growing including DTS

In this first quarter, Spain returns to a simultaneous year-on-year organic growth at both revenue and OIBDA level, starting a new growth cycle.

Top line posted a 0.2% year-on-year organic growth on the back of a strong transformation.

Turning to segments' performance, Consumer revenues are growing, underpinned by solid "Fusión" revenue, +26% year-on-year, while Business revenues are improving, driven by a change in the mix from pure communications services towards a richer IT offering.

More significantly, OIBDA posted a turnaround with a 2.0% organic increase leading to a benchmark OIBDA margin of 40.5% (up 0.7 p.p. year-on-year organically).

Let me mention that the voluntary redundancy plan still did not show any positive impact in the quarter, as employees' departures have started on April 1st.

And finally, the OpCF trend also improved significantly, being virtually stable year-on-year in organic terms, up 7 p.p. sequentially from a decline of 7.5% in the previous quarter.

Germany: Continued data monetisation

To review Telefónica Deutschland, please turn to slide 14.

We are keeping our momentum in a dynamic environment with a focus on retention over acquisition, with continued traction from partners. In this context, partner share of contract gross adds has been broadly stable around 45%.

LTE is the main lever of positive data monetisation, with customers up 10% quarter-on-quarter and usage 50% higher year-on-year helped by video and music streaming.

Total revenues declined 2.3% year-on-year affected by lower handset sales.

Fixed revenues maintained trends sequentially with record VDSL net additions.

Germany: Progressing in integration

Further progress on integration is shown in slide 15 with repositioning of the O2 brand, customer base migration, network integration and IT transformation.

These initiatives require significant investments, in terms of OpEx in the first half of the year with incremental synergies in the second half.

In parallel, network improvements are recognised in customer survey-based tests.

On profitability, we captured 55 million euros of OpEx & Revenue synergies in Q1, which are reflected in the 6.2% OIBDA growth year-on-year and the 1.8 p.p. margin improvement.

CapEx was down 1.2% versus Q1 15 as costs of integration efforts are back-end loaded and as a result, OpCF grew 16% to 173 million euros.

Brazil: Focus on profitable growth

Please turn to slide 16 for an update on Brazil.

In mobile, we continue increasing penetration in high-value products, leading to an ARPU growth of 14% year-on-year despite the weaker macro environment and regulation impact.

In the Fixed business our strategy is paying off:

- FBB ARPU increased 8% year-on-year as a result of the fiber network expansion outside Sao Paulo and the improvement of the legacy copper network.
- And Pay TV ARPU accelerated 13% year-on-year thanks to our differential value proposition.

Let me also remark that Brazil finalised the successful execution of the brand unification in April 2016.

Brazil: Best-in-class profitability

On slide 17, we continue outperforming the Brazilian market, posting positive revenue growth in both businesses thanks to our data-centric strategy.

It is worth highlighting the 7 percentage points sequential improvement in year-on-year OpEx evolution, despite inflation pressure, due to:

- First: a more selective commercial approach
- Second: credit and collecting actions to improve the bad debt trend
- And finally the early synergies the company has started to capture, which amounted to 48 million euros in OIBDA

As a result, OIBDA growth accelerated to 8.2% and OpCF to 32.1% year-on-year.

HispAm: Growing adoption of high-value services

Turning to slide number 18 let me summarise Hispanoamerica's commercial performance.

Commercial momentum was maintained in Q1 with the adoption of high-value services. As such, contract accesses grew by 7% with net adds 8 times higher than in the first quarter of 2015. FBB and Pay TV continued to show solid growth rates and increasing penetration over fixed lines.

- In Argentina, smartphones posted strong net adds, boosted by LTE deployment, and FBB maintained low levels of churn.
- Chile posted the best growth in contract accesses in the last 4 years while continuing to improve speeds on FBB.
- Peru once again presented outstanding figures in FBB & TV on the back of its differential assets and quality.
- Colombia posted strong net adds and low churn.
- And finally in Mexico, contract net adds grew 4 times year-on-year despite the higher level of competition.

HispAm: Focus on quality flowing into revenues

Moving to slide 19, the outstanding commercial performance is flowing into revenues.

Revenue accelerated to 11% year-on-year thanks to the improvement experienced mainly in Mexico, Colombia and Argentina. It's worth highlighting the growth registered in strategic services, like mobile data, fixed broadband and Pay TV.

Despite the negative impact of the depreciation of Latam currencies, the intense competitive environment in some countries and the pressure of inflation in some others, OIBDA grew 1% year-on-year thanks to outstanding data growth, efficiency measures and a more rational commercial approach.

UK: Market benchmark performance

On slide 20, we give you a brief overview of our operation in the UK.

Commercial traction continued, leveraged on a best-in-class customer experience and on successful propositions, which resulted in sustained contract churn at the market-leading level of below 1%. Quarterly contract net additions reached 115 thousand, driven by LTE, and a penetration of 38%.

