# Telefónica January-December 2017 Results Conference Call Transcript

# 22nd February 2018

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In October 2015, the European Securities Markets Authority (ESMA) published guidelines on Alternative Performance Measures (APM), applicable to regulated information published from July 3, 2016. Information and disclosure related to APM used in this presentation are included in the Appendix. Recipients of this document are invited to read our condensed consolidated interim financial statements and consolidated interim management report for 2017 submitted to the Spanish National Securities Market Commission.

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## Introduction

**Pablo Eguirón** - *Head of IR*

Good morning, and welcome to Telefónica's conference call to discuss January-December 2017 results. I am Pablo Eguirón, Head of Investor Relations.

Before proceeding, let me mention that financial information contained in this document related to the fourth quarter 2017 has been prepared under international financial reporting standards, as adopted by the European Union. This financial information is unaudited.

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We encourage you to review our publicly available disclosure documents filed with the relevant securities market regulators. If you don't have a copy of the relevant press release and the slides, please contact Telefónica's Investor Relations team in Madrid by dialling the following telephone number, +34 91 482 87 00. Now let me turn the call over to our Chairman and Chief Executive Officer, Mr. José María Álvarez-Pallete.

## Presentation

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

### Our mission: Let our customers choose it all

Thank you, Pablo. Good morning and welcome to Telefónica's fourth quarter results conference call. With me today are Angel Vilá, Chief Operating Officer and Laura Abasolo, Chief Financial and Control Officer, and during the Q&A session you will have the opportunities to address us with any questions you may have.

I'd like to start this call sharing with all of you my reflections after almost 20 months as a Chairman and CEO of Telefónica. More specifically, about the essential building blocks guiding our efforts.

If we look around, we see that the world in which we live is defined by one concept: connections. Across the world, economies and societies are being fundamentally transformed by digitalisation.

Far from decelerating, we should expect further technological disruption and digitalisation across every sector to be one of the global trends determining the future.

To grab this huge opportunity, we need to be open-minded and ready to transform. We see digitalisation as the key lever for this radical transformation and to unlock value for all stakeholders.

We articulate this purpose across 3 strategic priorities:

- First, to enable people with the power of connectivity;
- Second, operate in countries where we can have an impact and create value;
- And third, optimise our capabilities for a sustainable digital future.

With these actions we want to bolster a strong financial performance and shareholder returns.

## Our mission: Let our customers choose it all

Looking at the three of them in detail:

UBB connectivity tailored to each market is a key enabler, driving an integrated offer and the best customer experience, redefining the way we interact with our customers, and cognitive intelligence is a new tool to apply to this goal.

Operations will be centred in markets where we can have an impact and create value, leaders in convergence, leaders in mobility and in having successful challenger positions, with structural growth opportunities ahead.

In addition, we believe that the only way to successfully execute these goals is to do it in a sustainable manner, being sustainable for the long-term. This is our commitment to our almost 345 million customers, our more than 120 thousand employees, the citizens of the societies where we operate and our almost 100 years of successful history. To do that, optimising our capabilities is a must. Building a platform Company, being pioneers in digitalisation, pioneering the new technological wave, but at the same time with a relentless focus on efficiency and maximising group synergies.

All in all, this has to be reflected in financials, in growing numbers, and in 2017 we had a good start as we will explain now.

## Excellent execution of 2017 priorities

And now let me turn to page 4. 2017 was the year in which we achieved an excellent execution of our priorities as demonstrated by:

First, growth. Revenues, OIBDA and OpFCF grew simultaneously in organic and reported terms and FCF posted a double-digit increase.

Second, capturing the benefits of the digital transformation, with significant investments in UBB to have the most innovative, smart and efficient networks. As a result, we are number one in fiber deployment in Spain and Latin America and we are pioneers in Cognitive Power. Moreover, we are monetising the data traffic explosion, turning volumes into revenues.

And third, we strengthened our financial position, addressing the debt level, which was reduced by 4.4 billion euros, through both organic and inorganic measures. As such, our FCF was 4.9 billion euros and we sold a 40% stake in Telxius.

## Growth acceleration

Slide number 5 shows the business accelerating growth in 2017 thanks to our efforts in the past years.

Service revenues surpassed 3% organic growth, with high single-digit growth in Latin America and a positive result in Europe if we exclude the negative impact of regulation.

OIBDA accelerated to mid-single digit, with Latam growing by double digits and Europe ex-regulation 2%.

This growth, fuelled by a lower capital intensity than previous years, has enabled OpCF to grow 12%, with both regions growing at double digit ex-regulation.

And, FCF reached almost 5 billion euros, 13% more than in 2016, and leverage ratio decreased 0.3 times.

## Revenues gaining momentum

Moving to slide 6, revenues and service revenues accelerated growth in the fourth quarter to 4.8% and 4.3% respectively in organic terms, with both Europe and Latam yielding improvements ex-regulation. Total revenues for the year increased 4.5% ex-regulation.

We continued to improve data monetisation, as mobile data revenues improved sequentially to close to 20% organically, contributing to the change in the revenue mix. In 2017, more than 50% of our revenues came from broadband and services beyond connectivity.

Revenue flow, cost actions, efficiencies across different lines and merger synergies all explain the strong profitability we posted in 2017.

## Telefónica's model: digitalisation at the core

On slide 7, digitalisation is at the core of what we do. Our operating model is centred on two broad initiatives which will propel us forward on this journey: data monetisation and our digital transformation.