All this formed the foundation for the seventh consecutive quarter of MSR growth, +2.6% year-on-year ex “Refresh”.

Lastly, profitability is worth noting: OIBDA and OpCF were up 5.5% and 16% year-on-year respectively, and OIBDA margin increased by close to 2 percentage points, reaching 26.3%.

Leverage impacted by Q1 seasonal effects

Let me now move to the financial slides starting on slide 21.

Net debt at the end of the quarter stood at 50.2 billion euros; almost flat versus December 2015 figure despite seasonality impacts that usually take place in Q1, partly thanks to the savings related to GBP hedging.

For the remainder of 2016 and beyond, our leverage will reflect the cash flow generation from improved operational performance combined with corporate actions. All in all, we are on track to achieve our medium term leverage target.

Strong liquidity to face upcoming maturities

On slide 22, we continued reducing the effective interest cost in the first quarter, which has moved down by 39 basis points year-on-year, to 4.66%.

Our liquidity cushion, after the last euro bond issued in April, reached 19.9 billion euros, covering the full amount of 2016 and 2017 maturities, without considering cash generation, additional financing nor credit lines extensions.

Also, this cushion has been strengthened through 9 billion euros long-term financing since November 2015 (5 billion euros year-to-date), accessing different pockets of liquidity and benefitting from lowest historical benchmark rates.

Telxius: a leading telecom infrastructure Co.

Please turn to slide 23 for an update on Telxius, our infrastructure Company, one of the leaders in the sector in Europe and the Americas.
Telxius was created with a selection of Telefónica’s well-diversified assets and includes approximately 16 thousand towers in Spain, Germany and some countries in LatAm plus more than

65 thousand kilometers of fiber-optic submarine cable, of which around 31 thousand kilometers are owned.

Telxius's attractive proposition includes a high level of revenue visibility going forward, given the long-term contractual terms and the strong cash conversion, based on the low levels of recurrent maintenance investments and the strong profitability, around 45%.

In terms of financials, initial 2015 proforma figures indicate that revenues would reach around 680 million euros and OIBDA around 300 million euros.

Now, I hand back to José María for the concluding remarks.

José María Álvarez-Pallete – *Chairman and Chief Executive Officer*

Conclusion

Thank you, Ángel.

To recap, we had a solid start of the year.

First, our growth is accelerating, leveraged on a strong execution in fiber, Pay TV and LTE, which are delivering a differentiated network experience and, as such, OIBDA is growing across the board.

Second, Spain achieves both Revenue & OIBDA growth, while OpCF is stabilising.

Third, synergies captured and efficiencies led to a strong OIBDA growth and margin stabilization.

Fourth, OpCF is sequentially improving growth with targeted CapEx.

And finally, we confirm our outlook and dividend for 2016.

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

Q&A session

Mathieu Robilliard – *Barclays*

First, I had a question with regards to the potential UK transaction. If we assume for a moment that it may not proceed as expected, are you in a position to explore different strategic options right after that decision has been disclosed, or would you have to wait, for example in case your partner decides to appeal the decision, before you can take any action?

The second question has to do with Spain, where obviously you had a very strong performance; I was wondering if you could elaborate a little bit about how you think you can continue to differentiate in the fixed business considering that both Vodafone and Orange are expanding their fiber network and will also have access to content, notably soccer?

José María Álvarez-Pallete – *Chairman and Chief Executive Officer*

Taking your first question. First, allow me to say that Telefónica is convinced that the remedies that have been offered from Hutchison, we think address all the Commission's concerns. We think that those remedies are unprecedented and, nevertheless, we cannot exclude a level of political interference that can affect the decision of the Commission. We have several reasons to think that the merger merits a clearance decision.

First, this transaction we think will have a positive impact on effective competition in the UK market, in particular with regard to price competition, network quality and consumers' choice. We think that the failed Denmark merger is not comparable and that this transaction is much more similar to the Austrian or the Irish or German cases. We also think that the preliminary concerns that were exposed by the European Commission in their Statement of Objections are not materially different from the concerns that were raised in those previous cases, which by the way were cleared. I think that they are very similar to the German or the Irish cases. We also think that the remedies that have been offered by Hutchison are unprecedented, in terms of divestment in Tesco Mobile, which is 5% of the market share; offering a fraction of the combined network on a perpetual capacity based deal; and other capacity deals that were amounting to more than 40% of the combined network enhancement of the new entrants. All those remedies are substantially larger than the ones that were given by Telefónica in Germany, which by the way, the Commission recently described as quasi-structural in nature and conceptually close to an MNO.

So, basically we think that the remedies proposed by Hutch are more than enough to address those concerns. The decision of the Commission should be coming in May and we think that this transaction has been designed to really benefit the UK consumers.

Having said all of that, we think that the strictly legal analysis will justify a clear decision. But a negative decision cannot be disregarded, probably due to political reasons especially in the context of "Brexit", which is basically contaminating all debates; and also the strong opposition shown by the national regulatory authorities.