We are improving monetisation and seizing the opportunity presented by the explosion in data traffic. We are attracting more high-value customers, we are bundling and by doing so, protecting our revenues and increasing customer loyalty, and we are also up-selling across many elements: speed, allowance, additional lines, content, value added services, digital services, devices or elements of the digital home.

To fully capture the digitalisation opportunity, we are building leading smart networks to allow for the radical automation of our processes. This means we are creating a world-class digital customer experience (through Aura and Novum) and a distinctive digital value proposition built on real time offers responding to customer needs.

## Monetisation opportunities continuing

Monetisation opportunities are ongoing, as shown on slide 8.

In the Speed and Capacity wave, we are obtaining a price premium from the UBB networks deployed and ARPU accretion from innovative tariffs launched, like $O_2$ Free in Germany and flexible data YoYo tariffs in the UK.

In the Services Beyond Connectivity wave, ARPU uplift continues to be key, with TV as the main driver, along with other services, like security in the B2B segment.

In the Cognitive Power wave, Aura is the new customer relationship model based on trust, with key experience principles; natural language, single point of contact and personalised answers. Moreover, it will be launched in 6 countries during the Mobile World Congress.

## Targeted, ROI-based CapEx effort; peak already behind us

Over the last years, we focused our efforts on transforming our business into a digital Company, identifying new market conditions and adapting ourselves as the technological evolution presented new opportunities and requirements. As a result, we have been carrying a targeted and ROI-based CapEx investment to secure future growth, and now the CapEx peak is behind us.

As an example, we have the largest UBB footprint owned among peers and Spain's FTTH deployment is more than 75% of 2020 target. Once again, we are ahead.

### 2017 key financials & solid financial position

Turning to slide 10, we can see growth across all fronts, highlighting double-digit growth in euros vs. 2016 in OpCF, EPS and FCF.

Revenues topped 52 billion euros, underlying OIBDA 16.6 billion euros, underlying EPS of 0.75 euros per share, and Net Financial Debt down to 44.2 billion euros.

Leverage ratio came down to 2.66 times after a 4.4 billion euros reduction in net debt.

### Beating 2017 guidance

We have comfortably beaten our outlook for the full year 2017 as you can see on the slide 11.

Revenues grew 3.4% despite a 1.1 percentage point drag from regulation, OIBDA margin expanded 0.6 percentage points and Capex to Sales reached 15.8%.

The second tranche of the 2017 dividend, 0.2 euros per share, will be paid in June 2018 and complemented the first tranche of additional 0.2 euros last December. Calendar payments in the year amounted to 0.4 euros per share.

And now, let me hand over to our Chief Financial and Control Officer, Laura Abasolo

**Laura Abasolo** – *Chief Financial and Control Officer*

### 2017 key financials: FY & Q4

Thank you José María.

Moving to slide 12:

Fourth quarter results were solid, strengthening trends vs. Q3 in main metrics.

Our relentless focus on operational execution led to an expansion in OIBDA margin year-on-year and into an outstanding growth of more than 20% year-on-year of OpCF boosted by OIBDA and lower CapEx intensity.

Reported P&L was affected by non-cash factors, including restructuring charges, contingencies and capital gains. FX and European regulation also dragged on top line growth and profitability.

### Q4 results factors

On slide 13, you can see the details of how, the different factors affected the quarter. I would highlight specifically the restructuring charges, which will further improve future profitability and cash flow.

These factors deducted 317 and 319 million euros respectively from OIBDA and net income.

### FX impact structurally neutralised

Moving to slide 14, here we detail how FX is impacting at different levels on the numbers, and how its impact is structurally neutralised.

FX is having a negative impact in reported figures in recent years, but the more you go down on the FCF ladder, the lower impact you have. So, the negative impact in OIBDA is naturally hedged due to lower CapEx, Taxes, Interest, Minorities and Others. But at the same time, our debt is also reduced in a multiple of FCF reduction.

To provide more colour on the currency exposure, in the graph on of the bottom left-side of the slide, our FCF per share in 2017 totalled 0.97 euros; with cash flow from European operations representing 0.9, before interest payments. The conclusion is that European FCF significantly exceeds dividends and total interest payments. Therefore, we can consider Latam all upside, and again currency exposure is well managed.

## Deleverage driven by growing organic FCF

Let's move now to the financial metrics on slide 15.

Net debt has been reduced by 4.4 billion euros to reach 44.2 billion euros at year end and the Net Debt/OIBDA ratio has come down to 2.66 times as of December 2017. That is 10% ratio improvement in one year.

The main driver for our leverage improvement has been a strong FCF generation, nearly 5 billion euros, up 13% vs. 2016. On top of that, Telefonica has successfully complemented its deleverage with inorganic measures (Telxius partial disposal) and other levers (hybrid issuance).

## Cost effective long-term financing strengthens B/S

Slide 16 shows how Telefonica continues to strengthen its balance sheet with long-term financing. Our average debt life was 8.1 years at the end of December, up almost two years from December 2016.

We keep on tapping different markets at historically low rates, maintaining a significant liquidity cushion, currently close to 20.9 billion euros, to face comfortably next two years of maturities.

The interest payments effective cost stood at 3.32% as of December 2017, 62 basis points lower than December 2016. This positive evolution is mainly due to refinancing in Europe at very attractive rates and lower cost in Latam currencies.

Additionally, in 2017 we increased 20 percentage points up to 71% our debt with fixed rates. As a result, as of December 2017 we have reduced by more than 50% the potential impact of a 100bps increase in interest rates compared with December 2016.

I will now hand over to Ángel to explain in more detail segments performance and transformation.

**Ángel Vilá** - *Chief Operating Officer*

## Spain: Improved trading and value mix

Thank you Laura.

Starting on slide 17, Telefónica Spain improved operational momentum in the fourth quarter, amid the usual promotional activity of the period.

Fusión net adds recovered previous volumes, FBB was back to growth, and mobile contract maintained a strong performance.

Our leading assets have become key levers to increase returns: fiber wholesale accesses are accelerating their growth and have strong potential as they still account for just 20% of the total wholesale base.

At the same time, the focus on quality and the increase in the average number of services per Fusión customer, resulted in more high-end customers (27% of the base) and a 6% year-on-year growth in Fusión ARPU. There are already more than 20 million accesses in Fusión, growing double-digit.

In 2018, we continue to make progress in our "More for More" strategy, with more data and higher speeds.

## Spain: Revenue acceleration & OIBDA growth

Continuing with Spain, let's move to financials.

Service revenues accelerated sequentially in the quarter to +0.7% year-on-year, with a clear improvement throughout the year as we have highlighted several times.

Continued cost containment led to an improvement in OIBDA trend quarter-on-quarter, growing 0.5% vs. fourth quarter 2016; while margin reached 40%, up 0.2 percentage points year-on-year.

Having rolled out the largest NGN network in Europe, 2017 CapEx is falling 9% year-on-year to 13% of sales, supporting a 3% year-on-year growth in OpCF to 3.4 billion euros.

## Germany: MSR ex-regulation back to growth

Turning to slide number 19.

Telefónica Deutschland continued to drive strong operational momentum with $O_2$ Free and the partner business. The $O_2$ Free portfolio fuelled data growth in a dynamic environment with average usage above 7GB per month.

MSR excluding regulatory effects returned to growth in Q4 (+0.8% year-on-year) and OIBDA was 6.3% up year-on-year reflecting successful synergy capture, partially offset by regulatory headwinds and commercial investments for future growth.

These improving trends, combined with efficient CapEx spend, boosted OpCF growth to 27.4% in 2017.

## UK: Solid financials and commercial performance

Moving to slide 20, Telefónica UK has once again posted a positive performance driven by its customer-centric approach and great brand, as seen in the introduction of new, innovative propositions.

Contract customer base continued to grow, driven by market-leading churn, with accelerating net adds excluding M2M.

Thus, MSR grew 2.7% year-on-year in the quarter, after excluding the RLAH impact, which dragged 1.6 percentage points, and driven by the higher-value tariff mix. This, along with an increasing contribution from wholesale and higher handset sales led to a solid increase in revenues and 3.7% in OIBDA. Furthermore, Telefónica UK continued to deliver market leading margins.

CapEx was down 4.8% vs. 2016 as we met our LTE indoor coverage objective of 98%. So, OpCF grew 6.9% to reach 812 million euros in 2017.

## Brazil: Further improvement on differentiation

On slide 21, we show the performance of the Brazilian business, the best-positioned telco in that market.

Throughout 2017 Vivo has continued to widen its quality differential with 84% LTE coverage and 18.4m fiber premises passed, reflecting the best network and the best brand.

In mobile, we reached the strongest quarterly net adds over the last 3 years while our customers are accelerating their adoption of high-value plans, which in the end resulted in a remarkable year-on-year ARPU growth of 2.6% in 2017.

In fixed, we are achieving excellent results in the cities where we are expanding our fiber reach, with a take-up of between 40-60% just 6 months after deploying, and with a growing adoption of new capabilities, as shown by the more than 50% growth in IPTV.

## Brazil: Solid margin improvement, above 35%

Moving on to slide 22, we show how this successful strategy resulted in a solid revenue growth of 1.4% year-on-year in 2017, in spite of regulatory effect dragging 2 percentage points.

And, as a result of this positive performance together with an impressive cost discipline, which drove the 8th consecutive quarter of year-on-year OpEx decline, we reached the highest OIBDA margin in two years, surpassing the 35% mark.

At the same time, amid year-on-year stable CapEx, we are posting an outstanding double-digit OpCF growth of 13.6% in organic terms.

## Hispam: Sound commercial results

In Hispanoamerica, moving to slide 23, the penetration of value services continues to gain traction. In contract, we posted marked improvements in Argentina, Mexico, Chile and Peru. In LTE, the highlight was the strong uptake across our footprint and penetration rose by more than 10 percentage points year-on-year.

In addition, let me point out the positive results of our focus on deploying best-in-class fixed networks in the region, with penetration of fiber accesses increasing by more than 11 percentage points after consistently adding new connections throughout the year.

## Hispam: Delivering strong financial performance

Moving to slide 24, commercial traction has translated into a strong financial performance, which more than offset the negative impact of the depreciation of some currencies in the region. As such, full year reported figures showed profitability expansion, with OpCF rising by more than 22% to reach 1.4 billion euros.

By countries, in Argentina, full year OpCF rocketed +67.8% in reported terms; we are seeing progressive recovery in Mexico, with revenues back to growth again in the second half of the year, and in Peru and Chile, better commercial momentum is driving a gradual improvement in revenue performance.

## Telxius: Leading infrastructure, solid profitability

Slide 25 shows the solid performance of Telxius, our leading infrastructure unit.

First, it has been addressing the growing demand across its businesses.

In the towers unit we have increased the scope by more than 400 towers throughout the year and grown co-location rates across all geographies to reach 1.33x.