Our UK asset is a very attractive asset and has, by the way, continued to outperform our competitors on most key metrics. Regardless of the final decision taken by the Commission, we enjoy, as we have been stating, a very comfortable position in terms of liquidity because of the long-term financing that we have been achieving throughout this year. And therefore, we are ready to face a decision in whatever direction. We have put in place other initiatives to strengthen our financial flexibility and, in order to cover those, I hand over the question to Ángel.

Ángel Vilá – *Chief Strategy and Finance Officer*

Hi Mathieu, this is Ángel. You had a very specific question which was; "would we be bound by the contract when Hutchison would be appealing, if the decision was negative?". The answer is that we would only be bound until the moment when contractually there is what is sometimes called a "drop dead date", that does not stretch beyond the end of the second quarter.

With respect to what could be the financial implications were the deal to fall apart, first you have to take into account the strong free cash flow generation that the Company is going to produce. Second, that while consolidating (in that case of the deal not going ahead), the UK activities, our debt service and our dividend coverage would be improved. Third, we have already announced financial measures for that eventuality, including the voluntary partial scrip dividend in the

November tranche of 35 cents. Fourth, we are executing portfolio management measures regardless of the outcome of the UK, for instance releasing capital through transversal businesses like the potential Telxius IPO. We continue to review our geographic portfolio of assets. We are looking at the potential divestment of non-core assets and we're also evaluating minority stakes like Mediaset Premium, which has been dragged along by Mediaset. And finally, we would have several alternatives regarding the UK asset once the EU decision would become clear and final.

José María Álvarez-Pallete – *Chairman and Chief Executive Officer*

Taking your second question on Spain and our strategy in order to differentiate our offer. First, allow me to say that we do think that we have a best in class platform in Spain compared with our local competitors and namely at the level of European competitors.

We have the most extensive ultra-broadband network in Europe and the most complete compared with any of our competitors here in Spain. We have seen 83% of LTE coverage. We have one of the strongest, if not the strongest, TV platforms in terms of technological capabilities, catch-up TV, video on demand, "last seven days" recording and on top of that we have the best content of all the markets because remember that, in terms of premium content we are bound by the remedies out of the DTS transaction to offer 50% of the content premium to our competitors, and therefore they need to choose between the different ones.

That's why we think we have best-in-class growth and also best-in-class churn and customer loyalty around the Spanish situation. So, you should expect from us to build on those, on the technological capabilities of the platform, of the network and therefore, features like symmetric speed upstream/downstream and upgrading our offer, is the strategy going forward in order to upsell our customers and, therefore, to keep growing momentum on ARPU and customer base in Spain. So we feel in a strong situation, we acknowledge that there is strong competition, the infrastructure-based competition, which we think is the soundest competition, but we still feel that we have a very unique set of assets that allows us to be positive for the future.

Mandeep Singh - *Redburn*

Hi, thank you for taking the question. I'm really focused on sort of the development of trends in Spain, clearly you had a slow start to the quarter due to price changes and you said commercial activity picked up.

I just want to get a sort of picture of how the rest of the year will develop, I'm not looking for quarterly guidance because I appreciate you don't give that but, when do the extra content costs kick in? When do the headcount savings kick in?

Is the revenue trend, now that we're positive, is it sustainable, is the OIBDA trend now that it's positive, because you referred to the slides as a start of a new cycle which suggests to me you think of it as sustainable. So if you can just sort of map out when the extra content costs kick in, when the extra labour costs savings kick in and how the year could pan out please?

Thank you.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

Thanks for your question. In terms of the trends that we foresee, we think that those trends are going to be confirmed all around these years.

In terms of revenues, we highlighted on the last quarter of 2015 that we were aiming to have growth combined with DTS and we are already there.

We have had two offers' upgrades in terms of putting more value for a slightly, a little bit more of price in the last 12 months. In spite of that, churn is relatively stable, and in fact the performance of churn in the last month of the quarter, in March and what we have seen so far in April, confirms a better performance. And also in terms of competition, we see competition in Spain being much more focused on value than on price and therefore, we think that the trends that have been built all along the last 4-5 years in Spain are sustainable and should be going into this direction.

In terms of our OIBDA impact, namely on content impact and in terms of the efficiency plan that we have put in place in Spain, remember that this first quarter already includes an extra cost of the Champions League that was not there in the last quarter of 2015; therefore the first impact of content costs has already been there and we have been able to neutralise that in spite of the fact that we have been having no savings coming from the voluntary retirement plan in Spain, because the exit time for our employees was starting on 1st April. So, the first quarter of 2016 includes an extra cost of content and has no positive impact from efficiency coming from this voluntary retirement plan. As a result, we do think that OIBDA trends are also going into the right direction.