In the cable business, the priority has been to tackle growing traffic demand while completing the rollout of new cables MAREA and BRUSA, to capture further market growth.

And second, Telxius is delivering robust revenue growth, with a balanced contribution from both business units, while the full-year profitability above 47% reflects the operating efficiency after its first full-year of operations.

## Clear proofs points in 2017

After explaining the evolution of the different business units, I would like to go back to the digitalisation potential on slide 26. On this slide and the following ones, we will give you some details on where we are today and what is the expected future evolution to help you extrapolate future trends and efficiencies.

I would like to start by going over the clear proof points achieved this year:

- First, the best connectivity, with 73 million footprint premises passed, LTE coverage of more than 90% in Europe; 7 countries with VoLTE technology and more than 8 million VoIP customers.
- Second, in data monetisation, digital revenues surpassed the 5 billion euros mark, with Video as the main driver and contributor, but also leveraging on new ecosystem opportunities, like Cloud, M2M, Security, Big Data, Advertising and Artificial Intelligence.
- And third, we clearly moved forward in digital transformation: in network virtualisation, with our proprietary UNICA infrastructure; in customer apps, we doubled the number of unique users on our platforms such as Mi Movistar, Meu VIVO, My O2 and Mein O2; we are migrating 15 countries to full stack deployments. And on the back of all of this, we continue simplifying our operations: -6% physical servers, -8% applications; -2% data centres.

## More value customers, more services

Slide 27 shows how our high-quality base has expanded, as demand for fiber and LTE remains very strong.

We continue to progress in customer base monetisation, based on two levers: the first, bundling voice and data; the second, upselling thanks to higher speeds, data sharing plans, value added services, etc. So, protecting revenues through bundling and then upselling them to increase the ARPU, monetising data and fostering loyalty.

As such, we are obtaining more value, with average revenue per access 4% higher than in 2016 and with churn stabilised.

## Driving usage, increasing yield

Slide 28 shows some insights on how mobile data monetisation and connectivity are boosting growth.

We are living an era of exploding data traffic, the challenge, but at the same time, the huge opportunity is to monetise such traffic growth.

We continue to apply M4M strategies to improve our offering with higher value for money to increase ARPU. And to do so, we employ different levers: offering more mobile data or fixed speeds; introducing mobile tariffs including data dedicated to certain Apps and extending family plans to combine usage.

In addition, increased penetration of recurrent prepaid data in Hispanoamerica and successful deployment of Neuropricing techniques being deployed are improving the value mix.

All this translated into; first, mobile data revenue growth of close to 20% year-on-year in the quarter, to represent 60% of mobile service revenues; and second, steady usage and ARPU uplifts due to higher fiber adoption in fixed data.

Overall, data monetisation is a key growth driver with further upside.

## Digitalisation at the core of customer journey

Moving to slide 29, digitalisation is a key lever for our transformation centred on the whole customer lifecycle. It is structured around 5 priorities, which focus on direct sales through digital channels, making payments easier and enhancing service provision and post-sales technical support.

We have set ourselves concrete targets for each one of these 5 priorities for the coming years, which will bring further efficiencies to our cost structure. Out of our total OpEx, we have an addressable cost base for these digitalisation initiatives of 11.6 billion euros and we expect a run-rate of gross savings of more than 1.0 billion euros by 2020.

Digitalisation also brings CapEx optimisation opportunities as shown by the strong decrease of 47% in our unit cost per household passed with fiber. We will continue to apply data analytics to invest in network smartly, focusing on ROI.

In addition, digitalisation will bring higher customer satisfaction and loyalty, and it will define a closer relationship with our customers with innovative digital channels and new interaction models, such as our new Aura platform.

## Further room to improve efficiency

On slide number 30, our own transformation and digitalisation journey is critical to be competitive, to be sustainable, and opens up multiple efficiency sources.

The accelerated investment in future-proof connectivity is the key enabler for our business sustainability. Our extensive experience in Spain allows us to industrialise fiber deployment, thus LatAm countries now benefit from shorter and more efficient deployments.

So, it is not that we are investing less; it is that we are being more efficient in the deployment. In other words, we are passing more homes with the same investment meaning that we can capture the growth at a lower cost.

Network transformation and legacy management is another reality where we are ahead, just to give you an example we are projecting the decommission of approximately 650 central offices up to 2020. So again, not only better networks, but also a more sustainable business.

In addition, as we have already explained customer-centric digitalisation will deliver more than 1 billion euros savings and more initiatives will be added to this figure. And the restructuring plans already executed will continue generating additional savings. All of this will underpin our superior cash flow conversion.

Now, I will hand back to José María.

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

## 2018 outlook

Thank you, Ángel.

Now, on page 31 let me outline the 2018 guidance.

We aim to retain sustainable profitable growth: revenue growth of around 1% despite regulation dragging -0.9 percentage points. Applying prior organic criteria, guidance would be 2.0%. OIBDA margin continues expanding around 0.5 percentage points, in line with 2017, despite regulation dragging -1.6 percentage points on OIBDA growth. CapEx will continue with its rate of decline with a Capex to Sales ratio of around 15%, 1 percentage point lower than in 2017.

We will push additional deleverage while we improve ROCE. This will allow us to maintain a solid balance sheet and investment grade credit rating.

Regarding the dividend, we are maintaining a stable and sustainable amount of 0.4 euros per share, to be paid in two tranches of 0.2 euros, one in December and one in June 2019. And like in 2017, total payment will be 0.4 euros per share.

## Closing remarks

To recap, please move to slide 32:

First, in 2017, our results were solid, growing across all fronts, we continued to advance in digitalisation and data monetisation and we made a firm progress in deleverage.

Second, and for 2018, we will be exploiting a more sustainable business model, with increasing revenues, margins expanding and controlled CapEx. At the same time, value creation will be enhanced through digitalisation, which will enable us to achieve greater revenues, but also be more efficient. Improving ROCE and our financial flexibility will also be key.

And finally, our focus is on profitable and sustainable growth, with technology as a key enabler going forward, leveraging on our massive transformation over the last 7 years, which has led to us being at the forefront of the digitalisation process.

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

## Q&A session

**Joshua Mills** – *Goldman Sachs*

First, on digitalisation. So the cost saving target of more than 1 billion euros, which you lay out on slide 29, is obviously a gross number. What would that be do you estimate on a net basis? How much do you think you're going to have to reinvest in provisions or pass on in the form of competition? Just trying to get an understanding of how this will translate through to a mid-term EBITDA margin expansion target from your perspective.

And then secondly, I was wondering if you could give us a bit more detail on today's announcement of the fiber to the home wholesale agreement with Orange in Spain. How many homes does this apply to? And will you be extending the same access to Másmóvil, which is obviously working with Orange? And ultimately, just trying to understand whether or not this is likely to reduce Orange's current fiber to the home rollout target of 18 million homes by 2020?

**Ángel Vilá** – *Chief Operating Officer*

On your first question, on digitalization, the target that we are publishing today is a target that has to do with the items regarding OpEx that you can see on slide 29. This figure, first, does not include revenue benefits, does not include also CapEx benefits. This would be applying to OpEx.

It is expressed in terms of run-rate of savings that we do expect to capture by 2020, but we're also expressing that, for 2018 we are aiming to already reach around 0.3 billion euros of those savings. We prefer to give this figure in terms of gross savings because there is going to be moving pieces across the different P&L items, so an OIBDA indication would be probably difficult to give at this moment. But we are committed to achieving these savings, plus additional benefits that we will get at the revenue and CapEx levels.

Regarding Orange, we have announced today an agreement which demonstrates Telefónica's competitiveness in the wholesale market. This will generate sustainability of wholesale revenues for us and will improve the profitability of investment made to build the largest fiber network in Europe.

It's a 5-year commitment that we are entering into, which will apply to all Telefónica's footprint, both in regulated and non-regulated areas. This will not affect our plans to deploy, we will continue to deploy on our own means, and we continue to expect to reach 25 million premises by 2020.

But here, we are showing our will to reach commercial agreements with competitors. We are aiming to improve the long-term profitability of our infrastructure investments. It's similar to the agreement we signed with Vodafone. It will help our wholesale service revenue line, which is progressing, as you can see in our results; and very importantly, this will also benefit the customers and citizens in general because they will enjoy a wider fiber coverage, with alternative options being able to advance in the digital economy in Spain.

**Joshua Mills** – *Goldman Sachs*

Maybe just one very quick follow-up on the digitalisation point. I think if you go through the presentation it's clear that a lot of savings you're targeting are focused on the network side. Is there scope to reduce your personnel expenses as well as part of this? Is that a large component of the EUR 1 billion cost saving target? And if so, would you expect that you'd have to take further upfront provisions in the near-term to deliver those savings?

**Ángel Vilá** – *Chief Operating Officer*

If you look at slide 29, you will see that the benefits or improvements that we are aiming to in the horizon of the next three years are quite significant not only in network but also in commercial activities.

So we are aiming to increase customer interaction. In self-assisted channels, we plan to more than double the sales in self-assisted channels. This has benefits in terms of lower commissions, for instance, to a channel. So you should not think necessarily everything in terms of personnel. There are many other commercial expenses which are not linked to personnel that will improve. The top ups, which is the second block, that we're going to do through our apps and through digital channels, we expect to more than double online top-ups. The payments in self-assisted channels and collections, these are also going to improve. And this also reduces commissions that we're paying to some of the payment systems. And we will continue to solve incidents remotely, and we expect to improve and progress further in customer experience, which will lead to a reduction in calls to the tune of what you see in the slide to our call centres.

So there are many levers on savings, not only linked to network items, but to lots of the commercial activities and all the commercial journey, with a potential for savings that are clear across different levels of the channels.

**Georgios Ierodiaconou** – *Citi*

First one is a follow-up on Joshua's question earlier around digitalization. From what we understood yesterday, Telefónica Deutschland implied that there are some costs that are being invested, at least in Germany in 2018, in order to get more of the savings in later years. Obviously, my understanding of these gross savings is that they exclude the costs that may be around for the next couple of years to generate the savings. Is it possible to give us an idea across the Group how much will that number be roughly for 2018? And whether in the next couple of years we should assume most of it goes away, or whether it's replaced by other types of investment?

And then my second question is around the CapEx guidance and the reduction in CapEx that you highlighted. On slide 29, you show that fiber roll-out costs have come down a lot, but at the same time, if I flip this argument around that means the returns are even better. So I'm just trying to understand about the pace of the rollout of fiber outside of Spain, especially in Latin America. And why you're not accelerating the rollout more, given the efficiencies that you are managing on the fiber unitary costs?

**Ángel Vilá** – *Chief Operating Officer*

Thank you, Georgios. On the first question regarding digitalisation, we have given guidance on margins for 2018. So you should not be thinking of provisions that may affect the numbers. The investments we need to make to achieve these digitalization benefits that we're posting are already included in the guidance that we are giving to you for 2018.