The next stage is operating free cash flow growth and we are targeting to get there. So, overall more positive trends in the Spanish market. The overall environment in terms of competition is much more focused in value, in upselling customers than in price overall, and again I think that infrastructure based competition is motivating all of us to put more value on top of the table and that the customers are appreciating those attributes like speed, connectivity, content, technological attributes of the platform and we think this is the right market dynamic.

Luis Prota - *Morgan Stanley*

Yes, hello, two questions please. Firstly, on Fusión and the broadband market. Your net growth in broadband clients is just below 1% and you have now like 70% of the broadband base which is already in Fusión. So, what I want to understand is what are your expectations in terms of the total broadband market growth in Spain? And also, in terms of the migration of non-Fusión clients to Fusión clients, whether you could give us the ARPU of the non-Fusión clients now and what are the dynamics in the migration of non-Fusión to Fusión. What I mean is whether you expect reaching 100% of your broadband base in Fusión or this is not realistic for whatever the reason and maybe it's just 80% or 90% and how fast that would happen, so your thoughts in this would be very helpful.

The second question, I'm sorry for long first question, the second one is on the refinancing opportunity you have. I would like to understand what are your expectations in terms of lowering interest costs in the next few years? You have above 7 billion upcoming maturities annually, so what could be the potential extra cash flow coming from this area taking into account the average coupon of those maturities and the potential new coupon of the new bonds? Thank you.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

Thanks Luis, a pretty complete first question. Let me try to address it.

First, we still see growth in terms of penetration of Fusión customers on the total bundle and therefore we still see growth ahead of us in terms of bundling more customers and therefore bringing more customers from the competition to a bundled service from Telefónica. So, do not give up in terms of organic growth in terms of number of accesses.

In fact, remember that Fusión right now, the customer base, is 4.2 million, it has been growing 9% year-on-year and with 1.4 million of additional mobile lines, we have been growing on top of that 9% year-on-year as well. It is true that this first quarter has been negatively impacted by the tariff repositioning and by the TV promo benefits that ended on December of last year, but also remember that there are no retention clauses anymore and, therefore, now the market is much more dynamic.

Remember that in terms of the gross adds of this quarter, 51% were totally new customers, which is 13 percentage points of growth year-on-year, and 91% of those were bringing new accesses, which is again 9 percentage points of growth year-on-year. If you add on top of this organic growth the fact that we see a huge amount of possibilities in terms of upselling the existing customer base, high value mobile has been 74%, ultra-broadband is also doing significantly better.

We are also upgrading our TV customers. So, we see growth on the Fusión part of the residential revenues coming from both the organic additional new customer base and also from upselling our customers.

And in terms of calculating the ARPU of the non-Fusión customers, I think that we have disclosed the number of non-Fusión customers and you have also the figure of non-Fusión revenues, so we can help you through the IR department to calculate those numbers. I think that those numbers have been disclosed.

I will hand it back to Ángel for the second part of your question.

Ángel Vilá - *Chief Strategy and Finance Officer*

Hi, Luis. Our guidance of effective interest costs is below 5%, on a declining trend. At the end of the first quarter we had 4.66%. This 4.66% is a weighted average of the cost of debt in Europe and debt in LatAm. Debt in Europe, our cost right now is around 3.6%, in LatAm around 8.7%, so an assumption you can make is from that 3.6% a reduction of 1.5 p.p. to around 2% cost. You can apply this to the €6 billion refinancing average that we have every year of this type of debt, so this can lead you to some substantial savings on interest costs.

Ivón Leal – *BBVA*

Good afternoon everybody, just two questions again on Spain. The first one is, I would like to understand if there is still some potential revenue erosion from the old Digital+ pay TV subscribers migrating to your platform. So, I don't know if you could share with us how many pay TV subscribers are still Digital+ subscribers, what is their ARPU and what kind of ARPU we should expect from them when they migrate to Fusión pay TV offer.

And the second one, maybe on football, has your approach to the football rights changed at all since December or you think that football rights have the same value that you agreed to pay for in December 2015?

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

In terms of your first question on the potential revenue erosion of customers coming from the former DTS customer base, let me tell you that the initial overlap has been mostly covered in terms of customers moving to the "Movistar Fusión" bundle or customer just exiting or quitting the Telefónica Group perimeter. So, most of this process has already been made and in spite of that, if you go to the reported figure of Telefónica, overall pay TV customers have been growing year-on-year, which means that we have been adding more customers than the ones that have been leaving us and as a result what I can share with you in terms of overall number of customers, this overlap has been mostly covered. There is still a significantly minor part of the customers that haven't decided yet.

We read out of that, that some of them will preserve both platforms because it might be their second residence, so basically in our estimates most of this process have already been covered and in spite of that, we have been able to grow pay TV customers in Spain and to grow pay TV ARPU.