And regarding CapEx in Latin America into fiber, we are accelerating into that. You are seeing in our results in different units in Latin America that we are growing. And we have been even in Hispam, but also in Brazil. We are growing the deployment of fiber, we are enjoying a very efficient deployment, thanks to what we call the industrialization of the process, given the extensive experience that we have gained in Spain, we're accelerating fiber in Brazil, and we're accelerating it in Argentina. We're investing also partly in cable, but also in fiber in Peru and Chile. And also accelerating in Colombia. We are seeing a big demand, and very interesting rates of take-up, and you should be expecting us to be investing along this line.

**Georgios Ierodiaconou** - *Citi*

If I can follow up on the first one. I didn't mean exceptional provision, it's more my understanding in the case of O2 they are suggesting, and we'll find out tomorrow the numbers obviously, that there are one-off IT investments perhaps which will be affecting the cost line, which will be passed to the recurring OIBDA obviously. Is that something you are seeing in other countries? Is it German-specific?

**Ángel Vilá** – *Chief Operating Officer*

Well, first, I want to reiterate that the CapEx needed for transformation and digitalisation is included in the CapEx envelope. So even with that, we expect CapEx to revenue to continue reducing, and we have left our CapEx peak behind.

Regarding investments in IT, we have made huge progress already in moving to Full Stacks across our footprint in Hispanoamerica. We are upgrading those efforts, we are quite advanced in those efforts already in Spain and in Brazil. And maybe Germany, because they have been focused on the synergies of integration, have been more focused on integrating the systems from O2 with EPlus, and now they have to invest a bit in transforming those systems, but that is a very German-specific situation.

But to reassure you, the CapEx needed for transformation for digitalisation, the CapEx in systems is already included in the envelope that we are putting in front of you, and we think now that CapEx peak is behind.

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

If I may complement, I would like to say that keep in mind that we have done several integration process during the last years, the GVT process and the German process, and that has required upfront investment as well to accelerate the transformation. And those were one-offs coming out of the acquisition process. So that's why we think that we can do a highly significant effort in CapEx deployment with lower level of capital.

**Giovanni Montalti** – *UBS*

Can you share with us some update about the way you think about football rights, their renewal and the negotiation with Mediapro for the Champions League, in particular? And following your announced restructuring, can you share with us some thoughts about what is core in terms of geographies? And what you may be more pragmatic about, either for disposals, IPOs or any other strategic option?

**Ángel Vilá** – *Chief Operating Officer*

Regarding soccer rights, you should expect us to analyse the cost-benefit equation in a very rational way and to take decisions accordingly. We have noted the recent developments and dynamics in the soccer league auctions in places like the U.K. and Portugal which point in the right directions. And bear in mind that, given our customer base and given data analytics on an actual content consumption, we probably are very well placed to accurately assess the value of each content.

So, taking all of this into account, we should say that there is a distinct possibility that we may not renew the Champions League contract. And regarding La Liga, current rights run until the season 2018-19, so it's this season and the next. An auction could be held in the first half of 2018 for the rights for the season starting in September '19 for 3 years. Here, the key question of whether to bid or not to bid in such auction will be determined by the conditions and the minimum prices eventually set. But again, with a rational cost benefit analysis, we are going to exert financial discipline as we always do.

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

Taking your question on the new structure of the group. We have decided to separate the Hispam countries in 2 fronts. The South, which are mainly leaders, integrated incumbent players, and the North in which we are attackers, because we think that those deserve different management styles, different approach, different levels of CapEx intensity. And therefore, we wanted to really focus on enhancing the management performance of both units in order to make sure that we have the best return out of that.

That also means that, as you know, over the last years, we have reshaped our portfolio. We have been actively managing our assets because we want to finance profitable growth. And therefore, we are constantly reviewing our asset portfolio in order to reinforce our strategic positioning and significantly enhance our return on capital.

So, we evaluate the assets through a set of factors, including operating cash flow margin and market share, with the aim of optimising. So you should expect for us to have a very active approach to enhance our return on capital employed, and therefore, to reshape our portfolio.

**Giovanni Montalti** - *UBS*

Can you share with us some thoughts in terms of timing, in terms of how you see this as a priority for the group in terms of your capital vision strategy? How important, in your view, is it to move forward in terms of reviewing your portfolio? The share price does not factor in any M&A optionality, any strategic optionality for Telefónica. As a matter of fact, there's a lot of optionality there. So maybe if you can share with us some thoughts about these that would provide some more grounds investors to recognise this optionality?

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

Well, enhancing or improving our return on capital employed is at the top of the minds of the Board of Directors of Telefónica and of the management team. And therefore, you should expect from us to be very demanding internally with our own assets in terms of execution, because we are committing a significant amount of capital for CapEx. And therefore, you should expect from us to be very, very demanding internally on that front. I'm not going to comment on timings or processes, but you should be expecting for us to be much more demanding on that front.

**Akhil Dattani** – *JP Morgan*

Firstly, just on the Other revenues in Spain. Ángel, you mentioned the strong growth you're seeing in that segment from Wholesale, and I just wanted to understand a bit better how we should think about the performance as we go into 2018.

A key moving part I'm keen to understand is how and when your Orange contract phases through, so when does that start to contribute? And then, secondly, the other moving part we have is the Yoigo contract loss. If you can remind us again how that would phase as well, just to give us some sense as to whether this strong momentum we're seeing in Other revenues can continue to flow through to 2018?