So I think that this migration, once both databases have been combined, has been proactively managed, in terms of outbound call centre calls, and I think that we can read out of that, that this negative synergy coming from this DTS integration has almost been covered. So we have, in order to give you an idea, out of the total number that we had initially, something in the neighbourhood of 15-20% of these customers still pending of a decision. But most of them, we read that they will not be giving up both services. We'll keep you posted but what we can share with you is that most of that migration process probably has already been completed.

And in terms of the content, you know that we signed with Mediapro an agreement for the next three years. This extra content cost will start to flow starting from mid-August with a new La Liga championship for 2016/2017 and all the other content that we have, Formula 1 or MotorGP, we have also those rights signed for the next three years. So, I think that, over all these years you will have a full picture of what could be the extra costs.

Allow me to remind you that both Vodafone and Orange have decided to buy this, La Liga content from Bein, as well and that we have one of the packages, which is "El Partidazo", and therefore, I think that all along this year you will have a full picture of what could be this impact going forward for the next three years, both in terms of extra costs but also in terms of extra wholesale revenues for Telefónica going forward.

All in all, what I can share with you is that this extra content cost, we think is less than the savings that we are going to be able to generate with the efficiency plans that we have put in place and therefore I think that the equation is sustainable at least for the next three years.

Ivón Leal – *BBVA*

Okay, thanks José María, I thought you had to renegotiate your agreement with Mediapro because the regulator had for those eight matches per week.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

No, first piece of information.

David Wright – *BofAML*

Hello guys, thank you very much for taking the questions and congratulations José Maria on your new appointment. I'm just trying to understand the commercial activity in Spain with the Fusión adds running significantly below run rate. You have said that that was restored in March, but clearly that does correspond to poor adds when there were no promotions and then better adds when you relaunched the promotions at the beginning of March with the €65 package for ’15, so how should we read this? Does this mean dropping promotions means commercial momentum falls and churn picks up and in which case how sort of confident does this leave you feeling with the mid-term monetisation of content costs given it was somewhat predicated on promotional spin-off?

Then just my second question, just to clarify, you said a moment ago extra content costs should be more than offset by cost savings on the suspension plan. Do you mean OpEx savings or do you mean the actual cash cost savings if we assume the pre-retiree payments or the suspension plan payments? Thanks.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

Thank you very much for your first part of your question. In terms of the commercial activity we think that we need to read the Spanish market in a way that we will need to combine promotions with upselling of the offer. And therefore, now that the market has become more value oriented, I think that there is a strategy that we should follow in terms of adding new customers and at the same time trying to upsell those, and therefore you should expect from us to combine both things.

Tactical promotions are the ones that we have been putting place just for new acquisitions, for new customers, starting last month and that we have been extending; and also in terms of upselling the offer in terms, of putting more value for the existing customers or more optionality for the existing customers. Also remember that again, there is no more retention clauses and we keep deploying fiber to new zones in Spain. Therefore, I think that going forward there is a smooth way of trying to combine new covered zones, new coming customers with a reshuffle of the offer in order to try to upsell our customers, that’s why we think that combining both things, commercial aggressiveness in order to attract new customers, namely to the bundled product, with trying to monetise the new networks that we are deploying, should help us to keep the revenue growth momentum in Spain and therefore to cover the extra cost coming from content cost.

And in terms of my previous comment, in terms of the content cost being more than covered by efficiency, I was talking about OpEx but I have also highlighted that we are approaching a point in which operating cash flow in Spain, OIBDA minus capex, is going to start to grow, so we are going to be putting in place other cash that should allow us to be able to transfer this growth into a sounder or an increasing cash flow generation in Spain. So we are not giving up in any of the fronts, neither at the OpEx level nor at the cash flow level.

David Wright – *BofAML*

I see, just for the purposes of our understanding the modelling side, when you say operating cash flow, OIBDA minus CapEx, that clearly does exclude the 68% payments out to the suspension plan employees, correct?

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

Correct, at this level correct.

Giovanni Montalti – *UBS*

Going back to the UK, I'm just trying to understand how we should think about these assets. Assuming that the deal with Hutch doesn't go through, what would be your Plan A? Staying in the UK and let's say eventually seeking some strategic options that could give you a conversion asset base, or Plan A is still leaving the UK market? Thank you.

Ángel Vilá - Chief Strategy and Finance Officer

Hi Giovanni. First, I should reiterate what José María said at the beginning of the call; this is still pending a decision. In any case the UK asset is a very attractive asset. As I was saying when I was doing the presentation at the beginning, mobile service revenues are 2.6% up, margin is up two percentage points, 26.3%; cash flow generation is very strong and it can be even improved through working capital measures. So, it's a very attractive asset.

In addition to this, the whole discussion on remedies that has taken place with the Hutchison process has made everyone's priorities and intentions quite clear, so this provides good visibility on what could be feasible alternatives. And again, the asset is very attractive, so we have plenty of alternatives.