And then the second thing I wanted to just really point on was Spanish pricing environment. There has been a lot of news flow in the couple of months around your price increase, which seemed to have been followed very well by your peers. Másmóvil seems to have taken up their bottom-end price point by eliminating and therefore effectively and indirectly raising prices too. Do you feel that this has been-broad based enough yet? There have been some questions about whether Vodafone's matching here or not. And so how do you more broadly just think about how pricing is developing right now?

**Ángel Vilá** – *Chief Operating Officer*

There are 3 main drivers on the Wholesale and Other revenues. On the one hand, you have the wholesale MVNO, which we are forecasting the loss of the Másmóvil unit's revenues. They can still use our network for as long as they need it, and they have been migrating slower than initially envisaged. But, we are foreseeing during 2018 the loss of those revenues.

Then we have wholesale of content rights. We are wholesaling the rights of the "best match" of La Liga. We are wholesaling the international series channel. We're wholesaling the movies channels. So here, you have another element.

And very important, the wholesale of fiber. As you've seen in the slide, fiber wholesale keeps ramping up the growth, both on recent agreements and regulation, and penetration is still very low. The fiber accesses in NEBA have multiplied almost by 3 times year-on-year. And the migration from a copper unbundled loop to NEBA is revenue accretive, and it improves the return on investment.

So, in this segment, we will aim to mitigate the MVNO revenue loss and the regulatory impacts by growing the volume of accretive migrations from copper unbundled local loop to fiber wholesale.

Regarding the competitive situation in Spain. Well, here, we've seen a fourth quarter that traditionally has had strong promotional activity. But, even in this strong promotional activity, we have been able to make progress, both in commercial and in financial terms. So, we had a positive commercial momentum following the launch of convergent bundles and targeted promotions, and you can see on slide 17 these improvements. We are 5% up in the year in accesses in pay TV. Fiber accesses are up. Fixed broadband access are back to growth in the fourth quarter. We are growing in mobile. Fusión customer base is 2% up. So commercially, we are doing fine.

We are doing very well even in a very competitive quarter. And service revenue trends were back to growth. OIBDA was back to growth, and maintaining a margin of 39.9%, which is materially in the 40% level and our cash flow conversion is quite strong. So following this fourth quarter in which although there was additional commercial activity, we have done quite nicely in the market.

What we see now in 2018, rationality is back, the market is cooling down, promotional activity is diminishing and there are new 'More for More' tariffs and tariff upgrades which are being applied by almost every player. All of us are investing heavily, and we need to earn a return on our investments. So, rationality is back in this start of 2018.

**Akhil Dattani** – *JP Morgan*

Can I just ask one point on the wholesale comments that you made? I understand on a lot of these buckets, they're commercially sensitive so you can probably quantify the numbers that are behind each of those pillars. On the MVNO loss specifically, are you able to talk about what the total envelope is that Másmóvil is paying to understand how much might fall out this year?

**Ángel Vilá** – *Chief Operating Officer*

I'm not sure that we disclose this figure. I will check with the IR team and maybe they can get back to you. I will use your second question to comment something that I missed in my previous comment.

In addition to the volume in wholesale fiber, you also need to factor the pricing of the wholesale price in regulated areas. And also, obviously, and I spoke about it in the first question, the new Orange agreement that we have announced today. The price in NEBA is based on replicability; it used to be cost-oriented, now it's based on replicability. It means that every retail offer from Telefónica must be replicable with profitability by competitors. That also means that the price will be reviewed every 6 months. And 'More for More' strategies will be reflected in the revisions of the NEBA price increases.

So, this creates a positive and constructive environment for earning returns on the fiber investments in this country. We are expecting, there was some consultation on the price of this wholesale, announcements shortly by the CNMC, which should be in the line of fostering investment in the country, in the networks.

**Mandeep Singh** – *Redburn*

The first question is really building on Akhil's question. Again, appreciating, the moving parts, is it fair to say that the migration of DSL to NEBA fiber will not be enough to offset the loss of the Másmóvil-Yoigo contract?

So if I was to look at your revenues in Spain, if you take Other and Wholesale out, you've moved from +0.9% revenues in Spain to -0.1%, if you were to take that line out. So, a lot of the improvements come from that line. Consumer sequentially worsened versus Q3, B2B sequentially worsened versus Q3. So if Wholesale gets worse because of the loss of the MVNO contract, is it reasonable to think that Spanish revenues can be held flat in 2018?

And as a follow-up to that question, whether you think the 40% margins are sustainable?

And the second question was on hybrids. You issued some hybrids in 2017; it's still a reasonably expensive form of debt. Can you just sort of give us a bit more colour on why you still continue to view hybrids as an attractive form of financing and have any further plans to do so?

**Ángel Vilá** – *Chief Operating Officer*

So, as I was saying we are seeing rationality, and we expect in 2018 rationality in the market. We would expect commercially Fusión on positive net adds in 2018 with ARPU growth. Mobile growth to continue. And we expect the take-up of fiber to continue increasing. And growth in TV, which is solid, is also expected. As you know, we do not guide revenues by regions.

But, to try to help you with the moving pieces, we can extrapolate from 2017 trends.

In B2C, as you were pointing out in your question, service revenues have been steadily improving throughout 2017. We have seen increases both in volumes and prices, so we exit the year well in positive revenue growth territory.

In B2B, we have seen more irregularities through the quarters' trend. The trend should be better, as growing IT revenues would mitigate the decline in traditional communications, and we are aiming to sell more Digital Services (IoT, Cloud, Security), so we will aim for a stabilisation in B2B in 2018.