Some of them could allow us to combine the UK cash generation with a partial divestment. Some other alternatives would imply loss of control. We can have either capital markets or M&A solutions and you should expect us, in the case where this does not go ahead and once we are released from the contractual obligations, that we would be expeditious, but we would be in no rush. We have plenty of alternatives.

Giovanni Montalti – *UBS*

Sorry, if I may follow up, I don't want to push you in discussing things you cannot say because the deal is still on, but again assuming a scenario in which it doesn't go through, would an option of staying in the UK and looking for building up a convergent asset base be an option that you would consider; or again the other scenarios are just implying as you were mentioning remaining eventually selling a part of the asset, eventually selling it as a whole, but staying and developing a different business model more comparable to a certain extent to what you are doing in Spain or in Brazil, is this an option you're considering? Does that make sense to consider this scenario? Thank you.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

The answer is yes, if the transaction was not to be approved, we will be open to a strategic reflexion of the UK. And because of the performance that this has been having in the UK, and because of the information that we have right now out of the different remedy packages that have been offered by the different players, we will not exclude any possibility.

Justin Funnell – *Credit Suisse*

Thank you. Yes, just follow-up questions please. On pricing, you've done a great job of getting pricing up in the last year in Spain, probably the best in the sector, but it becomes a bit of a problem obviously as you hit the anniversary of the price increases, I guess that May 2015 was a big one. Do you think that's it for price increases or can you do more? This is my simple question.

In terms of the CapEx, you're pointing to the fact that OpCF growth, OIBDA minus CapEx, can grow faster than OIBDA perhaps. Are we starting to get to the end of the peak in the cyber capex in Spain? You know, is this sort of a new trend that we're going to see actually over the next few years that capex starts to come down a bit?

And then just finally in Brazil, can you give us a sort of view on your outlook for the business over the next two to three quarters? There's obviously, on the one hand, economic pressures and a bit of pricing pressure; on the other hand, your strategic advantage in the market, you're ready to take share. How do you see that playing out? Is it going to get worse or is Q1 the low point for your revenue growth in that market? Thank you.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

In terms of the anniversary of the year-on-year comparison of our upselling strategy in Spain, remember that we have put in significantly more value for a little bit more of ARPU and therefore the average price per unit of value is decreasing in Spain. But having said that, we have been able to do that intentionally and again, with no retention clauses, with very low levels of churn, and therefore it looks like customer loyalty is there because they appreciate the new product that we are putting on top of the play.

Now we have more than 50% of homes in Spain with the best fibre to the home technology. We think we are the single player in Europe that is ready to offer massively the highest fixed broadband symmetric speed – and I'm talking about symmetry of speed at some point which will be included in our offer, more than 300 Mbps and we can even upgrade that speed without significantly peaking CapEx.

And we have one of the best 4G mobile networks, which covers already 83% of the population, and we think we have the best nationwide TV content offer in the market. So, I think that you should expect from us to keep upselling our customers, to keep proposing our customers, the ones that are ready to do that, to enjoy more attributes in terms of either more speed, more capacity or more features on the technological TV platform or more content.

So, I think that we will be strategically improving or proposing upgrades of the offer for the customers going forward. And we do see competition in Spain going probably into the same direction because they are also deploying fibre, they are trying to catch up with us but still they are significantly behind. So, I think that you should expect from us further upgrades on our value proposition and therefore I think that this is a trend probably.

In terms of CapEx, it is true that it's going to be depending on the new regulation coming in Spain. Competition zones have already been declared. Also the way the wholesale offers are going to be calculated in terms of retail minus also offer some possibility in terms of wholesale revenues, depending on what's the level of those prices. But, it is also true that the bulk of the deployment has already been done. So probably, there is still a few more quarters to go on capex but yes, at some point, CapEx intensity should start to go down, and therefore that's why including the existing levels of CapEx intensity, we are very close to reach OIBDA minus CapEx growth in Spain.

And getting back to David's question before, including the retirement costs that are being carried out for the last years from the previous retirement plans, the retirement cost impact in terms of cash flow in 2016 is going to be lower than in 2015 despite the new plan. So we do think that the next pending issue in Spain is cash flow generation and I think that we can keep going.

In terms of summarising the answer, we think that we can still outperform our competitors. We think that the economic situation in Spain is also helping. The customers are focused more on value than on price, a significant amount of them, and we think that we can handle that with a contained cost impact and therefore with sounder OIBDA.

In terms of our Brazilian outlook, we are more positive than the market in terms of the situation of Brazil. We think that the macroeconomic trends, once the political situation is cleared, would recover probably sooner than what most people in the market are expecting, and that's why we keep being very confident on the Brazilian market.