On the Wholesale and Other area, I already commented. So although we do not guide on revenues, we are reasonably optimistic.

And I think you had a question about margins. We think that the 40% margin levers, or around 40%, should continue to be sustainable. CapEx should be below 2017, so operating cash flow should be growing in Spain.

**Laura Abasolo** – *Chief Financial and Control Officer*

With regards to your question on hybrids, we don't see the hybrids as expensive debt. We could call them a cheap equity. But I think, given that the last hybrid issuance we made in November was at a cost of 2.62% pre-tax, we could even say that hybrids today, at least in our last issuance was actually even cheap debt, not even expensive. But going forward, we do intend to maintain access to this source of funding. And depending on market conditions, we plan to replace existing hybrids with instruments of similar seniority. In fact, our first call date will be September 2018, and we do plan to replace it.

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

I think some of my question was answered there on B2B which maybe just stood out as being a little bit weaker.

And just a following from a couple of questions on content, would you always want to consider a standalone perspective? Or could you consider partnering with other parties, possibly OTT parties, for example, on content?

And then if we could just talk a little bit back about the U.K. business, which was recovering very well until, I think, the Q3 roaming impact, but looks to be back on track now. Is it purely the market condition and volatility that holds you back from an IPO consideration there, or are there any other factors?

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

I'll take the one on the potential partnership with over-the-top players. In fact, over-the-top players are seen by consumers complementary to our bundled TV, and therefore, we are also open to partnering with them for different things.

We think we have built a state-of-the-art third platform on top of our networks and systems. And therefore, we have become a very efficient technological distributor of digital products and services, and that includes over-the-top content players. So as we speak, we are having several conversations with some of them in different fronts. We don't have anything to announce yet, but we see ourselves as an aggregator and distributor of content being produced by us or being produced by others with a distribution agreement. So, we will be keeping you posted as soon as we have any news to announce.

And in terms of the IPO of the U.K. asset, the IPO is still an option. And in fact, we keep working on that option. We are preparing the asset as we speak. The operational performance of the Company during 2017 has been just outstanding. Our team in the U.K. is doing fantastic work. We do think we have the best mobile asset in the U.K. And in fact, judging by customer loyalty, we do have the best mobile asset in the U.K. because we have the lowest churn.

We are growing on all fronts. And therefore, as soon as we are clear out of the spectrum auction, we will explore the possibility of the IPO. In fact, we have been working throughout these quarters to be prepared as soon as there is a window of opportunity.

Allow me to remind you that we do think we have the best mobile asset in the U.K. and that our team has been doing a fantastic job operationally speaking in the previous year.

**Sam McHugh** – *Exane BNP Paribas*

You talked about the industrial experience you have in rolling out fiber. And you mentioned the U.K. IPO just now. Clearly, we've seen a lot of new deals signed between different operators for wholesale fiber in the U.K., often with actually very lower upfront capital commitment. I wonder if that's anything you have thought about doing. Have you been with talks with some of these guys regarding these kinds of builds? I would just love to get your view on fiber rollout in the U.K.

**Ángel Vilá** – *Chief Operating Officer*

We are in a mobile-centric mode in the U.K. We have, as José María was saying, a fantastic operation in the U.K. We are obviously getting fiber for the backhaul of our mobile operations, which is very important for 4G, and moving in a few years into 5G.

We don't think that the U.K. is a market driven by strong convergence, so we are not investing at this moment in fiber. But, we will monitor market dynamics, and we will be able to adjust our position accordingly.

**Keval Khiroya**– *Deutsche Bank*

Firstly, on Spain. I guess we got a fairly clear picture of how the football rights inflation has evolved. But can you just talk about the level of inflation you've been seeing on other types of content in Spain and whether that's been accelerating or not?

Secondly, Chile and Peru have obviously been slightly more problematic from a market structure perspective. Have you seen any improvement in the competitive environment there?

**Ángel Vilá** - *Chief Operating Officer*

We are not seeing a relevant inflation in other content costs. We have renewed some motor contents without significant inflation and we actually have them *de facto* in exclusivity because our competitors have not requested those contents.

We are investing in improving the delivery of some of the content that we have. So for instance, in basketball, we are now giving lots of technical features for viewers, while they are watching the match to have added information on what they're watching on demand.

So, no inflation on the content. We are adding value to that content to provide better experience for our customers.

We are investing in a moderate level in own productions, in series, which are being very successful. The last series that we launched has had 50% more viewers than the seventh season of Game of Thrones. Four series that we've launched have been between the top 10 of the series in terms of audience. And all of this, within limited budget, so we are not seeing inflation in our contents, we are adding value to those contents and getting better customer satisfaction.

On Chile and Peru, the situation continues to be very competitive, although with slight difference across the two markets.

In Chile, we are seeing progressive and positive commercial progress focused on value. We are having a positive contract portability balance. We have a positive LTE and fiber adoption. So, we are seeing revenue year-on-year trends stabilizing and profitability still reflecting the commercial efforts. Our Chilean operation adjusted quickly in terms of loyalty of customers. This took some impact on ARPUs, but stemmed the churn, and they are in a position to start recovering.

Regarding the situation in Peru, again, we also have better operational trends in mobile. Still, competition is very tough, but for instance, our loss of postpaid adds slowed down and in prepaid, the base with frequent top-ups grew for the second consecutive quarter. And in fixed, we continued to do well. So it continues to be challenging, but we are seeing some gradual revenue and OIBDA and commercial recovery. But still, both markets continue to be competitive.