During the bulk of the crisis, and remember that the year-on-year comparison is going to start to ease, namely in terms of currencies, because the next quarters the Brazilian currency, namely in the second half of this year, comparison should be more in our favour because the bulk of the impact on the real occurred in the second half of the previous year. Operational trends in the middle of the crisis have been outstanding at the level of Vivo, and I'm talking about both Vivos, the former GVT and the former Vivo, including the wireline business. The underlying trends are pretty sound and it is true that revenue growth has decelerated but it is also true that part of that deceleration is coming from ourselves stopping gross adds in order to control bad debt, and also coming from a regulatory drag, a drop of MTR and FTR that have an impact, and of course the macroeconomic situation.

Even scoring all of that, synergies of the GVT transaction are flowing and that's why we are outperforming our peers in Brazil both in terms of revenues because of cross synergies and because of the fact that we have the best customer base in Brazil, and because of the integration effort that we are doing in terms of taking the best out of both worlds, the former GVT and Vivo. So we are pretty confident on the future of our Brazilian unit. I think that our team, headed by Amos, is doing an outstanding job and it's precisely in times of recession when you check the quality of both your assets and your management team. And on that part, I think that we are clearly beating our peers.

Georgios Ierodiaconou - *Citi*

Good afternoon. My first question is on Mexico, and looking at your numbers, clearly a very good performance, especially compared to some of your competitors. However, I was just wondering how sustainable what we've seen in the first quarter is for the rest of the year. I noticed you mentioned there's been some agreements regarding previous disputes but other operators have benefited their results, I'm guessing also there's been some incoming benefit. So perhaps if you can talk us through those effects and what to expect for the rest of the year given the price pressure there.

And my second question is more around the options for deleveraging you have beyond disposals. So, some of the ratings agencies are talking about the option to issue more hybrids. I was just wondering whether you could update us on the magnitude of this hybrid issuance room you have, whether you would feel comfortable with that. I know the ratings agencies could allow it but it's still, to a certain extent, debt. So if you could talk us through how much of the shortfall, if the UK deal doesn't go through can be bridged with hybrids. Thanks.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

In Mexico, our results have been solid in this first quarter. It is also true that competition has significantly intensified in Mexico. It is also true that our first quarter has been impacted by the reduction of interconnection fees of the non-dominant players, which means that the asymmetry of interconnection has been also in our favour but is less in our favour than a year ago, because it has been also dropping. But it is as well true that we have been positively impacted, by an agreement reached with other players over disputes on interconnection fees of previous periods.

Having said all of that, and that's why commercial momentum in terms of revenue growth has declined, we see several trends going on, on the Mexican market. Some of the most aggressive promotions that were there during the Christmas campaign and in the first three weeks of January are starting to be removed and therefore even though this is still a high level of price-aggressiveness, it still is a little bit lower than at the beginning of the year, though still very high.

It is also true that we have our own differential features. I think that those are positive ones. We have for the first time having some continuous positive momentum in contract. We have been multiplying by four times the net adds in contract year-on-year and contract accesses have been growing 25% year-on-year and that should provide us, in spite of this commercial aggressiveness, with a little bit of more momentum going forward. Smartphones have almost reached 11 million on our customer base in Mexico and this is 47% year-on-year, and a smartphone customer has significantly more data consumption than a feature phone customer. Smartphone already represents 44% of our customer base in Mexico. And our LTE accesses have reached 2.2 million and this is more than doubling the number of customers that we had a year ago, but it is still just 9% penetration of our customer base.

So, commercial aggressiveness is there, it's still a little bit lower than at the beginning of the year but still there. There are some trends that are going to take a while to recover in terms of rebuilding the value for a customer that we used to have till November in Mexico, but we see some positive trends on our own business that allow us to be slightly more optimistic than the overall trend of the market. Having said that, we will keep you posted quarter after quarter.

Ángel Vilá - *Chief Strategy and Finance Officer*

And regarding deleveraging, let me give you some elements. In the case that the deal were not to go ahead, debt service and dividend coverage would improve while consolidating the UK OIBDA and free cash flow. And this OIBDA and free cash flow from the UK help to cover a debt service to the tune of €5 billion-ish or a bit higher in terms of euros.

Then, you have to think also in free cash flow generation. We have OIBDA and Operating Cash Flow growing organically, and the FX headwinds will be lower in the second half. Please bear in mind that the big devaluation in Brazil and in Colombia was in the third quarter; in Argentina in the fourth quarter. So, the second half is going to provide for better comparisons. And all our units, all, are simultaneously growing in OIBDA, with a sequential acceleration.

Then we're going to proceed with transactions like the potential Telxius IPO.

And then, with respect to financial measures, the voluntary scrip dividend for the tranche of 35 cents in November, if it has the same take-up ratio as last year, would provide a cash preservation to the tune of €1.5 billion-ish.

And finally, and specifically to your question, in addition to the partial voluntary scrip, if needed, we could consider other measures like hybrids. We have now €5.5 billion outstanding. Capacity could be equivalent to that, an additional 5 to 6 billion euros. If needed, we could consider but not to exhaust that figure at all. What we are not planning are any measures that may have dilutive impact.

Keval Khiroya – D*eutsche Bank*

I've got two questions and both are related to Spanish football. On the slides you highlighted that 52% of Pay TV customers take an add-on; last quarter that was 53%. And if I've looked at DTS disclosure correctly, the absolute subscriber number taking a TV add-on hasn't really grown. Within that, can you tell us or give us an indication of how many customers take football today and what trend you've seen in terms of growth in that number, if at all, for the past two or three quarters?

And then secondly, with the new agreements you have with Mediapro, can you tell us how these content costs would be split over the three years? Would they be split evenly? Or, is there a formula of how you split them over the three years? And are you able to tell us how much you've booked for Champions League in Q1? Thanks a lot.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

Thanks for your question. In terms of the number of customers that have TV add-ons, they are, as you're mentioning, 52% compared with 53% a quarter ago. But, also remember that we have been putting some football rights on the basic offer and we might be inclined to do so going forward in order to increase attractiveness of our offer and, at the same time, reduce churn.

So, the value should be judged not just on the pure football right customers, but also on the value that provides in terms of lower churn on the basic offer of some of those packages. Therefore, I think that we should consider the football rights as an overall impact on the revenues of Telefonica de España, than just specifically on the football package.

We do not disclose for commercial purposes the different customers that we have on the different premium packages. But, allow me to say that the ARPU expansion that we are having on the overall of Fusión year-on-year, out of that ARPU expansion, football rights are a significant driver.

And in terms of the agreement with Mediapro, they are not exactly linear, but they are mostly. I mean, there are some differences. We have not disclosed that in terms of the split. But again, allow me to stress the fact that in the next few years, including these extra costs not being as completely linear, we think that the savings that we have put in place more than compensate the extra cost of content going forward. Sorry for not being able to be more specific.

Jonathan Dann – *RBC*

Hi there. Two questions, one, do you see any benefits from the EC debt purchase? I mean, could you issue debt at very low rates straight to the European Central Bank rather than, say, expensive hybrids?

And then a second one is I guess with a clean sheet of paper, it looks like basically two of the main assets have a lot of fibre and then in Germany there's a credible wholesale alternative, but in pretty much all of Hispanoamérica, there's no fibre at all. Is there an ambition at some point to start to add fibre in Latin America ex-Brazil?

Ángel Vilá - *Chief Strategy and Finance Officer*

Hi Jonathan, on the first one, the answer is yes, we are issuing at the lowest costs ever across the range; on commercial paper we have been even issuing at negative rates, on mid-term bonds we are issuing at the lowest rates. On the ECB bond purchasing programme of corporate bonds, Telefónica is one of the entities that is going to benefit the most. So yes, we are going to be continuously using this possibility.

Jonathan Dann – *RBC*

I mean, why be so sort of rigid about the 2.35 times net debt/OIBDA if funding is so cheap? It's clearly causing a lot of stress. Why not sort of have 2.3 times leverage?

Ángel Vilá - *Chief Strategy and Finance Officer*

I don't know if I would call it rigidity. What we have is a commitment to have a rating equivalent of BBB stable, and this is what triggers this ratio. It's a midterm objective that we commit to and we are working towards that. But our liquidity is very high. The cost of debt is at historic minimums. OIBDA is growing. Our OIBDA generation machine is firing on all cylinders. The five geographies are, all of them, simultaneously growing in OIBDA and this allows us to look at debt service in a way that does not concern us. But we have a commitment to our rating and we are going to be working in that direction.

José María Álvarez-Pallete - *Chairman and Chief Executive Officer*

And taking your question on potential ultra-broadband in Latin America, well, you excluded Brazil from your question because you know that we are doing exactly that in Brazil. But we are going to be applying in the overall of Hispanoamérica the same strategy in terms of we are going to be mixing fibre to the cabinet with fibre to the home.

In fact, 55% of our customer base in Hispanoamérica have already speeds that are above 4 Mbps, which is significantly more than what we had a year ago and significantly more than we had two years ago, because we have been significantly investing in shortening the loops in most of our territories.

In Chile for example, 46% of our fixed broadband customers, already have speeds that are between 10 and 50 Mbps. Remind that in Peru, we have the cable operation and, therefore, we are combining cable with ultra-broadband, and we are also trying to do the same strategy in Colombia and in Argentina.

So the answer is yes, we will go there in terms of significantly improving our fixed broadband offer in Latin America, and we are already doing that. But you should expect from us to be more pragmatic in terms of the solution, mixing fibre to the home, fibre to the cabinet and in some places a pure LTE approach because of the topography of the region.

But we are already building on that, and take a look at the performance of the former wireline business in Latin America and you will see that there are increasing revenues. We have revenue growth precisely because our broadband offer is being significantly improved as we speak, and that's where we are devoting a part of our CapEx intensity during the last four years. So the answer is yes but we'll be pragmatic with the technological solution.

José María Álvarez-Pallete - *Chairman and Chief Executive 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. Good afternoon.